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<u>SPEECH</u>

ENERCOM 2006

February 28, 2006

Check Against Delivery

Thank you, Tom, and good afternoon everyone.

I'm glad to have the opportunity this afternoon to talk to you about the Ontario Energy Board and the role of economic regulation in the electricity sector.

I think that my experience in the electricity and the natural gas sectors has given me a good appreciation of the way that people look at the OEB.

As you know, there are concerns that regulation is too expensive and complex. That decisions take too long. As you also know, some consumer groups think the Board is too close to industry. Industry sometimes thinks that the Board takes more of a social policy role than it should, for example on environmental or low-income issues.

The OEB is sometimes accused of inconsistency or conversely, of taking a cookie cutter approach that doesn't take changing conditions into account. The questions are asked - does the Board understand when reliability issues should supersede economic ones or vice versa? Or when the regulatory compact must supersede market development or vice versa?

These are legitimate concerns.

But I also know that you understand that some of these frustrations stem from the profound changes in the industry itself.

All of us are living those changes, everyday. Many of us are leading them. And we are all struggling with them. With new rules. New expectations. New roles.

The industry has gone from the old government run model of Ontario Hydro to a more market-driven approach and part way back again. We've had Bill 210, Bill 23, Bill 4 and Bill 100.

Now we're in a hybrid model with some of the market model still in place but with the addition of such wrinkles as regulated price plans, market caps, and a new emphasis on conservation. And an alphabet soup of government entities: the IESO, the OPA, the SME and yes, the OEB.

Whether this hybrid evolves to markets or marches toward a fully regulated sector is still unknown. But what is clear is that we're not at the end yet - and will not be for several years.

What's made all of this upheaval even more challenging is that we're operating in a huge, dynamic province. Still the economic engine of the nation. With a corresponding need for energy.

That means we need more and more power. We need to replace and renew capacity.   More generation - both base load and peaking. More transmission to replace aging stock and carry a growing peak. And smart meters changing the world of distribution.

The challenge is to attract more investment - at a time when the competition for investment dollars has never been greater.

And if all of this wasn't challenging enough, we're faced with two public policy imperatives that fundamentally change how we do just about everything. Imperative one: move away from coal. And imperative two: develop a conservation culture.

So how does the OEB - the regulator - fit into all of this? Does the province even need a regulator? Why don't we just get out of the way and let those of you in the industry get on with the job of providing electricity to Ontario's homes and businesses?

Dangerous question! Given that the electricity distributors among you have just come through a comprehensive rate setting procedure for the first time, this may not be the best time to ask you!

So before I get more into why I think that the OEB has an important role in all this, I'll take a detour for a moment and talk about what we're doing to improve how we do our work.

Certainly we know the demands that being regulated place on businesses. For electricity distributors, we understand the anxiety about moving to an adjudicative process. And we know that industry resources are often limited and already strained.

A key part of our role is helping regulated companies manage the new regulatory requirements. We're doing this perhaps most fundamentally by developing a rate-making process that is less cumbersome and more standardized. Simpler to understand. With clear expectations, fair rules, a predictable process.

We must deliver regulation that is fair, regulation that is timely, regulation that is clear. Board policies must be unambiguous. These are the policies that serve as the underlying basis for our decision-making. These are the policies that set a context for your planning.

Providing timely regulation means becoming more efficient in how we operate. Last year, we handled 300 electricity, and 398 natural gas cases. That's why we are exploring ways of streamlining how we conduct hearings. We're experimenting with new procedural models. And we're moving, as much as possible, to generic hearings where common issues can be addressed and common precedents established.

So our goal really is not to make life more difficult for the companies we regulate!

Our role is to help direct the massive changes in our industry. Provide order. Predictability. Stability. Fairness. For those in the industry - and for consumers. To build - (and this is the balance) - an environment that encourages investment in the electricity sector and in the other businesses that make Ontario such a dynamic province.

It means ensuring that regulated companies get a fair return on your investment, with *only* the regulation that's necessary. But it also means ensuring, that consumers who purchase monopoly services are treated fairly - and that means providing *all* the regulation that's necessary.

Is there any inherent contradiction in this dynamic? Not in my mind. Without a fair return on investment, there will be less investment in the capacity and infrastructure Ontario consumers and Ontario businesses demand. Reliability will be compromised and consumers will suffer.

By the same token, if consumers felt that the public interest was not safeguarded; if they thought that rates could rise at the whim of distributors or of transmitters, the public outcry would lead to government intervention.

And, I would venture to say, that that intervention, political in nature, would not necessarily be made with a view to the long-term interest of the electricity needs of the province. After all, governments are more likely to respond to pressure to buffer customer prices than to bolster shareholder returns. This is not a criticism of government. In fact, it is because government recognizes this dynamic that they have created and strengthened an independent regulator.

The Board takes the view that there is not always, or even usually, one single "right" answer. There is a balance to be struck. And it's the Board's responsibility in many parts of the electricity sector to find that balance. The balance that constitutes the public's interest.

We understand that the lowest price is not always in the customers' best interest. We also understand that monopolies, even good intentioned ones – are not always incented to find efficiency and innovation.

Regulators, if we do our job well, provide incentives that allow utilities to make the most money at the lowest cost to consumers with the highest level of service.

Consumers can't get electricity service competitively. So regulation is required, to provide legitimacy that would otherwise come from the discipline of the market.

Every rate decision, every hearing related to your industry provides that legitimacy. It tells consumers and investors that rates are set by an independent body that understands these competing interests. An independent body that examines all the facts, gathers all the evidence and renders decisions in a transparent and public process.

For regulated companies and their customers that means credibility on the rates that are charged. And for the industry as a whole, it means that decisions on investment can be made with confidence, within a framework of stable, predictable regulation.

So while it may be tempting to say, "get rid of the regulator and leave us alone", consider:

- Who would ensure that investors receive a fair return?
- Who would judge what is fair for consumers?
- Who would deal with the issue of market power in transmission and generation?

And in a province built on the subsidization of electricity rates, who would oversee the redistribution of the burden from taxpayers to ratepayers?

We do all of these things.

Well, if that's our role, what are we doing about it? How do we go about creating a coherent framework that will allow all of the big pieces to fit together and function effectively?

We have a plan. And we have already moved on a number of fronts.

Those distributors among you who work regularly with the Board know we will reset commodity prices for electricity to take effect on May 1st. The new Regulated Price Plan is almost a year old. While not market pricing, it *is* over time recovering generating costs.

Beginning May 1st, the Regulated Price will change every six months to more closely keep pace with any significant variance between the price consumers have paid for their electricity and what it has cost to generate it. In addition, if the OPA RPP variance account reaches $160 million over or under what our forecast projected, RPP prices may also be adjusted.

The main focus of electricity utilities' work with the OEB is, of course, on distribution rates. Let me commend distributors for their patience and diligence as we have worked through the implementation of the RPP, distribution rates, and CDM programs together. We expect to start rendering our decisions on 2006 rate applications by late-March, to take effect on May 1st.

For the first time in some time, these rates will be based on up-to-date information and up-to-date utility revenue requirements. This will ensure that electricity distributors and their customers receive the fairest treatment possible

But, as you also know, major work is still ahead.

Those of you at yesterday's EDA Annual General Meeting would have heard our Chair, Howard Wetston, outline the Board's long-term plan for setting electricity distribution rates. He called it a "comprehensive approach to comprehensive change." We believe that this plan will improve the efficiency of our regulation and provide predictability for distributors and their customers.

In 2006, in preparation for 2007 rates, we will focus on three things:

- First we will review the cost of capital and rates of return for utilities;
- Second, we will develop a simple mechanism to annually adjust rates. The mechanism will provide efficiency incentives for utilities while allowing us to eliminate annual hearings. We will update all distributor's rates based on this mechanism in 2007. We call this mechanism, the 2nd Generation Incentive Rate Plan (the first, being a number of years ago.); and
- Finally in 2006, we will review the results of our study on the allocation of costs between distribution customers and in 2007 rates, implement what is material and prudent to do.

Besides adjusting all rates in 2007, and dealing with the most pressing cost allocation issues, we will be focusing on two key issues in preparation of 2008 rates:

- First, we will continue to work on what we call the Comparator and Cohorts project that was begun in the 2006. This project will provide comparative data which will allow us to screen and prioritize utilities for future rate review; and
- Second, we'll look at standards for depreciation, working capital and other elements of distribution utilities' revenue requirements that had been deferred from 2006.

2007 is the last year we expect that all of the distribution utilities will have their rates reset at the same time. After that we'll be taking a more selective approach to rate reviews.

In 2008, we expect about a third of LDCs to have new, re-based revenue requirements on which rates will be set, while the remainder will stay on the Second Generation Incentive Rate Mechanism. Their rates will be rebased in 2009 or 2010.

We also expect that the utilities which have their rates re-based in 2008 – and thereafter – will operate under what I will refer to as "Third Generation Incentive Rates.", a more comprehensive incentive mechanism. We will continue to review 1/3 of the utilities each year.

This staggered approach will allow us to consider what changes to rate design and rate classifications might result from the introduction of smart meters and the development of a culture of conservation.

That’s our plan for distribution rates.

For those among you focused on supply and generation, we have scheduled a proceeding to determine whether the Board should require the gas utilities to provide new rates and associated services for natural gas generators and whether the Board should forbear from regulating rates for gas storage services.

This is the next major step in our Natural Gas Electricity Interface Review. We launched the initiative last year because we recognized that this was going to be a critical issue as Ontario moves away from coal-fired generation toward more gas-fired generation.

This review is looking at issues surrounding the anticipated expansion of the natural gas network in Ontario. In particular, it explores the need for the expansion of the gas storage and transportation network, identifies issues associated with the allocation of costs of paying for this infrastructure and examines whether new rates need to be established to serve the needs of gas-fired generators.

In a comprehensive study prepared by our staff last fall, it was recommended that Union Gas and Enbridge Gas file proposed rates that would include a number of features that are required by generators but are not available now.

The Board also encourages the major pipelines – TransCanada Pipelines and Vector Pipelines – to file proposals for competing or complementary hourly services.

We recognize the critical role that storage will play in serving the new generators. So this proceeding will examine whether economic regulation of natural gas storage will continue or whether there is sufficient competition in storage so that the Board can forbear from regulating it.

We expect this proceeding to start mid-June.

So I've talked about how the OEB is improving delivery of its work. I've talked about why we need a regulator. And I've talked about some of the work we are doing. Now, I'd like to tell you about some of the challenges we face.

One is the impact of the introduction of 4 million smart residential meters on rates.

Distributors among you will have heard that you can choose whether to charge time of use prices for your customers who have interval or smart meters. Some of you have done that in pilot programs during the current year.

Time of Use RPP prices were to become mandatory, starting in May. However, the Board has proposed to extend the period of voluntary time of use pricing into next year. The government is of course preparing to introduce smart meters more broadly. It has proposed a smart meter entity that would ultimately manage smart meter data collection and storage for all distributors.

If the period of voluntary TOU pricing is not extended, electricity distributors would be required to make investments in their billing systems in order to handle Time of Use billing. Naturally we do not want distributors to establish interim smart meter billing systems that could become superfluous and lead to stranded costs that ratepayers would ultimately have to cover.

So we will update Time of Use RPP prices for the coming year but distributors will continue to have the option of implementing them.

I know that you realize that smart metering will change the way we consume and pay for electricity. What you may not have considered is that it also has the potential to revolutionize the way we set distribution rates. As I mentioned earlier, we need to consider carefully what rate structures best take advantage of the new metering and support conservation. The Board will focus on designing smart distribution rates that will fully leverage the capabilities of this new technology.

Smart meters then, is one challenge with an important goal – that of establishing a conservation culture for our province.

But our largest challenge is the scope and the complexity of the industry we regulate. One size regulation does not fit all. Let’s look at distribution, transmission and generation.

I have talked about how much we have to do in electricity distribution. But the cost of service model and the incentive rate model we are using are familiar ground for us. They are tried and true regulatory models.

Transmission is more complex for 2 reasons. Postage stamp rates and the growing requirement for capital projects for the primary purpose of increased reliability.

Generation on the other hand, and the transmission that serves it, is a very different story than distribution. This is the part of the industry which has been most buffeted by the political events of the last few years. Here, there is no “one” regulatory approach that applies uniformly across the sector.

Contracts between retailers or large consumers and merchant generators, for example, are essentially private contracts, with no regulatory or government involvement. But when it comes to Bruce contracts – or RFP contracts – the government is directly involved, on behalf of customers, with no or little regulatory oversight.

The case of government owned Ontario Power Generation is different again. Here the Board has been given another new mandate. By 2008 the Board must establish the means of setting prices for the heritage assets designated by the government.

And just to make things really interesting, the fuel of choice for new generation, at least in the short term, is natural gas. And the distribution and transmission of natural gas fall within another regulated industry altogether.

So you can see that trying to create codes, rules and processes - or to make decisions - involving generation is extremely complex. And the environment is continuing to evolve.
The various proceedings that touch on generation each bring their own unique challenges.

Here are some examples where we have no off-the-shelf regulatory model to guide us:

- a “leave to construct” application for transmission upgrades to serve new locations or sources of generation;
- a natural gas bypass application to fuel new generation;
- the Regulated Price Plan;
- the Standard Offer Program;
- approval of the budgets of the OPA and IESO; and
- review of the OPA’s Integrated Power System Plan - the IPSP.

With no one model to guide us, we have to return to two fundamental principles of economic regulation. First, to try and simulate true market conditions where they do not exist. And second, to provide transparency.

We do so informed both by public policy - whether legislation or otherwise - and by an understanding of the public interest involved.

One example where no regulatory model existed is the approval of the Integrated Power System Plan, the IPSP, currently being prepared by the OPA. Once completed, it will be our job to review the plan and approve it.

While the government had a number of objectives in creating the OPA, significant ones were power system planning and securing adequate supply for Ontario.

I don’t need to tell anyone in this room that electricity supply is at a low level in Ontario. This, combined with rising energy prices, environmental concerns and the time required for new power plants to be built, makes a comprehensive power system plan critical.

To achieve its goals related to adequacy and reliability of supply, we expect the plan will focus on the effective management of generation and transmission capacity and demand. This will include alternative and renewable supply. The plan will also address demand management.

The government sets the overarching goals and the OPA develops a plan to meet them. The government may also set out specific objectives relating to fuel mix and a number of other matters. The plan must also meet those objectives.

Our role at the OEB is not to second guess the planning decisions of the OPA. We are not planners. Our role is to review the plan to determine if it actually meets the government's goals and, most fundamentally, whether it does so in a way that is both economically prudent and cost effective.

Following our review, the Board may approve the IPSP or send it back to the OPA for further consideration. Once the IPSP is approved, our role is to facilitate its implementation.

The OPA will seek the Board's approval for the processes by which it plans to procure electricity supply, ensure capacity and guide demand management.

It is important that the IPSP be considered in a transparent and public way and we are thinking about how we can develop a process that gives the OPA and the public greater certainty about the criteria that we will use at the Board in reviewing the plan.

We are considering ways to expedite the approvals needed to implement the projects identified in the plan, such as transmission projects, as they come forward. While is it important that the integrity of the approvals process is maintained, we don't want to have redundancy in that process.

So to be an effective regulator – a responsive regulator – we need to be flexible. Use different strategies. And take different paths to the ultimate goal of economic efficiency.

Those are our challenges. There is much work still to do - but we have a clear plan for the road ahead. A plan that will provide sound economic regulation to this vital sector. A plan that will help meet Ontario's need for energy infrastructure and supply. A plan that will reduce both the regulatory burden on all of you as well as the regulatory barriers to conservation and demand management.

In implementing that plan, we will balance the needs of industry with the interests of consumers. Unreservedly. Unswervingly.

And while some would suggest that the speed and breadth of change in the electricity industry calls for a diminished role for the regulator, we hold a different view. And, according to the latest survey of our stakeholders, so do most of you.

We see our role as helping to enable change to occur in as orderly and responsible a way as possible - for the power industry and for consumers. The stakes are simply too high and the consequences too great not to do our job as thoroughly, professionally and fairly as possible.

We have all seen what happened in the past when the industry was whipsawed by attempts to rectify past mistakes. We think it's better to avoid mistakes in the first place. By balancing interests. Providing stability. Taking the longer view. Seeing the bigger picture.

Going back to my first comments, I understand and see the validity in some of the concerns raised about the OEB. We are working to improve. But I also believe that there has never been a greater need for a strong independent regulator in this sector than there is today. And that is what we strive to be.

Thank you.