Ontario Energy Board
Commission de l'énergie de l'Ontario

3rd Generation Incentive Regulation for Electricity Distributors

Board Staff Presentation
May 6, 2008

Overview

- Development of 3rd Generation Incentive Regulation
  - Process to Date
  - Recommended Next Steps

- Staff Proposal for 3rd Generation IR Plan

Development of 3rd Generation Incentive Regulation Plan

Process to Date

Identify Issues

- Staff Paper
- Conference
- Written Comments

June – September, 2007

Identify & Evaluate Options

- Working Group
- Staff & PEG Papers
- Transcribed Conferences
- Written Comments

October, 2007 – April, 2008

Next Steps

Finalize IR Plan

- Staff & Stakeholder Proposals
- Transcribed Conference
- Written Comments
- Board Report

May – July, 2008

- Present Staff Proposal to Stakeholders (May 6)
- Further Written Comments due (May 16)
- Board Report (mid-July)
- Filing Guidelines & Model (Sep)
- Web cast (Oct)

Incremental Approach Appropriate

- Framework should build on 2nd Generation IR.

- 3rd Generation IRM should be sustainable and long-term.

- It should be predictable, effective, and practical to the extent possible.

Staff Proposal for 3rd Generation IR

- Aim is to develop a plan for electricity distributors that is suitable for most.
  - Not looking for "one size fits all".
  - In the event that other approaches for rate setting may be appropriate in some circumstances, a distributor may apply to the Board accordingly.

- Staff Proposal for 3rd Generation IR:
  - a comprehensive price cap index approach with added flexibility to recognize incremental capital investment needs while protecting the interests of consumers.

Staff Proposal for 3rd Generation IR Plan

Core Mechanism	**Form**	Comprehensive Price Cap Index
	Term	4 years
	Inflation	GDP-IPI FDD (updated annually in March)
	X-factor	Industry TFP growth potential as calculated by PEG (including consideration for IPD and PD), plus stretch factors (simpler groupings)
	K-Factor	Continued Migration to Common Capital Structure
	Reporting	RRR Annual Requirements (modified as required)
	Earnings Sharing	Asymmetrical; +2% non-weather normalized earnings above the calculated ROE; net cumulative amount over plan term shared 50:50 at rebasing
Options	**Incremental Capital Module**	On application; materiality threshold of 25% of capital budget reflected in base rates going into IR plan; annual reporting on actual spend
	Off-ramps	On application or review initiated by stakeholders based on service quality and/or earnings concerns
	Z-factor	On application; materiality threshold of 0.5% of total revenue requirement approved going into IR plan
	CDM	On application

Form

- Comprehensive Price Cap Index Plan.

- Supported by Dx and stakeholders.
- Used in 1st and 2nd generation. Dx and stakeholder familiarity.
- Less regulatory burden.
- Sustainable, predictable, effective, and practical relative to other approaches.

Term

- 4 years.

- Most stakeholders comment that 3 to 5 years seems reasonable; some prefer shorter term and a few prefer longer term.
- 4 years a reasonable mid-point.
- Some concern over giving Dx choice.

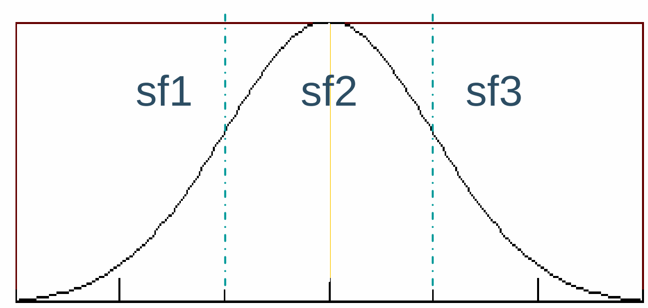
Inflation

- GDP-IPI FDD (updated annually in March).

- While all stakeholders support IPI in principle, they differ on the details, for example:
  - selection of sub-indexes;
  - the role of Dx-specific data, if any;
  - weighting of the sub-indexes; and
  - derivation and smoothing of a capital sub-index.
- GDP-IPI FDD in place now; IPI may be a longer-term objective.

X-factor

- Industry TFP growth potential as recommended by PEG, including input price differential and productivity differential.
- Stretch factors; simpler groupings and range as set by the Board, with majority (2/3) having the same stretch factor. Outliers (as based on efficiency rankings) would have a higher or lower stretch factor.
- Stakeholders generally agree that TFP is the correct basis for productivity factor.
- US data a reasonable proxy; represents best information available. More work to be done on Ontario data.
- Precedents exist for on-going applicability of stretch factors.



Earnings Sharing & Off-Ramp

- ESM: Asymmetrical; +2% non-weather normalized earnings above the calculated ROE; excess net cumulative amount over the plan term shared 50:50 at rebasing[1].
- Off-Ramp: Review may be initiated on a case-by-case basis on application by Dx and/or invoked by stakeholders.
- Strong support for ESM by ratepayers.
- Protection in light of certain elements in proposed plan that provide potential access to additional funding in rates through incremental capital module.
- Off-ramp common feature of IR.

[1] ROE would be recalculated annually based on that year's application of the ROE formula and earnings sharing would be calculated as +200 basis points from that number.

Incremental Capital

- On application.
- Eligibility criteria:
  - causation – drivers;
  - materiality – threshold of 25% of capital budget reflected in base rates going in to IR, must be met on an individual driver basis; and
  - prudence.
- Annual reporting on actual spend.

- CAPEX will be addressed in rebasing prior to IR; modular approach reasonable to address incremental needs.
- Minimizes the dilution of incentives under PCI.
- Applications should be accompanied by comprehensive evidence to support a claim for incremental capital.

Z-factors (unforeseen events outside of management's control)

- On application.
- Eligibility criteria:
  - causation;
  - materiality – threshold of 0.5% of total revenue requirement approved going in to IR plan, must be met on an individual event basis; and
  - prudence.

- General support for Z-factor; but split on whether should be limited.
- Current rules well understood.
- Some view thresholds as arbitrary. Option to simplify and set threshold based on total revenue requirement impact.