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September 27, 2007

VIA EMAIL & VIA COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto, ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2007-0673
3rd Generation Incentive Regulation for Electricity Distributors
Comments of Energy Probe

Attached please find three hard copies of the Comments of Energy Probe Research Foundation (Energy Probe). An electronic version in PDF format will be forwarded to the Board.

We wish to apologise for any inconvenience to Board staff due to Energy Probe not meeting the target date of September 21, 2007 for submission of Comments on the Board Staff Scoping Paper.

Should you require additional information, please do not hesitate to contact me.

Sincerely,

David S. MacIntosh
Case Manager

cc. Lisa Brickenden, Ontario Energy Board (By email)
Tom Adams, Energy Probe Research Foundation (By email)

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EB-2007-0673

Ontario Energy Board

3rd Generation Incentive Regulation for Electricity Distributors

**SUBMISSIONS OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")**

September 27, 2007

Energy Probe Research Foundation Submission

3rd Generation Incentive Regulation for Electricity Distributors

EB-2007-0673

Background

Current rates for Ontario local electricity distribution companies (LDCs) were set using the 2nd generation incentive regulation mechanism. In 2006, the Ontario Energy Board announced the development of a 3rd generation incentive regulation mechanism (3rd Generation IRM) to be used for setting rates following rebasing of the distribution utilities.

The first tranche of electricity distribution utilities for rebasing using a cost of service format, comprising roughly one third of LDCs, were scheduled to file their applications for 2008 rates on August 15, 2007. It is anticipated that these LDCs will have their 2009 rates set using the 3rd Generation IRM. The remaining two thirds of LDCs will have their 2008 rates set using the 2nd Generation IRM, have their rebasing processes split between 2008 and 2009, and thereafter have rates set using the 3rd Generation IRM.

Board staff prepared a Staff Scoping Paper to set out their proposals in relation to the key issues to be considered and manner in which this consultation might be conducted. The Paper was released on August 2, 2007 for comment by stakeholders following a stakeholder consultation meeting with Board staff on September 13, 2007.

Energy Probe Research Foundation is pleased that Mr. Randy Aiken was appointed to the stakeholder working group following his nomination by the Foundation, among others.

Comments of Energy Probe

IRM Robustness

Energy Probe urges the Board to move ahead with the 3rd Generation IRM and believes that the basic principles presented in the Staff Scoping Paper are sound and provide useful guidance going forward.

However, Energy Probe is concerned that significant work remains to be done in the area of quantitative analysis of utility costs before a robust 3rd Generation IRM approach can be applied with confidence.

Energy Probe undertook a simple cost ranking exercise to develop a better sense of robustness of the OM&A per customer approach of partial PBR.

We applied our analysis only to the cohort of large utilities identified in the PEG electric LDC cost analysis report. The reason for this selection was that we considered that factors such as unusual customer mix or significant dispersion of customer densities would be less likely to represent barriers to comparison than would be the case with smaller, probably more heterogeneous utilities.

Once we identified the cohort and imported the Board's latest OM&A per customer analysis, we then extracted from the OEB's 2006 Yearbook of Electricity Distributors data on distribution revenue and various indicators of production. To measure production or output we identified: customer numbers served, energy delivered, power delivered, and length of line. Each of these was converted into a simple unit cost ratio (e.g. delivery cost per customer).

The results of the cost analysis are presented in Appendix A to these Comments.

Once the data was assembled, we ranked the utilities using the PEG-proposed OM&A cost per customer and each unit cost ratio. We also created a global ranking based on cumulative scores.

The results of the ranking analysis are presented in Appendix B.

Energy Probe had anticipated that the rankings of the utilities for each cost effectiveness indicator would be relatively consistent for the sample we selected and that this consistency might be considered an indicator of robustness for the IRM approach that the Board is currently developing for most electric LDCs. However, the results did not confirm our hypothesis.

Only utilities two of the nine utilities we studied – Toronto Hydro and Enersource – were relatively consistent across the board. In both cases, these utilities were identified as relatively inefficient in each category. No other utility was consistently good or bad, although Hydro One Brampton and London Hydro appeared to be the strongest performers overall.

Energy Probe's conclusion from this analysis is that the OM&A/customer partial IRM methodology the Board is currently pursuing does not at present appear particularly robust. We believe that additional quantitative analysis should be pursued on a fairly urgent basis to improve the analytical foundations of IRM.

While some significant cost analysis questions may remain outstanding, one approach that Energy Probe recommends to the Board for consideration in moving forward with IRM is to apply a trigger mechanism with a relatively large annual earnings dead band. If utilities perform outside of the earnings dead band, a regulatory review might be engaged.

In order to maximize the incentive advantages of IRM, while taking into consideration the value that might be associated with optimizing the effort applied to mid-term reviews, Energy Probe suggests consideration be given to an ROE dead band of $\pm 6\%$.

Energy Probe is disappointed that no robust plan appears to be available for quantifying an efficient price covering the overall cost of distribution services nine (9) years after the Board gained authority to regulate electric LDCs and explicitly committed to pursue incentive regulation for this sector. It is particularly disconcerting that administrative deficiencies such as data consistency and data completeness (e.g. insufficient data on capital stock and vintage) continue to plague efforts at efficiency estimation quantification.

Form of IRM

Regarding the form of IRM, Energy Probe has consistently supported the use of price caps. However, although Energy Probe remains a steadfast supporter of price caps, we also believe that in the institutional circumstances of Ontario's electric LDCs, the Board must remain attentive to ensuring that under any IRM approach, utilities remain focused on efficiency gains that are sustainable in the long term.

Regulatory Oversight of Incentive Effects

Most of Ontario's electric LDCs are government-owned entities. These utilities may be subject to pressures from their owners with a different emphasis than pressures exerted on investor-owned utilities.

Energy Probe is concerned that short term financial transfers to owners should not be allowed to impair the overall long term health of the LDCs.

Normally, the regulator can count on investor-owned utilities taking into consideration both long term and short term financial interests. Regulators are assisted in this regard by the tendency of capital markets to take a dim view of businesses with declining future prospects. However, in the absence of capital market tests of the performance and prospects of most Ontario LDCs, the OEB bears an extra burden.

It would be in the public interest for the Board to continue to monitor the effects of IRM mechanisms on the overall performance of LDCs.

Energy Probe wishes to thank the Ontario Energy Board for the opportunity to participate in this consultation.

Respectfully submitted at Toronto, Ontario this 27th day of September, 2007.

Tom Adams

For the Energy Probe Research Foundation

Appendix A						
Comparison of Ontario Electricity Distributors Costs (EB-2006-0268)						
Groupings After PEG Report, updated with 2006 Data						
OM&A ranking built from Data submitted by LDCs via the Reporting and Record-keeping Requirements (RRR)						
2006 distribution revenue and output information drawn from OEB 2006 Yearbook of Electricity Distributors						
LDC Rank for Year ended Dec 31st, 2006						
LDC	Rank of Average OM&A ('02-'06) / customer	Average OM&A ('02-'06) / Customer	distribution revenue/ customer	distribution revenue/ kWh sold	distribution revenue/ average peak load	distribution revenue/ km of line
ENWIN Powerlines Ltd.	9	\$282	-\$4,341.02	-\$0.142	-\$731.44	\$317,520.46
Toronto Hydro-Electric System Limited	8	\$242	-\$5,938.80	-\$0.158	-\$984.32	\$241,145.95
Enersource Hydro Mississauga Inc.	7	\$224	-\$6,103.87	-\$0.144	-\$880.26	\$218,881.00
Veridian Connections Inc.	6	\$200	-\$3,350.56	-\$0.142	-\$860.68	\$181,731.88
Powerstream Inc.	5	\$178	-\$4,159.40	-\$0.141	-\$811.65	\$157,909.95
Hydro Ottawa Limited	4	\$164	-\$3,837.33	-\$0.145	-\$899.14	\$198,795.60
London Hydro Inc.	3	\$161	-\$3,486.81	-\$0.145	-\$872.19	\$190,100.47
Horizon Utilities Corporation	2	\$155	-\$3,423.93	-\$0.149	-\$906.36	\$242,767.97
Hydro One Brampton Networks Inc.	1	\$137	-\$4,439.80	-\$0.144	-\$874.05	\$205,456.51

Appendix B

Comparison of Ontario Electricity Distributors Costs (EB-2006-0268)						
Groupings After PEG Report, updated with 2006 Data						
OM&A ranking built from Data submitted by LDCs via the Reporting and Record-keeping Requirements (RRR)						
2006 distribution revenue and output information drawn from OEB 2006 Yearbook of Electricity Distributors						
		LDC Rank for Year ended Dec 31st, 2006				
LDC	Rank of Average OM&A ('02-'06) / customer	distribution revenue/ customer	distribution revenue/ kWh sold	distribution revenue/ average peak load	distribution revenue/ km of line	composite output effectiveness (only 6 grades)
ENWIN Powerlines Ltd.	9	6	2	1	9	2
Toronto Hydro-Electric System Limited	8	8	9	9	7	6
Enersource Hydro Mississauga Inc.	7	9	5	6	6	5
Veridian Connections Inc.	6	1	3	3	2	1
Powerstream Inc.	5	5	1	2	1	1
Hydro Ottawa Limited	4	4	6	7	4	4
London Hydro Inc.	3	3	7	5	3	2
Horizon Utilities Corporation	2	2	8	8	8	5
Hydro One Brampton Networks Inc.	1	7	4	4	5	3