

Ontario Energy Board
P.O. Box 2319
26th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'Énergie de l'Ontario
C.P. 2319
26e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



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**To: All Local Electricity Distribution Companies
Registered Parties to RP-1999-0034 and RP-2000-0069 Proceedings**

Re: Extension of First Generation PBR - RP-1999-0034

In assuming economic regulation of Ontario electricity distribution industry pursuant to the *Energy Competition Act*, the Board considered adoption of Performance Based (Rate) Regulation (“PBR”) for effective and efficient rate-regulation while motivating distributors to pursue productivity improvements, with the results of such improvements benefitting both consumers and the distributors’ shareholders. Following consultations with industry and other stakeholders, and review in a proceeding of a first generation PBR plan recommended by Board staff, the Board adopted a three-year price cap PBR scheme in its Decision with Reasons RP-1999-0034. Specifics of the first generation plan are documented in the Electricity Distribution Rate Handbook (the “DRH”).

Pursuant to the Minister’s Directive of June 7, 2000, the Board commenced a proceeding to review certain aspects of the PBR regime. On September 29, 2000, the Board issued its Decision with Reasons RP-2000-0069, revising certain aspects of the first generation PBR plan. On November 3, 2000, in light of the RP-2000-0069 Decision, the Board issued a letter revising certain sections of the DRH, including the timeline for first generation PBR. In light of delays in preparing for the opening of the market, the Board advised that “[t]he term of the first-generation plan ha[d] been adjusted with years two and three rate adjustments on March 1 of 2002 and 2003, and termination of the plan on March 1, 2004.”

Subsection 26(1) of the *Ontario Energy Board Act, 1998*, opening the market to competition in generation and in wholesale and retail marketing, came into force on May 1, 2002.

Utility management has had to focus much of their attention for over three years on restructuring and market opening issues, and the Board is concerned that the industry may not have had a full opportunity to explore the incentives for improvements and savings provided by the current PBR regime. The Board also recognizes that there are a number of issues relating to restructuring and market readiness, which remain

outstanding, such as the final disposition of transition costs, market opening variance accounts, and PILs 'true-ups'. In the Board's view, it would be beneficial if resolution of these issues can be dealt with before moving to second generation PBR.

In addition, the Board is concerned that not all utilities have started collecting load data necessary for the cost allocation studies that will be required before second generation PBR.

In light of circumstances, the Board considers that a one-year extension of the first generation PBR plan would be beneficial. Under this extension, the March 2004 electricity distribution rates adjustments will be processed using the current IPI-X price cap mechanism. The second generation PBR plan is expected to commence on March 1, 2005.

It is anticipated that the extension will allow parties to direct more attention towards other important near term issues, as well as commencing load data collection. An additional year of experience with 1st-generation PBR and the competitive Ontario electricity market should also be beneficial for development of the 2nd-generation PBR plan.

The Board is still committed to a comprehensive review of issues related to setting "going-in" rates as well as the rate adjustment mechanism that would operate over the term of second generation PBR. However, the Board has asked staff working on the second generation PBR project to follow a 'phased' approach. By this, the Board will review the various sub-components of the project - rate adjustment mechanisms and productivity, Service Quality Indicators, Demand Side Management, etc. - and decide at what specific time it will be best to bring each forward for stakeholder consultation. Workload management may prove smoother if some issues are addressed separately and sequentially. The Board will communicate its plans in due course.

To conclude, the underlying aim in extending first generation PBR by one year is to continue development of the second generation PBR plan, but at a pace that enables parties to devote adequate resources to ongoing business, including regulatory, matters.

For further information, please contact Keith Ritchie, Research and Policy Analyst, at 416-440-8124 or ritchike@oeb.gov.on.ca.

Yours truly



Assistant Board Secretary