

Report on Business

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COMMENT & ANALYSIS

AUDITOR-GENERAL'S REPORT

AG paints an incomplete picture of Ontario's power upgrade

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By sticking a red-hot knife into the performance of her province's electricity sector, Ontario Auditor-General Bonnie Lysyk has whipped up a tsunami of outrage. But while her assertion that Ontarians have paid \$37-billion more than market price for electricity over eight years certainly has shock value, it is of little probative value in understanding how Ontario's "hybrid" electricity market works, how we got here and what needs to be done to deliver better outcomes. The report is both a service and a disservice — providing excellent examples of the shortcomings of governance and long-term planning, but an incomplete picture of the costs of electricity production in Ontario.

The genesis of Ontario's current market structure and its subsequent evolution lies in the crisis period of 2003-04, when there was a shortage of supply, creating an imbalance that produced highly volatile prices. The opening of the retail market was

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abandoned and so the government's only remaining option for meeting the supply gap was contracts for generation.

With the policy commitments to both shut down the province's coal plants and meet growing peak demand, the work of long-term planning and creating incentives for investors to build new generation was given to the Ontario Power Authority through a legislative mandate. A decade later, Ontario no longer has a supply shortage. This is reason to rejoice, not scowl.

The total cost of electricity service in Ontario has increased, with the commodity cost going from 6.2 cents per kilowatt-hour in 2009 to 9 cents per kwh in 2014. Why is this upward pressure on cost such a source of consternation? It shouldn't be, unless you choose to live in a

world of make-believe and assume that new investment in new generation — on the order of \$30-billion — can come at no cost. Ontario's electricity sector has invested heavily in upgrading its aging infrastructure.

In her report, Ms. Lysyk gets unnecessarily tangled up with the global adjustment mechanism (GAM) and its relationship to the hourly Ontario energy price (HOEP). This is a unique aspect of Ontario's hybrid market structure that was created to provide incentives for operators to build new power-generating facilities. The cost of contracted generation is recovered through the global adjustment fees. The long-range average pricing of more than 80 per cent of Ontario production (including Ontario Power Generation's regulated facilities and cost of conservation programs) falls under the global adjustment fees. For the end consumer, it's simple: The electricity price charged for the quantity consumed is the sum of these two components — the HOEP and the GAM, a mixture of the old and the new.

The Auditor-General makes much of the increase in global adjustment fees from \$650-million in 2006 to \$7-billion in 2014. This is a simple reflection

of payments to contracted generators who have invested in Ontario; any suggestion of huge excess costs above market prices does not correctly reflect the Ontario situation.

Not all contracted generation within this GAM bucket comes in at the same price points — there is a wide variation, with nuclear at the low end of generation cost and solar and wind at the higher end of the spectrum. The Auditor-General has highlighted the cost of renewable generation as being disproportionately high and the policy directives that contributed to upward cost pressures.

The vast gap between the declining cost of solar and wind and the high prices offered through feed-in tariffs can be best characterized as egregious economic rent-seeking at the expense of the consumer. Oversight by the Ontario Energy Board can readily redress this imbalance. Although current data suggest a very high mitigation cost per ton of greenhouse gas reduction via solar and wind, the long-run declining cost picture is promising: Solar and wind, with cost-effective storage in a pivotal role, can add tremendous value to the system.

What has Ontario's electricity system achieved over the past decade?

The entire coal generation capacity, 8,000 megawatts, has been shut down and replaced with new generation, a combination of nuclear, hydro power, natural gas, bioenergy, wind and solar. More than \$30-billion of investment in the generation sector has resulted in a total capacity addition of 13,000 MW and a quarter of a million new jobs. This is not excess cost; it's value creation through new investment on a large scale in generation facilities that will provide electricity for years to come.

Given that demand for electricity has remained flat over the past five to six years, Ontario finds itself in an enviable position of surplus capacity, but with a very important and positive attribute: very low greenhouse gas emissions from the sector. The aspirational role of the electricity sector should be to help Canada meet the challenging targets emerging from the COP21 talks in Paris and, through electrification of mobility — electric vehicles, mass transit — to transform the rest of the economy to a low-carbon model.