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Ontario Energy Board

SPEECH

Ontario Energy Network

Luncheon Meeting

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Check Against Delivery

Good afternoon everyone. I am pleased to be back at the OEN and to have this opportunity to participate in your luncheon series.

While it's always a pleasure to join the OEN for lunch, it's particularly timely that we have this opportunity in light of the announcements which the OEB made last week.

As you know, we announced new electricity commodity prices for the Regulated Price Plan as well as distribution rates for most of the electricity utilities in Ontario.

Those joint announcements last week were an important milestone. With the comprehensive distribution rate review process that has just concluded, the journey to more stable economic regulation of the electricity distribution sector that started in 1999 –and stalled in 2002 - has resumed and is moving ahead.

Today, I will focus on rate-setting in general – the approach we are taking and the responsibilities we are exercising – and how the decisions we have just rendered lay the foundation for the way future rates will be set.

Now, last year, when I addressed you, the energy sector had embarked on an agenda of significant re-engineering. The government had set a new policy direction for the electricity sector. The Ontario Power Authority was establishing its new structure. New initiatives had been launched in the areas of conservation and demand management as well as renewable energy. Additional supply was being contracted.

The freeze on distribution rates was over. The government had allowed electricity distributors across the province to make rate applications to the Board. Perhaps most significantly, implementation began on the principle that consumers, long sheltered by rate freezes and subsidized commodity prices, had to pay their fair share of the costs of supplying and delivering their power.

Last week, much of that agenda came together with the Regulated Price Plan and distribution rate announcements, with important implications for public policy, the utilities and for us as the regulator. Today I want to talk about the rationale that has defined our approach to this work – so far – and into the future.

We have three goals. First, we want to regulate carefully and effectively in an era of rising energy prices. Second, we want to ensure that utilities are on a stable regulatory footing and this includes ensuring their costs of service are understood – and contained. Third, we are determined – as well as required under legislation - to promote economic efficiency in all aspects of the energy sector where we at the OEB have a role.

One of the key parts of our mandate at the OEB is to protect the public interest. Now the public interest is not a monolith and it involves a balance of many interests. Indeed one of the objects of regulation is balancing seemingly competing public policy considerations. And that was very much in our mind as we developed the RPP and distribution rates. In setting the rates of regulated utilities and the electricity prices for consumers, we wanted to ensure that what is charged is fair, equitable and sustainable.

Naturally, when consumers learn their bills may reflect average increases ranging from 3 per cent to as high as 15 percent, they will have questions. Consumers - understandably – want to know why they will be paying more.   And last week, the Board was emphatic that the largest driver, by far, of those higher bills is the cost of the electricity they consumed.

We have indicated clearly since last summer's prolonged heat wave, and since the hurricanes, which drove up natural gas prices, that consumers would have to pay the difference if it cost more to supply them than the regulated price covered.

Recovering last year's cost, as you know, accounts for about half of the increase in the Regulated Price Plan prices. The remaining half of the RPP price increase is the forecast cost of supplying electricity to RPP consumers over the next year. That's expected to be higher, as you also know, primarily due to the increased price of natural gas relative to last year's gas price forecast for the RPP.

So an unfortunate series of events, all leading to one result: higher than expected costs. And a stark reminder to all of us about the need for and the value of conservation.

That is the reality of a volatile energy sector - and it's not just in Ontario. Total bills are up in several jurisdictions because of commodity costs.

In Alberta, customers saw an increase of 17 to 18 per cent on their total bills on January 1st because of commodity prices alone, before transmission, distribution or other costs were included.

Nova Scotians are facing the second increase in electricity prices in a year. And it's much the same story in the United States. Maryland, for example, is facing total bill increases of 35 to 39 per cent from higher commodity costs alone. And in New Jersey, consumers will pay between 12 and 14 per cent more on their total bills, again because of commodity prices alone.

There appears to be a common thread running through electricity prices in North America: jurisdictions that don't have an abundance of hydroelectric power are facing higher electricity prices. And in almost every case, the Boards and Commissions are attributing those higher prices to the rising cost of fuel – both coal and natural gas.

Consistent with government policy, it is the OEB's responsibility to fully recover the money paid to generators for the power supplied to Regulated Price Plan consumers. At the same time, regulating in a time of rising energy prices also requires that we recognize the impact on consumers.

From the outset, the Board determined the inherent volatility in electricity prices would be levelled for low-volume consumers, and that blending any variances into future prices, was a better path than presenting them with a one-time lump sum adjustment.

From now on, the Regulated Price Plan builds in a review of prices every six months. Having given consumers a full year to adjust to the RPP prices, our structure now permits us to rebalance much earlier any financial shortfall – or surplus – that price volatility creates.

Of course there is criticism. Advocates of small businesses expressed concern these companies are not eligible for the seasonal consumption tiers that are offered to residential consumers.

We looked at this matter when we designed the plan. The fact is RPP business consumers generally consume more power overall and significantly above the winter and summer threshold amounts set by the OEB for residential consumers. So, a seasonal change in threshold would, in our opinion, have little effect.

Undoubtedly, there is always concern about the impact of higher electricity costs on those consumers least able to pay them. And we at the Board welcome the provincial government's initiative proposing an income-based program to assist low-income consumers. It is a more effective way to directly help those in greatest need, rather than subsidize the price for all consumers.

In our public communications last week we attempted to explain the reasons for the increases in rates and prices.

So naturally, consumers will be asking why the changes on bills will vary from place to place across Ontario. It may be hard for some consumers to understand why the bottom line cost to them should be higher than for those living in another part of the province.

They will ask why, here in Toronto, for example, consumers will see a distribution rate decrease on their bill while some consumers in other communities will see increases in double digits.

That point takes me to our second goal. That is – ensuring utilities are on a stable regulatory footing and that their costs are understood – and contained_ and that they are reasonable.

The reason for the total bill variations, of course, is the range of revenue requirements for each of the 79 electricity distributors which applied to the Board for rate changes. Some 17 of these companies actually applied for decreases while the majority sought increases. Those electricity distributors here today, of course, know the reasons well.

By way of example, some of the utilities had to resume pension contributions for their employees after a pension holiday from 1999 to 2003. There were rising regulatory costs - low-voltage charges and other fees for Ontario's electricity system that utilities collect from consumers but do not keep.

Some utilities needed to replace aging capital assets; for some, customer growth is driving new capital and operational spending. Different utilities had different revenue requirements, of course, at the time when their rates were frozen almost four years ago.

This is significant. Our decisions are the result of the first real cost of service review for LDCs in over five years. Some of you here today know first hand that when cost of service regulation commenced in electricity - it was based on utility data from 1999. So clearly, there was a lot of catching up to do.

Even so, with regard to the 62 utilities whose new distribution rates we approved last week, approximately 35 per cent of their residential consumers will see a decrease in distribution rates_ while the majority of other residential consumers will see an increase of less than 5 percent This is based on a residential consumption level of 1,000 kilowatt hours per month.

The cost of service review was important for a number of other reasons as well.

Recently the Supreme Court of Canada in the ATCO decision pertaining to the Alberta Energy and Utilities Board stated as follows:

"Moreover, although the Board may seem to possess a variety of powers and functions, the principal function of the Board in respect of public utilities, is the determination of rates. Its power to supervise the finances of these companies and their operations, although wide, is in practice incidental to fixing rates.

The goals of sustainability, equity and efficiency, which underlie the reasoning as to how rates are fixed, have resulted in an economic and social arrangement which ensures that all customers have access to the utility at a fair price – nothing more. The object of the statutes is to protect both the customer and the investor, and the Board's responsibility is to maintain a tariff that enhances the economic benefits to consumers and investors of the utility."

That is a recent and important comment about a Public Utility Board and its role with regard to utilities.

The OEB's cost of service review allowed us to discharge our responsibility to protect the consumer's interest. It gave us a much better appreciation for the realities faced by each utility. It identified areas of common opportunity for greater efficiencies among utilities. And it provided for a fair process for the utilities themselves. They had the opportunity to present their applications to the Board which made its decisions on the record before it.

What's more, the process was fully transparent, with clear guidelines, established by the Board, which outlined both what could - and could not - be recovered through rates.

This was also the first time that the RPP commodity prices were announced concurrently with distribution rates. This brought a very important benefit. Consumers had a better understanding of the bottom line impact on their total bill.

And by releasing the information about distribution rates at the same time, we have opened the door for the public to compare how one utility is doing vis a vis the others. That is important, because in a sector where many costs may be beyond the control of a utility, the real value-added comes through greater efficiencies.

It is interesting to note, again as we are here in Toronto, that Toronto Hydro–Electric System, in its public comment on our rates decision, credited amalgamation as a key driver of efficiencies and lower distribution rates. In that particular case, the OEB approved a decrease of 2.3 percent in its distribution rate.

Other utilities that amalgamated have attributed cost savings and lower rates to the same driver. And I also note that some utilities, in their public statements, have begun to compare their rate structure against the general range of total bill impacts for utilities that was announced last week.

While we have handled the applications of 79 utilities, each with its own particular financial circumstances, we standardized wherever we could. We developed common application criteria. We gave direction on how they could implement new conservation programs and how they could manage the costs of implementing smart meters.

Most importantly, we have completed the rebasing of revenue requirements for utilities serving virtually every consumer in every part of Ontario. We now have - and the public has – a far clearer picture of utilities' financial needs.

Which brings me to our third goal. And that is our determination – and our legislative obligation – to promote economic efficiency where we at the OEB have a role.

The OEB sees efficiency as a key method for utilities to manage costs and for the sector to reduce the impact of energy prices in the future, particularly in a time of rising prices.

For example, in the context of ratemaking, we believe that providing better inducements to maximize efficiencies and minimize costs benefits everyone. Consumers benefit from more efficient production and distribution. And producers and distributors benefit because they can keep more of the revenues realized through improved operations.

What criteria will we use? Let's look at electricity.

As I mentioned, the Board has a number of initiatives underway to examine what can drive greater efficiency in distribution. To that end, we are undertaking the first complete examination of cost allocation in electricity in some 20 years.

We have published a study of comparators and cohorts for the electricity distribution sector. This is the first step in a longer review to cluster utilities into preliminary "peer groups" based on similarities in their environmental and operational characteristics, permitting we hope better comparisons among them.

We have made it clear this is not to be a mechanism for the direct setting of rates. Nonetheless, this work can inform the rate setting methodology to be applied to a utility in the future.

The new incentive-based, multi-year rate structure we are developing also enables utilities to identify their own efficiencies. The rebasing we have just gone through should make way for more incremental rate changes.

Starting next year, we will have a simple rate adjustment mechanism for all electricity utilities. We can then begin to examine their operations, leveraging what we have learned through the cost allocation and other reviews.

Because incentive rate plans will be multi-year, they should create greater certainty and predictability for both the industry and consumers. By moving to a process where we stagger the review of distributors' rate applications, we won't have to handle as many as 87 applications at one time, or as we did last Wednesday, issue more than 60 decisions at once! That means less work for the utilities and more timely responses from the Board.

As you know, we are moving ahead with multi-year Incentive Rate Regulation for natural gas distributors.

Our purpose in setting electricity and natural gas distribution rates remains: to regulate effectively in the midst of rising prices, to ensure utilities are on a stable footing with their costs understood and contained and to promote economic efficiency wherever that is our role.

These are our aims because of the regulatory challenges we face.

We must continue to set prices under the RPP that better reflect the actual cost of supply. Doing so makes those who use energy more directly responsible for their consumption and more motivated to conserve a valuable commodity.

Requiring consumers to pay the true cost will always be a powerful conservation tool, as consumers see a direct and almost immediate effect on the bottom line of their bill.

We have to encourage an efficient level of investment in order to ensure reliable delivery of electricity and high levels of service.

And we must always be driven by our need as a regulator to achieve the best possible outcome for consumers.

In a sector as volatile as energy, interconnected systems and increasing demand in North America mean our province continually competes with other jurisdictions for supply – of natural gas or electricity. And powerful acts of nature – heat waves and devastating hurricanes – can trump all forecasting assumptions. Therefore, it is critical that we do a better job of controlling the costs we can.

For the OEB, striving for greater efficiencies and regulatory certainty is a key part of our commitment to consumers and to investors. Setting fair, equitable and sustainable rates. Realizing as many savings as we can. In everything we do.

Thank you.