November 1, 2004

TO ALL NATURAL GAS AND ELECTRICITY MARKET PARTICIPANTS IN ONTARIO:

Dear Sir/Madam:

Re: New Cost Assessment Model for the Ontario Energy Board

This letter is to inform you that the Ontario Energy Board (“the Board”) is developing a new cost assessment model and to invite you to participate in the related stakeholder consultations.

What is the cost assessment model?

The Ontario Energy Board (the OEB) recovers its operating and capital costs through assessments to the natural gas and electricity market participants that it regulates. The cost assessment model is the approach used by the OEB to allocate costs first across types of market participants (classes) and then amongst the individual participants within each class. Regulations passed under The Ontario Energy Board Act, 1998 identifies the classes of persons to be assessed and the basis of allocation across and within classes.

Why change the model?

The energy market and the OEB’s mandate have changed. In addition to rate setting, the OEB’s role includes licensing and monitoring compliance of market participants, responding to consumer inquiries and complaints, and providing consumer information and education. However, to date only rate-regulated entities have been assessed for the OEB costs.

It is appropriate to re-examine the cost assessment model in the context of the current mix of market participants and with an understanding of how activities associated with each type of participant drive the OEB’s costs. The allocation of the OEB’s costs across the types of market participants is a specific focus of this review.

The OEB’s financing situation has changed. The OEB became a Crown Corporation without share capital through legislative changes effective August 2003. A significant
impact of this change is that appropriations from the Province’s Consolidated Revenue Fund are no longer available to the OEB. The timing and frequency of assessments must be adjusted to ensure that working capital and other cash requirements are met through the assessments.

New Cost Assessment Model Study

The OEB is committed to providing high quality and timely regulatory services in a cost-effective manner. We recognize that the cost of regulation is borne by all ratepayers, and we are committed to using our resources effectively and efficiently.

A cost assessment study was undertaken to ensure a complete, fair and transparent review of all alternative cost assessment models and recommend a new model that would address the impact of the above noted changes on the OEB and the energy market. The study examined: the current cost assessment processes within the OEB; the mix of market participants today and how their activities drive the OEB’s costs; new financing options for the OEB; and regulatory best practices in other jurisdictions. Pursuant to a competitive procurement process, the OEB commissioned Navigant Consulting Ltd. to undertake this study and recommend a proposed cost assessment model for stakeholder and public input, and the OEB’s consideration. Navigant Consulting Ltd.’s resulting Cost Assessment Model report is posted on the OEB website http://www.oeb.gov.on.ca/documents/costassess_navigantreport_011104.pdf so that it is easily accessible by industry stakeholders and the public and can serve as a basis for consultation.

The New Cost Assessment Model report presents conclusions and recommendations in the following key areas:

- **Cost Apportionment Across Classes of Market Participants**

  The current cost assessment model used by the OEB apportions costs among three classes of payors, whereas the OEB’s activities encompass regulatory and oversight work for another five classes of participants in the energy sector. The proposed model extends the classes of payors to eight and would redistribute the total fees paid by all classes according to a time tracking system that reflects the proportion of activity that each class generates for the OEB. The attached report shows some classes of payors paying less, such as electric distribution companies, some paying more, such as electric transmission companies, some paying for the first time, such as natural gas marketers, electricity retailers, and the Independent Market Operator, and some paying substantially the same amount, such as gas utilities. The proportion of activity that each class generates for the OEB may change over time, thereby resulting in different assessments than those shown in the attached report, which is based on 2003/04 data.
• Cost Apportionment Within Individual Classes
  Costs apportioned to each class must be allocated to individual participants within the class. The report makes a recommendation for each class on the most appropriate basis of allocating to the individual participants.

• OEB Funding Requirements
  Under the proposed model, the OEB would continue to assess for operating and capital costs incurred during the year. To maintain adequate cash flows, the OEB would invoice market participants quarterly, in advance, based on its overall forecasted funding requirements.

  The OEB’s annual funding requirements would incorporate a 10% contingency to address budgetary uncertainty including unforeseen regulatory developments. However, when accumulated unspent revenues (including contingency funds) are 20%, no amount would be included for contingency in the annual assessment.

In summary, the main impact of the proposed cost assessment model would be to redistribute the assessed amount among a broader group of payors, according to the level of activity those payors generate. The study states that since the regulatory costs incurred by these classes of payors are ultimately passed on to end-use customers, it is likely that their bills will reflect more accurately the true cost of regulatory activity for the service they are receiving and that increased costs in one portion of their service may be offset by reduced charges in another.

The OEB would continue to assess its operating and capital costs based on its forecasted requirements, and would now include a capped amount for contingencies.

Under the proposed model, the annual assessment for an industry participant would be impacted by:

  • The OEB’s annual operating and capital requirements;
  • The level of unspent revenues (including contingency funds);
  • The proportionate level of the OEB activity generated by the participant’s class compared to other classes;
  • The proportionate size of the participant compared to others in the same class.

The study and report is based on 2003/04 data. Actual assessments will differ from what is presented in the study to the extent that the above amounts differ from 2003/04 experience.

The OEB will be establishing a deferral account to allow electric distribution companies to record the costs assessed by the OEB for 2004 and subsequent years. Distributors will be able recover the amounts booked in this account beginning in 2006 or in 2005 subject to the distributor receiving the approval of the Minister of Energy to make such an application.

Stakeholder Feedback - Contact And Timeline

Industry stakeholders and the public are encouraged to review the Cost Assessment Model report and provide written feedback to my attention by December 15, 2004.
The OEB will consider all input received as it develops the final Cost Assessment Model. The OEB will then share the final document and request the related legislative changes required to implement the final Cost Assessment Model.

Yours truly,

*Original signed by*

John Zych
Board Secretary

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