

January 14, 2011

**Via RESS and Canada Post**

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
PO Box 2319  
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Toronto, ON. M4P 1E4

Dear Ms. Walli

**Re: Proposed Revisions to the OEB Cost Assessment model;  
Board File: EB-2010-0362**

Direct Energy (DE) welcomes the opportunity to provide the Ontario Energy Board (the Board) with its comments on the Notice of Proposed Revisions to the OEB Cost Assessment Model, (the Notice) issued December 13, 2010. The Notice was issued in advance of the forthcoming enforcement of Ontario Regulation 499/10 (O.Reg 499/10), which amends Ontario Regulation 16/08 (O.Reg 16/08). O.Reg 499/10 creates two new classes of persons liable for Board expenses and expenditures (the classes), namely Gas Marketers and Electricity Retailers.

DE is of the view that even though the amendment allows the Board to make these two new classes liable for its expenses, neither the amendment nor section 26. (1) of the Ontario Energy Board Act appears to mandate that Board expenses must be allocated to these classes. Rather, the amendment and the Act appear to rely on the Board to determine a fair and reasonable assessment of costs, if any, to these classes. DE believes that the current Cost Assessment Model is appropriate, and that no changes to the current model are required.

The Current Board Cost Assessment Model

The Board's current Cost Assessment Model was finalized after extensive stakeholder consultations. A further review was completed in 2006 and the Board determined that no changes to the model were necessary. The Board found that the criteria for inclusion of market participants in the general cost assessments are as follows:

- their rates are regulated by the Board; and
- their key activities are subject to regular and routine supervision by the OEB; and
- their contribution would not lead to inequitable results for customers.<sup>1</sup>

It was also specifically determined that certain market participants should *not* be included in cost recovery. The Board intentionally excluded Gas Marketers, Electricity Retailers, Electricity Generators (except OPG), and Electricity Wholesalers as categories of market participants for

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<sup>1</sup> Ontario Energy Board Cost Assessment Model – Issued March 14, 2005; page 8

general cost assessment. Gas marketers and electricity retailers were excluded for the following reasons<sup>2</sup>:

*"Competitive Suppliers (Gas Marketers and Electricity Retailers):* The rates of competitive market participants are not regulated by the Board, and their inclusion in the General Assessment would lead to inequitable results for customers. Much of the Board's cost that is uniquely associated with retailers/marketers relates to compliance and enforcement. The OEB can and will collect the costs of proceedings (i.e., outside of the general cost assessment process) that directly relate to marketers/retailers. The OEB model ensures that all market participants share in the OEB's costs. In this regard fees have been expanded to include annual registration fees charges for all licenses, in addition to application fees."

In other words, the Board acknowledged that since gas marketer and electricity retailer rates are not rate regulated, the recovery of OEB costs from competitive market participants would lead to inequitable cost recovery for customers. The Board further explains its rationale for not including competitive market participants on page 6 of its Report on The OEB Cost Assessment Model Development and Consultation:

#### "Competitive Market Participants

The OEB was convinced that inclusion of gas marketers and electricity retailers in general cost assessment would lead to inequity in costs ultimately borne by customers who are served by default supply (whether gas or electricity) on the one hand, compared to customers who are served by competitive supply on the other. This is because distributors will pass through their assessment costs to all distribution customers regardless of whether these customers' commodity is supplied by the distributor or a retailer/marketer.

In other words, distributor assessments do not unbundle regulatory costs relating to distribution from regulatory costs relating to commodity. Thus all distribution customers pay for both. In light of this, it is the view of the Board that it is inappropriate for customers of retailers/marketers to pay these costs and in addition pay regulatory costs related to competitive supply. The Board believes that the recovery of costs through approved rates will more accurately apportion ratepayer costs.

Also, retailers and marketers offer consumers long-term, fixed-price contracts. In most cases, these participants are not able to recover newly imposed costs from existing customers and therefore either new customers or shareholders, or both, would have to bear these costs."

DE is of the view that these same principles and findings hold true today and that, consistent with the Board's findings on Cost Assessments, it would be inequitable to recover general Board costs on an ongoing basis from competitive market participants. It appears that the Board also agrees with this in the Notice for this very consultation. The Board rightfully noted in the Notice that:

"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....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

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<sup>2</sup> Ontario Energy Board Cost Assessment Model – Issued March 14, 2005; page 9

*the Board's allocation methods were in keeping with industry best practices and generally accepted utility regulation.*"[Emphasis added.]

Two knowledgeable, respected, and independent consultants have already confirmed that the Board's current Cost Assessment Model is appropriate, fair, and equitable. Direct Energy views the proposed change to the OEB model as unreasonably punitive to the industry. This change, if approved, will be detrimental to the private investment climate in Ontario's retail energy sector.

Competitive market participants already pay annual licensing fees in accordance with the Board's determination, and can be directed by the Board to pay costs to other parties, including the Board itself. Furthermore, it should be noted that gas marketers and electricity retailers are prevented from recovering their costs of participation in any Board proceeding or consultation, even though their contributions to such matters are for the benefit of the Ontario energy market as a whole.

It would be a further inequity to recover amounts from competitive market participants through the implementation of the suggested amendments, and then continue to prevent marketers and retailers from recovering their costs for participating constructively in regulatory proceedings.

It is notable that all entities liable for Board expenses and expenditures under the current provisions of Ontario Regulations 16/08 have both their budgets/cost-of-service and their charges/rates reviewed and approved by the Board. In that manner, there is parity between the Board's determination of both imposed and recovered costs. The extension of general Board cost liability to entities such as DE, which have no recourse to regulated rates, would be both illogical and punitive.

#### The Proposed Board Cost Assessment Model and subsequent recommendations:

As noted above, it is DE's position that the proposed changes to the Board's Cost Assessment Model are both unnecessary and punitive. However, without prejudice to the above comments, should the Board persist with changing the model as proposed in the Notice, DE strongly believes that substantive changes need to be made.

The proposed model indicates that Marketer and Retailer cost assessments will be based 50% on market share, and 50% on the number of complaints received by the Board. Furthermore, Marketers and Retailers would also not only be responsible for direct costs for their particular classes, but also for a proportionate amount of the Board's indirect costs. The issues with the proposed Cost Model Assessment include:

- The inclusion of indirect costs of the Board;
- The use of "complaints" as a determining cost assessment factor;
- The need for transparency into costs and audit processes; and
- The need for an independent review of the proposed model.

#### The inclusion of indirect Board costs:

For the reasons noted earlier in this submission, it is Direct Energy's view that the Board should not recover any costs from competitive entities with no recourse to regulated rate recovery, and in the case of the proposed model, specifically reject the inclusion of the indirect costs of the Board. As an equitable means to recover costs from all consumers, the Board's current model rightfully recovers these costs primarily through distribution rates. As the Board is already recovering these costs from all ratepayers, it would cause significant inequities to recover these costs again from competitive customers.

Retailers and Marketers do not have the flexibility to recover costs from their existing customers due to the nature of fixed priced contractual obligations. Imposing such costs on competitive Retailers and Marketers will either require them to absorb these costs in their entirety or pass all or a portion of the costs on to newly acquired customers. Assessing OEB indirect costs against competitive entities either punishes those entities financially or further erodes their competitive position in the market.

#### The use of "complaints" as a determining factor:

For many reasons, the use of complaints as a factor in Board cost assessments for Marketers and Retailers is not appropriate. The definition of a complaint itself is arbitrary, and the Board has not provided any definition of such in the Notice. Furthermore the Board has not made any distinction between what would be considered a justified complaint, versus an unjustified complaint from a consumer. If complaints were to be used as a factor in cost assessments, some competitive participants would be unjustly penalized due to the size of their customer base.

As the Board's contact centre is also used to educate consumers, the manner in which information is provided to customers by the Board in their future ECPA education program could inadvertently increase the number of "complaints" received through no fault of Marketer or Retailer actions. Complaint data used for the cost assessment period may also be outdated, and not reflective of the actual number of valid complaints received for the Marketer or Retailer during that period. Additionally, certain fixed call centre/operations costs must be covered before even the first enquiry is received by the Board. For this very reason using "complaints" as the basis for allocation of costs is flawed; and is likely the reason this metric is not used to assess costs against distributors.

For the reasons noted above DE respectfully suggests that the 50% factor that was to be applied to Marketer and Retailer costs based on complaint numbers, instead be applied equally across all active licensed participants within the class. This method would result in a more reasonable and fair allocation of costs, and ensure that all active market participants are contributing to the infrastructure support necessary to serve their customers.

#### Need for transparency into costs and the audit process

In the Notice, the Board estimated the allocation of costs may range from approximately \$1.6 million to \$2.4 million for electricity retailers and \$1.3 million to \$2.1 million for gas marketers. The Board has made this statement without providing the calculations that have derived these amounts. Should the Board decide to move forward with assessing Marketers and Retailers costs, a full review and disclosure of all items included in these costs must be completed and verified by the licensed entities within the class.

Given the fluctuations in the competitive market, the Board must also implement a relevant "true-up" mechanism each quarter that is unique to the effected new classes to account for variances between actual costs and forecasts; as well as changes in market share. Furthermore, an independent audit of the costs assessed to Marketers and Retailers should occur on an annual basis.

#### Need for an independent review of the Proposed Model

In 2004 the Board engaged Navigant Consulting to provide a report to the Board on an appropriate cost assessment model, which then became the basis for the model used today. Again in 2006, the Board engaged EES, another independent consultant to verify the model. Now, with the addition of two new cost classes DE recommends that the Board once again conduct an independent review of

whether or not it is appropriate to allocate costs to the two newly created classes, and if so, how that allocation should be done. DE suggests that the Board engage an independent consultant such as Navigant Consulting to review the Board's current Cost Assessment Model and provide recommendations, if any, in relation to the creation of the two new classes. Such a review should be done prior to the commencement of any invoicing, and stakeholders should have the opportunity to provide input to the scope and terms of the review.

Conclusion:

DE trusts that the Board finds these comments and suggestions constructive and valuable and would like to thank the Board for the opportunity to comment on the proposed amendments to the OEB Cost Assessment Model. Should you have any questions or concerns with the above noted recommendations, please contact the undersigned.

Yours sincerely

*Original signed by*

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