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Susan Frank

Vice President and Chief Regulatory Officer

By Facsimiles

June 28, 2006

Peter O'Dell
Assistant Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Mr. O'Dell

Re: EB-2006-0064 - OEB Staff Discussion Paper on Regulatory Options for Setting Payment Amounts for Ontario Power Generation Prescribed Generation Assets

Hydro One Networks Inc. (Hydro One) appreciates the opportunity to provide comments to assist the OEB (the Board) in this important matter. Hydro One is encouraged by the Board's staff proposal on an incentive based form of regulation for the Board's obligation in respect of regulating the payments for prescribed assets. Hydro One agrees that incentive regulation is a more efficient form of regulation that drives efficiency and streamlines the regulatory process.

Hydro One will limit its commentary to a general level that focuses on the key aspects of incentive regulation that the Board should take into consideration when setting the form of regulation. In this respect Hydro One makes the following comments:

- Incentive regulation necessitates that the details of the starting point for the incentive plan are appropriate and well understood by all parties to the proceeding. Accordingly, it is generally the practice that incentive regulation establish the initial base using a Cost of Service review. This provides the requisite level of detail to give the Regulator the assurance that costs are appropriate for the desired level of performance.
- If the starting point is inappropriate then the incentive plan will not yield the right signals for the Applicant to better manage its costs and drive efficiencies.
- Hydro One notes that the Board Staff propose to adopt the existing payment levels as a starting point for setting base payment levels after April 1, 2008 because that is the most effective way to begin this process given the timing concerns raised by some stakeholders¹.

¹ Staff Discussion Paper – Draft 2, June 20, 2006, Section 7.0.1, page 20

- Board Staff concerns about the ability of a Cost of Service proceeding to provide the answers as to the appropriateness and/or reasonableness of OPG's costs and earnings at this time, gives Hydro One concerns if incentive can proceed when there is no confidence that the underlying costs are understood.
- In Hydro One's view the matter of setting the appropriate level of payments for the prescribed assets is important. The existing payments are based on information that will be out of date by the time the Board begins to set the payment levels after April 1, 2008. Also, there are significant industry changes concerning OPG's assets that need to be considered in setting the succeeding payment levels, e.g. plans not to restart Pickering A units 2 and 3.
- Hydro One notes that the Board Staff propose the first proceeding for the setting of regulated payments to be no less that a year and that the Staff recognize that a multi-year incentive plan is preferable². Hydro One agrees that a multi-year incentive plan is preferable since that provides the Applicant with the best opportunity to drive efficiencies in managing its costs and assets. A one year incentive plan is unlikely to do so.
- The success of a multi-year incentive plan is very much dependent on the Regulator having access to the appropriate data and information in respect of the Applicant's expected costs during the incentive plan period as well as the supporting information to support the setting of the incentive mechanisms, i.e. the levels of inflation index and productivity factor.
- Hydro One is in favour of moving forward with a multi-year incentive plan for payments for the output from OPG's prescribed assets. In this respect it recommends that the Board encourage the Applicant to provide not only the historical costs but also a forecast of the expected costs during the plan period.
- Also, Hydro One encourages the Board to initiate studies to determine the benchmarks it would use for productivity factor adjustments as this is a crucial element in providing the appropriate signals to ensure efficiency and effective cost management.
- Hydro One believes that this is the most efficient manner in which to approach this matter so that the regulatory outcome provides the best possible signals to the Applicant to manage its assets and costs in a prudent and efficient manner that benefits the consumers of electricity in the Province.

Sincerely,



Susan Frank

² Staff Discussion Paper – Draft 2, June 20, 2006, Section 7.0.2, page 22, item (k).