

**Ontario Energy Board**  
**Regulated Price Plan (RP-2004-0205)**  
**Issues for Discussion**  
**August 23, 2004**

*The objective of this paper is to facilitate discussion in relation to identifying issues that should be addressed by the Board as it proceeds with the development of a regulated price plan. This discussion is expected to assist stakeholders in formulating their input into the Board's on-going consultation process for this project. The Board wants to hear your concerns and views.*

**Introduction**

Existing legislation, the *Ontario Energy Board Act, 1998*, requires the Ontario Energy Board (the "Board") to ultimately determine the commodity price for electricity payable by certain consumers. Bill 100 reinforces the Board's mandate by contemplating that the Board will develop an annual "regulated price plan" (RPP). The consumers that will be eligible for the RPP will be defined by regulation.

This RPP will be a replacement for the current "two-tiered" pricing of 4.7cents/kWh and 5.5 cents/kWh for low volume and designated consumers. In effect, the RPP is the price schedule that a defined set of consumers can choose as an alternative to, or in conjunction with, a retailer electricity contract. The RPP development process will culminate in a new code, which will replace the Board's existing "Standard Supply Service (SSS) Code".

**Context**

The Board's SSS Code defines a number of options for commodity pricing for consumers without retailer contracts. In reality, until Bill 210 went into effect, most SSS consumers paid the wholesale spot market price. It was an easily administered and explained option but with some undesirable characteristics such as high volatility and "after the fact" notification about the price consumers paid. It was analogous to consumers buying gas for their cars from gas stations that did not post the price and the consumers only finding out the price they paid when they received their credit card statement. As a result, most SSS electricity consumers had no ability to respond to changes in prices by altering their consumption to mitigate the impact of price increases. Most of these consumers were also unaware of how prices were determined in the market and passed through to them. Therefore, when high seasonal demand was matched with tight supplies, the resulting relatively high market clearing prices resulted in significant increases in consumers' total electricity bills. Consumers' reactions to these electricity bills were immediate and vociferous.

In response, the Government introduced Bill 210, which fixed the commodity price at 4.3 cents/kWh for low volume and designated consumers, regardless of whether or not they had

retail contracts. The resulting mismatch of the fixed price against fluctuating wholesale market prices, and the subsidization of retail contract prices, resulted in significant liabilities for electricity costs. To address this problem of growing liabilities and to provide incentives to conserve energy, a new consumption-related “two-tier” price structure was introduced in 2003 that increased the average commodity price for electricity, while retaining the same consumer eligibility criteria as the previous 4.3 cent fixed price scheme.

In early 2004, the Government received a report from the Electricity Conservation and Supply Task Force (ECSTF) recommending a future electricity supply market structure based on a “hybrid” market, i.e., a combination of market-based, regulated and contract-based supply with consumer prices established accordingly. Subsequent policy statements by the Government supported this recommendation along with others to establish an Ontario Power Authority (“OPA”) and withdraw some Ontario Power Generation (“OPG”) output (i.e., baseload) from the market and place it under regulated pricing.

In a major policy speech in mid-April 2004, the Minister of Energy outlined a vision for Ontario’s electricity industry. Central to this vision is a “standard rate plan” that will ensure that residential and small business consumers pay the true cost of electricity over time, but within a stable and predictable price framework. According to the Minister, the standard rate plan should also support conservation, “smart metering” and load shifting initiatives through “time of use” pricing.

Therefore, the charge to the Board is to develop a “regulated price plan”<sup>1</sup> that is forward looking, stable, cost-reflective and “blends” market, regulated and contract prices. This price “blending” is to take place in such a manner that revenues paid to generators for that proportion of load represented by eligible consumers is closely matched to the revenues collected from those same consumers. At the same time, the regulated price plan is intended to have some elements of tiering, seasonal, or time-of-use factors to encourage rational and efficient use of electricity.

### **The Basic Approach**

A single market clearing price pass-through mechanism, like the “spot price pass through” option chosen by the majority of electricity distributors (in the SSS Code) when the market opened to competition in May 2002, delivers many of the policy requirements for the regulated price plan, but not the crucial one of price “stability”, or, lack of volatility. It was also difficult for residential customers to understand. As a result, it was decided that a new approach was needed.

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<sup>1</sup> It is referred to as the “regulated price plan” instead of “regulated rate plan” because of the focus on the commodity price and not other elements of a consumer’s bill such as costs for distribution and transmission services, line loss costs, etc.

The introduction of the “hybrid” market means that there is no longer a single market clearing reference price but a number of different prices for specific generators under contract, regulated pricing for some OPG output, and a market price for the remaining subset of total supply. Multiply these prices (which may also be tiered, seasonal or time-of-supply determined) by the supply dispatched to the market by the generator receiving the specific price and the result is an “electricity supply revenue requirement” defined over time. This is the revenue that must be recovered from applicable consumers through the regulated price plan. However, the prices that consumers pay may not have the same time profile or even be equal to a specific supply side price as a result of the blending mechanism. Furthermore, since there will be a portion of the electricity supply revenue requirement that depends on unknown market prices, the regulated price plan will have to forecast those prices. The revenues collected are unlikely to exactly match the revenues paid because of the variation between forecast and actual market prices. As a result, a variance account or some other means to account for the difference between forecast and actual market prices will be required to ensure that consumers pay the full cost of electricity over time. This is necessary to ensure that the “user pays” (i.e., ratepayers instead of taxpayers) and that there is no cross-subsidization.

Although the basic approach appears simple (“match supplier revenues paid with consumer revenues collected”), the development and implementation of a regulated price plan must address a number of practical, philosophical and policy issues before the plan can be a realistic alternative to the current pricing system. The following highlights some of these issues. It is not intended to be exhaustive, but rather provides a useful starting point for discussion.

### **Discussion of Issues**

1. Addressing potential conflicting objectives
  - (a) How can we best balance achieving "price stability" with "cost reflective pricing" and incenting conservation? For example, such a conflict may arise within the context of the true-up frequency.
2. Hybrid Market "Price Blending"
  - (a) Contract supply: NUGs and new Request for Proposal (RFP) supply
    - i. Data sources and commercial confidentiality
    - ii. Contract non-performance - assumptions for replacement power
    - iii. How to handle "capacity payments", i.e., fixed cost per installed MW

- (b) OPG regulated supply
  - i. If OPG does not meet its MW quantities allocated to the rate plan from its regulated baseload assets, what are the options for replacement power and how should it be funded?
  
- (c) Market price supply
  - i. Forward price forecast - methods and models
  - ii. Tracking and adjustments - how frequent, what criteria?
  - iii. Risk assessments/error bands: forecast bias, over or under?
  
- (d) Price blending methodology
  - i. Pro rata shares - historical basis with growth factors; forecast and contract terms with error bands?
  - ii. What time frame? - daily, weekly, monthly, quarterly, annual
  - iii. Weighting and tiering: daily peak and off peak; seasonal?
  - iv. How many "price plans"? What criteria - customer class, metering capability, consumption levels, billing cycles, ability to respond to price sculpting (i.e., more detailed pricing than peak/off-peak).
  
- (e) RPP Eligibility
  - i. Customer classes
    - Government definition?
    - Retailer supply contract status?
  - ii. Entry and exit
    - Restricted or open?
    - Penalties or definitions (i.e., in RPP for a defined period of time)?
    - Permanent exit or periodic exit and return?
  
- 3. Settlement Issues
  - (a) Variances of blended price and actual price: who holds variances - local distribution companies (LDCs), OPA?
  - (b) Tracking the variance account: what criteria for clearing - periodic (quarterly, annual) or magnitude (absolute dollar or percent of total purchases)?
  - (c) Re-setting the RPP: annual only or in-year changes? If in year, what decision criteria to use? Is the current method used in Ontario for natural gas (i.e., quarterly adjustments) a viable option for electricity?
  - (d) What are the billing/settlement system implications where the RPP includes a retailer contract?
  - (e) In the case of non-interval metered RPP customers, what is the best method of allocating consumption? Province-wide net system load shape? LDC-differentiated load shapes? Regional load shapes?
    - i. Load shape data sources/availability.
    - ii. What are the best proxies where data is not available?

4. Policy issues
- (a) What will best support the conservation, DSM and smart metering objectives: peak, off peak pricing; critical peak pricing; steeply tiered pricing on a daily, weekly or quarterly basis? Should it be a combination?
  - (b) What peak-off peak price differential will support smart meter adoption?
  - (c) Should the RPP be designed to support retail contracting through price differentials and restrictions on exit and re-entry? If so, are there any implications?
  - (d) Should the RPP be designed to push certain customer classes into smart metering more quickly than others, i.e., business class above a certain demand level?
  - (e) What RPP terms and conditions might act as a disincentive to generation investment?