ONTARIO ENERGY BOARD

COST ASSESSMENT MODEL

April 1, 2016
Background

The Cost Assessment Model ("CAM") is the methodology the Ontario Energy Board (the "OEB") 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 OEB's costs under section 26(1) of the Act are set out in Ontario Regulation 16/08.

The OEB'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 OEB'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 OEB 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 an OEB hearing and subsequent OEB decision, and
- income earned on investments.

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

The OEB's CAM 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 OEB's website.

In 2006, EES Consulting reviewed the OEB's CAM and provided a report that concluded that no major changes were needed to the OEB's regulatory cost allocation procedures. The report found that the OEB'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 numerous times. 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). And in 2015, the OPA was removed as a payor class.

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 OEB’s Consumer Protection unit were assessed. At that time the OEB 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 OEB engaged Navigant to conduct a review of this matter. Navigant’s report is posted on the OEB’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 OEB 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 OEB’s 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.

In 2015, the OEB engaged MNP LLP to review the CAM. MNP’s objective was to identify areas for potential improvement based on jurisdictional best practices as well as the evolving operations of the OEB.

MNP’s report is posted on the OEB’s website. It concluded that the OEB’s staff time should be estimated every three years for costs associated with each payor class. It also concluded that the Market Surveillance Panel’s costs (both direct and indirect) should be attributed solely to the IESO. Lastly, MNP found that the intra-class allocations for some payor classes should be changed. MNP recommended that the electricity and gas distribution payor classes should use a customer based allocation (based on a 3 year rolling average of customer data) and that the electricity transmission payor class should use a 3 year rolling average for revenue ratios instead of just one year.

**Guiding principles**

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

1. All payor classes listed in Ontario Regulation 16/08 will be assessed.
2. The CAM should be clear and direct, fair, transparent, cost effective and provide incentives to use regulatory services efficiently.
3. The CAM should ensure that ultimately costs incurred in regulating the customer groups are recovered from those customer groups.

4. The CAM should allow the OEB to be financially self-sufficient and to avoid the need to borrow funds.

5. The CAM 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 OEB'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. OPG,

6. Retailers that are licensed under Part V of the Act to retail electricity to low-volume consumers as defined in that Part, and


Revenue structure

The OEB's annual section 26 revenue requirement is the total of operating expenses (excluding any costs recovered under section 30 of the Act and revenues or expenses related to administrative penalties) and capital expenditures, less other funding sources for the fiscal year as reflected in the OEB'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 OEB'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 an OEB 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 an OEB panel of non-compliance with legislation, regulations, codes, rules, licence conditions or OEB 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 OEB 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 OEB 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, industry operations and performance, strategic policy, consumer engagement, case administration and legal staff, based on time spent on activities per payor class. Timesheet data will be updated every 3 years.\(^1\)

(b) Consumer Protection costs, based on the most recent calendar year of complaint calls received.

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

(d) Project costs and per-diem costs of members of the Market Surveillance Panel (“MSP”) and any applicable staff costs. MSP costs are allocated to IESO.

Indirect costs are all costs to be recovered through the cost assessment process that cannot be specifically attributed to a class. The OEB 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. Indirect costs are allocated to all classes. Examples of indirect costs include:

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

(b) Lease costs for the OEB’s premises, and

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

The direct and indirect cost allocations to retailers and marketers became effective April 1, 2013. This change will be phased in equally over a five year period (it started April 1, 2013 and will be fully implemented by April 1, 2017).

\(^1\) It is assumed that over a three year period the level of effort remains fairly stable. However, unique circumstances within the period or periodic changes to policy or market structure may lead to more significant changes and therefore adaptions as required.
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 or OPG as these are single entity classes.

Gas Distribution

Apportionment within the gas distribution class is based on the most recent 3 year average of total number of customers of the distributor. The number of customers will be taken from the distributor's Natural Gas Reporting and Record Keeping Requirements filings. This intra-class allocation is effective April 1, 2016.

Electricity Distribution

Apportionment within the electricity distribution class is based on the most recent 3 year average of total number of customers of the distributor. The number of customers will be taken from the distributor's Electricity Reporting and Record Keeping Requirements filings. This intra-class allocation is effective April 1, 2016.

Electricity Transmission

Apportionment within the electricity transmission class is based on the most recent 3 year average of transmission revenue from the payor’s audited financial statements or similar documentation. This intra-class allocation is effective April 1, 2016.

Electricity Retailers

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 OEB’s Consumer Relations Centre. This intra-class allocation is effective April 1, 2013.
Gas Marketers

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 OEB’s Consumer Relations Centre. This intra-class allocation is effective April 1, 2013.