Incentive Regulation Mechanisms for the Distribution Sector

Presentation by

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General Comments

- Hydro One supports the concept of incentive regulation for wires companies
- Much work is required to attain a truly incentive driven regulatory model in Ontario, but Hydro One agrees that the concepts proposed for 2nd Generation Incentive Regulation Mechanism (IRM) are a start
- Hydro One has expressed concerns in some areas of the IRM proposal, namely
  - No allowance for incremental capital growth
  - Lack of detail on 3rd Generation IRM
  - Lack of incentives in application of Service Quality Indicators
  - Lack of Implementation details for 2nd Generation IRM

Hydro One's Vision of IRM

- Inflation – An industry specific inflation adjuster is preferred as this provides better indication of the impact of inflation on industry's cost of operations
- Productivity – An industry specific X-factor is preferable since that recognizes individual utility accomplishments, and establishes the relativity between LDCs and to the industry as a whole
- Performance – Incentives to perform drive utility's behaviours that benefit the utility and its customers, but this requires the setting of penalties and rewards and the establishment of meaningful targets

Key Concerns - 1

- **Capital growth**
  - potential for LDCs to incur incremental costs during the IRM period to maintain reliability standards and incorporate new supply projects
  - solution is to add a capital adjustment factor to the proposed IRM model
- **3rd Generation IRM**
  - Need enduring incentive regulation model for the distribution sector to better drive utility performance
  - Experience from other jurisdictions shows that such a model will require significant data
  - Solution is to embark now on cooperative approach to design model and gather the necessary data

Key Concerns - 2

- **Performance incentives - SQI**
  - Performance is the heart and soul of incentive regulation
  - Experience from other jurisdictions shows that significant benefits accrue to customers, utilities and regulators
  - Improving performance requires the setting of appropriate targets that reflect customer values, and the implementation of appropriate penalties and rewards
  - This requires substantial supporting data and information
  - Suggest leaving implementation till 3rd Generation IRM

Proposal for Capital adjustment mechanism

- Hydro One has retained Elenchus Research Associates (ERA) to provide advice as to:
  - how this issue is handled in other jurisdictions, and
  - what might be an appropriate mechanism to account for this in the adjustment model should an LDC choose to do so
- ERA's research indicates that capital investment allowance is indeed an integral part of the incentive models in other jurisdictions
- ERA has developed an adjustment mechanism for dealing with capital additions and an example is provided in a separate presentation

Closing Remarks - 1

- Hydro One strongly believes in incentive regulation and the benefit of its implementation in Ontario, and to ensure success it believes that we should:
  - learn from others experience to pick the best elements and avoid repeating mistakes
  - use those jurisdictions where incentive regulation has clearly produced benefits
  - engage early and set up an industry group to develop the models
  - quickly identify the steps needed to jump from 2nd Generation IRM
  - engage all stakeholders to ensure success of an enduring incentive regulatory model

Closing Remarks - 2

- In the meantime Hydro One supports moving forward with the implementation of the 2nd Generation IRM and the interim use of generic (common) levels for inflation and productivity factors
- To ensure success the implementation process needs to be:
  - Transparent (easy to understand)
  - Mechanistic (easy to apply)
  - Happen fast as the IRM period is short