



Ontario Energy Board

Commission de l'énergie de l'Ontario

Stakeholder Information Session on Cost of Capital and Incentive Regulation

Board Staff Proposals
June 20, 2006

2nd Generation IRM – The Formula

$$\% \Delta P = K + \% \Delta GDPPI - X$$

Where:

- ΔP is the annual percentage change in price;
- K is the adjustment for cost of capital;
- $\Delta GDP-PI$ is the annual percentage change in GDP-PI; and
- X is the 1% required efficiency offset.

This formula would be used to adjust distribution rates in the years 2007, 2008, and 2009 (as applicable depending on which tranche the distributor is in).



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Integrating Cost of Capital and Incentive Regulation

- Distributors whose rates will be re-based will have the proposed cost of capital method applied to their revenue requirements.
- Until rates are re-based, the adjustment factor will be applied to adjust their revenue requirements: **The K-factor**.
 - for 2007 would numerically approximate the adjustment for changes in ROE and debt rates; and
 - for 2008 would numerically approximate the adjustment necessary to move a distributor from their current structure to the proposed common structure.
- These adjustments are designed to make distributors indifferent to the timing of their rate re-basing (and the implementation of full cost of capital adjustments).



2nd Generation IRM – Staff Proposal

Mechanism Element	2nd Generation
Adjustment for cost of capital (K-factor)	% based on change in ROE and cost of capital
Base	2006 EDR
Form	Price Cap
Term	<i>Up to 3 years (per Rate Plan)</i>
Price Escalator	GDP-PI
Efficiency Benefit to Consumers (X-factor)	1%
Contingencies (off ramps, Z-factors)	None
Earnings Sharing	None
Service Quality Requirements	To be enforceable as a condition of licence



Cost of Capital – Staff Proposal

	% of Rate Base	Return
Debt		
Long Term Debt	Actual percent of rate base	New 3 rd party – market rates New affiliate – riskless rate + transactions cost updated annually
Short-term Unfunded Debt	Match to working capital allowance	Board approved ST rate for deferral accounts (1 year)
Tot Debt	60% rate base	Wtd avg of LT and ST Debt rates
Equity		
Preferred	Actual to max 4%	Actual rate subject to Board approval
Common	36% rate base	Riskless rate + ERP updated annually
Tot Equity	40%	Wtd avg of preferred and ROE on common
Total	100%	Wtd avg of debt and equity rates





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Outstanding Issues?