Ontario launches large competitive energy procurement: Opportunities for renewables and next steps for LT2

September 11, 2024

On August 28, the Ontario government announced the "largest competitive energy procurement in the province's history, focused on generating affordable electricity" that will leverage the second Long-Term Procurement (LT2) to procure up to 5,000 megawatts (MW) of energy resources by 2034, to meet the projected rise in demand.

Minister Lecce's letter to the IESO specifies as policy parameters: transparency, competitiveness, cost-effectiveness, and technology-agnostic energy resources, while prioritizing urgency and economic investment from digital services, artificial intelligence, and electric vehicle and battery manufacturers. The Minister requests the IESO to report back by Sept. 20, 2024, with options to accelerate the timeline for completion by Feb. 28, 2026.

Highlights from Minster Lecce's letter include:

- Endorsing the Enhanced Power Purchase Agreement (EPPA) framework, which provides policy certainty regarding this funding model.
- Confirming that all projects will require a municipal support resolution.
- Assigning rated criteria points to prioritize designated regions of northern Ontario.
- Confirming rated criteria points to incentivize economic opportunities for Indigenous Communities, including projects proposed on treaty or traditional territories.

Other key outstanding LT2 issues identified at the most recent IESO stakeholder engagement session on July 24, 2024, are highlighted and described more fully below:

- The pending implementation of the IESO's Market Renewal Program and comprehensive amendments to the IESO market rules, including transitioning to day-ahead and real-time markets, adopting local marginal pricing (LMP) and the Day-Ahead to Real-Time Adjustment (DARTA).
- The Agricultural Impact Assessment (AIA) policy, which reflects the direction of the Minister of Energy by joint letter with the Minister of Agriculture, Food and Rural Affairs, dated June 6, 2024.

- The potential for hybridization of the LT2 energy stream with storage resources. The IESO recommended that proponents explore these options to determine if either mechanism is sufficient to justify project development costs amortized over the commitment period of LT2.

The next IESO engagement webinar on the LT2 procurement will be held September 12, 2024.

Day-ahead to real-time adjustment (DARTA)

The EPPA model was endorsed by Minster Lecce's letter to the IESO. This will provide policy finality following extensive engagement on the financial model, where stakeholders expressed concern that the new contract payment formula presents uncertainty regarding the cost of capital and the availability of capital. Going forward, proponents comfortable with the changes will be able to more fully understand the economic of their respective projects.

The EPPA revenue model will comprise of a monthly payment, which is structured as follows and expressed in the formulas set out in Exhibit J to the LT2 contract:

- ***Monthly Revenue Requirement*** that is equal to the proposal price, multiplied by the annual imputed production factor, multiplied by the contract capacity, multiplied by the number of hours in the settlement month.
- ***Monthly Deemed Energy Market Revenue*** that is equal to the deemed energy market price, multiplied by the monthly imputed production factor, multiplied by the contract capacity, multiplied by the number of hours in the settlement month.
- ***Grid Reliability Payment*** (contractual payment) that is equal to the Monthly Revenue Requirement, less the Monthly Deemed Energy Market Revenue.

The formula is market-focused and comparable to the IESO's natural gas contract-for-differences precedent. For this reason, **the LT2 revenue model may favour facilities with characteristics similar to gas-fired plants**, such as adjustable output, speed of development and ease of entering a market. Intermittent resources will have higher capital costs, low fuel costs, and low output flexibility, as they are driven by resource availability. Ultimately, *the LT2 structure may not be a good fit for renewable technologies without combining with a storage resource*.

The new DARTA mechanism will protect 85 per cent of the day-ahead scheduled revenue and introduces an intervening forced derate factor to avoid incorrect day-ahead to real-time adjustments due to forced outages. The IESO indicated that its analysis suggests suppliers will be kept whole with the DARTA, even when 100% of any excess deemed revenues are clawed back and has invited stakeholders to test this statement.

Agricultural impact assessment (AIA)

While Minister Lecce's letter does not explicitly reference the AIA, it does clearly reiterate support for the underlying policy.

The stated purpose of the new AIA policy is to "*recognize the economic benefits that the agricultural industry provides, while supporting Ontario's growing electricity demand in a way that considers impacts to Ontario's agricultural lands and farm businesses*." The direction relies on the concept of "Prime Agricultural Area" (PAA), and requests the LT2 procurement to:

- Incorporate design-rated criteria points related to PAA policy;
- Prohibit new projects in specialty crop areas or the Northern Planning Board's Official Plan;
- Prohibit ground mount solar in a PAA;
- And require the municipality having jurisdiction to provide the AIA when a facility is located in a PAA.

In response to stakeholder feedback, the IESO indicated that it would revise the AIA submission deadline to require delivery before the 18-month anniversary of the contract date. Failure to deliver within the specified time period would be an event of default or require a contract facility amendment. **Proponents should be aware of the potential risk to project economics if the AIA is not secured** and consider submitting feedback to the IESO requesting an off-ramp in these instances. In the absence of such an off-ramp, proponents will need to consider adding a risk premium to their bid price.

Enabling the build

In May 2024, the Canada Electricity Advisory Council published a report on behalf of the Government of Canada, titled *Powering Canada: A blueprint for success*. As concerns the LT2 procurement, the report's *enable the build* recommendations are informative to project risk, including:

- streamlining approvals across government agencies, accelerating timelines, and eliminating redundancies to adopt a systemic approach;
- applying a risk-based approach to project reviews and using a compliance-based framework where possible;
- eliminating duplication in project assessments;
- designating more crown lands;
- assisting developers to understand the duty to consult and engagement with Indigenous communities; and
- alignment of financial, tax, labour and trade policies, and optimization of investment tax credits.

Although the report is referenced for guidance only and should not be interpreted as an additional requirement or factor that needs to be considered to advance LT2 planning, the report does inform the broader policy climate and corresponding competitiveness of procurements.

Next steps for LT2 project proponents

As of September 6, the IESO has posted the following documents on the Long-Term 2 RFP webpage:

- Draft LT2(e) RFP

- Revised Draft LT2(e) Contract
- Revised Draft LT2(e) Contract – Blackline to previous draft
- Preliminary Connection Guidance for the Long-Term 2 RFP – Energy Stream v2
- The Ministry of Natural Resources Renewable Energy Predevelopment Projects on Crown Land Document

The next engagement seminar will be held September 12, interested parties may register here. The IESO continues to invite stakeholders to submit their feedback over the course of the LT2 procurement, with the next round likely to be due in the weeks following the September 12 webinar.

BLG's Energy and Renewables group has advised clients throughout the LT2 RFP engagement. If you are interested in learning more about the LT2 RFP or how IESO procurements may affect your organization, please get in touch with any of the authors or the key contacts below.

By

John A.D. Vellone, Shane Freitag, Kristyn Annis, Nicholas Pinsent, Rob Blackstein

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BLG Offices

Calgary
Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa
World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver
1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal
1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto
Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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