Ontario Energy Board

Ontario

# Report of the Board

## on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors

July 14, 2008

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# 3 Implementation

A participant representing a group of ratepayers, building on a proposal by one of the distributors, recommended that in each rate order on rebasing, the Board panel structure the order so that annual adjustments, consistent with the IR plan as applied to that particular distributor, are included as part of the order. According to this participant, this approach could accomplish two things: first, where the Board accepts custom values based on specific application for any of the parameters in the IR plan, this approach would create a method by which that decision could be implemented; and second, it would also set the rates for each year of the IR plan term through a proper hearing on an evidentiary basis and any subsequent application by the distributor to re-open any of those years would be a reconsideration of the existing order (requiring an application to vary the existing order), not a fresh application. The Board sees merit in this suggestion and will give it further consideration.

## 3.1 How Adjustments Would be Determined

### 3.1.1 Continued Migration to Common Capital Structure

The Board will continue to include an adjustment to rates in 2009 and 2010 where applicable as outlined in its December 20, 2006 "Report of the Board on Cost of Capital and 2$^{nd}$ Generation IR for Ontario's Electricity Distributors", in order to transition distributors to the single deemed capital structure of 60% debt and 40% equity.

### 3.1.2 Conservation and Demand Management

The Discussion Paper noted that staff and the working group generally felt that the current Lost Revenue Adjustment Mechanism ("LRAM") is appropriate until the completion of the consultations on rate design for electricity distributors since those consultations will look at related issues. The Discussion Paper invited comment on a revenue stabilization adjustment mechanism ("RSAM"), on a model that would include a CDM adjustment factor based on the CDM targets set by the Government of Ontario and/or the Ontario Power Authority, and on the option of maintaining the status quo vis-à-vis the Board's current LRAM and shared savings mechanism ("SSM") for electricity distributors.

***Issues and Options Raised in Consultation***

Most participants supported the continuation of the current LRAM and SSM. Some participants commented that a RSAM would involve a significant change in the risk profile of electricity distributors and/or their allowed return on equity, would require the production of load forecasts, and would shift the risk of volume fluctuations and deviations from forecast from the distributor to the ratepayers. In addition, alternative mechanisms do not appear to be practical at this point in time. One participant suggested that, going forward, if there is evidence that revenue erosion during the term of an IR plan is increasing, adjustment mechanisms may then be considered by the Board. As such, this participant concluded, this could be part of a longer term framework.

Distributors commented that they believed that in the short term distributors can make use of the existing lost revenue adjustment processes and that revenue-oriented IR alternatives could accommodate broader concerns around reductions in load and customer numbers.

***Policy and Rationale***

On March 28, 2008, the Board issued its "Guidelines for Electricity Distributor Conservation and Demand Management" which consolidate all of the Board's policies in relation to CDM activities undertaken by electricity distributors. In those guidelines, the

Board noted that whether and how CDM funding may be included in the IR mechanism rate adjustment would be addressed in the appropriate forum.

As a result of these 3rd Generation IR consultations, the Board has determined that **CDM-related costs recovered through distribution rates (i.e., any new spending on CDM, revenues from recovery of a lost revenue adjustment claim, or a shared savings claim) will continue to be dealt with separately from the IR rate adjustment**.

This represents the status quo. The Board acknowledges that, should alternatives to the status quo be examined, these could have implications for electricity distributors and ratepayers. In the Board's view, these would best be dealt with as part of the consultations on rate design for electricity distributors (consultation EB-2007-0031).

### 3.1.3 Deferral and Variance Accounts

A set of authorized variance / deferral accounts are identified in the Board's Accounting Procedures Handbook. In its December 20, 2006 "Report of the Board on Cost of Capital and 2nd Generation IR for Ontario's Electricity Distributors", the Board indicated that, to the extent possible, it will limit reliance on the creation of new deferral accounts during the term of the 2nd Generation IR plan to well-defined and well-justified cases only. The Board will continue this practice for purposes of the 3rd Generation IR plan.

With respect to the disposition of commodity deferral and variance accounts, the Board is required to make an order at least every three months to determine whether and how the amounts recorded in such accounts (currently recorded in Account 1588 of the Uniform System of Accounts) shall be reflected in rates. With respect to non-commodity deferral or variance accounts, the Board is required to make an order at least annually.