Ontario Energy Board (Board Staff) INTERROGATORY #4 (KEMA Report)

Interrogatory

Does the evolution from cost of service rate-making to incentive based rate-making affect the arguments regarding the costs and the cost recovery model suggested on pages 3 and 4 of the evidence? Is benchmarking distributor performance not an element of competition? Please explain your response.

Response

The evolution from cost of service ratemaking to incentive-based ratemaking does not affect the arguments regarding costs and cost recovery, since both cost of service and incentive-based ratemaking are regulatory mechanisms based on the cost of service and designed to provide utilities with an opportunity to recover their cost of service,

However, where there is a loss of customers from an unanticipated boundary or service territory adjustment, there is an impact. Under cost of service, the distribution utility could apply for new rates based on the new, higher costs of operation. In an incentive-based system, that is meant to be an economic substitute for competition, the utility faces "double-jeopardy." The task of gaining economic efficiencies by reducing the long-run average costs through regulated performance expectation is overwhelmed by the need to spread a base of largely fixed costs against a smaller customer base. Thus, the single firm works under cost of service and incentive-based ratemaking system, but not for the latter if it is subject to competition for customers.

Utility ratemaking practice may rely on benchmarking to help establish appropriate performance levels for both cost of service and incentive-based ratemaking. Benchmarking, as a component of performance based ratemaking is not an element of competition, but rather an alternative regulatory ratemaking regime.