2007-09-19

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

Dear Ms. Walli:

Re: EB-2007-0673
3rd Generation Incentive Regulation Mechanism (3GIRM)
Comments on Staff Scoping Paper

Thank you for the opportunity to participate in this process. The Staff Scoping Paper and the discussion session held on September 13, 2007 are excellent starts to this important process. Some of the considerations below are as stated during the discussion session, others are expansions on previous statements and the remaining points are additional points of note.

Starting Point

One of the most primary matters for this initiative is to look at the fitness of IRM for the next phase of ratemaking that does not involve Cost of Service (COS) applications. Why was IRM developed? Has its intended purpose been fulfilled? Is its intended purpose still relevant and desirable? Is IRM still the most effective means to those ends? It may be that the changes to the electricity rate regime, and the electricity sector more generally over the past decade, have made IRM a less than optimal mechanism to set rates.

Just as a distributor must show its rates to be fair and justified through rate applications, this process must demonstrate that the next generation of ratemaking is fair and justified. 3GIRM should not be undertaken simply because 2GIRM is approaching its expiry date.

This starting point should consume a considerable portion of the working group's time at the outset. The first report of the working group should demonstrate that the status quo has been challenged and that proceeding or not proceeding with 3GIRM is the fair and justified evolutionary step for ratemaking. Giving a "nod" to the past is insufficient.

Whether or not 3GIRM is the next phase of ratemaking, clearly 2GIRM is unsustainable. Mechanical increases limited to a factor less than inflation cannot continue. Therefore, there must be a next generation of non-COS ratemaking. The work to date in beginning the 3GIRM development process is necessary regardless of whether the end-point is 3GIRM or some other form of rate determination mechanism.

Principles Underlying Next Generation Ratemaking

Here, Next Generation Ratemaking (NGR) is substituted for 3GIRM because the same principles apply regardless of whether NGR is 3GIRM or some other methodology.

All objectives of NGR should be made explicit. Even if the objectives are common to other Board objectives, such as those in the Act, they should be articulated.

The NGR development process and its outcome should be based on principles that are important to the government, Board, distributors, consumers, and other stakeholders. Those principles lead to a ratemaking system that:

- Provides the means to sustain and develop an electricity sector that meets the present and future needs of Ontario, including:
    - Recovery for the cost of distributing electricity
    - Return on investment that encourages further investment
    - Funds for the renewal of electricity distribution systems
    - Funds for the enhancement of electricity distribution systems (e.g. smart metering, distributed generation)

- Incorporates governmental policy objectives, including:
    - Economic development (e.g. attractive infrastructure for manufacturing)
    - Conservation and demand management
    - Distributed generation
    - Smart Metering
    - Transparency (e.g. tie fair and justified changes in costs to rate changes)
    - Further consolidation?

- Focuses on outcomes, including:
    - Rates
    - Service levels
    - Safety standards
    - Other specific government policy objectives
    - Outcome-focused as opposed to process-focused regulations
    - Outcome-focused application process and evidentiary requirements

- Minimize non-essential regulatory obstacles
    - Cost-effective, timely and transparent proceedings
    - Refined and optimized data and evidentiary requirements
    - Maximize synergies with other filing requirements

- Take into account the 2008-2010 COS proceedings
    - Maximize the opportunities resulting from extensive documentation and justifications in the 2008-2010 COS proceedings
    - Have regard to "multi-year test year" approved applications
    - Have regard to approved settlements and their going-forward implications
    - Develop components of NGR applications that can also be applied to COS proceedings to increase consistency and streamline rate proceedings

- Improve ratemaking regulation
    - Have regard to the lessons learned in previous generations of IRM and other rate design processes
    - Make understandable and significant improvements upon 2GIRM
    - Provide clear indication about the future direction and general requirements of NGR+1 (e.g. use of benchmarking, need for types of benchmarking information, use of service quality indicators, need for types of service quality information, service charges, smart meter charges, CDM charges, cost allocation)
    - Progress towards NGR+1

Issues for NGR

<u>Other Policy Developments: Benchmarking & Service Quality</u>

The announcement that Benchmarking and Service Quality policy development proceedings will develop in parallel with 3GIRM presents real challenges for NGR and associated policy development processes. The understanding is that benchmarking and service quality indicators are intended components of NGR in 2009. Very definite constraints are thereby imposed on all 3 processes.

Paralleling the 3 initiatives presupposes that the 3 should be integrated and that this integration should occur before 2009. That would necessarily and substantially curtail the options for the NGR process and NGR mechanism. It will also curtail benchmarking and service quality by funnelling them towards rate calculation rather than other possible objectives (e.g. best practices).

Perhaps most importantly, while no process or data set will ever be perfect, when it comes to ratemaking there is little room for error. It is possible to be imperfect, yet without material error; this is what we must demand of NGR. If distributors are to reap the benefits and bear the costs of NGR, then the causes of those benefits and costs must be clear and correct. It would defy the Board's fairness requirement for a distributor to be denied an incentive or put to disadvantage due to a margin of error in a benchmarked ranking or due to data recording inconsistencies in service quality reporting. These unfair situations are not only possible, but likely given the present status of the other policy initiatives.

Will benchmarking and service quality be ready in time for NGR? No one can know. However, it is clear that given the tight timelines, either or both process will have to rush their development in order to be ready and tested for 2009. Neither process has yet presented “clean data” that addresses numerous identified deficiencies. Even if the 2009 timeline could be met, distributors will not have an opportunity to consider and react to the “clean data”. These issues would negatively affect the legitimacy of NGR. They would also fail to properly incentivize distributors and adversely impact the development of the electricity sector.

NGR should proceed with data sets and processes that have already passed the scrutiny of the policy development process. The NGR process should consider future uses of benchmarking and service quality in NGR+1, but should not decrease the legitimacy of NGR or hurry the development of benchmarking and service quality en route.

COS Decisions/Settlements

The experience of ***ENWIN*** is that during the course of rate applications it may be in the interest of the Board and other stakeholders to make decisions or come to settlements that require modification of historical data or require unconventional future year modifications. A weakness of 2GIRM is that it does not provide room within the model to make those adjustments. The only modifications bearing any resemblance are Z Factors. The scope of Z Factors is too narrow to address the modifications that can be necessary. The model thereby prevents the Board from making the full range of decisions that are within its discretion, limits the options stakeholders can put to the Board, or puts disproportionate burdens on stakeholders for IRM applications.

This issue will increasingly be problematic as applications come to the Board that involve multiple forward test years. In addition, if the rate design movement is towards greater frequency of NGR years in place of COS years or towards a greater use of NGR tools in COS applications, then the need to make unconventional, situation-specific modifications will expand. The NGR development process should examine models and model components that accommodate Board decisions that require rate calculation flexibility in the NGR model and process.

Yours very truly,
***ENWIN* Utilities Ltd.**

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