Ontario Energy Board
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273

Ontario

ONTARIO ENERGY BOARD

COST ASSESSMENT MODEL

March 2012 (Effective

April 1, 2013)

Background

The Board's Cost Assessment Model is the methodology the Board uses to apportion its costs to the persons or classes of persons who pay costs under section 26 of the *Ontario Energy Board Act, 1998* (the "Act"). The persons or classes of persons that are liable to pay the Board's costs under section 26(1) of the Act are set out in Ontario Regulation 16/08.

The Board's annual cost assessment is comprised of the total of operating expenses (excluding non-cash expenses) and capital expenditures less other funding sources for the fiscal year. The Board's revenues arise from the following:

- fees charged under section 12.1 of the Act,
- cost assessments issued under section 26 of the Act,
- costs payable to the Board which are recovered under section 30 of the Act in relation to a specific proceeding or consultation process,
- administrative penalties assessed against a person under section 112.5 of the Act arising from a Board hearing and subsequent Board decision, and
- income earned on investments.

The majority of the Board's revenue is received through cost assessments issued under section 26 of the Act.

The Board's Cost Assessment Model is based on a November 2004 report written by Navigant Consulting Ltd. ("Navigant") and stakeholder comments on that report. The Report on the OEB Cost Assessment Model Development and Consultation Process, the Navigant report and stakeholder comments are all posted on the Board's website.

In 2006, EES Consulting reviewed the Board's Cost Assessment Model and provided a report that concluded that no major changes were needed to the Board's regulatory cost allocation procedures. The report found that the Board's allocation methods were in keeping with industry best practices and generally accepted utility regulation. The report is posted on the OEB's website.

The regulation identifying payor classes to be assessed has been amended twice. The original regulation in 2003 listed three classes: electricity distributors, natural gas distributors and electricity transmitters. In 2008, three classes were added: the

Independent Electricity System Operator (IESO), the Ontario Power Authority (OPA) and Ontario Power Generation (OPG). In 2010, the payor classes expanded to eight to include low volume electricity retailers (retailers) and natural gas marketers (marketers).

In 2011 the model was amended to assess retailers and marketers a portion of the direct cost associated with regulating these companies. Direct costs associated with the Board's Consumer Protection unit were assessed. At that time the Board committed to a further consideration of whether to assess the remaining direct costs and a proportionate share of indirect costs to these two payor classes.

The Board engaged Navigant to conduct a review of this matter. Navigant's report is posted on the Board's website. It concluded that there is "no reason to not allocate indirect costs to the electricity retailers and natural gas marketers. In fact, not allocating those costs triggers cost shifting to other industry participants thus triggering a cross-subsidy".

In 2012, the Board consulted with stakeholders with regard to whether retailers and marketers should be assessed these remaining costs. The revision to the cost assessment model details the Board decision to assess all direct and a portion of indirect costs to retailers and marketers, to be phased in over 5 years starting April 1, 2013.

Guiding principles

The following principles guided the development and implementation of the model:

1. All payor classes listed in the enabling regulation authorizing the Board's cost assessment will be assessed.
2. The Cost Assessment Model should be clear and direct, fair, transparent, cost effective and provide incentives to use regulatory services efficiently.
3. The Cost Assessment Model should ensure that ultimately costs incurred in regulating the customer groups are recovered from those customer groups.
4. The Cost Assessment Model should allow the OEB to be financially self-sufficient and to avoid the need to borrow funds.
5. The Cost Assessment Model should strive for stable and predictable assessments and/or fees for market participants.

6. The OEB should seek to mitigate year-over-year volatility in the apportionment of its funding requirements to each class of market participant.
7. Allocation within a given class of payor should balance fairness, accuracy and predictability where possible.

Regulated entities subject to the Board's cost assessment

The following persons or classes of persons can be assessed under section 26(1) of the Act:

1. Distributors licensed under Part V of the Act,
2. Transmitters licensed under Part V of the Act,
3. Gas transmitters, gas distributors and storage companies subject to section 36 of the Act,
4. IESO,
5. OPA,
6. OPG,
7. Retailers that are licensed under Part V of the Act to retail electricity to low-volume consumers as defined in that Part, and
8. Gas marketers licensed under Part IV of the Act.

Revenue structure

The Board's annual revenue requirement is the total of operating expenses (excluding depreciation and any other non-cash expenses that may arise) and capital expenditures, less other funding sources for the fiscal year as reflected in the Board's approved budget. The cost assessments issued under section 26 of the Act are determined using three steps:

1. The total amount to be recovered by the cost assessments is determined based on the Board's overall requirements less other funding sources,
2. The total amount is then apportioned amongst the classes of payors, and

3. The amount apportioned to each class is then allocated to the regulated entities within the class.

Costs are assessed for the fiscal year starting April 1 and ending March 31 of the following year. Costs are invoiced quarterly. Surpluses or deficits of the previous year are used to adjust the costs invoiced in the third and fourth quarters.

Licence fee revenues are generated through the invoicing of all licensed entities. There is an annual registration fee of $800 for each license held. The license application fee is $1,000. Licence fees are non-refundable and are not prorated.

Case specific project costs are assessed under section 30 of the Act. These costs are usually unique to a Board process and a specific regulated entity (or entities) will be assessed. These costs are not funded through the cost assessment methodology.

Liability to pay an administrative penalty arises through a hearing process as a result of a finding by a Board panel of non-compliance with legislation, regulations, codes, rules, licence conditions or Board decisions. Revenues from administrative penalties are not used to reduce the cost assessment. These revenues are internally restricted by the Management Committee to support activities related to consumer education, outreach and other activities in the public interest.

Investment income is generated through the prudent investment of operating reserve funds and short-term unallocated funds. Investments are made in instruments that provide complete protection of the principal being invested, allow for liquidity and provide the highest return based on the other restrictions.

An operating reserve was established to support working capital requirements and for cash flow management because the Ontario Energy Board is not able to access debt financing. The operating reserve can be up to 20% of the current annual funding requirement. If the operating reserve is less than 20% of the current annual funding requirement, future cost assessments may be used to fund the operating reserve. Any operating reserve exceeding 20% will be used to reduce payments under future assessments.

Method for Allocating Section 26 costs among Payor Classes

Both direct and indirect costs are allocated across all payor classes. Direct costs are costs of Board activities that can reasonably be attributed to a particular payor class. Indirect costs are all remaining costs to be recovered by the cost assessments.

Direct costs that can be reasonably attributed to a particular class of persons will be recovered from that class. Examples of direct costs include:

(a) Board member and staff costs related to applications and regulatory audit, regulatory policy, case administration and legal staff, based on time spent on activities per payor class (based on the 3 year period January 2007 to December 2009),

(b) Consumer Protection costs, based on the most recent calendar year of complaint calls[1] received, and

(c) Specific project costs such as consultants and stakeholder consultation costs for studies related to a particular class that are not recovered under section 30 of the Act.

Indirect costs are all costs to be recovered through the cost assessment process that cannot be specifically attributed to a class. The Board uses the percentage of direct costs for the class in relation to the total direct costs to determine the share of indirect costs each class should be allocated. Examples of indirect costs include:

(a) Staff costs for administrative areas of the Board,

(b) Lease costs for the Board's premises, and

(c) Other costs that do not specifically relate to a particular class.

Indirect costs are allocated to all classes.

The direct and indirect cost allocations to retailers and marketers become effective April 1, 2013. This change will be phased in equally over a five year period starting April 1, 2013 and with full implementation by April 1, 2017.

[1] The definition of a complaint is found in the Consumer Snapshot, produced quarterly and posted to the Board’s website.

Intra-class Allocation

The total amount to be recovered from each class is apportioned to individual regulated entities within the class. The basis of intra-class allocation for each class is detailed below. There is no intra-class allocation for the IESO, OPA or OPG as these are single entity classes.

<u>Gas Distribution</u>

Apportionment within the gas distribution class is based on net revenues. Net revenues include distribution revenue as well as transportation of gas for other customers, storage revenue and other revenue, but exclude commodity revenue. This information is taken from the most recent year information available.

<u>Electricity Distribution</u>

Apportionment within the electricity distribution class is based on distribution revenue. This is the distribution service revenue less the cost of power. This information is taken from the most recent year information available.

<u>Electricity Transmission</u>

Apportionment within the electricity transmission class is based on transmission revenue from the payor’s audited financial statements or similar documentation. This information is taken from the most recent year information available.

<u>Electricity Retailers</u>

Apportionment within the low volume electricity retailer class is based on a combination of two factors, each having equal weight (i.e. 50% each). The two factors are the total number of customers of the retailer (annual average of the quarterly customer numbers) taken from the most recent 3 year average Reporting and Record Keeping Requirements statistics and the most recent 3 year average number of complaints relating to the particular retailer received by the Board’s Consumer Relations Centre. This intra-class allocation is effective April 1, 2013.

<u>Gas Marketers</u>

Apportionment within the gas marketer class is based on a combination of two factors, each having equal weight (i.e. 50% each). The two factors are the total number of customers of the marketer (annual average of the quarterly customer numbers) taken from the most recent 3 year average Reporting and Record Keeping Requirements statistics and the most recent 3 year average number of complaints pertaining to the particular gas marketer received by the Board's Consumer Relations Centre. This intra-class allocation is effective April 1, 2013.