CONSUMERS COUNCIL OF CANADA

FURTHER COMMENTS ON THE ONTARIO ENERGY BOARD STAFF DISCUSSION PAPER ON 3RD GENERATION INCENTIVE REGULATION FOR ONTARIO'S ELECTRICITY DISTRIBUTORS

RE: REVISED PROPOSAL FOR AN INCREMENTAL CAPITAL MODULE

EB-2007-0673

May 20, 2008

INTRODUCTION:

On February 28, 2008, the Ontario Energy Board ("Board") Staff issued a paper entitled, Staff Discussion Paper on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors ("Staff Paper"). In addition, the Board released a report prepared by Board Staff's expert consultant, Dr. Lawrence Kauffman of the Pacific Economics Group, entitled "Calibrating Rate Indexing Mechanisms for 3rd Generation Incentive Regulation in Ontario" ("PEG Report"). The Staff Paper and the PEG Report were drafted following the Board's consultation and working group processes. Stakeholders were asked to provide comments on the papers by April 14, 2008.

On April 23, 2008, the Board issued a letter announcing a stakeholder meeting to allow participants in the consultation process to explore the implications of new positions and alternative mechanisms advanced by other participants in response to the PEG Report and the Staff Paper. That meeting was held on May 6. Parties were asked to submit further comments on May 16.

On May 15, 2008, Board Staff submitted a revised proposal regarding an incremental capital module to be incorporated into an overall price cap plan. These are the submissions of the Consumers Council of Canada ("Council") regarding the Board Staff proposal to deal with incremental capital.

BACKGROUND:

In its earlier submissions the Council proposed that the Board adopt a three-year price cap plan for Ontario electricity distributors as the model for 3rd GIRM. The Council's support for a three-year term is based on a number of considerations:

1. The industry continues to go through substantial changes. Initiatives like the smart meter program, the development of LDC delivered conservation and demand management programs, and increases in distributed generation projects all present administrative challenges and potential cost pressures for LDCs. Other government driven initiatives may arise over the next several years that could further impact the operations of the LDCs. Economic conditions are also expected to change. Putting in place an IRM for four or five years would better suit an industry operating in a steady state environment. From the Council's perspective three years represents an appropriate balance given the political, economic and regulatory environment that the LDCs operate in;

2. If the plan term is for three years it is less important to have the parameters precise. For example, under a three year plan the variability between inflation indexes may be less significant than under a longer plan. In addition, for many LDCs under a three-year plan the need for a capital adjustment mechanism may not be required whereas the need may be greater under a five year plan; and

3. There is considerable debate amongst the stakeholders and their experts regarding the development of an X-factor(s), the need for a stretch factor and how best to measure inflation. A compromise approach to put in place values for three years allows for a reconsideration of the parameters based on better data in three years.

A three-year plan would, from the Council's perspective, make the need for any capital adjustment less likely. In effect, capital adjustments mid-plan should be the exception not the norm. Accordingly, the Council supported an approach that would allow for the Board to consider, on a case-by-case basis applications to make adjustments during a plan term to reflect required incremental capital expenditures. Those applications should be accompanied by comprehensive evidence to support the claim for incremental capital, and not be treated as simple pass-throughs.

BOARD STAFF'S PROPOSAL:

The Council understands that the Board Staff approach would entail the following:

1. If the distributor's average CAPEX exceeds a proposed threshold of 150% of the Board-approved base year depreciation expense the distributor may apply to recover the revenue requirement associated with unusually high rates of capital spending;

2. The distributor's average CAPEX is calculated as the sum of the total CAPEX in each year since the base year divided by the number of years since rates have been rebased; and

3. The proposal is indifferent to the driver. (i.e. life-cycle replacement of aging plant)

Each application would require the filing of evidence prescribed by the Board setting out among other things: an analysis demonstrating that the threshold had been met; a description of the underlying causes and timing of the expenditures; the specific rate relief sought; and a justification that the amounts to be incurred are prudent.

SUBMISSIONS ON THE INCREMENTAL CAPITAL MODULE:

The Council has advocated that an incremental capital module be adopted by the Board. Given the new Board Staff proposal the Board must determine the following:

1. What is the appropriate threshold that would trigger an application?;
2. What evidentiary base is required to accompany an application for relief?;
3. What regulatory treatment is appropriate if the LDC has justified the incremental capital?

Trigger:

The Council is wedded as to what trigger mechanism would be appropriate. Tying the trigger to depreciation may be appropriate, but may have different impacts depending upon the nature of the assets that were in the initial base year adjustments. From the Council's perspective the incremental capital requirements of the LDC must be significant and the LDC must demonstrate that the price cap is not sufficient to allow for prudent investments. Using the Board Staff proposal initially, with potential changes to the trigger in later years depending upon the number applications, may be the appropriate approach. It may well address the concerns expressed by certain LDCs at the stakeholder meetings.

Evidentiary Base:

The Council supports the filing requirements set out by Board Staff which would support any application for approval of incremental capital spending. In effect, the LDC must provide sufficient evidence to support its request. Ultimately, the Board will decide each application on its own merits, but it would be useful to define the initial filing requirements up front. Over time those requirements may be refined based on experience.

Regulatory Treatment:

What is not clear from the Board Staff Proposal is how the incremental capital expenditures would flow through to rates. The Council supports a proposal that captures the revenue requirement associated with the capital spending in a deferral account, subject to a true-up upon rebasing based on the actual amounts spent. This could be captured through rate rider rather than an adjustment to rates. This is consistent with the current mechanisms in place to deal with smart meter expenditures.

In addition, it is not clear if the LDC would need to file and seek approval on a one-year basis or if multi-year approval of the capital associated with the trigger expenditures would be allowed. From the Council's perspective if a true-up mechanism was used then the need for annual approvals would be less significant. If the Board adopts a longer term plan (more than three years), or considers recovery of the capital on a forecast basis, then annual applications should be a requirement.

Overall, the Council is supportive of an incremental capital module. As noted earlier, these applications should only be in exceptional circumstances and supported by a comprehensive evidentiary base.