Ontario Energy Board

Commission de l'Énergie de l'Ontario

RP-2004-0064
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RP-2004-0100
RP-2004-0117/0118

IN THE MATTER OF

REVIEW AND RECOVERY OF REGULATORY ASSETS - Phase 2

DECISION WITH REASONS

2004 December 09

Executive Summary

Ontario's local electricity distribution companies have incurred a variety of costs in preparation for the competitive market which opened in May 2002. In addition to these costs, they have incurred other costs associated with regulatory directives related to market restructuring and the ongoing competitive market. All of these costs for retail settlements, power purchases and market readiness were recorded in deferral accounts and were expected to be eligible for recovery through rates in accordance with the Board's review and audit guidelines and rate setting procedures. However, with the announcement of the Electricity Pricing, Conservation and Supply Act (Bill 210) on November 11, 2002, these accounts were deemed to be Regulatory Assets until such time as the Board addressed their disposition.

The Board's consideration of the distributors' applications in this decision reflects the two-phase process that had been established earlier. In Phase 1, the distributors applied for the recovery in rates of up to 25% of their total Regulatory Assets (or more if required for rate stability), on an interim basis beginning April 1, 2004. In approving these rate changes, the Board did not examine the prudence of the total amounts.

In Phase 2, the current phase, the Board is reviewing the prudence of the total Regulatory Asset amounts claimed by electricity distributors. Amounts which the Board finds to be prudently incurred, net of Phase 1 and any earlier interim recoveries, will be recovered in distribution rates.

The Board has begun Phase 2 by holding an oral hearing, which is the subject of this decision, for four large electricity distributors. These distributors, which together account for 48% of the customers in Ontario are Hydro One Networks Inc., Toronto Hydro-Electric System Limited, Enersource Hydro Mississauga Inc., and London Hydro Inc.

In addition to the decisions on the rate recovery amounts for each of these four distributors, the Board also assessed what would constitute the best evidence, forum and process to determine the reasonableness of Regulatory Asset amounts for the remaining distributors.

The Board observes that there has been considerable discretion applied by the four distributors in their accounting and reporting of the deferral accounts, even on accounts that can be characterized as mechanistic. The Board emphasizes that if a distributor approaches the Board's guidelines in a casual way, as was evident in many circumstances, this inevitably leads to cumbersome and expensive reviews to capture deviations and adequately deal with them. There are close to one hundred electricity distributors under the Board's regulatory purview. A detached or indifferent approach to adhering to the Board's guidelines, whether on Regulatory Assets or more generally, leads to a greater regulatory burden when there are so many utilities involved.

The Board also observes that many data errors were uncovered in the evidence of the four distributors during the proceeding. The Board finds this discouraging. Errors that should have been detected before the filings were made were not detected, thereby creating a general uneasiness with the reliability of the data and other information

provided. It is the Board's perception that this led to a lengthier and more complicated review.

Having ordered a number of adjustments to the four distributors' claims, the Board directs the four distributors to re-file their claims for disposition and sets out a process for final recovery of costs to commence May 1, 2005.

The Board also notes the context of this review. As was generally acknowledged, not to undertake the initiatives needed to meet the requirements of market restructuring was not an option for distributors. The utilities had to comply with the demands of Government legislation and directives, and the requirements set by the Ontario Energy Board and the Independent Market Operator. The utilities also had to deal with a number of changing requirements and circumstances during the move toward market opening. It was generally acknowledged, and the Board agrees, that it was a challenging period for the distributors and many aspects of the initiatives and expenditures were beyond the control of management. This context weighed heavily in the Board's assessment of the prudence of transition costs incurred.

The cost effectiveness of decisions made and actions taken must be seen in light of the circumstances in which those decisions were made. Transition cost claims may be higher than they would have been under less anomalous circumstances. Speculation as to what the costs might have been under a different environment is not productive. While the higher costs are unfortunate, the Board does not see it as appropriate to penalize the distributors. The ongoing changes in legislation and in circumstances were essentially beyond the control of the distributors.

Benchmarking one utility's performance with another, taking into consideration differences that may exist, can be an important regulatory tool, especially in Ontario's electricity sector with close to one hundred distributors. Benchmarking need not be absolute; its gradation or granularity can differ. Its use very much depends on the degree of harmonization or normalization of data from one utility to another to account for these differences. The Board sees harmonization and normalization of data as key challenges in deriving the many potential benefits from benchmarking.

Regarding benchmarking, comparison of one utility with another can be a useful regulatory tool to assess best practices, which may partly explain differences in performance, including costs. A crude benchmarking approach can be beneficial as a screening tool. As many parties acknowledged, a crude form of benchmarking was already used to subject the four (originally five) distributors to closer scrutiny. During the proceeding, the Board became convinced that benchmarking in its strictest sense was not generally an appropriate tool to assess prudence of each of the four distributor's transition costs relative to another's. There were different starting points from both technological and operating perspectives. The fact that transition costs are higher for one distributor compared to another, does not necessarily suggest that transition costs for the first distributor were not prudently incurred. Given the peculiar nature of transition costs, the Board was satisfied to assess prudence in this review generally on the merits of each of the four distributor's case, not on benchmarking. One exception was for costs incurred for customer education. The Board's assessment of prudence for each of the four distributors therefore relied on testing the evidence based on the tests enunciated in the Board's guidelines.

The Board reiterates that benchmarking has value as a screening tool. Various adaptations are possible in the effort to streamline the regulatory process for the close to 100 electricity distributors.

The Board uses a screening tool for purposes of establishing the process of assessing transition costs for the remaining distributors, which includes a provision for minimum review. Under minimum review, final recovery of costs could begin as early as May 1, 2005. Otherwise, final recovery will commence May 1, 2006. These distributors will continue to collect the interim recovery provision reflected in their rates.