



Ontario Energy Board

Commission de l'énergie de l'Ontario

Consultations on Development of 3rd Generation IRM

Update to Stakeholders

December 14, 2007

Overview

- Process to Date
- Current Thoughts
 - Context over Next 3-5 Years
 - What 3rd Generation Should Be
 - “Big picture” Issues
 - Alternative Ways to Address Issues
 - Illustrative Core Plan
 - Issues/Concerns
- Next Steps



Process to Date

Target	Event/Milestone	Regulatory Schedule
2007		—2007—
August 2 nd	Initial consultation on issues	
September 7 th	A stakeholder working group established.	● August – 1 st tranche of distributors filed rate rebasing applications.
September 13 th	Stakeholder consultation conference on Staff Scoping Paper	● September – 2 nd Generation IRM filing guidelines issued.
<i>September 21st</i>	<i>Written comments due on issues. Written comments on the Scoping Paper received from 16 interested parties</i>	
November 20 th	Update on Project and Timeline. The Scoping Paper was prepared to elicit comment on the issues to be considered in this consultation. In light of comments and feedback from working group, timeline revised to allow for further examination of the issues.	● November – Remaining distributors filed 2 nd Generation IRM applications.
October-January	Stakeholder working group meetings.	



Current Thoughts – Context over the next 3 – 5 years

- Initiatives that may affect distributors in the coming years, include:
 - Smart Meters;
 - Integrated power supply planning, including:
 - Conservation and demand management; and
 - Distributed generation (SOP);
 - Regulatory, including:
 - Comparative utility cost analysis;
 - Review and implementation of service quality regulation;
 - Review of distributors' cost allocation information filings;
 - Examination of rate redesign; and
 - Mergers & acquisitions to enhance rationalization.



Current Thoughts – Context over the next 3 – 5 years

- Other cost pressures that may affect distributors in the coming years, include:
 - Significant replacement of ageing assets;
 - Lumpy assets to meet new growth (eg. Transformer stations);
 - Capital contributions to HONI transmission;
 - Costs to meet significant employee retirement/workforce demographic; and/or
 - Customer location/growth Unpredictable weather and increasing storm damage.



Current Thoughts – On What 3rd Generation Should Be

- **Sustainable**
 - flexible and reasonably able to handle changing and varied circumstances while ensuring that underlying principles are consistent between distributors;
- **Predictable**
 - facilitates planning and decision-making by consumers and electricity distributors;
- **Effective**
 - encourages distributors to implement efficiencies and allocates the benefits from greater efficiency fairly between the distributor/shareholder and consumers; and provides for prudent capital investment necessary to maintain an appropriate level of reliability and quality of service and to meet legislative and regulatory requirements; and
- **Practical** without sacrificing the other criteria
 - the costs to administer should not exceed benefits; and the approach should be able to be implemented through clearly defined, open and transparent regulatory processes.



Current Thoughts – “Big picture” Issues

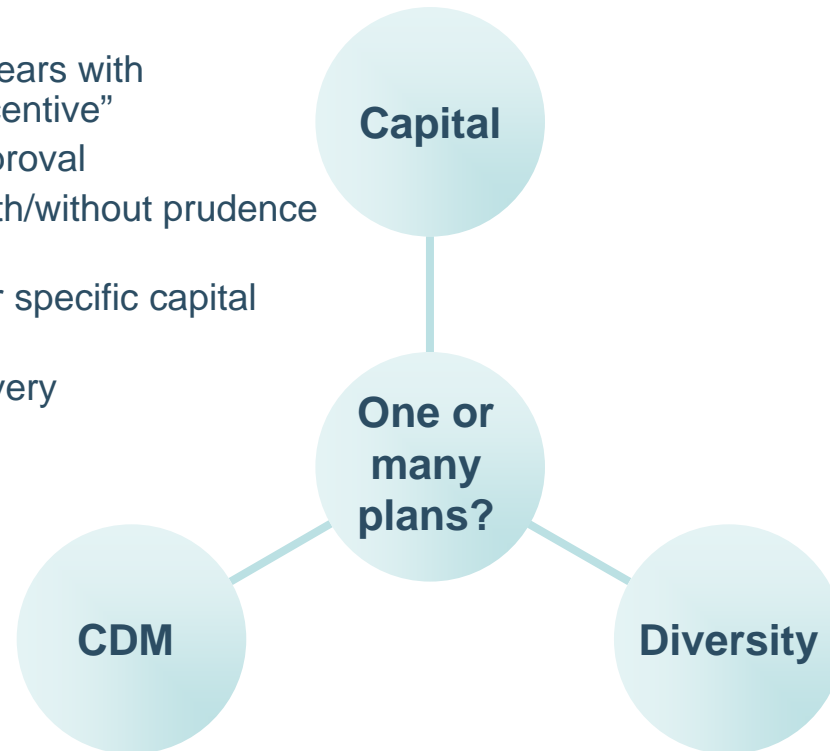
- In today’s context, “big picture” issues are capital investment, lost revenue due to changes in consumption and recognizing distributor diversity. Issue statements open-ended:
 - Is there a need for special treatment of incremental capital spending in a framework?
 - What alternative mechanisms might address lost revenue due to changes in electricity consumption?
 - How and to what extent should distributor diversity be reflected in a framework?



Current Thoughts – Alternative Ways to Address Issues

- Index-based price adjustments – with or without “modules”
- Forward-looking test years with “information quality incentive”
- Capital project pre-approval
- Capital cost tracker with/without prudence reviews
- Unit cost incentives for specific capital projects
- Accelerated cost recovery

- A Revenue Stabilization Adjustment Mechanism
- “CDM” factor in an Index Based Price Adjustment
- Status Quo treatment



- Different X factors
 - Tailored productivity factors (individual, groups)
 - Tailored consumer dividends (individual, groups)
- Different inflation factors
 - Economy-wide inflation factor
 - Industry specific inflation factor
- Capital investment mechanisms
- Earnings sharing mechanisms
- Off-ramps



Current Thoughts – One or Many Plans?

□ At the start of a plan, if the Board provides for multiple approaches, what should the eligibility criteria be to identify which distributors are eligible for which approaches?

Single Year
Multi-Year?

Status Quo for CDM Planning and Funding (until Rate Re-Design)

Hybrid Plan

Legend		
Symbol	Count	Description
💡	3	Alternative Plans
?	5	Question
⊘	3	Do not do
⚠️	1	Warning
🚩	2	Needs follow up
□	5	To do
😊	4	Good

Forward-looking Test Years

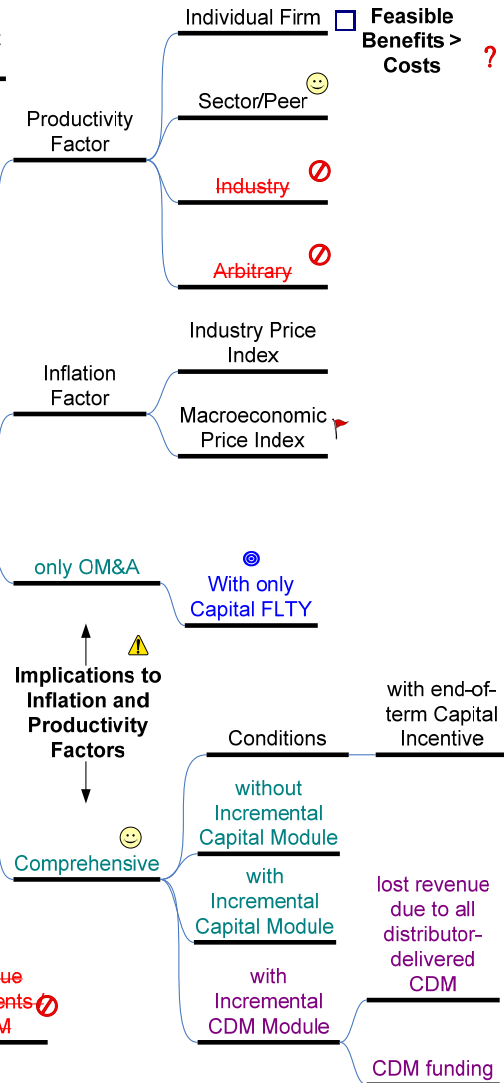
Options for 3rd Generation IRM

Index Based

□ During a plan, if the Board provides for multiple approaches, what might be appropriate triggers for, and treatment of unforeseen events (i.e., "Z-factor-like"), if any, under each approach?

□ If the Board provides for multiple approaches, what reporting requirements and rebasing rules are needed to support each approach?

Starting Base is Single Forward Test Year



Feedback
November 16, 2007



Current Thoughts – One or Many Plans?

- Aim is to develop a core plan for electricity distributors that is suitable for most.
 - Not looking for “one size fits all”.
 - In the event that other approaches for rate setting may be appropriate in some circumstances, a distributor may apply to the Board accordingly.



Current Thoughts – Illustrative Core Plan

Work to develop a core plan does not mean that it will be designed to the lowest common denominator. Proactively providing for an appropriate level of flexibility to complement the core plan is needed to develop a sustainable plan.

Core Mechanism	Form	Price Cap Index	
	Coverage	Comprehensive (i.e., Capital and OM&A)	
	Inflation	Industry Specific Index	
	X-factor	Peer Group X-factors (3 to 5)?	
Dual Stream Based on Term	Term	3 years	5 years (other?)
	Consumer Dividend	lower%?	higher%?
	Earnings Sharing		?
	Modules (subject to thresholds)	CDM?	CDM, incremental capital, others?



Current Thoughts – Issues/Concerns

Industry IPI Preferred Inflation Factor

Industry IPI

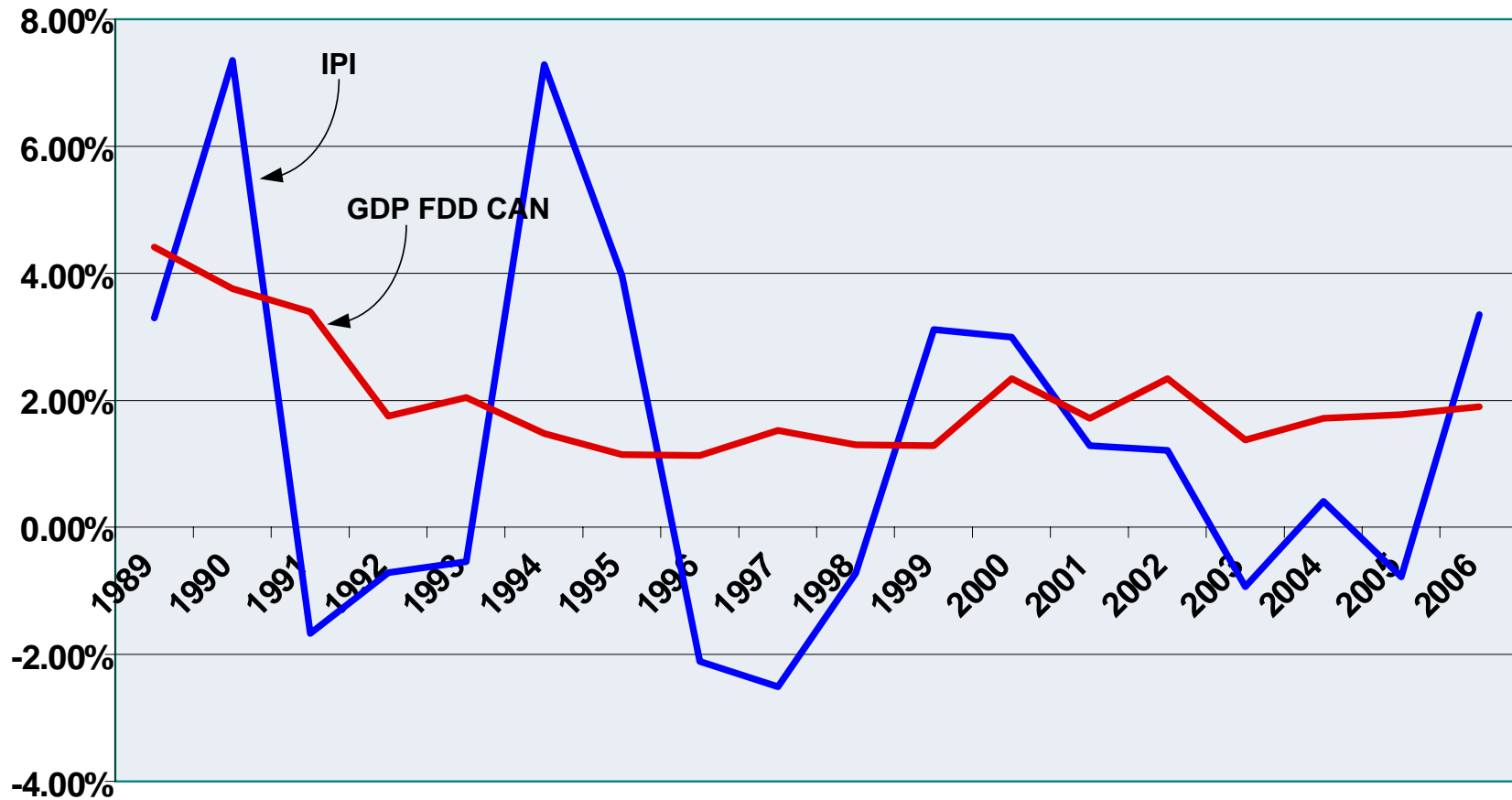
- Better tracks input price trends for the business.
- However, generally more volatile than “macroeconomic less an input price differential”.
- Avoid having to deal with complexity of input price differentials in X-factor calculations.
- Can be smoothed?

Macroeconomic

- Tracks input price trends for the economy as a whole.
- Can be brought closer to input price trends for the business through an input price differential (IPD).
- IPD is a component of X-factor and is set once at the start of a plan.
- IPD estimation is complex and contentious.

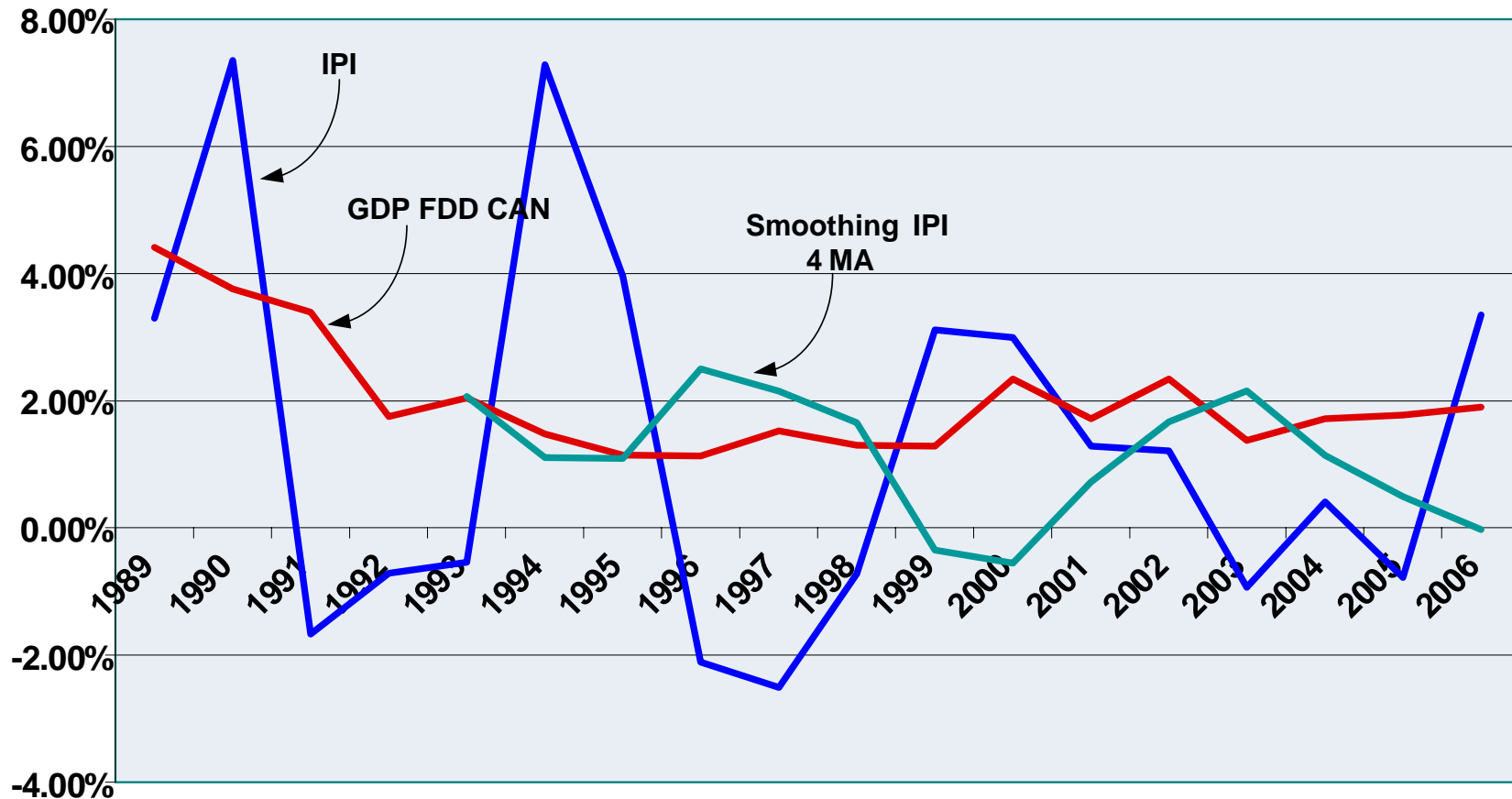


Illustrative IPI vs GDP IPI FDD Growth Rates



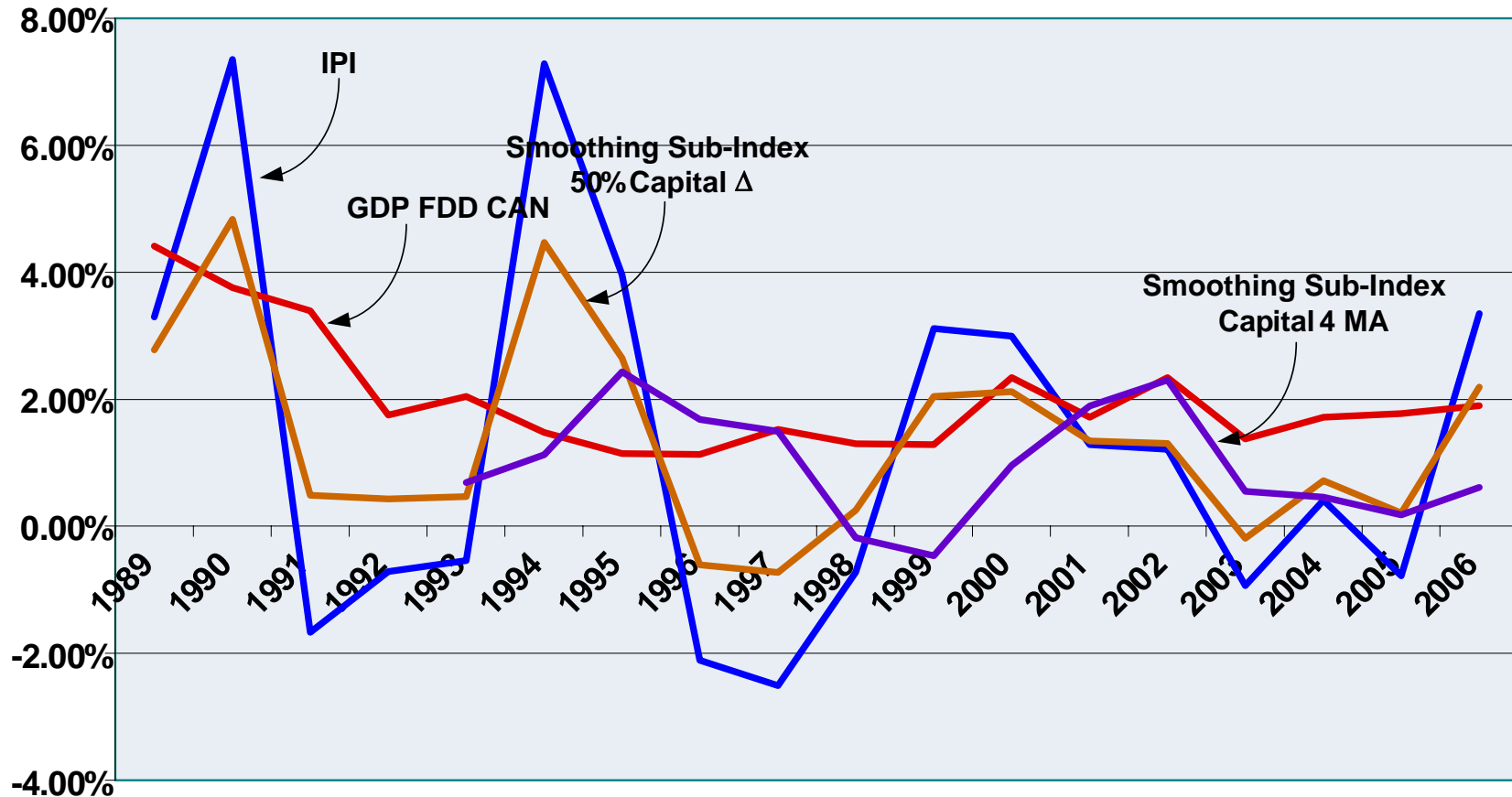
Illustrative IPI vs GDP IPI FDD Growth Rates

Should IPI Growth Rate be Smoothed?

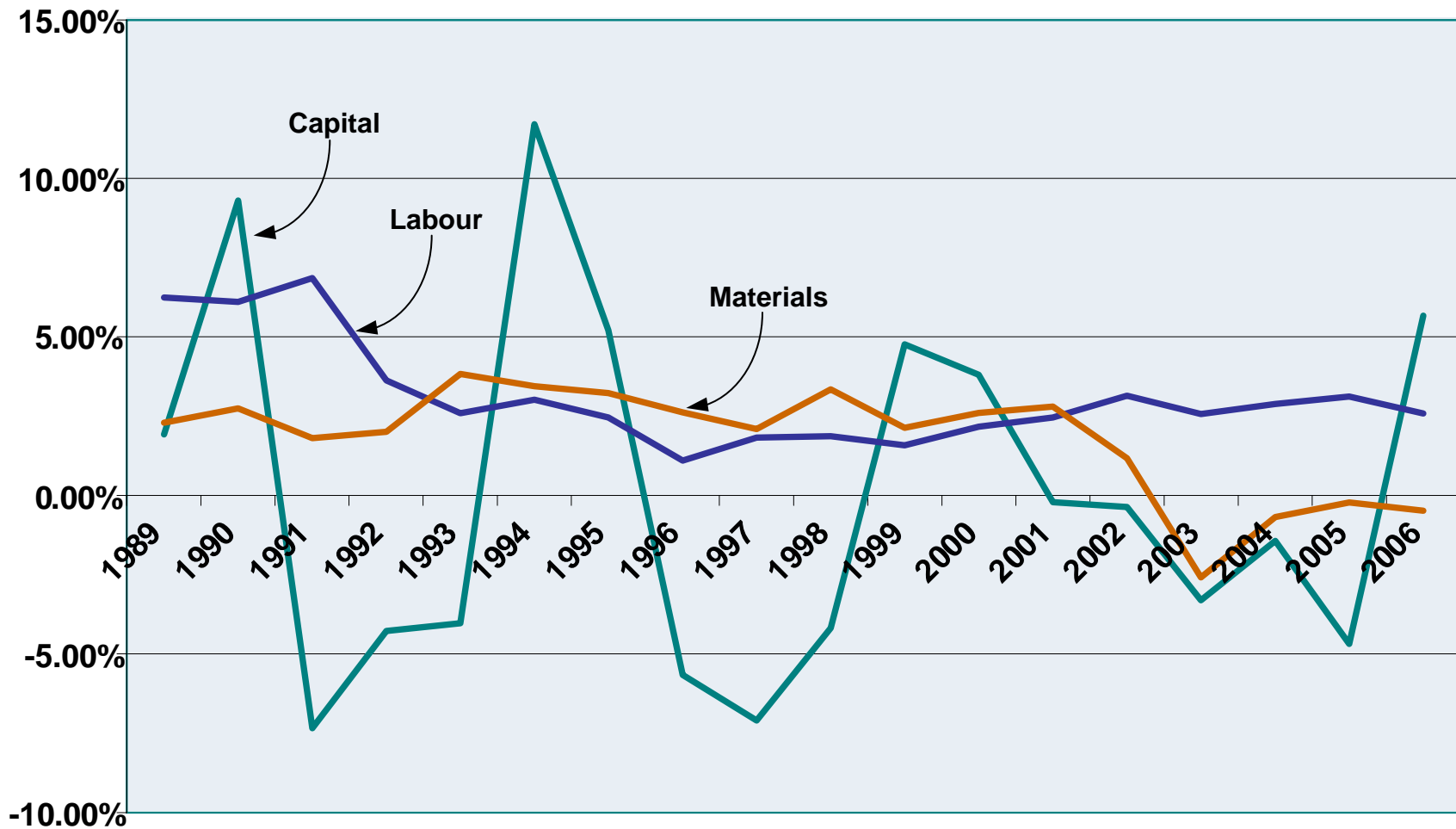


Illustrative IPI vs GDP IPI FDD Growth Rates

Should the Capital sub-index of the IPI be Smoothed?



Illustrative IPI – Sub-index Growth Rates



The X-factor

- How to derive X-factors for Ontario distributors?
 - specificity (industry-wide, peer, or individual); and
 - method (indexing, econometrics, stochastic frontier analysis, data envelopment analysis, or other).
- How to assign X-factors to Ontario Distributors?
 - to recognize diversity in terms of the external factors that will impact on TFP; or
 - offer some flexibility/opportunity for increased earnings in exchange for acceptance of higher X factor.

Current Thoughts – Issues/Concerns

Dual Stream Based on Term

- Unclear as to what appropriate upper boundary, if any, on term should be:
 - 3 years?
 - 5 years?
 - 7 years?
 - longer?



Current Thoughts – Issues/Concerns

A Modular Approach

- It is still unclear as to whether special treatment of incremental capital spending is necessary in a framework.
- Base capital is addressed at rebasing; however, where indexed rates are not sufficient to cover business-as-usual incremental capital incurred during the IR period, some expenditures may need to be outside the model:
 - Smart meters; CDM-related; capital contributions required as a result of the TSC decision; Others?
- Propose “modules”
 - Develop rules based approach for modules so that it is clear when it may be invoked. Clarify “what’s inside” and “what’s outside” of a module and any associated regulatory requirements.



Current Thoughts – Issues/Concerns

Other Matters

- **Lost Revenue due to Changes in Consumption**
 - Symmetry important.
- **Interdependencies** – now and later (long-term vision)
 - Service Quality Regulation
 - Benchmarking
 - Ratemaking and Consolidation
- **Implementation Considerations**
 - Triggers for, and treatment of unforeseen events
 - Reporting requirements
 - Rebasing rules
 - How adjustments would be determined



Next Steps

Target	Event/Milestone	Regulatory Schedule
December 14 th	Stakeholder consultation conference on working group progress	—2007—
2008		—2008—
Late-January	Staff initial proposals A Board staff discussion paper will be released for comment.	<ul style="list-style-type: none"> ● August – 2nd tranche of distributors file rate rebasing applications. ● August – 2nd and 3rd Generation IRM filing guidelines issued. ● October – Remaining file 2nd or 3rd Generation IRM applications.
Early-February	Stakeholder consultation conference .	
<i>Late-February</i>	<i>Written comments due on staff's initial proposals.</i>	
January-April	Revised proposals (if necessary). Working group meetings (March). Revised paper (mid-April). Comments due (mid-May). Stakeholder consultation conference (late-April).	
June	Board Report issued.	
2009	Rates are Set	—2009— <ul style="list-style-type: none"> ● April - Board approves 2009 rates and issues rate orders. ● May 1, 2009 – Rates in effect.





Ontario Energy Board
Commission de l'énergie de l'Ontario

Thank you