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SPEECH

AMPCO Fall Meeting
November 17, 2005

Check Against Delivery

Thank you for that kind introduction. It's a pleasure to be here with you at your fall meeting and to have the opportunity to speak with so many of Ontario's major consumers of electrical energy.

I think it's safe to say that no other sector is undergoing as much fundamental change and significant adjustment as electricity in Ontario.

It's created tremendous uncertainty in the marketplace.

It's given rise to concern over pricing and adequacy of supply and, consequently, the legitimate demand for clarity and a greater understanding of the role of the OEB in this evolving marketplace.

In short, it has presented all of us with significant challenges.

Today, I would like to discuss some of those challenges and I'd like to do so by focusing on three main areas.

The first is the evolving electricity marketplace and the risks and opportunities it poses for all of us.

The second is how the regulation of the electricity sector itself is evolving – who the players are and what their roles are – and the importance of the regulator balancing your concerns for fair prices with the industry's need for adequacy of returns.

And finally, I want to talk about what the Board has done in the past year and what it plans for the immediate years ahead.

I'll begin with a look at the risks and opportunities of this new electricity environment.

Let me say first off that I understand your concerns as you watch prices for electricity rise.

Prior to joining the OEB, I spent more than two decades in the natural gas and electricity sectors and provided consulting services to some of Canada's largest utilities.

I realize that electricity pricing is critical to your operations and your profitability.

So, too, is the reliability of supply. And as we come to grips with obtaining that supply, the cost will have an impact on your businesses and bring new challenges to the industry and new risks.

One driving force behind these increases is the changing generation mix and related fuel price and development costs.

With the phasing out of coal, we are looking to gas-fired generation, generation from renewable sources and possibly increased reliance on nuclear.

Natural gas prices are going to permanently higher levels. Through the late 1990s, the average natural gas price at Henry Hub was \$2 to \$3 U.S. a MMbu. This year, we have seen gas prices go as high as \$15. Analysts predict that the average price over the next few years will be in the \$9 range, with continued volatility. We foresee that these fuel costs as well as new sources of generation will continue to drive electricity costs over the next few years.

That's commodity. You are also affected by distribution and transmission costs.

As an example, the OEB now is in the process of considering the 2006 distribution rate applications of Ontario's electricity utilities.

And while some distributors have indicated they are not asking the Board for increases, the vast majority are. The good news is they are not coming forward with high increases. Most of them will be a relatively small percentage change.

These cost increases have an impact on your bottom lines and no doubt, they will be a topic of discussion this afternoon when you go into your strategic planning session.

The good news is that higher prices bring new opportunities for conservation and the introduction of new, alternative processes and technologies that are rapidly becoming more cost-effective.

Using these new technologies and processes will give all of us in this room the opportunity to become North American leaders in conservation – to reduce our need for electricity and thus better manage the costs we face.

But there is no denying that uncertainty remains for consumers, generators, transmitters and distributors.

To address this, the OEB has spent a great deal of time and energy working with the various parties to bring stability to the sector. I'm pleased that AMPCO often exercises the important opportunity it has to intervene in our electricity rate decision making processes and our energy regulatory policy initiatives.

One clear element of our mandate is to regulate in the public interest and to execute our work in a way that looks ahead and adapts to changing demands. We are actively executing on that mandate.

As you know, historically electricity rates have not been extensively regulated. In the past, rates for electricity distributors were approved through Ontario Hydro.

By contrast, this year for the first time, rates for Ontario's utilities will be subjected to a basic review of revenue needs and a cost-allocation analysis.

Our goal is an effective and efficient electricity sector.

We regulate not only from the perspective of economic efficiency, but also from the perspective of protecting the interests of all electricity consumers.

We need to ensure regulatory certainty for those wishing to make investments and to ensure – for providers and consumers – that costs are recovered in a just and reasonable manner.

Have you considered why we need regulation at all?

Quite simply, because, in this sector most of the services and associated costs are delivered by monopolies.

Regulation thus protects all consumers by acting in areas in which there is an absence of market competitive forces to manage costs

We regulate – in the absence of market forces –gas and electricity utilities with total annual revenue requirements exceeding \$5.8 billion. This figure does not include the commodity price. If it did, the amount would be about double. These amounts together represent your costs as consumers.

This is why the Board's oversight as economic regulator is vital.

There is a cost to regulation that must be incurred to balance the interests of consumers and the needs of the energy industries.

We are working aggressively to reduce the overall costs of regulation, but without compromising our ability to carry out our mandate.

I've been asked who the Ontario Energy Board works for.

The answer is fairly straightforward. In essence, the OEB works for everyone in the electricity sector – consumers, distribution companies, transmission entities and generators.

We exercise a clear oversight role regarding rates, budgets, costs and fees of various entities – all of which ultimately end up being funded or paid by Ontario's electricity consumers.

That, in a nutshell, is why it is important to have an economic regulator in place.

In the past, energy regulation in Ontario seemed more clear-cut.

Now, however, there is a new electricity environment and our commitment in this new environment is to establish greater consistency and predictability in our processes. By doing so, we will help everyone better manage the new regulatory requirements they face.

Here's how we are attacking this challenge.

First, we are streamlining our processes.

For example, we are developing a rate-making approach that is less cumbersome and more standardized.

Second, we're communicating better, issuing regular bulletins, keeping all stakeholders informed.

And, finally, we are implementing new Performance Measures for Processing Applications.

All of these initiatives share a common goal – greater clarity and greater transparency.

The result will be greater timeliness of decisions and more certainty and clarity for the entities we regulate and their customers.

All of which should make planning easier and save everyone involved time and money.

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In sports they say you can't tell the players without a program. And it's just as true in today's electricity environment.

I'd like to help you understand the roles and responsibilities of the OEB and two of the entities we regulate – the Ontario Power Authority and the Independent Electricity System Operator.

Let's start with the OEB.

Besides our primary mandate of regulating utilities, we have other key responsibilities.

We have the legislative responsibility to develop new mechanisms for setting electricity prices, and we maintain regulatory oversight over other public agencies and companies.

Our mandate allows us to play a constructive role, coordinating responses and addressing emerging issues without waiting for all of the formal institutional arrangements to fall into place.

We have a great deal of power and responsibility in monitoring Ontario's competitive electricity market to ensure its efficiency, fairness, transparency and competitiveness.

This was increased in the past year with the transfer of the Market Surveillance Panel to the OEB from the Independent Electricity System Operator – the IESO.

The Panel monitors, investigates and reports on activities and behaviour in the IESO--administered markets in Ontario's electricity sector. This ensures participants do not abuse their market power.

The transfer of the Market Surveillance Panel to the OEB has helped to focus and clarify roles and responsibilities among the key agencies in the sector while separating market operation and oversight.

In addition – earlier this year – we took on responsibility for the regulation of the Ontario Power Authority and further regulatory responsibilities related to the IESO.

For its part, the OPA is responsible for long-term integrated power system planning and managing the supply, capacity and demand of electricity through procurement processes which have been approved by the OEB.

Within that mandate, the OPA develops forecasts for electricity demand and resource adequacy for the medium and long term and develops and contracts for new electricity resources through a competitive procurement process.

The OPA is also responsible for preparing the Integrated Power System Plan for generation, transmission, and conservation.

The responsibility at the OEB is to review the plan and ensure compliance with the Minister's directions, economic prudence and cost effectiveness.

One other important item: the OEB will also review the contract procurement process. Costs incurred under contracts entered into in accordance with these processes are recovered from consumers.

Finally, let me turn to the Independent Electricity System Operator – the entity responsible for the day-to-day operation of Ontario's electricity system.

The IESO operates independently as a non-profit corporation licensed by the Board.

Its mandate is to manage the province's power system, balancing the demand for electricity against available supply through the wholesale market and directing the flow of electricity across the transmission system.

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So those are the major players in today's electricity market. Each has its role to play and in fulfilling that role, each has an impact on consumers.

As regulator, the OEB has a very direct impact. And so to help you in your strategic planning, I'd like to give you some idea of the road ahead and what we're planning to do in the next year or so.

But first, let me briefly turn to the road already traveled.

We started fiscal 2004-2005 working on a number of high-profile key initiatives.

Among them:

- The Regulated Price Plan
- The Smart Meter Implementation Report
- The approval of new Distribution Rates for Electricity Distributors and
- The Natural Gas Forum Report

To date, all of these projects have either been completed or are now in subsequent implementation stages.

This would have been a satisfying year even if those initiatives were all that we had on our plate. But we also had one of the busiest years ever in terms of hearing applications – 398 in total – 300 electricity and 98 natural gas.

We also implemented the third stage of electricity rate adjustments for local distribution companies. This enabled them to recover revenues associated with the return on their equity investment and foregone during the electricity rate freeze.

As a part of this, we approved more than \$163 million in investments by local utilities for conservation activities over the next three years.

Another major accomplishment was the completion of the comprehensive report of the Natural Gas Forum, outlining our vision for a regulatory framework for the sector and laying the groundwork for improved efficiency and effectiveness in the regulation of natural gas.

Among its key recommendations were a multi-year and incentive rate-making plan – one that we believe will encourage gas distributors to uncover and implement efficiencies in their operations that will benefit both them and their customers.

Going forward, we will focus on an initiative recommended in our Natural Gas Forum report that will become one of the most important issues facing all of us in the coming years – the gas-electricity interface.

As the regulator of both the natural gas and electricity sectors, we are responsible for ensuring better coordination among system operations. That's vital, because as Ontario increases its reliance on gas-fired generation we must be certain the infrastructure exists to deliver that gas.

So we must clearly understand the issues in order to make sure the electricity and gas segments work hand-in-hand.

Specifically, we need to know what the new demands will be, the capacity of the current infrastructure and the services that will be required to meet this demand. And most importantly, if there are going to be new infrastructure and services, we need to know what they are going to cost and who should pay for them.

To get the answers to these questions, the Board established the Natural Gas Electricity Interface Review.

The comprehensive information flowing from this review will equip us to deal with the number of generation projects already announced and the applications that will be forthcoming.

With the move toward greater gas-fired generation already well underway, we are taking a proactive role on this front.

In the months ahead, we also will be holding hearings to determine Hydro One transmission rates for the years 2006, 2007 and 2008.

We will require Hydro One to establish their revenue requirements and set new transmission rates based on these. The OEB's goal, here, as in all its regulation, is to set rates that are just and reasonable.

During the hearing period and before the implementation of new rates, you will continue to pay the prevailing rates. However, there may be monies to be recovered by ratepayers in 2007, depending on the Board's findings and the new rate schedule.

For information purposes, we're also moving toward having electricity distributors file a cost-allocation study.

This will be the first time electricity rates have been subject to this kind of review in about 20 years. It will determine – among other things – the existence and extent of any cross-subsidization between customer rate classes.

Our first job is to get a clear picture of where things stand and this fall, we are developing a common methodology for doing cost allocation studies.

Then, next year, we will ask distributors to submit informational filings based on that methodology.

This way, we can establish the facts in order to decide to what extent, if any, the Board should move on adjusting rates among various customer classes - and how quickly.

We are working through these rate-making issues with three goals in mind.

First, to assess if the rates currently being charged reasonably reflect the costs of providing the service.

Second, to provide incentives to utilities to provide distribution services in the most efficient way possible.

And third, to reduce the need for annual rate setting.

Those final two points – providing incentives to focus on efficiencies and reducing the need for annual rate setting – will introduce stability to the sector.

We'll build on that next year, with a cost of service analysis, which will review the revenue requirements of close to 90 electricity distributors in Ontario.

The process will require that utilities provide a business case justification for the costs that you and other consumers must bear and will establish a predictable rate regime.

Then, starting in 2007, we plan to set rates by using an incentive mechanism applied to these rebased revenue requirements. Our goal will be to create a simple and straightforward rate adjustment mechanism.

Earlier, I mentioned that we approved more than \$163 million in investments by local utilities for conservation activities over the next three years.

As background, before the price freeze, electricity utilities were allowed to increase rates in three stages to achieve a specified rate of return during the 2001, 2002 and 2003 rate years.

The price freeze prevented collection of the third stage.

The Minister of Energy subsequently said electricity utilities could recover the third stage of rate increases provided they spent an amount equal to the actual rate increase on conservation initiatives.

When this third stage money was released, we were faced with an immediate policy goal of government that we had to implement rapidly.

This meant a great deal of conservation activity had to be approved very quickly.

We were able to provide guidance to electricity distributors on the kinds of initiatives that might be eligible and how their initiatives should be reported. But a more detailed framework – including the Total Resource Cost Guide – ended up coming into being after the fact.

So while we recognize this process was not perfect to begin with, we are continuing to refine it and put more rigour into it.

One of the questions the Board often hears is how can electricity consumers know that they are getting value for Board approved investments in conservation and demand management.

That's a valid question.

After all, this is a part of the costs you face.

And the answer is that we know we are getting value and that the costs you face are fair because we have put stringent controls in place at the front end of the process and we apply rigorous standards to our assessment at the back end.

This includes having an auditor review their books, the requirement that they file business cases for their conservation initiatives, the comprehensive evidence they are required to file, and the opportunity in the process for intervenors to review their submissions.

The utilities have to report on their conservation initiatives quarterly – and going forward we will require an annual report with cost-benefit analyses.

As an important part of these rigorous standards we released The Total Resource Cost Guide in September to assist local distribution companies in meeting the filing requirements for 2005 conservation and demand management plans approved by the Board.

The 2006 Electricity Distribution Rate Handbook Report also requires that local distributors, who plan to include additional expenditures on conservation in their 2006 rates, must file a cost-benefit analysis in advance of Board approval.

In this way, we are rigorously assessing conservation initiatives to ensure they deliver value for money for all consumers.

Let me sum up.

These are challenging times for all of us.

We face new risks – a rising cost for electricity and the need to ensure adequacy of supply – but also tremendous new opportunities.

The Board has focused on greater transparency, clarity and timeliness in our processes and made major strides on new initiatives including the Regulated Price Plan, the Smart Meter Implementation Report, new distribution rates for Electricity Distributors and the Natural Gas Forum.

These and our other initiatives will benefit those who operate in the energy sector and those, like you, who rely upon it.

And we're ensuring fairness in the rates Ontario consumers pay for electricity while balancing the industry's need for adequacy of returns.

Our goal is to build a strong, viable electricity sector in Ontario and to do so in a way that protects the interests of all who are affected by it – large business consumers such as your organizations, residential and other low-volume consumers, and our economy as a whole.

Ontario needs and Ontario deserves effective, efficient, fair and transparent regulation of its electricity sector.

At the OEB, we will make sure Ontario gets just that.

THANK YOU.