



Overview of the Electric Distribution Rate Handbook

Questions You May Have About the Rate Handbook

- ◆ **Why develop and adopt an electric distribution rate handbook?**
- ◆ **What does an electric distribution company have to do?**
- ◆ **What process is being employed to adopt the rate handbook?**
- ◆ **What is the purpose of the rate handbook?**
- ◆ **What are the elements of the rate handbook?**
- ◆ **What is PBR?**
- ◆ **How long will PBR last, and what will replace it?**
- ◆ **How will initial rates be established?**
- ◆ **How will rates be adjusted over the term of the plan?**

Why Develop and Adopt a Rate Handbook?

- ◆ **The OEB has assumed the role of electric distribution rate regulator from Ontario Hydro**
- ◆ **The OEB has indicated its intent to adopt a performance-based regulation (PBR) scheme**
- ◆ **A rate regulation process must be adopted to replace the process previously applied by Ontario Hydro**
- ◆ **The imminent opening of the retail electric market requires that rates be unbundled to support the new market structure**
- ◆ **A rate handbook can organize these changes and establish the processes and calculations necessary for the Board to administer rates in the Province**

What Does an Electric Distribution Company have to do?

- ◆ **Establish base unbundled rates**
 - Unbundled rates must be in place before market opening
 - These are the initial rates that will be adjusted by the Performance Based Regulation (PBR) rate adjustment mechanism
- ◆ **Utilities must file evidence to support these base rates**
 - May 1, 2000 if the utility has more than 30,000 customers
 - August 1, 2000 if the utility has 30,000 or fewer customers
- ◆ **Institute service quality and reliability monitoring procedures to track compliance with service standards**
- ◆ **File annual data in accordance with filing requirements (Chapter 6 and Appendix B)**
- ◆ **Conduct a cost allocation study to be used to rebalance rates subsequent to 2002**

What Process is being Employed to Adopt the Rate Handbook?

- ◆ **The rate handbook is staff's proposed rate handbook**
 - Formed on the basis of thousands of hours of advice provided by stakeholder task forces
 - It is staff's recommendation for a balance between the various interests and issues confronting rate regulation in Ontario
- ◆ **Board is starting a consultation process to review, revise, and adopt the rate handbook**

What Process is being Employed to Adopt the Rate Handbook?

Board Consultation Process

- ◆ **Parties must indicate if they wish to participate in the process by July 28, 1999**
- ◆ **Written comments will be accepted by the Board until Tuesday, August 12, 1999**
- ◆ **A technical conference will be held in August to seek clarification on the written comments**
- ◆ **The Board will issue an issues list on which it will hear oral comment in late August**
- ◆ **The Board will hear time-limited oral comments at a later date yet to be scheduled**
- ◆ **The Board will revise the handbook upon weighing the oral and written evidence**
- ◆ **The Board will subsequently issue its Electric Distribution Rate Handbook**

What is the Purpose of the Rate Handbook?

- ◆ **Describe the performance-based regulation rate framework that staff is recommending the Board adopt**
- ◆ **Provide a simplified mechanism to unbundle electric rates into distribution and commodity components to facilitate retail market opening**
- ◆ **Provide mechanisms for distributors to adjust rates for prudently incurred costs associated with the transition to the new market structure as well as for a market-based rate-of-return**
- ◆ **Adopt a process for submitting evidence to the Board and annually adjust rates**
- ◆ **Detail the obligations of electric distribution utilities in setting rates and filing information necessary to administer rates**

What are the Elements of the Rate Handbook?

- ◆ **Will ultimately consist of two parts:**
 - Part A provides the regulatory framework and design
 - Part B will provide calculation procedures

What are the Elements of the Rate Handbook?

Part A

- ◆ **Discusses the calculations necessary to establish base rates (Chapter 3)**
 - Simplified unbundling procedure
 - Provides the ability to incorporate a market-based rate of return if so desired
 - Allows for a historic rate of return on historic contributed capital
 - Allows the utility to incorporate prudently incurred booked transition costs into rates in the first period
- ◆ **Adopts a Price Cap PBR mechanism to adjust rates from year to year (Chapter 4)**
 - The PBR formula caps rates according to the net of inflation and an offset for productivity growth
 - The utility is at risk to manage its cost within the PBR formula
 - If it is more efficient than the index, it can increase its ROE to the cap
 - If it is less efficient than the index, its ROE will fall
 - The utility must choose a productivity factor which will establish its ROE cap

What are the Elements of the Rate Handbook?

Part A

- ◆ **Adopts Service Quality standards (Chapter 5)**
 - Customer Service standards
 - Reliability Standards
- ◆ **Requires periodic filings (Chapter 6)**

What is PBR?

PBR consists of three components:

- ◆ **A rate adjustment mechanism that creates potential rewards for controlling costs and innovating**
- ◆ **Standards that temper the incentives of the rate adjustment mechanism and insure appropriate service quality standards**
- ◆ **Risk mitigation measures for both the utility and the consumer**

What is PBR?

Rate Adjustment Mechanism

- ◆ **The rate adjustment mechanism decouples the utility's cost from its prices**
- ◆ **This creates potential rewards (in the form of increased profits) if the utility can control its costs below the experience of the industry**
- ◆ **The utility can keep a portion of these increased profits for the term of the plan, but rates will be rebased for the second generation of PBR**
- ◆ **Thus, the rate adjustment mechanism provides strong incentives for the utility to find cost savings and efficiencies**

$$\% \Delta P_j^t = \% \Delta IPI_{LDC}^t - \% \Delta PF_K + \% \Delta Z_j^t$$

What is PBR?

Standards

- ◆ **Left unchecked, the incentives of the rate adjustment mechanism might lead the utility to cut service quality below acceptable levels**
- ◆ **Service quality standards require that service be maintained over the term of the PBR plan**
- ◆ **Two types of standards will be included in first generation PBR:**
 - Customer service standards
 - Reliability standards

What is PBR?

Risk Mitigation Mechanisms

- ◆ **PBR mechanisms have often led to excessive and unearned earnings**
- ◆ **This plan includes caps on the ROE**
- ◆ **In addition, transition costs and extraordinary events can lead to depressed earnings if no allowance is made for interim incorporation of these costs**
- ◆ **This plan includes a mechanism to incorporate these expenses if prudently incurred**

How Long Will PBR Last, and What Will Replace It?

- ◆ **The term of first generation PBR is three years (2000-2002)**
- ◆ **The Board will initiate an interim review to:**
 - Review experience with PBR to date
 - Rebase rates for the beginning of the next generation of PBR
 - Design the second generation of PBR and select a term
 - Adopt more complete and tighter service quality standards
 - Adopt revised cost allocation factors between the rate classes
- ◆ **Electric distribution utilities must conduct cost allocation studies**
 - Utilities are encouraged to jointly develop new load research data
 - These cost allocation studies must consider the new structure of the industry

How Will Initial Rates Be Established?

- ◆ **Utilities must file unbundled rates**
 - A simplified unbundling process is provided
 - Utilities may use an alternative approach if justified to the Board
- ◆ **Utilities may adjust their rates to incorporate a market-based rate of return**
 - This adjustment occurs in establishing base rates -- subsequently, a utility's ability to earn the return is dependant on its performance
 - The adjustment is based on a "deemed" capital structure -- utilities may adopt whatever capital structure is appropriate as long as it is consistent with their licence requirements
 - The deemed capital structure varies by risk of the utility
- ◆ **Prudently incurred transition costs may be incorporated into initial rates**
 - Utility must supply evidence that they meet the four criteria

How Will Rates Be Adjusted Over the Term of the Plan?

- ◆ **Utilities will submit data to the OEB on an annual basis useful for calculating the inflation in the purchases of utilities**
- ◆ **The OEB will calculate the input price index (inflation factor) for use in the price cap formula**
- ◆ **Utilities will then calculate the rate adjustment**
 - A utility may choose not to implement a rate increase
 - But a utility must implement a rate reduction
- ◆ **Sequence**
 - Utilities file data before February 1
 - The OEB will publish the input price index by February 15
 - Utilities must enact rate changes on March 1