EB-2006-0209 November 2-3 Stakeholder Meeting
Comments from School Energy Coalition

Goals of IRM

There are only two goals of this kind of regulatory structure:

- Create a win-win rate-setting mechanism in which the utility is given the freedom and the motivation to achieve efficiencies, and those efficiencies are then shared equitably between the shareholder and the ratepayers in a pre-agreed manner. In effect, a process in which rate-setting is zero-sum (ie. anything more the shareholder gets comes from the ratepayers, and vice versa), is replaced with a process in which additional wealth is created through productivity, and then shared.

- Make the regulation of the utility more efficient by setting rates through a more streamlined market proxy. This is mainly a question of saving time and money, but it also involves making the regulatory process simpler and easier to understand for both utilities and their stakeholders.

The first goal should be primary, and the second goal should be pursued only to the extent that it does not undermine or limit achievement of the first goal.

Parameters of this IRM Plan

School Energy Coalition has been vocal in its views on the conceptual structure of incentive regulation schemes. The following are key points:

1. Ratepayers are concerned about rates. Establish a structure in which rates must decrease in real terms over the life of the plan. This locks in the net benefits to the ratepayers. This means no off ramps, and limited or no Z factors. The utility managers are given the prices they can charge for a fixed period of time (in effect, the market prices) and their challenge is to operate the utility at the highest profit they can within those market prices. There are no "extras" or "changes of scope". The ratepayer benefit must be secure and immutable.

2. Calculate the ratepayer benefit fairly, based on a reasonable level of productivity and an assumption of good but not stellar management. Productivity analyses are fine, but in reality the X factor, which should be the measure of the ratepayer benefit during the plan, is a guess that is largely a compromise between competing economic interests. In the best of all possible worlds, it is negotiated between the utility and its ratepayers, since then everyone buys into the result, for better or worse.

3. Business owners and managers need upside, and are willing to take some risks to get it. Establish a structure in which 100% of all efficiencies during the life of the plan, other than the net benefits to the ratepayers that have already been locked in, accrue to the benefit of the shareholder. No earnings sharing under any circumstances. If the utility delivers efficiencies, let them keep what they earned. The ratepayers are already getting their benefit.

4. The most creative ways of making businesses more efficient require an investment period, and a period of returns on that investment. The longer the incentive regulation period, the more opportunity the business managers will have to implement creative efficiencies and realize a fair return on them.

5. Establish clear operating policies or limitations at the outset, so that utilities understand any limits on their creativity, and so that when the time comes for rebasing the possibility of disputes or rancour is minimized. For example, if shifting profits outside the utility to an affiliate is not acceptable, or only acceptable with certain disclosures, decide that at the outset.

6. Fix cost allocation and rate design in advance. Ratepayers cannot rely on receiving the built in benefits if they can be taken away through rate design changes. Changes to cost allocation and rate design can be worked on, discussed, and even debated during the course of a plan period (in fact, a convenient time to do it), but all implementation should be at the time of rebasing.

7. Establish service quality levels equivalent to those currently in place and therefore achievable. If service quality is to go up or down during the plan, value that cost change and assess openly how the incremental cost, or the cost saving, should be shared between shareholder and ratepayers.

8. On rebasing, the default should be that the new cost of service becomes the base. However, the utility should be free to propose that some part of specific efficiency improvements should continue to be enjoyed by the shareholder for a finite period, for example if the improvement is one that has a long payback.

Reporting Requirements

There are two goals for the reporting requirements:

- Prophylactic, ie. through transparency restrict the utility from engaging in activities that are either against the rules, or against the spirit of the rules.

- Communicative, ie. through transparency ensure that the ratepayers and the public see what is happening, and thus understand a) how much the utility is benefitting from the regulatory framework, and b) the nature and creativity of the efficiencies management is introducing to drive higher profits.

This is an area in which School Energy Coalition would be most assisted by hearing the input of others. The following constitutes our preliminary suggestions.

Each year, the utility should file two base documents: a report on the activities and results of the previous year, and a budget and plan of activities for the current year. These should be extensive. For example, the budget and plan should be at a level of detail similar to what individual executive sponsors would have available to them internally when they approve components of their budget and plan. While this is short of the detail in a cost of service rate application, it is close. In the case of both the historical and current data, the utility should file a full cost allocation study and rate impact analysis based on actuals and plan, as the case may be.

In addition to the two base documents, the utility should file a report, in a pre-agreed format, setting out the specific steps taken to create efficiencies and drive profits, and the results achieved. The annual (or more often) filings of this report impose a discipline on the utility to be rigorous in its management of efficiencies, and also can be used at the time of rebasing to inform the Board's decision at that time.

In the first year, the Board should establish a type of interrogatories process for stakeholders to seek supplementary information. On the basis of those additional filings, the Board should revise the filing requirements for the following year, and so on. Eventually, the need for additional information should be limited. If it isn't, either the utility or the stakeholders are not doing their job properly, and that needs to be identified and fixed.