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VIA EMAIL AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: Multi-year Electricity Distribution Rate Setting Plan
Draft Report of the Board re: Cost of Capital (EB-2006-0088) and 2nd Generation Incentive Regulation Mechanism (EB-2006-0089)

VECC's Written Comments

As Counsel to VECC, I am writing to provide comments regarding the Draft Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors.

In general, VECC considers the Draft Report to represent a reasoned and balanced approach to the various issues discussed during the consultation process and the varying positions taken by those participating. VECC appreciates that compromises were required in order to both reconcile the various parties' positions and to meet the timetable for new rates starting in 2007. Indeed, VECC would urge the Board to resist making fundamental changes to the proposed guidelines at this point as they would likely upset the delicate balance the Board has managed to achieve. In this vein, VECC has generally limited its comments to issues of clarification and implementation.

Cost of Capital

- As VECC understands the Report (pages 29 and 43), formal adjustments to the cost of debt and cost of equity will only occur at the time of rebasing. It would be useful if this point was also made in the Cost of Capital section of the Report.

- It is not clear from the Report precisely how the introduction of 4% short-term debt (page 9) will be integrated with the phase-in of the proposed 60/40 capital structure. For example, is the 4% assumed to be implemented entirely in the first year of the phase-in or gradually over the entire phase-in period? Given the observation in the Report that "many distributors are using short-term debt to finance their operations" and the interest in keeping things simple, it would be seem reasonable to adopt the 4% short-term debt in the first year of implementation.

- VECC notes that the implementation schedule for the capital structure changes (page 43) extends from 2008 to 2009 or 2010, depending upon the current deemed capital structure of the utility. For those utilities that are rebased during this period (i.e. in 2008 or 2009), the implementation of the new capital structure will extend into the 3rd Generation IRM (3GIRM) period. VECC believes there is merit in trying to minimize this overlap.

  The form and structure of the 3GIRM is yet to be determined and having to accommodate a carry over of the capital structure realignment could create unnecessary complexity. For example, if the 3GIRM was to use an industry specific price escalator that included changes in the cost of capital (similar to the 1st Generation IRM), there would be a need to integrate these two adjustments for those utilities still going through the capital structure transition.

  This overlap could be reduced by starting the implementation of the new capital structure in 2007 and eliminated if the transition period was reduced to two years in all cases.

- The Report suggests (page 15) that the short term debt rate will be set when a cost of service rate application is filed. However, the implementation of the new cost capital structure (including a short-term debt component) will be initiated for some distributors during the 2GIRM and a prior to any rebasing of their rates based on cost of service.

  In these cases, a rate for short-term debt will have to be established outside of their cost of service proceedings. For such utilities it would seem reasonable to adopt the same short-term rate as will be established for distributors actually undergoing a cost of service review for the test year in question. However, in the event that the capital structure change was initiated in 2007, then a generic short-term debt rate would need to be established for all distributors outside of a cost of service proceeding.

Incentive Regulation

- The Board notes (page 24) that it is "currently consulting with stakeholders on the criteria that should be used to determine the Rate Plan groupings (i.e. which distributors will be rebased in which years)". To date VECC has not been contacted for its input. As the Board is aware VECC has made comments on this issue in previous submissions and would welcome the opportunity to further discuss its views with the Board.

  One area where the Board has managed to strike a delicate balance between the interests of the various parties is with respect to the issues associated with Deferral Accounts, Earnings Sharing Mechanisms, Z-Factors and Timing of Rebasing. In VECC's view, a key component of this balance is the need to include earnings levels as one of the major factors in determining the Rate Plan groupings for rebasing.

- The discussion on Form of IRM (page 24) notes that "the implementation of mandatory service quality requirements is needed to provide balanced incentives for efficiency improvements and the maintenance of adequate service quality over course of the 2GIRM". However, the discussion on Service Quality (pages 38-40) only states that the "Board will resume its SQR regime for electricity distributors in consultation with stakeholders". There is no indication or commitment that a revitalized SQR regime will be in place for the 2GIRM. In VECC's view, and as noted in the Board's Report, this is a critical component of the 2GIRM.

- The Board Report states (page 34) that "**Z-factors will be limited to changes in regulation, changes in accounting or tax rules and natural disasters**". However, this wording is not directly reflected in the Z-factor Eligibility Criteria Table provided in Appendix C. In VECC's view this wording should be included under the section "Inability of Management to Control" in order to avoid any future ambiguity on the issue. Also, given the interest in narrowly defining the scope of Z-factor adjustments VECC would submit that the causation criteria in the Table should be increased to 90%. Finally, with respect to materiality of Z-factor adjustment, the Report should clarify that the 0.2% is based on the financial year for which the claim is being made.

VECC appreciates the opportunity to comment on the Board's Draft Report. If there are any questions or if clarification is required regarding the Comments please contact either Bill Harper (416-348-0193) or myself (416-767-1666).

Yours truly,

Michael Buonaguro
Counsel for VECC