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BY E-MAIL AND WEB POSTING

February 28, 2008

To: All Participants in Consultation EB-2007-0673
All Licensed Electricity Distributors

Re: **3rd Generation Incentive Regulation for Electricity Distributors
Board Staff Paper, Consultant's Report and Stakeholder Meeting
Board File No.: EB-2007-0673**

A consultation process is currently under way with respect to the development of the principles and methodology for the 3rd generation incentive regulation ("3rd Generation IR") mechanism that will be used to adjust electricity distribution rates starting in 2009 for those distributors whose 2008 rates were rebased through a cost of service review.

This letter invites comments on two papers that are being released today in relation to this consultation, and that are now available on the Board's web site at www.oeb.gov.on.ca. This letter also provides details on a stakeholder meeting that will be held in March.

On September 11, 2007, the Board issued a letter which provided stakeholders with a schedule for this initiative along with two other concurrent initiatives relating to incentive ratemaking: the Comparison of Utility Costs (EB-2006-0268) and Service Quality Regulation for Electricity Distributors (EB-2008-0001). Appendix A contains an update to the estimated dates of the key activities which are known at this time for these initiatives.

Invitation for Written Comment on Staff Discussion Paper and Consultant Report

The Board has posted on its web site a Board staff Discussion Paper presenting options for the 3rd Generation IR mechanism framework. Board staff would be assisted in furthering its work by written comments on the Discussion Paper. While the Discussion Paper identifies a number of issues in relation to which input from participants is specifically requested by staff, participants should feel free to comment on all aspects of the Discussion Paper. Participants that wish to put forward alternative proposals or options for consideration are encouraged to include in their comments not only a detailed description of each proposal or option (including steps necessary for implementation, where applicable), but also the underlying rationale and principles that support the proposal or option. Written

comments on staff's Discussion Paper must be filed with the Board by **April 14, 2008** in accordance with the filing instructions set out below.

The Board has also posted on its web site a Report prepared by Board staff's expert consultant, Dr. Lawrence Kaufmann of the Pacific Economics Group, entitled "Calibrating Rate Indexing Mechanisms for 3rd Generation Incentive Regulation in Ontario" (the "PEG Report"). The PEG Report makes specific recommendations for the productivity and stretch factor components of the X-factor. Written comments on the PEG Report must be filed with the Board by **April 14, 2008** in accordance with the filing instructions set out below.

Participants that wish to do so are invited to provide their own expert reports on the issues addressed in Board staff's Discussion Paper or in the PEG Report. Participant expert reports must be filed with the Board by **April 14, 2008** in accordance with the filing instructions set out below.

Stakeholder Meeting

A stakeholder meeting will be held on **March 25 and 26, 2008**. Board staff's expert consultant will be in attendance at the stakeholder meeting, and participants that intend to file expert reports are similarly invited to make their experts available at that time. The stakeholder meeting will be transcribed.

The objectives of the stakeholder meeting are:

- to allow participants and their respective experts to express their views;
- to provide participants with an opportunity to explore in some depth the rationale and merits of alternatives or options put forward by other participants and their respective experts; and
- to help staff, the Board and participants to gain, through the presentations and an interactive exchange, an understanding of different perspectives and of significant issues and areas of concern.

Presentations

Each participant's expert, as well as Board staff's expert consultant, will be provided with an opportunity to make a presentation on issues associated with incentive regulation. **A set of questions to guide participants in preparing their presentations is provided in Appendix B.** Participants that do not intend to file an expert report may also make a presentation. Participants that intend to prepare joint written comments or to jointly sponsor an expert are encouraged to consult with one another and make a common presentation representing their shared views.

To ensure ample time for discussion, presenters are asked to complete their presentations within 30 minutes and be available for questions from other participants for up to an additional 1.5 hours.

Location and Registration

The stakeholder meeting will take place in the Board's West Hearing Room, 25th floor, 2300 Yonge Street, Toronto. A detailed schedule will be issued to participants prior to the meeting.

Participants that are interested in making a presentation and all other participants that are interested in attending the stakeholder meeting are asked to register in advance by e-mail to EDR@oeb.gov.on.ca or by telephone to Doreen Robinson at 416-440-7612 by **4:30 p.m. on March 17, 2008**. Participants that intend to make a presentation are asked to file copies of the presentation with the Board by **March 20, 2008** in accordance with the filing instructions set out below.

Cost Awards and Instructions on Filing Material with the Board

The Board, in its September 25, 2007 Decision on Cost Eligibility determined that the following participants in this consultation process were eligible for cost awards: the Association of Major Power Consumers in Ontario; the Consumers Council of Canada; Energy Probe Research Foundation; the Green Energy Coalition; London Property Management Association; Pollution Probe; School Energy Coalition; and the Vulnerable Energy Consumers Coalition (collectively, the "eligible participants"). Cost awards will be available to those eligible participants in relation to the consultation activities described in this letter. **Details regarding cost awards are set out in Appendix C.**

All filings in relation to this consultation must quote file number **EB-2007-0673** and include your name, address, telephone number and, where available, an e-mail address and fax number. Three paper copies and one electronic copy of each filing must be provided. Paper copies are to be addressed to the Board Secretary at the Board's mailing address set out above. The electronic copy must be in searchable/unrestricted PDF format, be submitted through the Board's web portal at www.errr.oeb.gov.on.ca and conform to the document naming conventions and document submission standards outlined in the RESS e-Filing Guides (available on the Board's website at www.oeb.gov.on.ca on the e-Filing Services web page). A user ID is required for filings through the web portal. If you do not have a user ID, please visit the Board's web site on the e-Filings Services web page and fill out a user ID password request. If the web portal is not available, the electronic copy may be submitted by e-mail to BoardSec@oeb.gov.on.ca. Participants that do not have internet access may file their electronic copy on diskette or CD.

Filings must be received by **4:45 pm** on the required date.

All materials related to this consultation will be posted on the "Key Initiatives & Consultations" portion of the Board's web site at www.oeb.gov.on.ca. The material will also be available for public inspection at the office of the Board during normal business hours.

Next Steps

Stakeholder input provided at the stakeholder meeting and through written comments and expert reports will help to provide staff and the Board with a thorough analysis of the issues.

As indicated in the Board's November 20, 2007 letter to stakeholders that provided an update on the project and timeline, the Board anticipates that it will confirm the principles and methodologies for the 3rd Generation IR rate adjustment mechanism in June 2008. Leading up to that, further stakeholder working group meetings may be needed in April to provide additional assistance to staff. A report containing proposals on the 3rd Generation IR mechanism is expected to be issued for comment in May. A stakeholder meeting on the report may be scheduled in mid-May.

If you have any questions regarding this consultation, please contact Lisa Brickenden at 416-440-8113, or by e-mail at EDR@oeb.gov.on.ca. The Board's toll-free number is 1-888-632-6273, and the Market Operations Hotline is 416-440-7604.

Yours truly,

Original signed by

Kirsten Walli
Board Secretary

Attachment: Appendix A – Estimated Dates for Key Activities
Appendix B – Guide for Presentations
Appendix C – Cost Award Information

Appendix A: Estimated Dates for Key Activities in Consultations Related to Incentive Ratemaking

3 rd Generation IR Mechanism (EB-2006-0673)	Utility Cost Comparison (EB-2006-0268)	Service Quality Regulation (EB-2008-0001)
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February, 2008

Feb 4 th - 8 th			
11 th - 15 th			
18 ^h - 22 nd			
25 ^h - 29 th	Staff Discussion Paper ^h and Pacific Economics Group Report Issued for Comment		

March, 2008

Mar 3 rd - 7 th			Notice of Proposed Amendment of Distribution System Code Issued for Comment
10 th - 14 th			
17 th - 20 th		Board Report and Pacific Economics Group Report Issued	
24 th - 28 th	Stakeholder Meeting (Mar 25 th & 26 th)		

April, 2008

Mar 31 st - Apr 4 th			Stakeholder comments due
7 th - 11 th			
14 th - 18 th	Stakeholder comments due Apr 14 th		
21 st - 25 th			
29 th - May 2 nd		RRR Reporting Deadline	

May, 2008

May 5 th - 9 th			
12 th - 16 th			<i>If no further changes,</i> Notice of Amendment of Distribution System Code Issued
19 th - 23 rd			
26 th - 30 th			

June, 2008

Jun 2 nd - 6 th			
9 th - 13 th			
16 th - 20 th			
23 rd - 27 th	Board Report Issued		
30 th - Jul 4 th		2007 Comparative Utility Analysis Results Issued	

Appendix B: Guide for Presentations

The following general questions are intended to provide points for general discussion through presentations and questions. This list is not intended to be exhaustive, and participants may address other matters in their presentations that they feel are pertinent to incentive regulation.

- What is your vision for a sustainable and long-term incentive regulation (IR) regime? What steps might be taken to evolve ratemaking towards your vision?
- Consultations to date have confirmed the high level issues for 3rd Generation IR are capital investment, lost revenue due to changes in consumption and distributor diversity. What elements or combination of elements do you believe might best address these three issues and constitute an incremental approach towards a sustainable and long-term regime for most electricity distributors in Ontario (i.e., term, form, inflation factor, productivity factor, stretch factor, Z-factor, off-ramp, earnings sharing, menus and/or modules, other)?
 - Disparate views exist on the efficacy of implementing macroeconomic (with or without input and productivity differentials) versus industry specific inflation factors in an IR rate adjustment mechanism. What issues and outcomes should be considered by the Board when selecting an inflation factor for the 3rd Generation IR mechanism?
 - What empirical approaches might be considered to determine an appropriate X-factor, either for all distributors or for groups of distributors? What reasons can be provided for including a stretch factor? What methods might be considered to determine an appropriate stretch factor?
 - Disparate views exist on the efficacy of Z-factors, off-ramps and earnings sharing mechanisms to fairly mitigate, in whole or in part, company and ratepayer risk under IR schemes. What issues and outcomes should be considered by the Board in relation to the use and role of each of these mechanisms in 3rd Generation IR?
 - What trade-offs, if any, may be appropriate when designing the IR plan? For example, if stretch factors are designed into the plan to share expected benefits between shareholders/companies and ratepayers up front and an ESM is designed into the plan to share achieved benefits between shareholders/companies and ratepayers after-the-fact, then they may need to be calibrated to maintain an appropriate balance. As another example, in a comprehensive price cap plan, if an additional parameter is included to provide for incremental capital adjustments, then a forecasting incentive, end-of-term capital incentive and/or an ESM may be needed to maintain appropriate incentives in the plan.
- Are there any implementation details of the 3rd Generation IR mechanism that need to be addressed?

Appendix C: Cost Award Information

Cost awards will be available in relation to the following activities.

Table 1: Activities Eligible for Cost Awards

Activity	Total Eligible Hours <u>per Eligible Participant</u>
Preparation for, attendance at, and reporting on the stakeholder meeting to be held in March, 2008. * See also the clarification below	A maximum of 18 hours per meeting day, covering preparation, attendance, and reporting time
Preparation of an expert report For eligible participants that collaborate and jointly sponsor the preparation of an expert report * See also the clarification below	Up to 42 hours or Up to 42 hours plus 21 hours for each additional member in the collaborative
Written comments on Staff's Discussion Paper and on the PEG Report	Up to 30 hours

Eligible participants that submit both written comments and an expert report must ensure that they do not claim cost awards twice for the same underlying work.

Cost Awards for Jointly Sponsored Expert Reports

The Board is providing for up to 42 hours for preparation of an expert report. To recognize that, for eligible participants that collaborate, time will be spent developing a shared understanding of the positions among the eligible participants in the collaborative, the Board will allow for an additional 21 hours for preparation of the expert report for each additional member in the collaborative. For example, if an expert is sponsored by three eligible participants, then the Board will provide for up to 84 hours (42 hours + (21 hours * 2)) for the preparation of the expert report by the collaborative. The eligible participants will be left to allocate the cost awards amongst themselves as they determine appropriate.

Cost Awards for Participation at Stakeholder Meeting

With regard to the preparation for, attendance at and reporting on the stakeholder meeting, the Board clarifies that this applies to each eligible participant and each expert. An eligible participant that makes an expert available for the stakeholder meeting will be eligible for cost awards for up to 36 hours per day (up to 18 hours per day for each of the eligible participant and the expert). In the example outlined above, this would mean up to 18 hours per day for each of the three eligible participants in the collaborative, plus up to 18 hours per day for the expert.