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April 20, 2012

## VIA RESS AND COURIER

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street, Suite 2700  
Toronto, ON M4P 1E4

Dear Ms. Walli:

### **Re: Renewed Regulatory Framework for Electricity (“RRFE”)**

The OEB issued a letter dated April 5, 2012 to all parties participating in the OEB’s Renewed Regulatory Framework for Electricity (“RRFE”) initiative requesting comments by April 20, 2012. The letter requested comments on specific issues, including comments in relation to the strawman regulatory framework prepared by Board Staff and distributed to participants in the RRFE by letter dated February 6, 2012.

OPG provided initial comments on the strawman regulatory framework by letter to the Board Secretary dated March 27, 2012 (see Appendix 1). In light of the discussion at the stakeholder conference held on March 28 to 30, OPG provides additional comments below under the headings and proceeding numbers outlined in Attachment A to the Board’s letter dated April 5, 2012.

### **Planning (EB-2010-0377)**

#### **Use of multi-year capital plans:**

OPG supports the use of a longer planning horizon as an aid to the approval of multi-year capital plans and large individual capital projects by utilities. This would provide greater certainty to both ratepayers and utilities.

The Ontario electricity sector is in the midst of a period of very significant transition and re-investment and accordingly a flexible regulatory model is needed. OPG agrees with the views expressed during the consultation by the EDA, Hydro One and others, that a “one-size fits all” approach should be avoided. The use of a multi-year capital plan is a reasonable option that should be available to utilities. Multi-year capital plans provide greater certainty to both ratepayers and utilities during an incentive rate period and the subsequent rebasing period. Multi-year plans provide the opportunity to smooth customer rates (i.e., avoid “rate shock”), address any concerns regarding the incentive identified by some utilities during the consultation to back load capital investments

during the IRM period, and improve the ability of the utility to fund its capital requirements.

There are a number of ways in which a multi-year capital plan can be applied within the context of a price or revenue cap incentive regulation model. A multi-year capital plan can replace the annual adjustment to the capital portion of base rates established in a typical rate rebasing under a price or revenue cap model. Hydro One described some alternatives (i.e., a “rider” versus an “adder”) for such a model, and discussed circumstances<sup>1</sup> where the different options may be more appropriate in the context of an electricity distributor. OPG is of the view that both of these approaches have merit and should be developed further.

The presentation of the Distribution Regulation Review Task Force discussed the capital budget in terms of various components, noting that different capital components have different rate impacts (page 6 of their presentation). Another option that should be available to utilities is to apply a multi-year capital plan to specific components of a capital budget, rather than the entire capital budget. As discussed below, the specific components may include large multi-year infrastructure renewal investments, significant mandated investments or large increases in previously approved levels of investment. Under this approach, the price cap or revenue cap escalation mechanisms would still apply to specific components of the base year revenue requirement; however some components would be excluded from the price or revenue cap. The excluded components would be included in a multi-year capital plan and would be reflected in rates using one of the alternatives (rider or adder) discussed above.

This approach would require a logical basis for determining whether a component of the capital budget should be included in the price or revenue cap, or whether instead the component of the capital budget should be included in the multi-year capital plan. Further discussion would be required, but the criteria advanced by Hydro One to determine whether an oral or written hearing process should apply (presentation, page 5), is a reasonable starting point for further discussion. To the extent the utility investments reflected in the capital budget are significant and are mandated, are multi-year infrastructure renewal, or reflect a large increase in investments over previously approved levels, these capital budget components would not be “typical” of the capital budget necessary in the test period (the premise of the 3<sup>rd</sup> Generation IRM as summarized by Paul Sommerville during the consultation), and therefore are candidates for inclusion in the multi-year capital budget. Indeed these types of investments in a typical price or revenue cap would be primary drivers of significant customer bill impacts during the subsequent rebasing period, which was a concern expressed by both customer groups and the Board during the consultation. It is the significant impact on rates which distinguishes atypical investments that would be candidates for exclusion from the multi-year capital plan. In OPG’s case, the Niagara Tunnel and Darlington Refurbishment are two examples of capital budget items that would be included in a multi-year capital budget.

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<sup>1</sup>Factors such as asset vintage (management of assets at mid-life is more predictable than at commissioning or end-of-life), demographic changes (such as the potential loss of a major customer) and renewable connection requirements (timing, location, system modifications are often unknown) can impact the accuracy of the capital budget. An adder approach with an after-the-fact prudence review may be more appropriate for utilities subject to factors which may undermine the accuracy of the capital budget.

There are a number of ways in which multi-year capital budgets could be reflected in rates during the incentive rate period. OPG supports the comments by Hydro One as to “what” would be recovered during the incentive rate period. Specifically, depreciation, interest and return on capital budget components reflected in the multi-year capital budget should be recovered. OPG favours approaches whereby rate-setting would allow for the timely recovery of costs associated with multi-year investment plans. In traditional COS regulation, costs are recovered when an asset is placed in service. This often causes a sharp rate increase. Under the current 3<sup>rd</sup> Generation incentive regulation mechanism a similar sharp rate increase would occur at re-basing (absent capital spending allowed under an approved Incremental Capital Module) OPG believes that alternative rate-making approaches that have more of a rate smoothing effect that should be considered. For example, the costs of a multi-year investment plan could be recovered through a multi-year rider that parallels spending by the utility, not in-service additions. Under this approach, the annual depreciation, interest and return would be determined based on the forecast net capital addition (rather than forecast net rate base). Smoothing considerations are part of the building blocks approach applied in the United Kingdom referenced during the consultation.

Under this approach, a true-up could be applied whereby the depreciation, interest and return associated with any differences between the budget and actual capital spend could be determined and recorded in a variance account for future repayment to or recovery from ratepayers. The OEB could also apply a dead band approach (deviations within a small range are not recorded in a variance account) which could include some form of incentive associated with forecasting accuracy. The OEB could also include off ramps, whereby major differences between forecast and actual capital budget amounts over one or two periods would require a utility to provide an update to its multi-year capital plan as part of the annual rate adjustment process. OPG is of the view that there are a number of options for incorporating a multi-year capital budget into the incentive ratemaking regime and that further consultation in this area is necessary.

#### **Use of empirical and qualitative tools and methods:**

The Board is considering whether empirical and qualitative tools can be used to inform utility planning processes, utility applications to the Board, and the Board’s review of utility plans. OPG is not aware of any empirical tools or methods that are universally accepted and is of the view that any application processing standards should be developed over time so that a broad consensus can evolve. Rushing to adopt particular tools and methods could lead to significant unintended consequences. At this time, with the exception of application of the rate mitigation criteria (10 per cent increase in total customer bill) which has been in place and worked effectively for approximately a decade, OPG is of the view that the best tool is reasonable judgment, which the OEB is quite capable of applying.

#### **Performance and Incentives (EB-2010-0379)**

##### **Use of Scorecards:**

OPG recommends that performance metrics be related to things that utilities actually use to manage their business. Many utilities use approaches such as balanced scorecards to set the desired operational focus for utility management, and to assess

performance on the key metrics developed to drive that operational focus. As discussed in the consultation by the Medium Sized Distributor Group and others, the interests of shareholders and the OEB are generally aligned - both want the utility to provide customer value, contain costs, operate safely and in an environmentally conscious manner, and perform other specified priorities. An effective balanced scorecard reflects the interests of all of utility's stakeholders: its customers, its shareholders and the public at large. Each utility believes that its metrics reflect customer preferences. OPG recommends that scorecard metrics should, at a minimum, be considered by the OEB in establishing desired performance.

Scorecards are developed within the context of current utility performance—while the setting of metrics often involves a consideration of industry standards, the performance objectives reflect the current operating circumstances facing each utility. Therefore they are more meaningful standards both to set utility specific performance expectations and to assess the performance of that utility.

A scorecard approach can be applied in a number of ways. A scorecard can be used directly to set rewards and penalties that are incorporated into future rates through Z factors, or scorecards can be applied within the context of an earnings sharing mechanism (e.g., poor performance could result in higher sharing of over-earnings or a reduced sharing of under-earnings). Both are reasonable alternatives that should be permitted by the OEB in establishing its renewed regulatory framework.

### **Rate Setting and Mitigation (EB-2010-0378)**

#### **Use of Benchmarking:**

OPG believes that benchmarking is a useful tool that can be used as the starting point for additional analysis of significant deviations in cost or performance. The additional analysis is then used to inform reasoned judgment in the setting of rates. OPG does not support the direct application of benchmarking results to: (a) help determine appropriate cost levels; (b) achieve further efficiencies; and/or (c) assist in managing cost increases. During the consultation, a number of utilities (particularly Waterloo North Hydro) articulated the limitations associated with benchmarking.

OPG is pleased to offer its additional comments on the RRFE and welcomes the opportunity to comment at a later stage as the initiative evolves and as proposals and recommendations are developed.

Yours sincerely,

[Original signed by]

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March 27, 2012

Ms. Kirsten Walli  
Board Secretary  
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Dear Ms. Walli:

Re: **Renewed Regulatory Framework for Electricity ("RRFE")**

I am writing to provide OPG's comments on the OEB's Renewed Regulatory Framework for Electricity ("RRFE") initiative.

While the OEB has been clear that the RRFE will apply to transmitters and distributors, OPG's regulated operations face some similar issues, including the need for significant new investment over the next decade against a backdrop of increasing customer concerns over increases in the total bill for electricity. Accordingly, it is likely that the RRFE initiative will inform to some degree any separate process to examine proposed changes to OPG's regulatory framework.

Our comments below address each category in the "Straw Man" proposal issued by the OEB on February 6, 2012.

### **1. Integration of Planning**

The Straw Man includes a proposal for a longer planning/rate setting horizon. OPG supports the use of a longer planning horizon as an aid to the approval of multi-year capital plans and large individual capital projects by utilities.

This is particularly important for OPG, which has capital projects that are planned and executed over several rate periods and which does not have access to a leave to construct process like the one available to distributors and transmitters. A longer planning horizon leading to approvals of multi-year capital plans and projects would significantly reduce uncertainty for utilities and for ratepayers.

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The Straw Man also proposes additional co-ordination and integration of transmission and distribution facilities to ensure optimal investment in these sectors. In OPG's generation context this type of integrated planning occurs through the development of the Long Term Supply Plan and the related Integrated Power System Plan.

## **2. Treatment of Capital**

As indicated above, OPG supports the pre-approval of multi-year capital projects and the plans to provide greater certainty for utilities and also for ratepayers. While the Straw Man proposes that approval of such multi-year capital plans be tied to the reliability of the system, OPG notes that other considerations such as safety, capacity additions, and refurbishment of existing facilities, etc. are also important objectives that are achieved through capital spending by utilities.

In OPG's view, this pre-approval of multi-year capital projects and plans should mean that any prudence review of that project once it comes into service should be limited to looking at cost variances and whether the approved work was completed as planned.

## **3. Performance Standards and Incentives**

The Straw Man proposes that there be new performance expectations associated with investment planning and reliability and new financial incentives and consequences to encourage utilities to achieve their investment plan objectives.

OPG recommends that performance metrics be related to things that utilities actually use to manage their business (i.e., taken from actual corporate scorecards). Any financial incentives should be symmetric and proportionate and be grounded in the milestones and targets included within the utilities' capital plans.

## **4. Approach to Rate Setting**

The Straw Man has proposed a move away from the existing comprehensive price cap plan such that the treatment of capital investment and OM&A spending are severed. This recognizes the significant need for capital investment across the sector.

OPG supports this change since it promotes greater certainty and allows for more efficient planning of multi-year capital projects and plans.

Price caps and other forms of incentive regulation can work in stable business environments since they are grounded in historic trends. They are less suited to periods of significant transition and re-investment in capital – both physical infrastructure and human capital. The Ontario electricity sector is in the midst of a period of very significant transition and re-investment and accordingly a more flexible regulatory model is needed.

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## 5. Period of COS/IRM Review

The Straw Man proposes that the period between cost-of-service reviews is more flexible and where off-ramps are stricter and are determined by performance against plan rather than by financial criteria.

OPG supports more flexibility with respect to the timing of cost of service reviews.

## 6. Total Bill Mitigation

The Straw Man includes a new approach to bill mitigation. However, it is not entirely clear how this new proposal might work.

If it leads to the denial of otherwise prudent costs then it would be both unfair to the utility and would potentially impair the safety and reliability of the electricity system. Alternatively, if it leads to the deferral of cost recovery it could lead to a significant rate shock for customers in later periods.

The proposed approach could also potentially create an advantage, in an environment of rising costs, to those applicants who are "first in the door". Care also needs to be taken to ensure that it does not result in disallowances or deferrals of investment that are required to maintain the safety or reliability of a particular part of the electricity system.

Other opportunities to manage bill impacts should also be considered. Taking a long-term view of mitigation, one possible approach is to advance cost recovery while construction work is ongoing. Another approach would involve individual utilities managing and pacing their expenditures in light of their individual circumstances so as to contribute to the overall goal of managing the impact on the total bill. This is a fair and reasonable expectation to impose on utilities, since those increases are to some extent within their control.

OPG is pleased to offer its views on the RRFE and welcomes the opportunity to comment at a later stage as the initiative evolves and as proposals and recommendations are developed.

Yours sincerely,



Andrew Barrett

Vice President,  
Regulatory Affairs & Corporate Strategy