

R-3401-98

**IN THE MATTER OF an Application by Hydro-Québec to the Régie de
L'Énergie (the Régie) for an Order or Orders approving year 2001 rates and
conditions of service for the transmission of electricity**

Argument of Ontario Power Generation, Inc. (OPG)

September 6, 2001

Summary of OPG's Recommendations

Theme 5 – Transmission Rates

- The Régie should direct TransÉnergie to use consistent rate design methodologies to establish tariffs for long and short-term point-to-point transmission service. TransÉnergie's weekly, daily and hourly rates for point-to-point service should be based on the number of calendar days in the period and not business days (i.e., weekly equals annual charge divided by 52; daily equals weekly charge divided by 7).

Theme 6 – Marketing

- The 60-day renewal provision set out in section 2.2 of Bylaw 659 should not apply to the transmission service associated with all Hydro-Québec energy sales contracts in place prior to the start of this proceeding. When these energy sales contracts expire or are terminated, the associated transmission capacity should be made available on a one-time basis, to all market participants by way of an open auction process. The standard automatic renewal provision should then be included as part of these re-sold contracts. Details of the auction process should be developed through consultation with stakeholders and approved by the Régie.
- The Régie should make permanent its requirement that TransÉnergie post on OASIS the type of ATC information that was provided in this proceeding in response to OPG data request at HQT-13, Document 13.2, R1-(II-3a through e). Additional dialogue and explanation, consistent with that provided by other jurisdictions such as PJM and NEPOOL, should be required to follow within 90 days of the decision in this proceeding. All of this information should be posted in a straightforward, easy-to-use manner.
- The Régie should require an independent, third-party audit of TransÉnergie's ATC calculations each year. The results of this audit should be publicly available via an annual compliance filing with the Régie. The Régie should also order TransÉnergie to forthwith ensure and demonstrate compliance with FERC Order 889 requirements concerning the retention and availability of historical ATC supporting information.
- The Régie should order TransÉnergie to, within 6 months, work with stakeholders to develop a proposal for an open auction process for the administration of discounts for short-term point-to-point service.
- TransÉnergie's proposed "essential conditions" for the offering of discounts should be rejected.
- TransÉnergie's proposal to modify its discounting policy such that discounts will be offered only on unconstrained paths leading to the same delivery point should be accepted as an interim measure until TransÉnergie's auction-based approach is finalized.

Régie de L'Énergie
R-3401-98: Hydro-Québec Transmission Rate Application
Argument of Ontario Power Generation, Inc.

I) Introduction

The Régie's R-3401-98 proceeding is the first comprehensive, public review of TransÉnergie's transmission tariffs to be undertaken by Québec's energy regulator. Clearly, the decisions reached by the Régie panel in this case will establish important principles and precedents for Québec's electricity industry. The importance of this proceeding is exemplified by the active participation of a number of intervening parties, from both inside and outside of the province, representing different interests and views. All of these parties have a legitimate stake in the outcome, and the Régie's challenge is to carefully weigh the arguments that each intervenor, along with the applicant, puts forth. The *Loi sur la Régie de l'énergie* gives the Régie the clear mandate to examine any question related to the relative interests of all users of the electricity transmission system. Indeed, OPG submits that the reconciliation of private and public interest is the very essence of the Régie's jurisdiction.

With the anticipated opening of Ontario's electricity market to competition by May 2002, OPG expects to be in a position to receive a marketers licence from the Federal Energy Regulatory Commission (FERC) to sell electricity in the United States at market-based rates. As a prospective point-to-point service customer of TransÉnergie, OPG's primary objectives in this proceeding are: (i) to ensure that it, along with other competitors, has a fair opportunity to secure desired transmission service on TransÉnergie's system; and, (ii) to ensure that decisions by TransÉnergie regarding its transmission service are made in an independent, transparent manner and provide comparability to all market participants. OPG has sought to provide the Régie with responsible, focussed recommendations that will help to foster a truly open transmission market, while recognizing the unique nature of Québec's electricity system. Our submissions are set out below.

II) Functional Separation and the Problem of Real/Perceived Discrimination

In May 1997, Hydro-Québec functionally separated its transmission and generation activities. TransÉnergie was created as a division of Hydro-Québec responsible for performing both the

transmission and system operations functions. TransÉnergie was to operate as an independent entity, pursuant to an internal code of conduct. Hydro-Québec's generation and energy marketing business units would be treated on an equal footing with all other transmission customers. This functional separation approach was consistent with the principles set out in FERC Orders 888 and 889 regarding open access.

OPG submits that this decision to continue operating as a vertically-integrated utility places the onus on Hydro-Québec and TransÉnergie to demonstrate that functional separation is actually working. Based on the evidence filed in this proceeding, OPG has serious concerns regarding the adequacy of TransÉnergie's current controls and procedures in this regard.

As noted in the direct evidence of Dr. Roach, it is widely recognized that functional separation "has the potential to lead to discrimination in transmission access or the perception of discrimination, both of which are equally harmful to the development of competitive transmission markets" (OPG-1, page 6). In fact, the evolution of markets in the United States to Regional Transmission Organizations (RTOs), as contemplated in FERC Order 2000, demonstrates that functional separation has not fully met the requirement of independent, non-discriminatory transmission access.

The reality is that, as a business unit of Hydro-Québec, TransÉnergie has both the incentive and the opportunity to favour Hydro-Québec's Production division over competing generators and marketers. A clear example of this is the structure of TransÉnergie's management incentive plan, which is tied to the overall corporate performance of Hydro-Québec (TR. Volume 23, questions 447-457). A key driver in Hydro-Québec's overall performance is electricity sales to lucrative U.S. markets. Indeed, revenues from cross-border sales, particularly purchase/resale transactions on the short-term markets, are cited in Hydro-Québec's 2000 Annual Report as one of the primary reasons for the company's significant net income growth in 2000 (please see Appendix A).

It should come as no surprise, therefore, that competitors of HQ-Production and HQ-Energy Services feel uneasy about the fact that, despite pledges of non-discriminatory conduct, Hydro-

Québec's structure is such that the managers of TransÉnergie have a personal pecuniary interest in the maximization of Hydro-Québec's purchase/resale operations on the American short-term market; operations for which they post the available capacity of the various paths involved and seek to decide the extent of the discounts for each path.

TransÉnergie suggests that market participants need not be concerned about preferential treatment to Hydro-Québec's generation and energy marketing divisions because the company strictly adheres to its Standards of Conduct and Procedure (HQT-2, Document 5). However, based on the evidence in this case, OPG submits that there are serious shortcomings with the implementation and administration of TransÉnergie's code of conduct.

There appears to have been little formal training regarding the code of conduct and how it impacts the day-to-day activities of employees of the functionally separated transmission division. The attitude of managers such as Mr. Roberge and Mr. Gagnon was that they were "already up to speed" (TR Volume 23, question 231) and "already sensitive to the issue" (TR Volume 23, question 234) and therefore did not require any training. It appears that the code was simply distributed to employees, who were then asked to attest that they had read and understood it.

There is no requirement for ongoing training, no monitoring or compliance auditing, no defined sanctions and no formal mechanism to deal with complaints (TR Volume 23, questions 237-283). According to Mr. Bastien, TransÉnergie's Standards of Conduct have never been violated (TR Volume 23, question 255). But with no monitoring or auditing program in place, OPG suggests that there is little basis for such a claim and the absence of such a program should serve as a red flag to the Régie.

OPG submits that much more is required than a written code of conduct to effectively implement functional separation. The transition from integrated to separated decision-making represents a fundamental shift in corporate culture that does not happen by itself. It involves a comprehensive effort to identify and remove barriers to change and ensure that the people, processes and systems are in place to make it work. Old habits die hard and it is naïve to suggest

that the mere distribution of a code of conduct document is sufficient to achieve this crucial transformation.

This fundamental point was emphasized by authors Charles Sirois, then CEO and largest shareholder of Teleglobe Canada, and Claude E. Forget, ex-Minister of Health in Québec and well-know teacher and consultant, in their book *The Medium and the Muse*:

However, even more telling than arguments about implementation difficulties is the fact that, under any regime short of complete structural separation, the change in corporate culture required to transform a former monopolist operator of telecommunications infrastructure into a competitively minded provider of content and retail services may not be possible. Any formula that preserves common management is likely to leave in place for some time the traditional corporate culture associated with infrastructure facilities operators. (*The Medium and the Muse*, p.98)

It is also important to recognize that internal standards of conduct focus primarily on the exchange of information between related parties. OPG submits that there are numerous scenarios in which TransÉnergie, without having received any “restricted” information, could be in a position to favour Hydro-Québec Production. TransÉnergie’s experience with the market and its knowledge of transmission service requests undoubtedly puts it in a position where it has both the ability and the enticement to favour its sister production and marketing division.

Evidence uncovered during this proceeding clearly validates the concerns of OPG and other market participants regarding potential conflicts of interest due to the integrated nature of Hydro-Québec. At the time of the Québec market opening on May 1, 1997, Hydro-Québec Production (then Groupe Services Énergétiques) had existing firm energy contracts with New England Utilities (2000 MW, expiry August 31, 2001), Vermont Joint Owners (305 MW, expiry October 31, 2012) and NYPA/Consolidated Edison (400 MW, expiry March 31, 2004). Since the current transmission agreements that are associated with these contracts include a right of first refusal, many in the industry, including OPG, had assumed that they had never been “grandfathered.” However, after a review of the somewhat confusing sequence of events that transpired in the months following open access, it was discovered that the firm transmission capacity associated with these energy contracts was in fact “grandfathered”, meaning that it was not offered as available transfer capacity (ATC) on OASIS in May, 1997 (TR Volume 23, question 289).

The effect of such “grandfathering” would have been that, upon expiration of these sales contracts, the associated firm transmission capacity would be made available to all market participants. But it was revealed that on November 21, 1997, TransÉnergie and Groupe Services Énergétiques entered into an agreement to retroactively change the capacity “grandfathered” for the three contracts into OASIS reservations for long-term point-to-point transmission service. However, as indicated in the transcript excerpt below, this capacity was in fact never offered on OASIS:

Mr. Gagnon: ...I think you understood from what I said that the ATC was posted one day and that they reserved it.

Mr. Tourigny: The contract appeared.

Mr. Gagnon: What I said was that the reservation request appeared.

Mr. Tourigny: I understand, but the capacity was never available to anyone else; that wouldn't make sense?

Mr. Gagnon: No, I think that it could not be made available because those contracts were in effect. (TR Volume 23, questions 315-317)

OPG also notes that the actual request from Groupe Services Énergétiques to change the status of these previously “grandfathered” contracts was not posted on OASIS until December 15, 1997 (HQT-4, Document 1.1.3). Hydro-Québec claims, in its response to Undertaking #69, that no customers were penalized by this practice, “since between May 1 and November 21, 1997, TransÉnergie did not receive any requests for long-term point-to-point service on those paths” (HQT-4, Document 1.2). OPG respectfully disagrees with this position and submits that the primary reason that TransÉnergie received no requests was because potential market participants assumed that the capacity was not available. The absence of third party requests should come as no surprise given that there was little or no firm ATC posted for these paths during this period. Posting an after-the-fact notice concerning a retroactive change of contract status is akin to placing an advertisement in today’s newspaper for a sale that ended months ago...it is meaningless.

TransÉnergie's response to Undertaking #69 claims that this action was taken "to clarify the transmission tariff applicable to these contracts" (i.e., that the applicable rate was \$71.09 per kW rather than the previous price of \$62.76). OPG suggests that there appears to have been a much more important motive for these behind-the-scenes maneuverings between TransÉnergie and its sister business unit. By transferring the contracts to point-to-point service, Hydro-Québec Production, by virtue of the automatic renewal provision of the tariff, effectively receives a perpetual option to control 2,705 MW of firm transmission capacity to lucrative markets in the Northeastern U.S. (see section III). OPG notes that less than a week had passed between the date at which HQ-Energy Services (U.S.) received its FERC Marketer's Licence and the timing of these contract status changes. OPG strongly questions whether the actions of November 21, 1997 are consistent with the principles and spirit of Bylaw 659, particularly sections 2.1 and 2.2, which govern initial allocation and renewal procedures.

It is clear from the evidence that there is little meaningful competition for point-to-point transmission service. Over 99 percent of TransÉnergie's total point-to-point service revenue is attributable to HQ-Production (TR Volume 21, questions 156-157). This situation seems unlikely to change unless steps are taken to level the playing field and encourage competition. The participation of parties such as OPG, New Brunswick Power and PG&E National Energy Group (NEG) in this proceeding demonstrates that other market players have a genuine interest in securing both long and short-term transmission capacity on TransÉnergie's system. However, HQ-Production's control over the most sought-after paths, and legitimate concern regarding the potential for discrimination, has effectively squeezed out third parties from the market.

The above examples illustrate that there are clearly shortcomings with respect to Hydro-Québec's functional separation. OPG therefore recommends that the Régie adopt some basic, practical measures that could be used to improve the effectiveness of this separation and assist TransÉnergie in accomplishing its stated objective of operating in a fair, impartial and independent manner. These recommendations, which are discussed in the sections which follow, will result in a more open, transparent system and help to reassure current and prospective market participants that the system is indeed administered equitably.

III) The Automatic Renewal Provision gives HQ-Production an Unfair Advantage over Competitors

TransÉnergie's proposed amendment for Section 2.2 of Bylaw 659 specifies that holders of long-term firm transmission service contracts "have the right to continue to take transmission service from the Transmission Provider when the contract expires, rolls over or is renewed...under condition that the client advise the Transmission Service Provider at the latest sixty (60) days before the end of the contract" (HQT-11, Document 2, p33, clause 2.2). This is typically referred to as a "right of first refusal" or "automatic renewal provision".

There are currently eight long-term point-to-point service contracts for approximately 4000 MW on TransÉnergie's system. Of this amount over 97 percent, representing all but one of the contracts (the exception being a 100 MW contract with MacLaren Energy), are with HQ-Production (TR Volume 24, questions 164-166). In its response to information request 1.3 from the Régie, OPG presented data to demonstrate HQ-Production's control over long-term, firm transmission service for paths to and from New England, New York and New Brunswick (OPG-2, pages 2-4). During cross-examination by Me Sarault, witnesses for TransÉnergie confirmed that annual service for pathways to U.S. markets is close to the limit (TR Volume 24, questions 167-171). As noted by Mr. Roberge, these interconnections are, and will continue to be, "quite coveted, especially when Ontario opens up" and "there is a certain importance, a certain value to being able to renew these rights" (TR Volume 23, Q480).

The practical effect of the automatic renewal provision, therefore, will be to perpetuate HQ-Production's control of firm transmission service and confer an unfair advantage to HQ-Production over its competitors in transacting with lucrative markets in the U.S. Northeast. Indeed, OPG submits that this is exactly what HQ-Production intended when it suddenly decided, on November 21, 1997, to retroactively convert the transmission capacity associated with the "grandfathered" energy sales contracts to reservations for long-term point-to-point service. As indicated earlier, this clever "shell game" allows HQ-Production to avoid having to offer up this capacity on the market once the "grandfathered" contracts expire. OPG suggests that such maneuvering is a blatant violation of both the principle and spirit of fair and open access.

Given these circumstances, OPG submits that the 60-day renewal provision should not apply to the long-term transmission service associated with all HQ-Production energy sales contracts in place prior to the start of this proceeding. It is nonsensical that in a so-called “open-access” environment, one party, that happens to be the sister division of the transmission service provider, is able to indefinitely retain control over key transmission paths. Simply put, competitors should have a fair opportunity to compete. OPG recognizes that certain “grandfathering” was indeed necessary to allow the restructured incumbent utility to meet its contractual obligations. However, OPG strongly objects to Hydro-Québec’s attempt to erect artificial entry barriers by quietly replacing the previously “grandfathered” transmission capacity with OASIS “reserved” capacity that is subject to rights of first refusal.

If, as suggested in TransÉnergie’s response to Undertaking #69, the change in contract status was done solely for administrative purposes, it therefore follows that HQ-Production should have no objection to the withdrawal of the first refusal clause from its contracts. Indeed, HQ-Production presumably intended to make this capacity available when the contracts expired anyway so as not to unfairly monopolize such sought-after interconnection capacity. The fact that such a convoluted approach was taken to clarify the applicable contract prices, when it seems that such an administrative change could easily have been accomplished through a simple exchange of letters, is both puzzling and suspicious. OPG stresses to the Régie that this kind of behaviour tarnishes the credibility of the system and causes current and prospective market participants to seriously question TransÉnergie’s independence.

OPG submits that the most appropriate means of allocating the transmission capacity that becomes available when HQ-Production’s existing energy sales contracts expire or are terminated, is through an auction process open to all eligible market participants. Under this approach, the long-term, firm transmission rights for the relevant paths would simply be awarded to the highest bidder. As indicated in OPG’s response to information request 3.1 from Hydro-Québec, OPG believes that an auction approach is consistent with the Régie’s ability under section 49 of the Act to use whatever method it considers appropriate in determining fair and reasonable rates (OPG-3, page 3).

OPG acknowledges that its recommendation on this matter could be viewed as a deviation from generally accepted practice; however, OPG submits that the unique circumstances in Québec (i.e., functional rather than physical separation and the method by which HQ-Production obtained control of existing long-term point-to-point service) warrant such special treatment. OPG also notes that such an approach is certainly not without precedent. The New York ISO tariff, for example, stipulates that the renewal right does not apply to transmission service associated with existing energy sales that were “grandfathered” at the time of open access (OPG-1, pages 10-11). In addition, Dr. Roach, in response to a question from Mr. Tanguay, noted that “auctioning, broader or longer-term auctioning is pretty common now in the States and with the secondary market, it is becoming even more popular” (TR Volume 25, question 375).

RECOMMENDATION:

- 1. The 60-day renewal provision set out in section 2.2 of Bylaw 659 should not apply to the transmission service associated with all Hydro-Québec energy sales contracts in place prior to the start of this proceeding. When these energy sales contracts expire or are terminated, the associated transmission capacity should be made available on a one-time basis, to all market participants by way of an open auction process. The standard automatic renewal provision should then be included as part of these re-sold contracts. Details of the auction process should be developed through consultation with stakeholders and approved by the Régie.*

IV) Greater Transparency in TransÉnergie’s ATC Postings is Required

In Order 889, the FERC recognized that non-discriminatory access to important market and system information is an essential underpinning of open access. FERC Order 889 instructed transmission providers to create Open Access Same-time Information Systems or “OASIS” sites for the purpose of providing all market participants with access to the same information at the same time. The Order set out standards for the disclosure of information relevant to the availability of transmission capacity (e.g., ATC and Total Transfer Capability (“TTC”)), prices and other information pertaining to the transmission system. Requirements for the auditing of transmission service information were also specified (NEG-10).

Various principles and guidelines concerning the derivation of TTC and ATC have been developed by the North American Electric Reliability Council (“NERC”), an industry group made up of regional reliability councils such as the Northeast Power Coordination Council or “NPCC” (of which TransÉnergie is a member). In its response to question 1 in Part II of OPG’s information requests to Hydro-Québec, TransÉnergie confirmed that its methodology is consistent with the NERC recommendations, with the exception that it does not co-ordinate the calculations or the results of its transfer capabilities with other neighbouring systems (HQT-13, Document 13, page 3).

OPG’s primary concern with respect to the ATC information provided on TransÉnergie’s OASIS is in ensuring that it is accurate, reliable, timely and complete. Based on a review of the information available on TransÉnergie’s OASIS, OPG noted that essential data relating to TransÉnergie’s TTC and ATC calculations, such as information related to the portions of the TTC that have been allocated for operational needs (e.g., Capacity Benefit Margin (“CBM”), Transmission Reliability Margin (“TRM”)), was not readily accessible. OPG successfully contested TransÉnergie’s non-response to an OPG request for such ATC information. In its decision on the matter, the Régie, citing the importance of transparency in a reservation system for electricity transmission capacity, required that TransÉnergie make the information publicly available on OASIS (D2000-214, page 68).

During cross-examination by Mr. Tourigny, Mr. Roberge indicated that he did not have a problem with OPG’s recommendation that the Régie make permanent its requirement that TransÉnergie post on OASIS the ATC information that was provided in response to OPG’s contested information request (TR Volume 23, question 410). Mr. Roberge also did not seem to object to OPG’s suggestion that TransÉnergie provide additional dialogue and explanation consistent with that provided by other jurisdictions such as PJM and NEPOOL.

Mr. Tourigny: ...can we assume that the discussion is posted on OASIS and the explanations required to understand the ATCs will be posted, as they are elsewhere – I could go further, if the people want...the actual discussions, it’s

because people can ask questions and...would you be prepared to post that as well?

Mr. Roberge: You mean the specific calculation methodology?

Mr. Tourigny: The specific methodology and even the questions and your answers to those questions?

Mr. Roberge: Yes. (TR Volume 23, questions 413-414)

OPG's final recommendation in this area concerns the need for audits of the posted ATC information. There are two related elements to this recommendation. First, OPG submits that the Régie should require an independent audit of TransÉnergie's ATC calculations each year. Based on an information request that OPG received from Hydro-Québec, it appears that TransÉnergie's position is that the NPCC already conducts this type of audit (OPG-3, page 3, response to question 4.1). However, as indicated in OPG's response to Hydro-Québec's interrogatory, and re-iterated by Dr. Roach in his oral testimony on May 24, the NPCC's current audit procedure appears to be a "self-assessment" that is not publicly available. Although NERC's Planning Standards clearly embrace the concept of public dissemination of ATC standards and annual reviews of ATC calculations, OPG submits that that in itself is not enough to allay suspicions given TransÉnergie's ability to manipulate ATC for overall corporate gain.

Dr. Roach: This is a good step forward, you know, if NERC can come up with standard methods definitions, that is good but the word, you know, you need those applied, it is not mechanistic, there are judgments to be made and I think this third-party audit will get to those judgments and will get to the values and the results and look for consistencies. So, I think that is, I think it is good that NERC will come up with some standards and standardization but I think the audit is required to see how those are applied here (TR Volume 25, question 362).

The second element of OPG's recommendation for audits relates to the need for an archived database of all relevant information that is used in the calculation of the posted long and short-term ATC. As noted by NEG in its oral evidence, TransÉnergie appears to fall short of the FERC Order 889 requirements in this regard (TR Volume 30, pages 41-46). The specific shortcoming relates the requirement in Section 37.7 (b) of Order 889 that "audit data are to be

retained and made available upon request for download for three years from the date when they are first posted in the same electronic form as used when they originally were posted on the OASIS” (NEG-10, p277).

According to NEG, only two of the ten categories on TransÉnergie’s OASIS site for audits are functional (TR Volume 30, p45). In addition, TransÉnergie’s response to NEG’s requests for historical transaction information took over four months to process and was incomplete and in an unusable format (TR Volume 30, p45). OPG is simply asking that the Régie require TransÉnergie to comply with all FERC requirements for the auditing of transmission service information as Hydro-Québec had committed to do in its previous application to FERC for market-based rate authority.

Transparent, non-discriminatory, user-friendly access to ATC information is clearly a fundamental criterion for all open electricity transmission networks. OPG submits that the importance of this basic principle is necessarily magnified in the case of utilities such as Hydro-Québec that are only functionally separated. In addition, the unique nature of Hydro-Québec’s system creates expanded opportunities for gaming that must be held in check through accurate, reliable, timely and complete disclosure.

For example, the evidence in this proceeding indicates that the posted ATC information for certain paths, such as those relating to the Beauharnois-Chateauguay-Les Cedres (“BCC”) complex, is not based solely on the physical limitations of the transmission path, but is also a function of generation configuration (TR Volume 23, questions 379-391; HQT-13, Part II, Q4(a)). Since: (i) it is HQ-Production that determines generation unit configuration, and (ii) it is reasonable to expect that HQ-Production will seek to configure its generation in a manner that maximizes its revenue (i.e., allocate more generating units to higher priced, more profitable markets), it is not difficult to imagine a situation where a potential conflict of interest could occur. Posted ATC could be reduced, not because of any changes in the physical transmission capability of the path, but because of generation dispatch decisions. In other words, revenue optimization by Hydro-Québec’s merchant function could take precedence over system

optimization by the transmission function. Such “hypothetical” behaviour would clearly disadvantage other market participants.

In summary, the basic theme of OPG’s recommendations on this issue is perhaps best articulated by the authors of Order 889-A:

“...the purpose of ATC supporting information is to ensure that Transmission Customers have confidence in ATC/TTC postings. The OASIS and the Commission’s functional unbundling policy depend on customers being able to rely upon the accuracy of ATC postings. The availability of ATC supporting information is essential for building and maintaining this confidence.” (NEG-11, p48)

RECOMMENDATIONS:

2. *The Régie should make permanent its requirement that TransÉnergie post on OASIS, the type of ATC information that was provided in this proceeding in response to OPG data request at HQT-13, Document 13.2, R1-(II-3a through e). Additional dialogue and explanation, consistent with that provided by other jurisdictions such as PJM and NEPOOL, should be required to follow within 90 days of the decision in this proceeding. All of this information should be posted in a straightforward, easy-to-use manner.*
3. *The Régie should require an independent, third-party audit of TransÉnergie’s ATC calculations each year. The results of this audit should be publicly available via an annual compliance filing with the Régie. The Régie should also order TransÉnergie to forthwith ensure and demonstrate compliance with FERC Order 889 requirements concerning the retention and availability of historical ATC supporting information.*

V) TransÉnergie’s use of Inconsistent Allocation Methodologies in its Rate Design Inappropriately Discriminates against Users of Short-Term Point-to-Point Service

There was considerable discussion in the hearing regarding the methodologies used by TransÉnergie to derive its tariffs for long-term (i.e., annual) and short-term (i.e., monthly, weekly, daily and hourly) point-to-point service. TransÉnergie’s written direct evidence, as well as its responses to various information requests, characterized its approach as a combination of

the “1-CP” and “12-CP” approach. In other words, the transmission revenue requirement (less short-term sales revenue) is divided by the forecast annual peak demand for the annual point-to-point rate (i.e., “1-CP), but by the sum of the monthly coincident peaks for the monthly point-to-point rate (i.e., “12-CP) (HQT-10, Document 4).

During the hearing, however, both Mr. Chéhadé and Dr. Orans felt compelled to rebuff this characterization and sought to “clarify” the use of certain terminology around this issue.

Dr. Orans: If you look at the way we are doing the proposed design, proposing to allocate between point to point and network load, which is the same as domestic in this case using 1 CP, so that’s what is clear here; the allocation method is 1 CP. When I refer here - - this was probably a mistake on my part to actually call this 12 CP in calculating the short-term rates.

What we are really doing, if you followed the presentation this morning, is adding up the reservations and it is not 12 CP, it is whatever the reservations are on the service. In this case, we have a mix of different types of reservations and you get something equivalent to - - if you were going to pin a name to it, it would be the expected billing determinants.

If you wanted to call it some kind of CP, it would be like an 8 or a 9 or whatever the equivalent average is. So it is really not a mixing of 12 CP and 1 CP. (TR Volume 19, question 114)

OPG submits that this so-called clarification from TransÉnergie is not at all helpful and does nothing to change the basic fact that different methodologies are used to derive annual versus monthly point-to-point rates. Regardless of whether you call it a “billing determinant”, “12-CP”, “8 or 9-CP” or some other label, the fact remains that the formula for determining the monthly tariff is inconsistent with that used to determine the annual tariff. The denominators are different, and the practical effect of this is to increase monthly rates over what they would have been had a consistent methodology been used.

The evidence is clear that TransÉnergie’s dual approach goes against accepted industry standards. Mr. Chéhadé admitted that “elsewhere, they do not have the problem of the monthly tariff” (TR Volume 22, Question 59). Dr. Orans also reluctantly acknowledged this fact in his oral testimony:

Mr. Tourigny: You said that “other than the difference” between 1 CP and billing determinants, the computation of rates mirrors the standard industry practice.

Whatever it is, wherever it comes from, 2000, 888, whatever, so, I am saying that the minor difference, the minor difference is 1 CP versus billing determinants; is it not? That is what you meant by this “minor difference”?

Dr. Orans: Yes, that is correct. (TR Volume 20, questions 296-297)

Dr. Orans’ response to questions from Me Sicard on the matter leaves no doubt: “(t)he standard practice would have been to give the identical rate to both the longer term and the short term and then, allow discounting” (TR Volume 19, question 115).

OPG takes issue with Dr. Orans’ attempt to trivialize this methodological inconsistency as a “minor difference”. TransÉnergie’s switch in allocation methods has a significant impact on the rates that short-term point-to-point service customers must pay. As noted by Dr. Roach in his written direct evidence, if consistent methodologies were used for annual and monthly rates, the monthly rate would be 28% lower (i.e., \$6.27/kw-month instead of the \$8.02/kw-month proposed) (OPG-1, Table 1, page 22).

TransÉnergie’s Theme 5 witnesses attempted to downplay the magnitude of this differential in their oral testimony by pointing out that the posted short-term rates are “maximums” to which discounts may be granted (TR Volume 19, question 115). Indeed, Dr. Orans indicated that he expected discounts to occur “a lot – in many hours” (TR Volume 19, question 115). This is in direct contrast to the oral evidence offered by TransÉnergie’s Theme 6 witnesses, who suggested that it was unlikely that discounts would be offered over the next two to three years (TR Volume 23, page 39, lines 1-6). But even if there were to be significant discounts available to cushion the impact on short-term users of inconsistent methodologies, OPG submits that TransÉnergie’s dual approach violates fundamental rate design principles.

The only rationale offered by TransÉnergie in support of its unconventional rate design approach is that management somehow felt that an additional incentive was needed to encourage point-to-point customers to always opt for the longer term rate (TR Volume 19, page 69, lines 1-20).

OPG submits that this is entirely inappropriate and discriminatory. The reservation priority that is attached to longer term service under the standard terms and conditions of the Open Access Transmission Tariff already gives customers ample incentive to opt for longer durations. OPG notes that no other jurisdiction has found it necessary to further entice longer-term reservations by unfairly skewing the rate design methodology. In addition, as the evidence from this proceeding demonstrates, the fact is that annual point-to-point service in Québec is largely unavailable due to HQ-Production's control over existing reservations.

OPG also suggests that many market participants may be primarily interested in shorter-term service consistent with the shorter term nature of the transactions that predominate the New York and New England markets and will also predominate in the Ontario market. Furthermore, longer term contracts in general favour the marketing affiliate of a transmission owner. When a market participant purchases long-term transmission service, it takes on significant risk that it will be unable to utilize the service in some or many of the hours that have been reserved. For an affiliate, such non-usage merely represents a transfer of funds between affiliated companies or divisions; a minor concern for management since their incentives are related to overall Corporate performance. For a non-affiliate, such non-usage represents a real cost that serves to effectively increase the cost of transmission because costs incurred over the hours that are reserved must be recouped in the hours when the service is actually utilized.

It is illogical that short-term point-to-point customers should be forced to pay a higher price for an inferior quality service that does not generate any additional costs for the transmitter. The often-cited FERC principles require a transmission pricing mechanism that treats all customers fairly and comparably, that promotes economic efficiency and that is practical (OPG-1, page 21). OPG submits that TransÉnergie's unorthodox approach to tariff design significantly compromises these principles.

TransÉnergie gives the same questionable rationale for its use of working days instead of calendar days in the derivation of weekly and daily point-to-point rates (HQT-13, Document 1, pages 129-131). Once again, OPG submits that such an approach is unwarranted because it creates the appearance of bias against short-term transmission contracts. It is inappropriate for an “independent” system operator in an open access environment to use different methods of developing point-to-point tariff charges based solely on the duration of service.

As noted by Dr. Roach in his oral testimony “(t)his is an issue of discrimination and there is really, at FERC and other organizations, there is no flexibility on discrimination” (TR Volume 25, p178). TransÉnergie has not provided any valid justification in support of its deviation from established industry standards. OPG submits that the use of inconsistent, discriminatory methods to calculate tariffs for similar services is simply an unacceptable ratemaking practice that should not be permitted.

RECOMMENDATIONS:

4. *The Régie should direct TransÉnergie to use consistent rate design methodologies to establish tariffs for long and short-term point-to-point transmission service.*

TransÉnergie’s weekly, daily and hourly rates for point-to-point service should be based on the number of calendar days in the period and not business days (i.e., weekly equals annual charge divided by 52; daily equals weekly charge divided by 7).

VI) Discounts should be openly determined by the market and not left to the arbitrary judgment and discretion of TransÉnergie employees

TransÉnergie’s short-term point-to-point tariffs have been characterized by the applicant as “price caps” to which discounts may be applied. In his written evidence, Mr. Chéhadé outlines the following guiding principles or objectives for TransÉnergie’s discounting policy:

“to optimize utilization of available system capacity once native load demand is met, thus reducing the remaining revenue requirement that must be recovered from all of the transmission provider’s customers”;

“to maximize the revenues generated by short-term sales”; and

“to bring the transmission price in line with its economic value and facilitate cost-effective transactions”. (HQT-10, Document 1, page 17)

TransÉnergie has proposed two significant changes to its discounting policy in this proceeding. First, rather than continuing with the current practice of offering the same discount for the same period on all unconstrained paths, TransÉnergie is proposing to offer discounts only on unconstrained paths leading to the same delivery point on the network (HQT-10, Document 1, page 17). Secondly, Mr. Roberge, in his oral testimony regarding Theme 6, announced that, going forward, the following “essential conditions” must be in place before a discount can be granted: (i) there must be a reduction in the amount of revenue coming from point-to-point service; and, (ii) this reduction must be directly linked to the fact that the transportation tariff is too high relative to market rates for electricity and therefore hindering transactions (TR Volume 23, page 37). Based on the application of these “essential conditions”, TransÉnergie, as of mid-2001, has ceased offering discounts to customers and does not foresee the need for any discounts in the short to medium term (TR Volume 23, page 39, lines 1-6).

According to TransÉnergie, it is not required to obtain approval from the Régie for its discounting methodology. It is merely asking the Régie to approve the principle that: (i) discounts may be given at TransÉnergie’s will and discretion; and (ii) discounts can be different from one path to another, as deemed necessary by TransÉnergie (TR Volume 23, page 112, lines 6-12; page 115, lines 3-12 and 20-29).

OPG supports the general practice of offering discounts to short-term customers for the purpose of maximizing utilization of the transmission system. OPG submits that TransÉnergie’s proposal to offer discounts on a path-specific basis is entirely consistent with this goal and is therefore justified. However, OPG has serious concerns with respect to the process that TransÉnergie currently uses to determine discount levels. In addition, OPG strongly questions both the appropriateness and the need for TransÉnergie's proposed “essential conditions” as part of its discounting policy.

Historically, TransÉnergie has taken a rather ad hoc approach to establishing discounts for short-term point-to-point service. TransÉnergie's Theme 6 witnesses described the period of 1997 through 2001 as "trial by error" and an "experiment" (TR Volume 23, questions 434 and 435). There are no formal procedures or decision criteria to follow. Instead, a small group of TransÉnergie officials decides when and how much to discount based on their judgment of the market. Given that there is no ongoing monitoring or review process, TransÉnergie has no idea, and indeed does not seem to care, how effective its discounting policy has been in accomplishing its stated objectives.

Mr. Roberge: Up until now, well okay we'll see in the future, but up to now, we're talking about short-term transactions because the discounts would apply to short-term service only. The numbers show revenues of about ten, fifteen million dollars per year. In comparison, long-term reservations are about \$2.4 to \$2.5 billion, so it's a very small niche. So, to implement a system to optimize all that, yes, but it seems a bit unnecessary at this time. (TR Volume 23, question 423)

OPG finds Mr. Roberge's attempts to downplay the significance of TransÉnergie's discount policy arrogant and offensive. The evidence is clear that TransÉnergie's rates for short-term point-to-point service are significantly higher than in other jurisdictions (NEG-1, page 10). Discounts are important to market participants since they improve the economic feasibility of accessing Québec's transmission system and thus encourage transactions that otherwise would not take place. The fact that revenues from short-term reservations are small relative to TransÉnergie's total revenue requirement does not give TransÉnergie license to abandon the pursuit of its underlying discounting objectives. OPG also points out that Mr. Roberge's characterization of this "very small niche" is based on a comparison of TransÉnergie's short-term service revenues to revenues generated from both long-term point-to-point service and native load customers. OPG submits that it is more appropriate to exclude the \$2.2 billion in native load revenue from this comparison; doing so would dramatically alter the relative magnitude of this so-called "niche".

The result of TransÉnergie's unstructured approach to discounting has been a literal mishmash of discounts with no discernable trends or patterns. As illustrated in HQT-10, Document 1.3, page

2, historical monthly discount levels vary dramatically and often defy logic. For example, TransÉnergie somehow determined that it was appropriate to offer significant discounts during the high demand summer periods in 1997, 1998 and 1999, but relatively minor discounts during the lower demand shoulders seasons in the Spring and Fall.

TransÉnergie's witnesses acknowledge that the current method used to offer discounts is not accurate (TR Volume 23, question 182). According to TransÉnergie, the primary reason for the shortfalls of the current approach is that the markets are extremely volatile and difficult to predict (TR Volume 23, question 177). OPG certainly agrees that electricity markets are, by their nature, unpredictable. However, OPG submits that there is no need to rely on subjective forecasts of market conditions to establish discount levels. If you want to know what the market is going to do, it is far more effective to simply ask the market.

OPG proposes that an open auction process be used to determine discounts. A well-designed, transparent auction mechanism removes the requirement for TransÉnergie to try and predict market outcomes, which are, by their nature, unpredictable. The "crystal ball" that was referenced by Mr. Roberge in cross-examination could be thrown away and replaced by much more reliable and accurate method of gauging market forces (TR Volume 23, question 438). Everyone would understand the rules about how discounts are determined and the mechanism would be much better aligned with the underlying objectives behind TransÉnergie's discounting policy.

With an auction-based approach, there would be no need for TransÉnergie to impose its so-called "essential conditions" for the granting of discounts. OPG submits that these conditions are ill-conceived and, in any event, should be rejected by the Régie. TransÉnergie's discounting philosophy seems to revolve around relative market prices in other jurisdictions, rather than on the optimization of the system (and of revenues). Its attitude seems to be that there is no need to offer discounts because market participants will make enough money without them. As Mr. El-Ramly correctly pointed out during his oral testimony, such an approach is entirely misguided and inconsistent with the achievement of TransÉnergie's stated objectives.

“Looking at what the price in New England is and adjusting the discount does not help you optimize that [the system]. It is like Air Canada trying to find out why I am trying to come to Montreal, to charge me accordingly. They should charge me according to how many seats they have available, not how much money I am going to make when I come to Montreal. [TR Volume 26, p178]

...That is my problem with the proposal. It is that you look at other systems and you look at the marketplace. I do not think you should be looking at the marketplace. I think you should be looking at your system utilization and available capacity. Just like an airline, if you have 200 seats, you have 200 seats. I do not care if the connection from Toronto is busy. I have 200 seats, that is what I should sell.” (TR Volume 26, p207)

During cross-examination by RNCREQ on May 22, Mr. Roberge indicated that he was “open to any suggestions to help circumscribe the rebate policy” (TR Volume 23, question 182). OPG is encouraged by Mr. Roberge’s comments and has offered practical, innovative solutions to help remedy the current shortcomings. A transparent, well-defined, auditable discount process is essential in a functionally separated environment. OPG believes that the use of auctions would be quite effective in addressing many of the issues associated with the Québec market.

On the question of the Régie’s jurisdiction in granting discretion to TransÉnergie to provide discounts on rates that the Régie has set, OPG submits that the Régie’s Act makes it clear that TransÉnergie cannot offer discounts without the permission of its regulator. Section 53 of *Loi sur la Régie de l’énergie* states that “the electric power carrier...may not, in respect of a consumer, impose or agree to a rate or to conditions other than those fixed by the Régie or the government.” Clearly the Act provides the Régie with considerable flexibility and discretion in fixing the rates, provided, of course, that the tariffs remain fair and reasonable (*Loi sur la Régie de l’énergie*, section 49). OPG therefore suggests that, at a minimum, the Régie’s approval of the basic principle of discounting must be given and specifically included in TransÉnergie’s tariff.

The discounts on TransÉnergie's short-term rates are meant to ensure at least some contribution to revenue, rather than none at all when paths are idle or not fully utilized. OPG submits that the use of an auction mechanism to administer discounts will effectively optimize this process. Instead of a vertically-integrated monopoly arbitrarily offering discounts based on the perceived conditions of a rapidly evolving market, it is far more efficient to let the market itself decide what is fair and reasonable. A transparent auction process will serve to limit the degree of discretion involved in setting discounted rates and help to alleviate concerns about the potential for discrimination.

It is important to note that in the decision of the Régie du gaz naturel that is cited in Hydro-Québec's argument-in-chief (D94-52), the discounts that Gaz Metropolitan were authorized to provide were based on a pre-established formula. This formula was essentially designed to mimic the market and thus limit the discretion of the distributing monopoly.

OPG's recommendations on this issue enhance this general approach by removing the need for a formula and going directly to the market. A properly designed auction process will instantly and automatically reflect the multitude of objective and subjective variables that influence the value of a particular transmission pathway at any given point in time. There is thus no need for judgment or approximation. OPG submits that the clarity of this approach makes it particularly well-suited to Hydro-Québec's functionally separated environment.

RECOMMENDATIONS:

5. *The Régie should order TransÉnergie to, within 6 months, work with stakeholders to develop a proposal for an open auction process for the administration of discounts for short-term point-to-point service.*
6. *TransÉnergie's proposed "essential conditions" for the offering of discounts should be rejected.*
7. *TransÉnergie's proposal to modify its discounting policy such that discounts will be offered only on unconstrained paths leading to the same delivery point should be accepted as an interim measure until TransÉnergie's auction-based approach is finalized.*

Conclusion

The evidence in this proceeding demonstrates that there are serious shortcomings with the functional separation that has been executed by Hydro-Québec. These shortcomings have caused current and prospective third-party customers to openly question TransÉnergie's ability to provide independent, non-discriminatory transmission access. The Régie should not dismiss these concerns. In order for a viable market to exist, participants must have confidence that the market is truly open and fair. The so-called market for point-to-point transmission service in Québec clearly has failed to instill this confidence. As noted by FERC, the fundamental problem with mere functional separation of a vertically-integrated utility is the real and/or perceived ability of the system operator to discriminate in favour of its generation and marketing affiliates.

OPG has offered straightforward, common-sense recommendations to address the legitimate concerns that parties have regarding Hydro-Québec's functional unbundling. OPG respectfully submits that these recommendations, if adopted, will help to foster meaningful open access in Québec. Based on its participation in this important proceeding, OPG is confident that the Régie will responsibly exercise its full authority under the law to arrive at a decision that is fair and reasonable.

All of which is respectfully submitted this 6th day of September, 2001.

Pierre Tourigny

Counsel for Ontario Power Generation, Inc.