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ONTARIO ENERGY BOARD

COST ASSESSMENT MODEL

January 2011

TABLE OF CONTENTS

Executive Summary

The Board's Cost Assessment Model is the methodology the Board uses to apportion its costs to the persons or classes of persons that have to 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 the total of operating expenses (excluding non-cash expenses) and capital expenditures less other funding sources for the fiscal year. Both direct and indirect costs will be allocated across all classes of persons ("classes"). Indirect costs will be allocated in proportion to the direct costs of the class. The total amount assessed to each class will be allocated to the regulated entities within the class on the following basis:

- net revenue for the gas distribution class,
- distribution revenue for the electricity distribution class,
- transmission revenue for the electricity transmission class,
- a combination of total customers (50%) and the number of customer complaints received by the Board (50%) for the electricity retailer class, and
- A combination of total customers (50%) and the number of customer complaints received by the Board (50%) for the gas marketer class.

Three classes have only one regulated entity in each. These are the Independent Electricity System Operator (the "IESO"), the Ontario Power Authority (the "OPA"), and Ontario Power Generation ("OPG").

Revenues are also generated by licence fees (Section 12 of the Act), specific project costs (Section 30 of the Act), administrative penalties (Section 112 of the Act) and investment income. There is an annual registration fee of $800 for each license held. The license application fee is $1,000. Administrative penalties are applied through a hearing process in specific cases related to non-compliance of codes, rules, licence conditions or Board decisions.

An operating reserve was established in 2005 equal to 15% of the annual funding requirement. The operating reserve may be adjusted annually to be up to 15% of the current annual funding requirement.

Background

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, and
- income earned on investments.

The majority of the Board's revenue is received through the cost assessments issued under section 26 of the Act. The Board's Cost Assessment Model is the methodology the Board uses to apportion its costs to the persons or classes of persons that have to pay costs under section 26 of 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 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 in 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.

Guiding principles

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

1. The Cost Assessment Model should be clear and direct, fair, transparent, cost effective and provide incentive to use regulatory services efficiently.
2. The Cost Assessment Model should ensure that ultimately costs incurred in regulating the customer groups are recovered from those customer groups.
3. The Cost Assessment Model should allow the OEB to be financially self-sufficient and avoid the need to borrow funds.
4. All licensed market participants should contribute to the OEB's funding.
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.

The Board's view is that the Cost Assessment Model reflects an appropriate balance of the guiding principles.

Regulated entities subject to the Board's cost assessment

The following persons or classes of persons are currently liable to pay the Board's cost assessments 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.

Fiscal structure

The Board's annual funding 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. Other funding sources in respect of the cost assessment include licence fees, specific project costs (section 30) and investment income. Surplus or deficits incurred in a previous year will be added to or subtracted from the amount assessed for the current year.

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 licenced 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.

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

Administrative penalties are applied through a hearing process in specific cases related to non-compliance of codes, rules, licence conditions or Board decisions. Revenues from administrative penalties are not used to reduce the cost assessment. Revenues from administrative penalties 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 15% of the current annual funding requirement. If the operating reserve is less than 15% of the current annual funding requirement, future cost assessments may be used to fund the operating reserve. Any operating reserve exceeding 15% will be used to reduce payments under future assessments.

Cost Assessment Methodology

Both direct and indirect costs will be 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) staff costs related to applications and regulatory audit, regulatory policy and compliance, 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 Relations Centre costs, based on the nature of calls received, and

(c) Specific project costs such as consultants and stakeholder consultation costs for studies related to a particular class and 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. Indirect costs are allocated in proportion to the direct costs of the class. 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.

The Board will use the following formula to allocate these costs in direct proportion to the class' share of direct costs:

$$\text{Class share of indirect costs (\%)} = \frac{\left(\begin{array}{l}\text{Class share of direct staff costs} \\ \underline{\text{Plus}} \quad \text{other direct costs of the class}\end{array}\right)}{\left(\begin{array}{l}\text{Direct staff costs for all Classes} \\ \underline{\text{Plus}} \quad \text{other direct costs of all classes}\end{array}\right)}$$

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.

Gas Distribution
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.

Electricity Distribution
Apportionment within the electricity distribution class is based on distribution revenue.

Electricity Transmission
Apportionment within the electricity transmission class is based on transmission revenue.

Electricity Retailers
Apportionment within the electricity retailer class is based on a combination of two factors, each having equal weight (i.e. 50% each). The two factors are the average total number of customers of the retailer taken from the three most recent annual Reporting and Record Keeping Requirements statistics (if available) and the average number of complaints received by the Board's Consumer Relations Centre taken from the three most recent year information for the retailer (if available).

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 average total number of customers of the retailer taken from the three most recent annual reporting and record keeping requirements statistics (if available) and the average number of complaints received by the Board's Consumer Relations Centre taken from the three most recent year information for the marketers (if available).