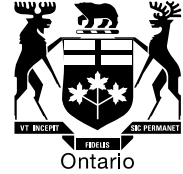


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BY E-MAIL AND WEB POSTING

January 4, 2008

**To: All Licensed Electricity Distributors
All Participants in Consultation Process EB-2007-0673
All Other Interested Parties**

**Re: Service Quality Regulation for Electricity Distributors
Board File Number: EB-2008-0001**

The Ontario Energy Board (the "Board") is initiating a consultation process to assist it in the development of a service quality regulation regime for electricity distributors.

Initiation of this consultation process reflects the Board's commitment to the implementation of an effective service quality regulation regime in association with the move to incentive rate regulation in the electricity distribution sector. The Board confirmed its intention to address service quality in its December 20, 2006 *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* and in its 2007-2010 Business Plan.

This letter identifies how interested parties may participate in this consultation process, including in relation to the issue of cost awards. It also invites comment on a Board staff Discussion Paper that is being released today and is available on the Board's website at www.oeb.gov.on.ca.

The Role of Service Quality in Regulation

One of the key issues regarding the implementation of a service quality regime is the question of the regulatory consequences to a distributor of above- or below-standard performance.

Different regulators have implemented different types of service quality regimes, and these can generally be classified as involving one of three different approaches. The first can be referred to as the "monitoring approach", where a utility's performance is monitored and reported to the regulator. This approach enables the regulator to review a utility's performance, to determine whether service levels are being maintained and to

ascertain whether any steps are being taken to address declines in performance. Ontario currently uses a monitoring approach in relation to electricity distributors.

The second approach can be referred to as the “standards approach”, where a utility is required to meet a certain performance standard. Under the “standards approach”, compliance with the performance standard is mandatory and can be enforced by the regulator. Ontario currently uses a standards approach in relation to natural gas distributors.

The third approach can be referred to as the “incentive approach”, where the level of performance triggers an automatic penalty (for below-standard performance) or reward (for above-standard performance). This approach is generally used in association with an incentive rate regulation regime, with above- or below- standard performance affecting the utility’s revenue.

A review of other jurisdictions indicates that the monitoring and standards approaches are the most common, with fewer jurisdictions using the incentive approach.

Some of the contentious issues associated with the incentive approach were identified by Board staff in its 2003 paper entitled *Service Quality Regulation for Ontario Electricity Distribution Companies: A Discussion Paper*.¹ Specifically, the following comments were made:

Linking financial consequences to service performance is often contentious. The financial consequences should be severe enough that they motivate the firm to maintain service at adequate levels (or to quickly remedy problems), as opposed to paying a penalty that is less costly than providing the expected level of service. However, penalties should not put the firm in (risk of) financial distress. There is an argument that the "risk" of penalties should be factored into the base revenue requirement of the firm.

The need for symmetry of financial consequences is also debated. The emphasis in most schemes is to act as a disincentive against service degradation. There are arguments that reward mechanisms are unnecessary and inefficient. First, reward mechanisms may result in "goldplating" of service (an accusation also frequently leveled at cost-of-service regulation). Second, a firm, even a monopoly, will often benefit from providing service above the minimum standard as customers will appreciate the good service and tend to purchase more from the firm. The firm may also find that its costs may be lower at some level (or range) of performance above the standard as improved quality requires less rework and customer handling. The firm is free to choose an operating level of service, above the minimum regulatory-

¹ http://www.oeb.gov.on.ca/documents/cases/RP-2003-0190/sqr_discussionpaper_150903.pdf

set standard, that maximizes its profits and profitability, and does not require an additional "reward" incentive. (page 31)

A further issue that relates to the incentive approach is that of quantifying the value attributed to achieving particular levels of service quality performance. At the present time, neither the willingness of customers to pay for certain higher levels of service quality nor the customer or societal costs of degraded service quality are known. As a result, attempts to link service quality levels to monetary rewards or penalties may be arbitrary.

In addition, this consultation process may well lead to significant changes to the service quality indicators that are currently in place for monitoring and reporting purposes, as well as to the introduction of new service quality indicators or requirements. Until such time as the sector gains experience with any new or modified service quality indicators or requirements, it is in the Board's view premature to move to an incentive approach.

The Board has therefore concluded that a standards approach is appropriate for Ontario at this time. Under this approach, electricity service quality requirements ("ESQRs") will be established and codified, and compliance with the ESQRs will be monitored and enforced as required.

The Board anticipates that this consultation process will culminate in the adoption and codification of a set of well-defined ESQRs, each having an effective performance standard. To the extent that this consultation process reveals that this approach is not feasible or desirable in relation to one or more of the existing or proposed service quality indicators at this time, they may remain subject to the existing monitoring approach.

In the coming years, the Board, electricity distributors and other interested parties will gain additional experience with mandatory service quality requirements. That experience, combined with supplementary information on consumer expectations regarding service quality, will provide the Board with a better basis upon which to further consider the merits of moving towards an incentive approach.

Staff Discussion Paper

The Board has today posted on its website a Board staff Discussion Paper entitled *Regulation of Electricity Distributor Service Quality* (the "Discussion Paper").

The Discussion Paper provides background on the development of service quality regulation in Ontario, as well as staff's proposals regarding modifications to existing service quality measures and the adoption of new ones.

The Board is inviting written comment from interested parties on the Discussion Paper. Details on how to provide your comments are set out below. The Board welcomes views on all aspects of the Discussion Paper. While the Discussion Paper identifies

questions in relation to which stakeholder input would be particularly beneficial, interested parties should feel free to comment on other issues as they consider appropriate.

Cost Awards

Cost awards will be available under section 30 of the *Ontario Energy Board Act, 1998* to eligible persons for their participation in this consultation process. The costs awarded will be recovered from all licensed electricity distributors based on their respective distribution revenues.

Appendix A contains important information regarding cost awards for this consultation process, including in relation to eligibility requests and objections.

In order to facilitate a timely decision on cost eligibility, the deadlines for filing cost eligibility requests and objections will be strictly enforced.

Invitation to Participate and Filing Instructions

The Board encourages participation in this consultation process by all interested parties.

Those interested in participating in this consultation process should indicate their intent by letter addressed to the Board Secretary by **January 14, 2008**. The letter should include the following:

- A statement as to whether the participant intends to make written comments on staff's Discussion Paper, and/or whether the participant wishes to be on the distribution list for future developments in this consultation; and
- A statement as to whether the participant intends to request cost eligibility. All requests for cost eligibility should be accompanied by the information specified in Appendix A under the heading "Cost Award Eligibility".

Participants who wish to provide written comments on staff's Discussion Paper must do so by **February 4, 2008**.

All filings to the Board in relation to this consultation must quote file number **EB-2008-0001** and include your name, postal address, telephone number and, where available, an e-mail address and fax number. Three paper copies of each filing must be provided. The Board requests that interested parties make every effort to provide electronic copies of their filings in searchable/unrestricted Adobe Acrobat (PDF) format, and to submit their filings through the Board's web portal at www.errr.oeb.gov.on.ca. A user ID is required to submit documents through the Board's web portal. If you do not have a user ID, please visit the "e-filings services" webpage on the Board's website at www.oeb.gov.on.ca, and fill out a user ID password request. Additionally, interested parties are requested to follow the document naming conventions and document submission standards outlined in the document entitled "RESS Document Preparation –

A Quick Guide” also found on the e-filing services webpage. If the Board’s web portal is not available, electronic copies of filings may be filed by e-mail at boardsec@oeb.gov.on.ca.

Filings must be received by **4:45 p.m.** on the required date.

Next Steps

Following review of comments received on Board staff’s Discussion Paper, the Board anticipates that proposed amendments to the Distribution System Code will be prepared to codify those service quality measures that the Board believes should be implemented as mandatory ESQRs. The proposed amendments will be issued in accordance with the statutory process for giving notice of and receiving comments on code amendments. The Board will also issue for comment proposed amendments to the RRR as required to address service quality matters.

All materials related to this consultation will be posted on the “Key Initiatives & Consultations” portion of the Board’s web site. The material will also be available for public inspection at the Board’s office during normal business hours.

Any questions regarding this consultation should be directed to Paul Gasparatto at paul.gasparatto@oeb.gov.on.ca or at 416-440-7724. The Board’s toll-free number is 1-888-632-6273. The Market Operations Enquiry e-mail is market.operations@oeb.gov.on.ca

Yours truly,

Original signed by

Kirsten Walli
Board Secretary

Appendix 'A'

Cost Awards

Cost Award Eligibility

The Board will determine eligibility for costs in accordance with its *Practice Direction on Cost Awards*. Any person requesting cost eligibility must file with the Board a written submission to that effect by **January 14, 2008**, identifying the nature of the person's interest in this process and the grounds on which the person believes that it is eligible for an award of costs (addressing the Board's cost eligibility criteria as set out in section 3 of the Board's *Practice Direction on Cost Awards*). An explanation of any other funding to which the person has access must also be provided, as should the name and credentials of any lawyer, analyst or consultant that the person intends to retain, if known. All requests for cost eligibility will be posted on the Board's website.

Licensed electricity distributors will be provided with an opportunity to object to any of the requests for cost award eligibility. If an electricity distributor has any objections to any of the requests for cost eligibility, such objections must be filed with the Board by **January 21, 2008**. Any objections will be posted on the Board's website. The Board will then make a final determination on the cost eligibility of the requesting parties.

Eligible Activities

Cost awards will be available in relation to the following activities:

<u>Activity</u>	<u>Maximum Total Eligible Hours per Participant</u>
Written comments on Board staff's Discussion Paper	15 hours
Written comments on proposed amendments to the Distribution System Code	To be determined
Written comments on proposed amendments to the Reporting and Record Keeping Requirements	To be determined

Cost Awards

When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of its *Practice Direction on Cost Awards*. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied. The Board expects that groups representing the same interests or class of persons will make every effort to communicate and co-ordinate their participation in this process.

The Board will use the process set out in section 12 of its *Practice Direction on Cost Awards* to implement the payment of the cost awards. Therefore, the Board will act as a clearing house for all payments of cost awards in this process.

For more information on the cost award process, please see the Board's *Practice Direction on Cost Awards* and the October 27, 2005 letter regarding the rationale for the Board acting as a clearing house for the cost award payments. These documents can be found on the Board's website at www.oeb.gov.on.ca on the "Rules, Guidelines and Forms" webpage.