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Ontario Energy Board

SPEECH

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Check Against Delivery

No doubt the economic success of Ontario has been due to the productivity and innovation of its industries - resource, manufacturing and processing companies such as yours.

It is a success that has also been built on a readily available and a relatively affordable supply of power.

Now, as your organization has made clear, your industries feel under threat. Adequacy of electricity supply is no longer a given and prices are rising.

In the bottom line world of business, power supply is a major driver of cost – and one of the inputs to your total costs that you believe is within the purview of your government and your provincial agencies to control – perhaps even mitigate.

You will know as the purchasers of power for your companies that the Ontario Energy Board does not establish the commodity price that you pay. That is determined on the open market or through the contracts you negotiate. We do set the distribution and transmission rates that you pay.

So how does the OEB relate to the business decisions you make about your power needs? Particularly today when you are here to discuss “initiatives and opportunities.”

I would say it is because the OEB is the economic regulator of the energy sector. In that role, it is our job to ensure that efficiency, which enables opportunity, is maximized.....and that risks are carefully calculated for any new energy initiative in which the Board has a role.

Nowhere is this truer than when it comes to our role in the consideration of the Integrated Power System Plan or IPSP.

We as a province have embarked on a major initiative over the next twenty years to identify electricity demand and develop a plan to ensure a sustainable and reliable supply.

The Ontario Power Authority, from whom I know you will be hearing later, is developing the power system plan. And it will come to the Ontario Energy Board later this year for review and approval.

You will have heard this month about our decisions..... establishing delivery rates for electricity utilities across Ontario as well as about the regulated price plan (RPP), commodity price we have set for residential and certain other low-volume consumers.

Less front page news is our regulation of major infrastructure investments – pipelines, transmission lines and some new responsibilities we are starting to carry out. Yet ultimately our work here will have a critical impact on your costs.

Now, even in a typical regulatory environment, regulation of the cost of large infrastructure investments is challenging.

Tradeoffs must always be made – the consumer seeks supply that is as low-cost and reliable as possible. The utility seeks long-term revenue stability and pricing to support investment.

What is normally a very difficult set of tradeoffs becomes much more complex when we are looking at a plan that takes us out twenty years. Three factors contribute to the difficulty we are facing.

First is the sheer enormity of the infrastructure that has to be developed.

The OPA in its advice last year to the government on the power supply needs for the province indicated the combination of demand growth and the retirement of generation capacity would create a gap of some 24,000 megawatts by the year 2025.

The OPA estimated the capital costs to meet supply capacity would be \$70 billion over twenty years. This is unprecedented in Ontario. I expect it is unprecedented elsewhere in Canada.

Secondly, there is an urgency to carrying out this infrastructure expansion that we have not faced before. Calls from the industry itself - and the analysis of the Independent Electricity System Operator - present Ontario's need not as an option but as an immediate imperative.

The general view is that we in Ontario should have moved to ensure sustainable and reliable supply years ago - that we have much catching up to do - and very little time.

The third complicating factor is that we are in a different public policy environment than we as a province have been in before.

Whether it is environmental assessments or whether it is fuel source issues and their perceived environmental impact, the reality is there is an important environmental context in which all these investments have to be made.

So environmental scrutiny is layered on the need for a massive number of investments, on an urgent basis, over the next two decades.

It is in that context that the OEB has to operate – and has its unique role. The Board is charged with examining the cost of this type of investment.

The Board recognizes time is of the essence. Yet, it cannot sit on the sidelines. The Board is required to take a careful look at the projects to make sure they will be implemented in as cost effective and efficient a manner as possible.

With respect to the Integrated Power System Plan, the OEB has a unique mandate. We have to review the plan for its prudence and its cost effectiveness. We will do this through the prism of achieving efficiency outcomes.

Now we do not want this review to go on forever. We are going to be timely in our review of the IPSP.

But we will look at the business case for the plan. We expect the OPA to demonstrate that its plan is a cost-effective way to meet the government's objectives for electricity supply.

And with the needs and the costs of the future in mind, we are also concentrating on where we can spur greater efficiency at this time – through the ongoing regulation of the energy sector.

It is fundamental to our legislated objectives in electricity to promote economic efficiency. We will look at the tools we can use to promote efficiency within the sector – to promote innovation, to lower costs of doing business and to support new investment.

This is why the OEB is focusing on what we call our efficiency agenda. It has three main elements: efficiency in the sector, efficiency in the regulation of the sector and efficiency in the OEB's own operations.

The first aspect is key. We have to focus on efficiency outcomes in the energy sector. This takes place in a number of areas.....and so we are retooling our regulatory approach to encourage efficiency.

To explain how, I will talk about the rate regulation of utilities.

When it comes to natural gas and electricity distribution and transmission, the approach of the Board and of many regulators has traditionally been to use a cost of service model of regulation.

Cost of service regulation has some advantages: transparency, and full hearing processes with the opportunity to scrutinize every investment by the utility.

At the same time, cost of service is not very results oriented. The costs that a utility incurs are passed through to customers, if they meet the test of prudence.

As a result, the Board has asked itself two fundamental questions:

- 1) Is the sector realizing its potential for efficiencies? And
- 2) Has our approach to regulation failed to provide the incentives for efficiency?

We have launched incentive regulation initiatives for both the natural gas and electricity sectors. At its core, incentive regulation is about reviewing a utility's rates by reference to what level of productivity improvements or efficiency gains it can realize.

Under incentive regulation, if a utility's costs go up, the utility has to manage that by reducing other costs. A rate increase is no longer the default position.

In the gas sector, we have gone a long way in setting a good base for gas utilities through decades of cost of service regulation. We are confident that the sector is strong and can produce improved results and innovation under incentive regulation.

In the electricity sector, we are accelerating the move to incentive regulation. We believe that capturing efficiency in both distribution and transmission is critical. There must be a focus on productivity as well as on recovering costs.

So we are going to develop an adjustment mechanism based on an expectation of productivity. And this adjustment mechanism will be used to set the rates. The productivity factor we will use to set rates under incentive regulation has yet to be determined. It will be the subject of stakeholder consultation.

And we will have to provide utilities with the flexibility to implement productivity gains that are achievable.

Unlike an unregulated company that can directly benefit from any savings it realizes, utilities regulated under cost of service may lose out. When they find ways to reduce their costs, their revenues go down in the future.

Consider, from your own experience, the extensive planning, the effort, the upheaval that can accompany business re-engineering in an organization – or a major investment in new technology.

Utilities are not encouraged to do that under the cost of service model. Why risk the upheaval with no sustained reward for achieving a more efficient result? That is what we want to change.

Our consideration of incentive regulation does not end with distribution and transmission of electricity and natural gas. We will assess whether it can apply to other areas as well. Let me give you one example.

On April 1, 2008, the OEB will begin to regulate for the first time the prescribed generating facilities of OPG. Among them are OPG nuclear generating stations and base load hydroelectric assets in the Niagara and St. Lawrence River regions.

As you know, we license generators in Ontario. But this is a new responsibility for us. We are already studying the most effective way to regulate OPG prices and have issued a notice with respect to this project.

We will consider cost of service regulation but not necessarily default to it. We will also look seriously at whether there are incentive mechanisms that we can use to encourage greater efficiency.

Our staff are developing a concept paper on the approach to OPG regulation for public comment in early May. We expect this will lead to the development of filing guidelines that are clear to both OPG and the parties who will want to participate in the rate regulation proceeding itself, which will be public.

We encourage the stakeholder community to get involved in the development of this approach. And we are pleased that AMPCO and a number of other organizations have already expressed interest in participating.

I have described the first element of our efficiency agenda. Now I will turn to the other two elements.

They are: the efficient use of our own regulatory processes - and maintaining efficiency in our own performance.

In terms of the efficiency of regulatory processes, we are paying particular attention to how efficiently we are facilitating infrastructure investment in Ontario.

We are looking at how we carry out our role in the context of the responsibilities of other agencies and institutions..... whether, for example, for environmental or municipal planning approvals.

We think about the following: Are we duplicating approval processes? Are we creating a risk of inconsistent decision making internally?

The drive toward efficiency around our own regulatory processes is really aimed at ensuring that there is an appropriate review of the cost of investment – that is the prudence of the costs and the allocation of those costs.

At the same time, we will avoid imposing an unnecessary regulatory burden for companies.

We know that regulation adds cost. The cost of conducting a hearing...The added costs that result from uncertainty...The cost of companies deferring investment. So we continually examine our processes to see how we can provide greater predictability for industry.

You will see this in our approach to the IPSP.

Once the IPSP establishes the need for new electricity supply and what major investment is required to obtain it – and once the OEB approves a final IPSP - our regulatory processes will turn to implementation.

Part of our mandate on the IPSP is to facilitate its implementation to ensure that the investment is made, that the costs are prudently incurred, and that they are properly allocated.

Therefore, we are putting a special focus on how we review proposals flowing out of the IPSP once it has been approved.

For example, if we approve specific transmission lines within the overall plan, Board processes will turn to getting those lines in place efficiently – without requiring the need for them to be proved once more.

We intend to make this clear to the OPA and to stakeholders as they prepare for the Board's review of the IPSP.

The third element of our efficiency agenda looks at our own performance.

We are about to publish our business plan for 2006-09 which has been approved by the Minister of Energy. For the third consecutive year, our plan outlines strategic objectives and clear performance measures.

Over the last year, we established new standards for processing applications. We now set out clear timelines for when applicants can expect to obtain a decision, whether on a new license or a rates case.

We too make a business case and report publicly on how we perform. After all, ratepayers ultimately bear the cost of our own operations.

So from a substantive basis, our focus on efficiency really comes down to ratepayer value. That is the case whether we look at the utility network industries, OPG generation, the major system plan for the province or our own operations as a regulator.

We want to enable opportunity through efficiency. Because efficient outcomes in the sector lead to a fair outcome for customers.

Borrowing from the language of the Supreme Court of Canada in the ATCO decision, we want rates that are sustainable, equitable and efficient and that are fair with respect to the prices for the services that you receive.

Thank You.