EXECUTIVE SUMMARY

Following a proceeding, this Decision deals with certain issues raised by parties on Board staff's proposals regarding the draft Rate Handbook to govern Performance Based Regulation for licensed electricity distributors for market opening, currently anticipated in November 2000. The revised Rate Handbook is not included as part of this Decision. It will be issued in due course.

The Board reaffirms its policy to move to a PBR regime and accepts the current rates charged by the electricity distributors as a reasonable base for unbundling the distribution component from the cost of power and in establishing the initial rates on which PBR will apply in the future.

The Board accepts the two-part (fixed charge and volumetric charge) rate structure proposed in the draft Rate Handbook. The Board allows the electricity distributors to establish the levels of the fixed charge and the volumetric charge based on their utility-specific cost allocation studies. In the absence of such studies, the Board sets a minimum default value for the volumetric charge for residential customers. For the general service class the methodology for determining such minimum charge is being currently investigated by Board staff and it will be included in the Rate Handbook.

The Board however expresses concern that the two-part rate structure and the specific levels chosen by a distribution utility may give rise to undue rate impacts for low volume users. The Board authorizes the distribution utilities to create sub groups within the general service class. For low volume customer groups in each rate class the Board sets an allowable maximum impact of 10% of the customer's total bill. Although the Board expresses concern about the suitability of a minimum bill provision in a two-part rate structure, in order to provide for additional flexibility for mitigating rate impact the Board authorizes the continuation of the minimum bill provision for those distribution utilities that currently include it in their rates.

In establishing initial rates, the Board makes findings on three revenue requirement adjustments to the unbundled base rates proposed in the draft Rate Handbook: (i) market-based return (including payments in lieu of income taxes), (ii) treatment of historical contributed capital, and (iii) transition costs.

With respect to market-based return, the Board authorizes the distribution utilities to propose rates targeted at earning the Board-approved return but leaves that decision at the local level. The Board, however, expresses concern about undue rate impact and cautions that unless rate impacts are adequately addressed by a utility, the Board will either seek a new proposal from the utility, or will itself fix the rates. To provide the utilities with flexibility to address rate impact, the Board authorizes the recording of the deferred revenue for disposition at a later time.

With respect to historical contributed capital, the Board finds that such capital should be included in rate base. Beginning January 1, 2000, new contributed capital will not be included in rate base.

The Board classifies transition costs into two categories. The first category is costs related to corporate reorganization and to the municipal transfer by-law. The Board finds these costs to be to the account of the shareholder, not recoverable from rates. The second category is costs related to business re-engineering of the incorporated distribution utility to conform to the new business orientation and requirements of a "wires only" company. The Board finds these costs to be considered for recovery through rates. However, since these latter costs will be incurred over a period of time that will likely extend beyond the date of the initial rates being in place, they are being deferred and thus will not to be included in the initial rates.

Once initial rates are set for market opening, the price cap mechanism will come into effect starting the second year of the PBR term. The price cap will be adjusted for inflation and productivity and for other items referred to as Z factors.

The Board accepts the electricity distribution industry-specific Input Price Index (labour, materials, capital cost) proposed in the draft Rate Handbook as the appropriate measure for inflation. However, in an attempt to moderate year to year changes to the capital cost component of the index, the Board finds that observed changes to that component should be limited to half.

The Board does not accept the proposal in the draft Rate Handbook for a menu of productivity and earnings cap. The Board adopts a single productivity factor for all utilities of 1.5 percent, inclusive of a "stretch factor" of 0.25 percent, combined with a 50/50 earnings-sharing mechanism for after tax earnings above the Board-approved target.

The Board accepts the six customer service indicators and three service reliability indicators proposed in the draft Rate Handbook but finds that, contrary to the proposal in the draft Rate Handbook, all nine indicators should be reported to the Board. The Board also finds merit in the suggestion that results should be disseminated more widely and indicates that the specifics of such dissemination will follow at a later time. The Board also makes findings on the frequency of the recorded data and reporting to the Board. The Board declines to adopt any financial measures at this time in the event of service quality degradation.

The Board concludes that better understanding of all of the issues surrounding Demand Side Management is needed before DSM principles, programs and mechanisms can be incorporated into a PBR regime for the electricity distribution industry. In the meantime, the Board encourages the continuation of DSM programs where they exist and the offering of new programs if they can be established cost-effectively within the price caps.

Throughout the Decision, explicitly and implicitly, the Board's determinations are largely influenced by the need to assist the electricity industry to ease into first generation PBR in the most simple and practical manner possible. In many of its conclusions, the Board points out that matters will have to be revisited for the purpose of the second generation PBR plan. Also, certain of the Board's determinations are influenced by the desire to moderate the rate impact of moving from the existing rates to the initial rates on which PBR will apply.

Given the provisions in the legislation for turning the utilities into commercial entities by, among other things, allowing market-based returns (including proxy income taxes), unfavourable rate impacts in some cases may be unavoidable. It would be inappropriate to use the likely initial impacts as arguments for negating the potential benefits of performance based regulation past the initial stage.