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Howard I. Wetston, Q.C.
Chair

Président

March 9, 2005

To: Licensed Electricity Distributors and Electricity Stakeholders

The purpose of this letter is to provide further details on future rate setting initiatives as set out in the Board's draft business plan. Effective January 1, 2005 electricity distribution utilities no longer require the Minister of Energy's leave to make an application to change distribution rates. The Board is supportive of this change, which re-establishes normal regulatory practice and facilitates our ability to address issues facing the industry. It is important that the Board, utilities and stakeholders work together to ensure an efficient and effective review of rates for the more than 90 distribution utilities in Ontario.

The Board has indicated on a number of occasions its intention to address four areas:

- Cost Allocation
- Revenue Requirement
- Incentive Rates
- Comprehensive Rate Design Review

Cost Allocation

The Board will continue its review of cost allocation. A number of utilities are currently collecting new load data which will be helpful in this regard. It is important to recognize the potential for significant rate design and classifications changes resulting from smart metering and other developments in the electricity sector. For this reason the current review will be based primarily on the existing rate classifications and a limited number of rate design issues. The cost allocation review will allow the Board to address anomalies on a utility specific basis for 2007 rates.

The Board's comprehensive study of the distribution rate design, discussed below, will help inform the sector as to whether more detailed allocation and design works need to be done and when.

Revenue Requirement

2006 EDR will establish the methodology, guidelines and models for the new distribution revenue requirements. The Board expects this process to be completed by April 2005. Applications for new revenue requirements are expected in July 2005 for rate implementation in May 2006.

The decision was made in the 2006 EDR process to postpone a number of important revenue requirement issues. Some of these issues, such as the appropriate cost of capital, may need to be considered by the Board in a broader context of transmission and distribution regulation in both the gas and electricity sectors. Other issues, such as asset depreciation, can only be addressed after

studies have been completed. The Board expects to resolve these issues prior to 2008. Adjusted revenue requirements will be implemented beginning in 2008 for some utilities.

Multi-year Incentive Rates

There is a need to reduce simultaneous annual rate setting for all distribution utilities. Allowing rates to be set for multi-year periods will increase regulatory efficiency. The Board foresees setting rates beginning in 2007 by using an incentive mechanism applied to the rebased revenue requirements determined for 2006 rates. The Board's emphasis will be on a simple and straightforward rate adjustment mechanism.

During the period of the multi-year rate plan the Board will selectively rebase the revenue requirements of some utilities. The approach of staggering utility rebasing will allow the Board to prioritise on a more considered basis. It will also produce a more efficient and less costly regulatory workload for all concerned.

Comprehensive Rate Design Review

Distribution rates should encourage the efficient use of electricity and take advantage of changes in metering technology. Smart metering will allow for the establishment of new rate design. Distribution rates need to be reviewed from the perspective of both cost causality and government conservation policy. The need for consistency and the management of bill impacts are also important considerations.

The Board will begin a comprehensive study of rate design which considers industry changes, new technologies and conservation policies. We will seek stakeholder views once our initial research has been completed.

Hearing from you

Clearly there are many issues which need to be resolved over the next few years. The Board intends to address these issues, but to do so recognizing the realities and complexities facing the electricity sector. This means that not all issues can be resolved immediately and that interim solutions may be the most prudent way of moving forward.

I look forward to the opportunity to discuss with you the ways we can work together to meet our challenges.

Sincerely,

Original signed by

Howard I. Wetston, Q.C.