

# Electricity Sector— Regulatory Oversight

## Background

Electricity is an essential commodity required for the well-being of Ontario's economy and the day-to-day activities of its citizens. That, along with the electricity sector's status as a near-monopoly, necessitated a system of oversight and regulation to ensure sustainability and cost-effectiveness in the generation and delivery of electricity to meet the needs of consumers, business, and industry. Ontario's electricity sector serves 4.7 million customers and is composed of several key entities, as illustrated in Figure 1.

The Ontario Energy Board (Board) was originally established in 1960 to set rates for the sale and storage of natural gas and to approve pipeline construction projects. Over time, its powers and responsibilities evolved through legislation. In 1973, it became responsible for reviewing and reporting to the Minister of Energy on electricity rates charged by the old Ontario Hydro, a function that it performed until the late 1990s, when Ontario Hydro was split into several successor companies.

Today, the Board still regulates the province's natural-gas sector, but devotes most of its time to oversight of the electricity sector in Ontario. The Board is required to oversee the sector through effective, fair, and transparent processes, in accord-

ance with the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*. The objectives of the Board include protecting the interests of consumers, facilitating the maintenance of a financially viable electricity sector, and promoting efficiency and cost-effectiveness in the sector. The Board's key functions with respect to fulfilling these objectives include:

- setting prices for electricity and its delivery;
- monitoring electricity markets and licensing participants;
- approving the annual expenditure and revenue requirements of the Ontario Power Authority and the Independent Electricity System Operator; and
- reviewing and setting regulatory policies.

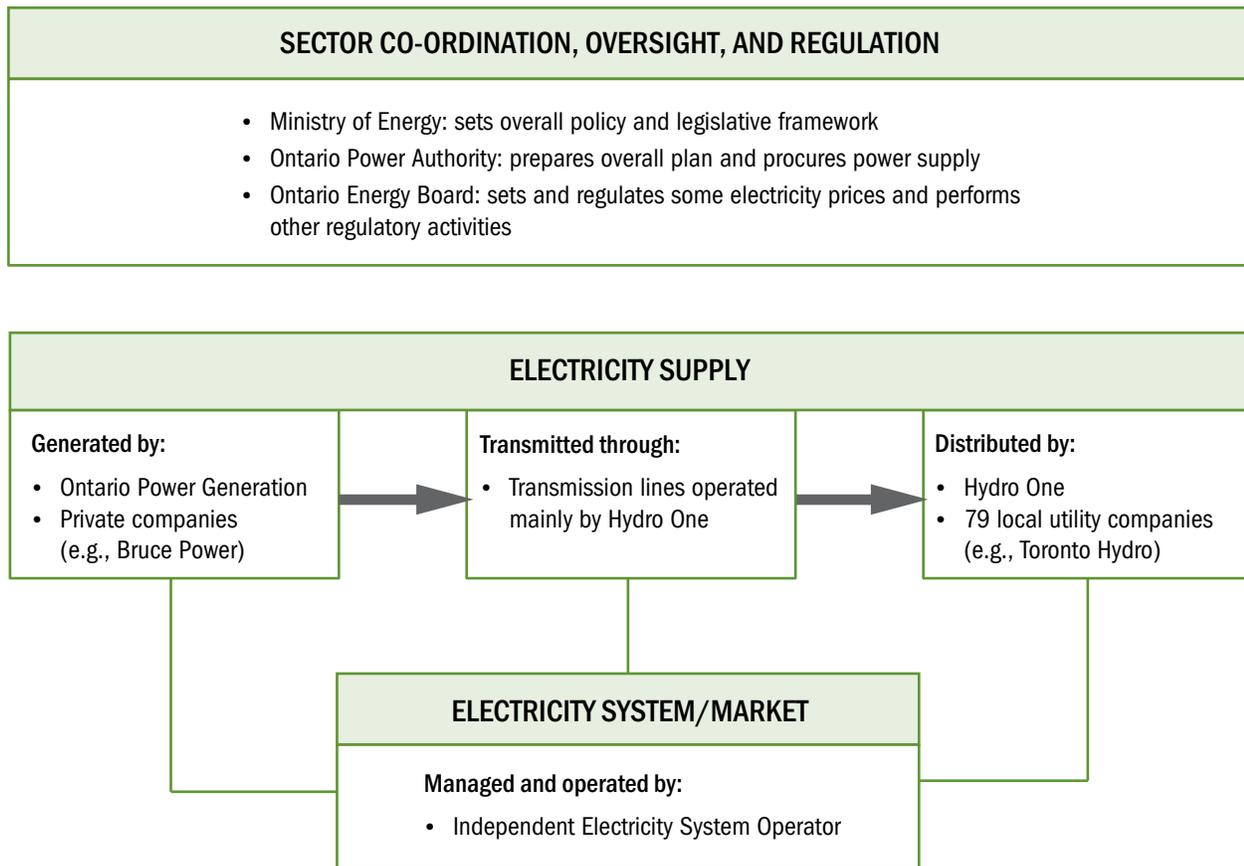
The Lieutenant Governor-in-Council appoints members to the Board. At the time of our fieldwork, the Board had eight members—seven full-time and one part-time—supported by a staff of about 170. Board operating costs were \$34.8 million in the 2010/11 fiscal year, with 80% of that paid by regulated electricity entities and 20% by the natural-gas sector.

## Audit Objective and Scope

The objective of our audit was to assess whether the Ontario Energy Board (Board) had adequate

**Figure 1: Selected Key Roles of Entities in Ontario's Electricity Sector**

Prepared by the Office of the Auditor General of Ontario



systems and procedures in place to protect the interests of electricity consumers and ensure that the electricity sector provides reliable and sustainable energy at a reasonable cost.

A secondary and equally important objective of our report was to look at the regulatory context of the charges on Ontario electricity bills and explain what these charges relate to. In keeping with our aim to inform readers in the simplest terms possible, we use the terms “ratepayer,” “customer,” and “consumer” interchangeably in this audit report.

The scope of our work included a review and analysis of rate applications and filing guidelines and interviews with members and appropriate staff at the Board. We also met with staff from other provincial agencies, including the Ministry of Energy, the Ontario Power Authority, the Independ-

ent Electricity System Operator, Ontario Power Generation, and Hydro One.

We also spoke with various participants and stakeholders in the electricity market, including local distribution companies and intervenors, to get their perspective on their interactions with the Board as well as its regulatory processes. Intervenors are individuals or groups representing consumers or other interested parties who actively advocate on their behalf in the hearing processes. In addition, we researched the operations of electricity regulators in other Canadian jurisdictions and engaged an independent consultant with expert knowledge of electricity regulation across Canada to assist us on an advisory basis. The Board follows a quasi-judicial process to make its rate-setting decisions. These decisions and the judgment of the Board panels were not a subject of this audit.

Before beginning our work, we developed audit criteria that we used to achieve our audit objective. These were discussed with and agreed to by the Board's senior management.

## Summary

A key role of the Ontario Energy Board (Board) as regulator of the electricity sector is to protect consumers while providing a reasonable rate of return for the industry by setting just and reasonable prices. This role is especially important given that electricity prices for the average consumer have increased 65% since the restructuring of the electricity sector in 1999, and prices are expected to rise another 46% in the next five years.

We observed that Board staff undertook to provide Board members with useful analyses and other information to assist them in their deliberations. As well, the Board has undertaken a number of initiatives to educate consumers about the charges on their electricity bills, including an on-line bill calculator that has garnered industry recognition. However, we identified certain factors that could limit the Board's ability to perform its regulatory duties to the extent that consumers and the electricity sector might reasonably expect. Among our observations:

- The Board is not responsible for ensuring that electricity bills as a whole are just and reasonable, insofar as its jurisdiction extends to only about half of the total charges on a typical bill. The Board's role is largely limited to setting rates for the nuclear power and some of the hydro power produced by Ontario Power Generation (OPG), along with transmission, distribution, and certain other charges. The other half of power bills is based on government policy decisions over which the Board has no say. For example:
  - About 50% of the electricity sold to residential customers comes from suppliers

who signed long-term contracts with the government or the Ontario Power Authority, and the price of this power accounts for 65% of the cost of the electricity component on the typical bill. However, the Board has no regulatory oversight role with respect to this portion of the electricity charge. Rather, it regulates only electricity from certain OPG nuclear and hydro plants, which constitutes about one-third of the electricity charges on a typical bill.

- The debt retirement charge that consumers pay each month was originally created by the government in 1999 to help pay off the estimated "residual stranded debt" of \$7.8 billion that remained after the old Ontario Hydro was broken up. The Board has no oversight role with respect to this charge or how long it is to be applied to consumers' electricity bills.
- The Board has regulatory oversight over only about \$190 million of the close to \$900 million collected from ratepayers to administer and operate the electricity market and to meet other legislated requirements.
- In areas where it does have jurisdiction, the Board sets rates using a quasi-judicial process that requires utilities and other regulated entities, such as OPG and Hydro One, to justify any proposed rate increases in a public hearing. Many small and mid-sized utilities said that this process costs ratepayers an average of between \$100,000 and \$250,000 per application—or as much as half the revenue increase sought in the first place by these utilities. These costs are generally incurred once every four years and are recovered from consumers over the next four-year period.
- Individuals or organizations wishing to participate in the hearings on behalf of consumers can obtain intervenor status, and can qualify for reimbursement of their expenses by utilities and other regulated entities. However,

many of these utilities and other regulated entities cited the high cost of providing the large quantities of detailed information requested by intervenors and called for better co-ordination by the Board to manage these requests.

- In monitoring utilities for compliance with its guidelines and reporting requirements, the Board identified a number of significant deficiencies in the utilities' record-keeping and reporting practices. This could be an indication of inaccuracies in the information the Board uses to make decisions. However, the Board does not consistently follow up to ensure that the noted deficiencies were corrected by the utilities.
- Consumers can purchase their electricity either through their utility at the Regulated Price Plan prices set by the Board or through an electricity retailer at a price set by the retailer. Some 15% of residential customers, looking for price protection and stability on their power bills, signed fixed-price contracts with electricity retailers. However, we found that these consumers could be paying anywhere from 35% to 65% more for their electricity than they would pay had they not signed those contracts. In the last five years, the Board has received more than 17,000 complaints from the public; the overwhelming majority of them have been against electricity retailers. Issues included misrepresentation by sales agents and even forgery of signatures on the contracts. Although the Board follows up on complaints, the number of enforcement actions taken against retailers has been very limited.
- The Board has a well-structured performance-reporting process, but its performance measures need to be more results-based rather than process-oriented.

## Detailed Audit Observations

### OVERVIEW OF THE ONTARIO ENERGY BOARD AND THE ELECTRICITY SECTOR

The Ontario Energy Board (Board) was founded in 1960 to regulate the natural-gas sector in Ontario. In 1973, its role was expanded to include the electricity sector. A significant shift in the Board's mandate came when the government enacted the *Energy Competition Act, 1998 (Act)*, which broke up the old Ontario Hydro into several successor companies and sought to introduce competition to the electricity sector.

The Act mandated the Board to protect the interests of consumers while simultaneously ensuring a financially viable electricity industry. More detail about legislative and policy changes since 1999, and the impact of these changes on the electricity sector and the Board, is shown in Figure 2.

### IMPACT ON CONSUMERS

Ontario consumers have experienced significant electricity-cost increases over the past decade as a result of major changes to the province's electricity sector. Since 1999, the average residential consumer using 800 kilowatt hours (kWh) per month has seen a 65% increase in his or her power bill. The Ministry of Energy predicted in its 2010 Long-term Energy Plan that residential electricity bills will rise another 46% over the next five years to help pay for upgrades to Ontario's existing nuclear and natural-gas generation capacity and its transmission and distribution facilities, and to help finance new and cleaner renewable-energy generation.

A summary of the impact on energy bills of the major policy changes since 1999 is shown in Figure 3.

### UNDERSTANDING ELECTRICITY BILLS

In 2004, the government passed a regulation requiring electricity bills for low-volume consumers

**Figure 2: Government Legislation and Policy Changes in the Electricity Sector, 1998–2011**

Prepared by the Office of the Auditor General of Ontario

Legislation/Policy and Year	Impact
<i>Energy Competition Act, 1998</i>	<ul style="list-style-type: none"> <li>• Breaks up Ontario Hydro into several companies</li> <li>• Ontario Energy Board (Board) assumes responsibility for regulating three Ontario Hydro successor companies and local distribution companies</li> </ul>
<i>Electricity Pricing, Conservation and Supply Act, 2002</i>	<ul style="list-style-type: none"> <li>• Caps electricity price at 4.3¢/kWh, for two years, effective May 1, 2002</li> <li>• Freezes transmission and distribution rates until at least May 1, 2006</li> </ul>
<i>Ontario Energy Board Consumer Protection and Governance Act, 2003</i>	<ul style="list-style-type: none"> <li>• Creates a management committee to oversee Board activities</li> <li>• Strengthens Board powers to protect and educate consumers</li> </ul>
<i>Ontario Energy Board Amendment Act (Electricity Pricing), 2003</i>	<ul style="list-style-type: none"> <li>• Replaces 4.3¢/kWh price cap as of April 1, 2004, with 4.7¢/kWh for the first 750 kWh/month, and 5.5¢/kWh beyond 750 kWh/month</li> <li>• Allows local distribution companies to recoup costs by lifting freeze imposed by <i>Electricity Pricing, Conservation and Supply Act, 2002</i></li> </ul>
<i>Electricity Restructuring Act, 2004</i>	<ul style="list-style-type: none"> <li>• Amends <i>Ontario Energy Board Act, 1998</i> and <i>Electricity Act, 1998</i></li> <li>• Board assumes responsibility for Market Surveillance Panel</li> <li>• Establishes Ontario Power Authority (OPA) to ensure adequate, reliable, and secure electricity supply in Ontario</li> </ul>
Minister's Directive to Board (2004)	<ul style="list-style-type: none"> <li>• Develops smart-meter implementation plan</li> </ul>
Minister's Directive to OPA (2006)	<ul style="list-style-type: none"> <li>• Develops plan to replace coal-fired generation with cleaner sources as soon as possible</li> </ul>
<i>Green Energy and Green Economy Act, 2009</i>	<ul style="list-style-type: none"> <li>• Establishes responsibility for Board and other entities to achieve objectives of conservation, promotion of renewable energy, and technological innovation</li> </ul>
Harmonized Sales Tax (2010)	<ul style="list-style-type: none"> <li>• Adds 8% to total electricity bill effective July 1, 2010</li> </ul>
<i>Energy Consumer Protection Act, 2010</i>	<ul style="list-style-type: none"> <li>• Requires that Ontarians be provided with the information they need about electricity contracts and prices and that consumers be protected by fair business practices effective January 1, 2011</li> </ul>
Ontario Clean Energy Benefit (2011)	<ul style="list-style-type: none"> <li>• 10% discount on electricity bill for five years from January 1, 2011</li> </ul>

(residential and small-business consumers) to show four categories of charges: Electricity, Delivery, Regulatory, and Debt Retirement. The regulation also specifies how these categories of charges are to be explained on or with the bill. A sample bill for an average Toronto Hydro residential consumer with an 800 kWh monthly consumption (or about 830 kWh when adjustment due to loss in the distribution system is included) is shown in Figure 4.

The various charges break down as follows:

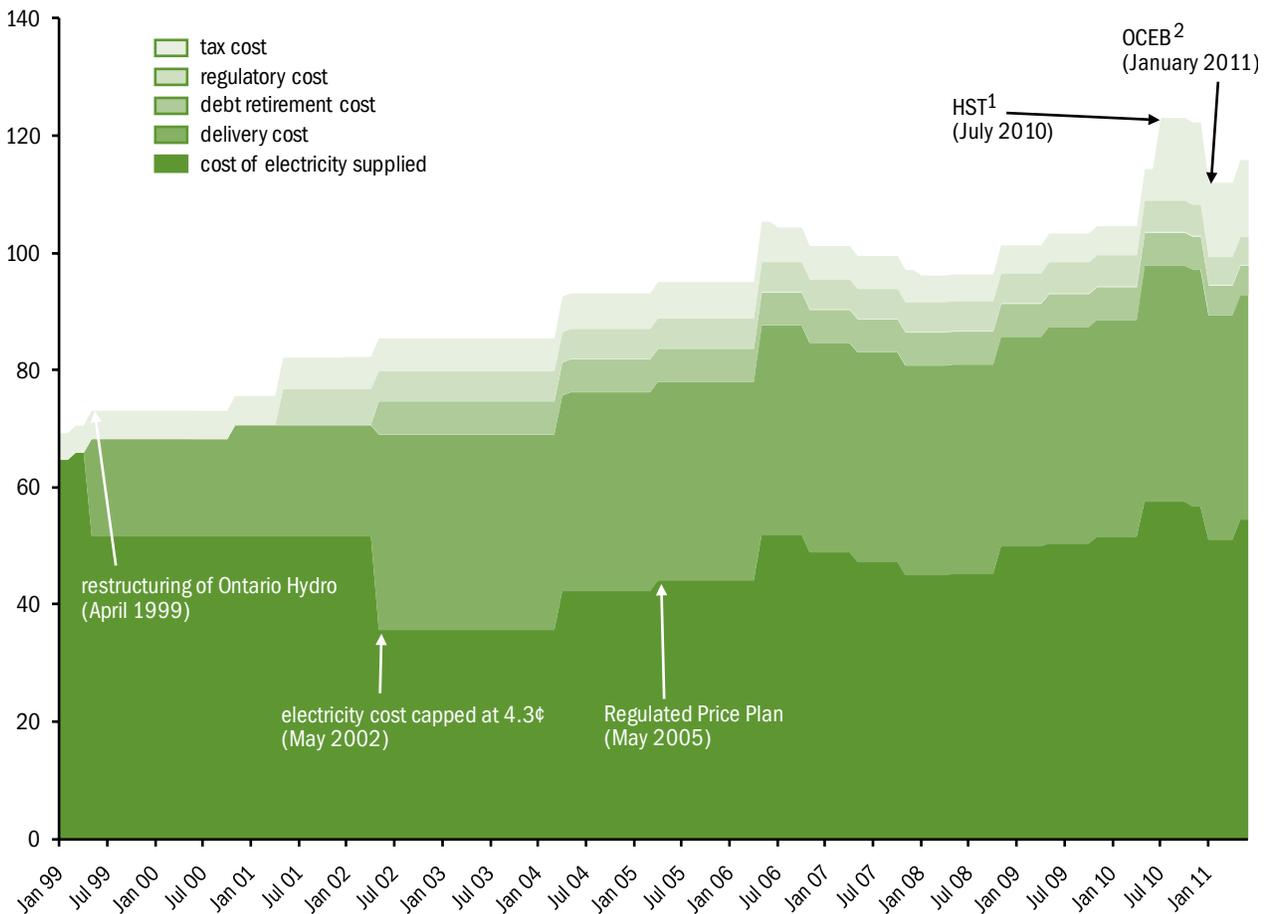
- “Electricity” is the cost of the actual power consumed, which the province obtains primarily from Ontario Power Generation (OPG) and from suppliers who have signed contracts with the government or the Ontario Power Authority (OPA). The presentation of this

charge on bills varies, depending on whether the consumer buys from a utility or has signed a contract with a retailer. In Ontario, 85% of residential consumers purchase their electricity from local utilities and pay what is known as Regulated Price Plan (RPP) prices, while the remaining 15% purchase their electricity from electricity retailers.

RPP prices are set by the Board. Time-of-use RPP prices—where the price of electricity varies depending on when during the day the consumer uses power—apply if the consumer's utility has migrated to time-of-use billing. Otherwise, two-tiered RPP pricing—where the price of electricity varies depending

**Figure 3: Electricity Costs for Average Toronto Consumer Using 800 kWh of Electricity a Month, 1999–2011 (\$)**

Prepared by the Office of the Auditor General of Ontario



1. Harmonized Sales Tax: additional 8%

2. Ontario Clean Energy Benefit: 10% discount over the next five years

on how much power the consumer uses per month—applies.

Consumers with retail contracts pay the price stipulated in their contracts plus a Global Adjustment—mostly consisting of the difference between the market price and the price paid to generators as set by the Board for OPG or under contract with the government or the OPA. The Global Adjustment has been rising steadily over the last few years and is expected to continue to rise as a result of investments in existing generation capacity and renewable power generation. The RPP prices calculated by the Board include a forecast of the Global Adjustment. RPP consumers

therefore do not see a separate Global Adjustment charge on their electricity bills.

- “Delivery” is the cost of transmitting and distributing electricity from the generator to the consumer. Transmission is handled primarily by Hydro One over high-voltage wires connecting generators across the province to local utilities, which handle distribution to homes and businesses. Delivery rates vary across the province, with rural and remote locations generally paying higher rates.
- “Regulatory” is the cost to operate the electricity system and maintain the reliability of the provincial grid. This includes the operational costs of the Independent Electricity System

**Figure 4: Monthly Electricity Bill Comparison (Regulated Price Plan vs. Retail Contract Consumer)**

Source of data: Ontario Energy Board website, August 2011

Monthly Bill Statement	
Toronto Hydro-Electric System Limited - Main	
<b>Account Number:</b> 000 000 000 000 0000	
<b>Meter Number:</b> 00000000	
Your Electricity Charges	
<b>Electricity</b> (what is this charge?)	
Off-Peak @ 5.900 ¢/kWh	31.34
Mid-Peak @ 8.900 ¢/kWh	13.30
On-Peak @ 10.700 ¢/kWh	15.99
<b>Delivery</b> (what is this charge?) 40.50	
<b>Regulatory Charges</b> (what is this charge?) 5.95	
<b>Debt Retirement Charge</b> (what is this charge?) 5.60	
<b>Total Electricity Charges</b>	<b>\$112.68</b>
HST	14.65
<b>Subtotal</b>	<b>\$127.33</b>
<b>Ontario Clean Energy Benefit (-10%)</b> (what is this?)	(-12.73)
<b>Total Amount</b>	<b>\$114.60</b>

Monthly Bill Statement	
Electricity Retail Contract	
<b>Account Number:</b> 000 000 000 000 0000	
<b>Meter Number:</b> 00000000	
Your Electricity Charges	
<b>Electricity</b> (what is this charge?)	
Supplied By: your selected retail company Phone No.: 000.000.0000	
Global Adjustment (what is this charge?)	30.80
800 kWh @ 8 ¢/kWh	66.41
<b>Delivery</b> (what is this charge?) 40.50	
<b>Regulatory Charges</b> (what is this charge?) 5.70	
<b>Debt Retirement Charge</b> (what is this charge?) 5.60	
<b>Total Electricity Charges</b>	<b>\$149.01</b>
HST	19.37
<b>Subtotal</b>	<b>\$168.38</b>
<b>Ontario Clean Energy Benefit (-10%)</b> (what is this?)	(-16.84)
<b>Total Amount</b>	<b>\$151.54</b>

Operator (IESO) and the OPA, charges to partly offset the higher cost of providing electricity to rural and/or remote areas, and a charge to cover administrative costs of local utilities.

- “Debt Retirement Charge” is mandated by the government to help pay off the residual stranded debt of the old Ontario Hydro that could not be funded by other revenues. This charge will be collected from consumers until, in the opinion of the Minister of Finance, the debt has been eliminated.
- “Ontario Clean Energy Benefit” is a 10% discount on the total electricity bill that applies for five years starting January 1, 2011, to help offset price increases. The annual cost of this rebate is estimated at \$1.1 billion and is

funded by taxpayers through the Ministry of Energy’s annual appropriation.

## REGULATORY OVERSIGHT OF ELECTRICITY

The Ontario Energy Board (Board) is mandated to regulate the electricity sector in Ontario. However, its authority to review and regulate is limited to only about half the charges on the average residential or small-business bill, as illustrated in Figure 5.

### What the Board Does—and Does Not—Regulate

For the electricity component of a bill, the Board regulates the cost of power from certain OPG assets

such as nuclear and large hydro generating plants; however, the costs of power from OPG's other generation assets, as well as the costs of electricity supplied under contracts negotiated by the OPA and under power agreements with non-utility suppliers, are not subject to Board regulation. Every six months, the Board reviews the RPP electricity prices being paid by residential and small-business consumers and, if necessary, adjusts them to ensure that they reflect the cost of supplying electricity to those consumers.

The Board regulates the entire delivery component (that is, all of the transmission and distribution charges).

For the regulatory component, the Board regulates the operational costs of the IESO and the OPA, but there are other regulatory costs that it does not regulate.

The debt retirement charge is not subject to Board regulation.

### CHARGES SUBJECT TO REGULATORY OVERSIGHT

The old Ontario Hydro followed a relatively straightforward rate-setting process, calculating rates on a cost-recovery basis. It was not required to consider whether the costs incurred were reasonable or whether all costs were being billed to

consumers over an appropriate time period. The current system is more complicated. It requires that the Board set just and reasonable rates, with the result that the Board's information needs are more complex than those during the time of the old Ontario Hydro. Such rate-setting oversight involves assessing projected operating costs as well as recovering the cost of capital investments.

In the case of such infrastructure investments, the Board must determine whether these capital costs are fairly distributed between current and future consumers. It must also examine the costs of building or acquiring different types of electricity assets, and how long they will last. Regulated entities investing in such assets are entitled to a reasonable rate of return on their investment, and their returns are largely guaranteed once the Board approves their rates. For proposed capital investments, the Board must satisfy itself that the investments are needed. For example, is more investment required to maintain or enhance the system's reliability, when should new electricity generators be connected to the transmission system given forecasted future demand, and how should new initiatives such as the smart grid be implemented?

In fulfilling its rate-setting role, the Board follows a quasi-judicial process that is open to public participation. The Board advised us that it takes seriously the need for its adjudication decisions to

**Figure 5: Percentage of Electricity Bill Regulated by the Board, 2010 (average utility customer consuming 800 kWh a month at a cost of \$116) (%)**

Prepared by the Office of the Auditor General of Ontario

Bill Component	Costs Included	Regulated by Board	Not Regulated by Board	Portion of Bill
electricity	OPG generation assets, Non-Utility Generators (NUGs), OPA Renewable and other contracts	19	37	56
delivery	distribution and transmission	33	—	33
regulatory	wholesale market service charge, rural remote rate protection, IESO and OPA operating costs, and other charges	3	3	6
DRC	debt retirement charge	—	5	5
<b>Electricity cost before tax and benefit</b>		<b>55</b>	<b>45</b>	<b>100</b>
HST	Harmonized Sales Tax (13%) effective July 2010			
OCEB	Ontario Clean Energy Benefit (-10%) reduction on bill effective January 2011			

be made—and to be seen to be made—independently and impartially. The hearing process must comply with statutory requirements and principles of administrative law.

The regulatory process the Board follows is summarized in Figure 6.

Applicants, including utilities, OPG, and Hydro One, are expected to provide sufficient detail about proposed rate increases to enable the Board to determine whether the proposed rates are just and reasonable, although the onus is on applicants to prove that the proposed increases are justified. In considering such applications, the Board examines the applicant’s forecasts, along with financial and operational details, in a public forum. Applicants must provide documentation to cover current operations and historical data going back three years. The Board aims to set rates that allow applicants to recover their ongoing operating costs and the cost

of capital expenditures over an appropriate time period and earn a reasonable rate of return. The rate of return set by the Board for 2011 was 9.58%.

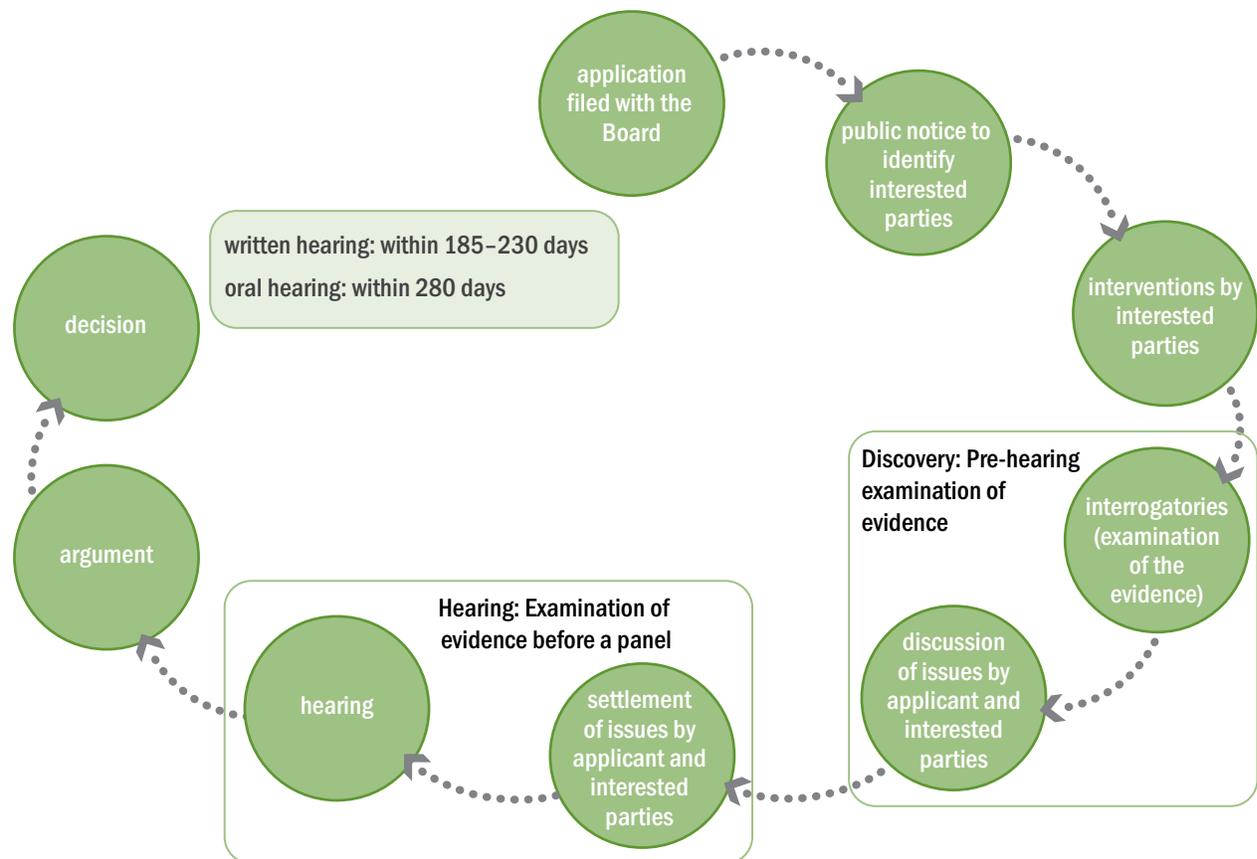
Rates and fees subject to regulation include the rate charged for power supplied by OPG’s nuclear and large hydro generating assets, IESO and OPA operating costs, and transmission and distribution charges.

Rates for distribution costs are set using a combination of two mechanisms, as follows:

- The Cost of Service (COS) review sets rates for each distributor every four years or whenever the Board deems necessary (the Board has also allowed distributors to apply for more frequent COS reviews). COS applications are detailed and require documentation and calculations supporting the applicant’s electricity demand forecasts, estimates of the cost to service this demand, and past operating revenue

**Figure 6: Rate-setting Adjudication Process at the Board**

Source of data: Ontario Energy Board



and costs. A typical COS application runs to between 800 and 1,200 pages for a small to mid-sized local utility.

- The Incentive Regulation Mechanism (IRM) is an annual process that, between COS reviews, adjusts rates. It does so by applying a formula that considers inflation and productivity. Other factors may also be considered in the annual rate adjustment on a case-by-case basis. A typical IRM application for a small to mid-sized utility would require 80 to 100 pages of documents, including a summary with all requested rate adjustments, the models used to calculate the new rates, and a list of all current rates and charges.

On average, the Board adjudicates 20 COS applications and 60 IRM applications each year for Ontario's 80 distribution utilities.

The rates for transmission (primarily through Hydro One) and OPG payments for its regulated assets are set using the COS mechanism, and the IESO and OPA operating costs are subject to annual reviews by the Board.

As mentioned in our Audit Objective and Scope section, the individual Board decisions were not a focus of this audit, but we did observe that Board staff undertook to provide Board members with useful analyses and input to assist them with their deliberations.

### Complexity and Cost of Regulatory Oversight

Regardless of their size, all utilities are expected to meet the same filing guidelines. We found that this "one-size-fits-all" approach to rate-setting is a costly exercise that seems to focus as much on getting complete records into the public forum as on ensuring that the process has the information it needs to set just and reasonable rates. In addition, all costs of the regulatory process must be recovered from consumers through rate increases.

The Board cited customer-service-quality statistics for utilities that had gone through COS

reviews in 2008 or 2009 as evidence that utilities can cope with these requirements. However, staff of distribution utilities told us that meeting filing requirements required significant overtime. In addition, small and mid-sized utilities often had to engage costly external consultants to help complete their applications. Meeting the documentation requirements has been particularly challenging for the smaller utilities, some of which have fewer than 2,000 consumers and only five or fewer administrative staff. We further noted that the Board used to provide utilities with rate-application templates but no longer does so, providing them instead with models, suggested data formats, and filing guidelines, which, we were advised, were more complicated to use than the templates.

The average cost of filing a COS rate application is approximately \$100,000 for a small utility and \$250,000 for a mid-sized one, representing between 15% and 55% of the revenue increase these utilities are seeking in the first place. Most of these costs relate to consulting and legal services to assist with preparation of evidence to meet Board filing requirements, to answer questions from intervenors, and to pay intervenor billings. The cost of a rate application for the biggest utilities can run to \$1 million or more. The impact of this cost ranges from about \$1 per consumer for the largest utilities to as much as \$40 per consumer for the smaller ones. These amounts are recovered from ratepayers over a four-year period.

The Board had not analyzed the cost/benefit impact of its current regulatory requirements in protecting consumers. The Board did acknowledge the problems faced by smaller utilities in dealing with filing requirements but said that every consumer in Ontario deserved the same level of protection.

### Intervenors

Intervenors are individuals or groups of individuals who actively participate in the regulatory processes. Intervenors may include consumers, consumer and trade associations, environmental groups, public

interest groups, and affected individuals. The costs of their participation in the regulatory process are borne by the regulated entities and, eventually, consumers. Intervenor costs can range from \$10,000 for a small utility with one intervenor to over \$1 million for a larger applicant with more intervenors.

Prior to the start of proceedings, intervenors may apply to the Board to have their costs paid by the rate applicants. A Board panel rules on a case-by-case basis whether intervenors are eligible for an award of reasonably incurred costs, which include time spent reviewing evidence and participating in hearings, and travel and accommodation expenses. Because the focus of our audit was not on individual Board decisions or judgment, our observations relate only to concerns we noted regarding the administrative processes—not to individual panel decisions or intervenor costs the Board had agreed to have applicants reimburse.

The intervenor community is composed of a small number of specialists, primarily lawyers, and we recognize that their knowledge and experience can add value to the process. However, it is also important that intervenors be integrated efficiently and effectively into the hearing process to ensure that the value they provide is not outweighed by the additional costs they impose on consumers, who ultimately pay for their services.

The rate applicants with which we met indicated that better co-ordination between Board staff and intervenors was needed to manage the heavy volume of questions and requests for information stemming from intervenors. The applicants also noted that there is significant overlap between the questions and requests from the intervenors and the Board staff; intervenors are recycling questions or requests for information from other rate cases and, in some instances, the name of the previous applicant had not even been removed from the questions; and the intervenor questions and requests were not always relevant or of significant importance to the current case. This last point was echoed by the Board in its 2011 OPG decision, which raised the concern that an inordinate focus

on lower-priority issues diminishes the time and resources available to pursue the more substantive, higher-priority issues. As well, intervenors bill for the time that their external consultants and legal advisors spend, and all such billings are eventually paid by electricity consumers.

Total intervenor costs over the last three years were \$16 million for the electricity sector. The reasonableness of intervenor cost claims can be challenged either by the Board or by the rate applicant, and there have been 17 claim reductions totalling about \$750,000 against intervenors over the last three years. However, utilities and other applicants advised us that they felt this did not reflect the full extent of questionable cost claims. They also said that they were generally unwilling to challenge intervenor billings because they did not want to incur the additional costs of such challenges.

### RECOMMENDATION 1

To enhance the cost-effectiveness of its rate-setting process, the Ontario Energy Board should:

- work with the regulated entities to address their concerns about the cost and complexity of the current rate-setting filing requirements and the impact on their operations; and
- better co-ordinate and evaluate intervenor participation in the rate-setting process in an effort to reduce duplication and time spent on lower-priority issues.

### BOARD RESPONSE

The Board is committed to improving the efficiency of its processes, which the Auditor General has recognized as being transparent and as benefiting from the work of staff and the contribution of intervenors. The rate-setting process requires appropriate information on the public record to support sound and responsible decision-making. We annually update our filing requirements for rate applications to ensure that only appropriate information is being requested.

We will continue to consult with the industry and other stakeholders to ensure that our rate-setting processes are as efficient as possible.

## CHARGES NOT SUBJECT TO REGULATORY OVERSIGHT

### Non-regulated Electricity Charges

In recent years, rates for the electricity component of the average bill that is supplied by unregulated sources have been significantly higher than rates for that supplied by regulated sources, which must be approved by the Board. As a result, although unregulated electricity accounts for only 50% of the total electricity supplied, the price of the unregulated electricity accounts for about 65% of the price paid by the average consumer. Accordingly, only about \$35 of every \$100 in the cost-of-electricity component on a typical bill is subject to rate regulation by the Board.

The unregulated sources are primarily suppliers under power contracts that have been signed by the OPA under the government's direction, because the province's long-term power-system plan has not been approved by the Board. On August 29, 2007, the Board received the OPA's application for review and approval of the Integrated Power System Plan (IPSP), the blueprint for electricity in Ontario. The IPSP must be approved by the Board before the plan can be implemented. However, the hearing was adjourned on October 2, 2008, pending new government targets requiring a revised IPSP, and the Board was directed by the Minister of Energy on February 17, 2011, to complete its review of the OPA's revised IPSP within 12 months of its submission. As of August 2011, the revised IPSP had not been submitted to the Board for review.

Over the last four years, the government has directed the OPA to enter into new long-term electricity-supply contracts in the absence of an approved IPSP, which would have set out guidelines for such transactions. According to the Board, these

contracts are outside the scope of its statutory mandate and regulatory powers, so any eventual approved IPSP would have no impact on procurement commitments already made by the OPA.

### Non-regulated Regulatory Charges

There are a number of components in the regulatory charge, including service charges to cover the cost of administering the wholesale electricity market and maintaining the reliability of the overall electricity grid. These charges account for about half of the total regulatory charges collected. Other components include the operating costs of the IESO and OPA; the cost associated with funding government conservation and renewable-energy programs; a charge to subsidize consumers living in rural and/or remote areas; and a charge to help recover utility administration costs.

Most regulatory charges are not subject to any form of Board oversight. The exceptions are the costs to operate the IESO and OPA, which account for about \$190 million of the close to \$900 million in regulatory charges collected annually. The other charges either are prescribed by government regulation or consist of other costs not subject to Board oversight.

### Market Surveillance Panel

As noted earlier, the only regulatory charges in an electricity bill whose rates the Board regulates are the fees that the IESO and OPA charge to cover their operating costs. The Board does not regulate any of the other costs of operating the wholesale market. The Market Surveillance Panel (Panel), which was transferred from the IESO to the Board in 2005, monitors wholesale market activities and reports on them to the Board twice a year. The Panel has consistently recommended that the IESO explore structural changes to the electricity market to reduce or eliminate what are known as "congestion management settlement credit (CMSC) payments" where they do not contribute to market efficiency. These

payments are a result of the current electricity market structure, which compensates generators or traders when, for example, transmission constraints curtail their ability to participate in the market.

From 2006 to 2010, the IESO paid more than \$420 million in constrained-off CMSC payments to generators and traders whose power cannot be fed into the grid because of the transmission system's capacity constraints. In its May–October 2010 report, the Panel reported that it had two ongoing investigations into these market activities. One was at the request of a market participant, and the other a formal investigation of potential “gaming” of the system to obtain increased CMSC payments.

The Board advised us that, although the Panel reports to the Board, it is up to the IESO to implement Panel recommendations. However, given that the Panel is required to report to the Board, we questioned why the Board would not be more proactive in ensuring that the IESO gives adequate priority to Panel recommendations. In March 2011 we noted that, for the first time since assuming responsibility for monitoring the market in 2005, the interim Chair of the Board asked the IESO to report back on its proposed response to certain Panel recommendations.

### Non-regulated Debt Retirement Charge

When Ontario Hydro was broken up in 1999, the government created the Ontario Electricity Financial Corporation (OEFC) to assume its \$38.1-billion debt and other liabilities and provided it with \$18.5 billion in financial assets. The difference between the assets and debt, \$19.4 billion, came to be known as the “stranded debt.” The government established a long-term plan to repay most of it using future electricity revenues, including the profits of OPG and Hydro One in excess of the government's financing cost for its investment in the two entities.

However, the government also said at the time that these anticipated repayment streams would be insufficient for an estimated \$7.8-billion portion of

the stranded debt known as the “residual stranded debt.” In order to repay this amount, the government imposed a new debt retirement charge to be included on electricity bills and used to service the residual stranded debt.

The original 1999 plan estimated that the stranded debt would likely be retired by 2010. However, since then, the OEFC has faced a number of challenges in managing the stranded debt, which have included the impact of interest charges on the \$38.1 billion in assumed liabilities, volatility in OPG and Hydro One profits, and other government-mandated electricity expenditures. As a result, OEFC currently estimates that the stranded debt will be eliminated between 2015 and 2018. For additional information on the stranded debt and the debt retirement charge, see Section 3.04, Electricity Sector—Stranded Debt.

The Board has had no role in setting or otherwise regulating the debt retirement charge. However, given that the Board regulates the industry, consumers could reasonably assume that it is responsible for overseeing all facets of their electricity bill. To prevent this misconception, the Board should clearly spell out charges over which it has no power and identify which entities do have control over these charges.

### RECOMMENDATION 2

To help ensure that the interests of consumers are protected with respect to those charges not subject to Ontario Energy Board (Board) oversight and regulation, the Board should:

- encourage the Ministry of Energy (Ministry) and the Ontario Power Authority (OPA) to consult with it on a more timely basis with respect to the interests of consumers in all energy-supply and pricing undertakings by the Ministry and the OPA;
- work more proactively with the Independent Electricity System Operator to address the high-priority recommendations from the Market Surveillance Panel; and

- clearly explain the reason for each charge on consumer power bills, identify the entity receiving the proceeds from each charge, and disclose whether the Board has any oversight role relating to the charge.

## BOARD RESPONSE

The Board supports the objective of enhanced co-ordination among energy-sector agencies, while at the same time respecting both its own mandate and the authority and responsibilities of other agencies. The Board will work with the Independent Electricity System Operator to ensure that high-priority recommendations made by the Market Surveillance Panel are appropriately addressed in a timely manner. The Board has already developed several innovative consumer education tools (such as the on-line bill calculator) and will examine how to assist consumers further.

## CONSUMER PROTECTION

### Consumer Education

As noted previously, the government enacted a regulation in 2004 that required electricity bills issued to residential and small-business consumers to be broken down by electricity, delivery, regulatory, and debt retirement charges. However, these components typically have to be further divided into sub-components to be fully explained.

Given the increased complexity on residential electricity bills, consumers need additional sources of information to help them understand just what they are being asked to pay for. Such education is crucial as the sector continues to evolve and consumers are given more choices in how to manage their power costs. For example, they need to understand the risks and potential benefits of signing retail fixed-price contracts. They also need to understand the time-of-use system and how they may save money by adjusting their power-usage patterns.

Although the Board has indicated that consumer education is a responsibility it shares with other entities in the electricity sector, the Board has established a number of educational programs and communication tools, including consumer outreach programs, advertising campaigns, and on-line resource materials. The Board has also included a bill calculator function on its website that enables consumers to calculate a monthly estimated bill with their local utility or to compare how their charges would differ on a retail contract. This is a beneficial tool for consumers who want to understand the price differences between a retail contract and the Regulated Price Plan (RPP) before committing to a long-term fixed-price contract. A sample from the bill calculator is given in Figure 4.

Although we acknowledge that some of these programs have garnered recognition from industry associations, there is still room for improvement. For instance, in a focus group conducted in 2010, many participants said that they still did not understand the meaning of the charges on their electricity bills and were unaware of the Board's role in protecting them. In a 2010 stakeholder survey, respondents rated the Board poorly on its consumer and public education efforts, and similar results were noted in focus groups from previous years. A continuing lack of understanding of the nature of electricity charges by the general public clearly poses challenges for the Board in providing assurance to the public that the interests of electricity consumers are being protected.

We agree that consumer education is a responsibility that is shared with other entities in the electricity sector; however, the Board could use its authority over these entities to better influence them to meet their responsibilities.

### Monitoring for Compliance

Regulated entities are required to adhere to the accounting, reporting, regulatory, and record-keeping requirements specified in the terms and conditions of their licences. Regulatory requirements

cover a wide range of activities, including conduct toward consumers by the regulated entities, billing practices and calculations, and related-party transactions.

The Board conducts compliance activities to ensure that regulated entities are adhering to their statutory and regulatory obligations, and it works to ensure that entities understand their obligations. It also investigates allegations of non-compliance, and undertakes enforcement action where it deems appropriate.

Three Board groups are responsible for compliance. The Regulatory Audit and Accounting Department focuses on ensuring that utilities use appropriate accounting policies and practices to generate reliable data for regulatory decision-making, and conducts audits to ensure that data collected from regulated entities is reliable to use in decision-making. The Regulatory Policy Group and the Consumer Protection Unit assess for compliance by monitoring the complaint process and identifying issues from other sources. They also conduct follow-up work, where warranted, on issues they have identified.

### Compliance with Reporting Requirements

The Regulatory Audit and Accounting Department (Department) audits selected accounts and service-quality information reported by regulated entities. In the last three years, the Department has identified consistent deficiencies in utility record-keeping and reporting practices and persistent difficulties in meeting regulatory accounting and reporting requirements. Over the last two years, the Department has attempted to address some of these weaknesses by organizing three on-line training seminars for regulated entities.

In addition, local utility companies advised us that they had concerns about some of the reporting requirements. For example, they are not clear why some of the requirements even exist, or whether the Board uses the information it gets. They also noted issues with the required frequency of reporting, including a Board requirement that utilities report

certain information on a quarterly basis, including the number of consumers by rate class, the energy sales in kilowatt hours for each rate class, and the energy sales by electricity retailer. The utilities said that there is no need to report this information on a quarterly basis, because the industry does not change materially within such a short period of time. Instead, they said, it would be more cost-effective to report on an annual basis. Our review of the information collected by the Board also shows that the Board did not use this and other reported information on a quarterly basis.

The Board also collects, reviews, and analyzes information submitted by utilities to assess the reliability and quality of their service and to monitor their financial health. However, it has not clearly communicated to them why it needs the information and how the information is used. Such communication would help regulated entities understand the reporting requirements and ensure that they report correctly, which in turn could also enable the Board to identify systemic concerns that warrant its attention.

### Compliance with Regulatory Requirements

In July 2009, the Board's compliance functions became the responsibility of its Regulatory Policy Group, which has not since conducted any proactive reviews of whether electricity utilities are complying with specific regulatory requirements. We noted that the current monitoring for compliance with codes and guidelines relies primarily on outside feedback, mostly customer complaints, and issues noted in the review of rate applications.

The last proactive reviews for conditions of service and affiliated relations (that is, related-party transactions) were conducted in 2007. These reviews noted a number of non-compliance issues. Among them:

- Some local utilities unduly transferred financial benefits to their affiliates. Examples included a \$1-million interest-free loan and inappropriate sharing of employees between the utility and the affiliate.

- The *Ontario Energy Board Act, 1998* (Act) bars distributors from carrying on certain activities. Some utilities' provision of municipal street lighting was in contravention of the Act.

Because the Board had not done any recent work relating to affiliate transactions, we conducted an analysis of affiliated loans currently reported by local utilities and selected 10 for follow-up. We noted three errors in the information provided to the Board regarding these loans, including mistakes in reported interest income, loan-related expenses, and loan balances. Although the Board agreed that these were indeed reporting errors, it also indicated that they were identified in the rate-setting applications and were therefore taken into consideration in the rate-setting process. However, because we looked at only one narrow area, it is possible that there are errors in other information reported to the Board. Without more proactive surveillance, such errors could be difficult to detect.

### Consumer Complaints

The Board's responsibilities include responding to inquiries from electricity consumers about the Board and dealing with consumer complaints about regulated entities. Consumers can contact the Board by telephone, on-line, or in person. The number of complaints against regulated entities in the electricity sector grew from 1,400 in 2006 to 4,300 in 2010, and totalled 17,000 over the last five years. Complaints against electricity retailers account for between 70% and 90% of the total, with the remainder primarily about local utilities.

Common complaints include customers being switched to retail pricing without a contract, which can happen when a retailer obtains a customer's electricity account number; misrepresentation of identity by retailer agents claiming to work for the Board or the local utility; refusal to cancel contracts; misrepresentation about retail-contract pricing; and even forgery of signatures on the contracts.

The Board's Consumer Relations Group resolves most complaints by contacting the regulated entity

and by encouraging consumers to try to resolve the complaints directly with the company. Complaints that cannot be resolved in this way are escalated for review and follow-up by the Retail Markets and Compliance Management Group. The Board was unable to provide data from before 2006, but it said that in the last four years, 1,442 cases, representing about 11% of complaints against electricity retailers, were escalated for follow-up. In the last three years, 658 electricity retail contracts were cancelled through the complaint process and consumers received refunds worth more than \$700,000.

Given the continuing high number of complaints against electricity retailers, along with the costs involved in pursuing enforcement actions, it would be helpful for the Board to determine the underlying causes of these complaints and to determine whether appropriate mitigation measures can be implemented.

In 2010, the province passed the *Energy Consumer Protection Act* to ensure that Ontarians have the information they need about electricity contracts and electricity pricing, and that they can count on fair business practices. The new rules came into effect in January 2011, and the Board has contracted an external accounting firm to perform compliance audits on retailers with respect to the new requirements. The related costs of these audits (together with most of the costs of operating the Board's Consumer Protection Unit) are being allocated and charged back to retailers and marketers through the Board's cost-assessment process. This new allocation is effective as of April 1, 2011, in accordance with amendments to the Board's cost-assessment regulation.

### Retail Contracts

In the current electricity market, consumers can purchase their supply of electricity for consumption either through their utility at the Regulated Price Plan (RPP) rates set by the Board or through an electricity retailer at a price set by the retailer. There are currently nine active retailers in Ontario,

and approximately 630,000 residential consumers (representing 15% of the total) have entered into contracts with them.

The Board licenses all retailers who sell electricity contracts in Ontario but does not set the prices they charge. The Board indicated that the existence of the retail sector and its ability to conduct door-to-door sales are matters for the government. The Board also indicated that there are inherent difficulties in taking enforcement action against door-to-door salespeople, given that there is always a question of “who said what.” However, because the Board licenses these entities, we believe that the public could reasonably expect it to play a more proactive role in protecting consumers from unfair business practices.

### Consumer Desire for Price Protection

Consumers generally enter into retail contracts because they want price protection and stability in their electricity bills. However, such contracts do not actually offer protection against price increases. The potential protection they offer is applicable only to the “market price” portion of the electricity charge on the bill. They provide no protection against increases either in the Global Adjustment component of the electricity charge or in other costs. As noted earlier, the Global Adjustment has been rising steadily over the last few years with the cost of acquiring the electricity supply, even though the overall market price has been declining because of oversupply. Most consumers do not follow these developments, something that some retailers appear to have exploited to encourage consumers to sign a contract with them.

As the government moves forward with its long-term energy plan, Ontarians can expect continued increases in the cost of electricity. Most of these increases will be the result of upgrades to existing generating and transmission capacity, and commitments to purchase renewable energy through long-term contracts. As long as there is surplus capacity, the price increases associated with many of these

investments will likely be reflected in the Global Adjustment and not the market price. Accordingly, consumers with fixed-price contracts will have no protection from these increases even though such “fixed-price” protection was undoubtedly why consumers signed these contracts in the first place. In fact, the OPA is projecting electricity surpluses in the future that will put further downward pressure on the market price. Fixed-price contract holders will obtain no benefit from any such decreases because they will continue to pay their contracted price.

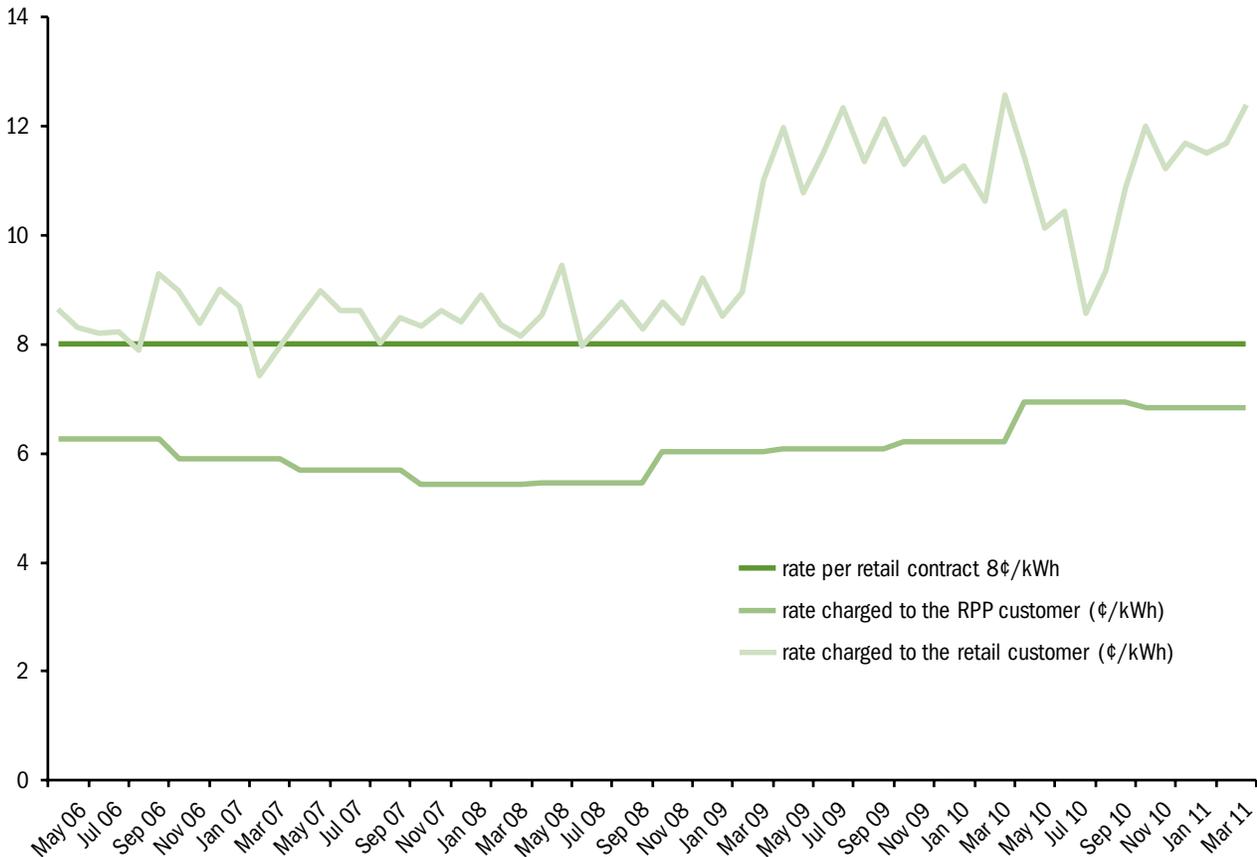
### Effectiveness of Price Protection

We sampled customer bills from 2006 to 2009 from various retailers, and noted that retailers offered fixed electricity rates in the range of 8.49¢/kWh to 10.53¢/kWh. During this same period, the average market electricity rate ranged from 3.2¢/kWh to 5.2¢/kWh. The Board set the average RPP price, including both the market and Global Adjustment rates, at between 5.4¢/kWh and 6.3¢/kWh. Accordingly, our sample of retail-contract customers paid anywhere from 35% to 65% more for their electricity, before tax and other charges, than the highest RPP rate over the term of their contract.

For example, a consumer who committed to a five-year fixed-price electricity retail contract at 8¢/kWh would have actually seen more dramatic electricity price increases and price fluctuations on his or her electricity bill than a customer who stayed on the Board’s Regulated Price Plan, as shown in Figure 7. This effectively negates the main reason—price stability—that leads people to enter into such contracts in the first place. Over the term of a five-year contract, we estimate that under this scenario a customer using 1,000 kWh per month could pay about \$2,000 more for electricity than one on the RPP plan. As well, retailers have profited without facing some of the usual business risks because the utilities that supply electricity to the retailers’ customers are required to pay the retailers first and then attempt to collect from consumers.

**Figure 7: Electricity Price Comparison (RPP vs. Retail-contract Price), 2006–2011**

Prepared by the Office of the Auditor General of Ontario



As noted earlier, approximately 70% to 90% of all customer complaints in the electricity sector to the Board over the last five years were against retailers. The Board advised us that dealing with retailers choosing to conduct door-to-door sales is not within its authority; however, because it is responsible for licensing retailers, we believe that it has at least some responsibility to protect consumers from unfair practices by the retailers it licenses. To the extent that the Board's responsibility is shared with others, such as the Ministry of Consumer Services, it would be prudent to ensure that a co-ordinated and effective process is in place for resolving consumer complaints about these retailers.

### Enforcement

In its compliance work, the Board has continually observed non-compliance with its regulatory and

reporting requirements by the regulated entities. Some of these instances of non-compliance might be addressed through better communication, such as the on-line training sessions put on by the Board's auditing group and the information bulletins it puts out. Adequate follow-up reviews are also required, to ensure that these and other remedial actions have been effective in ensuring compliance.

In addition, since assuming the increased responsibilities for regulating the electricity sector in 1999, the Board indicated that it made a deliberate and principled decision in the earlier stages of its activities to focus on voluntary compliance, recognizing that regulated entities required some time to understand and adapt to the legal and regulatory requirements and to correct their practices. We acknowledge that time is required for regulated entities to adapt to new regulatory requirements

and that the Board needed to work with these regulated entities to ensure that they understand and build up their capacity to meet these new requirements. However, a voluntary system is effective only if it leads to eventual compliance; if non-compliance is persistent, other remedial actions are required.

The Board clearly recognizes the importance of enforcement in effectively regulating the near-monopoly that is the electricity sector, because its business plans and annual reports acknowledge the importance of enforcement as a key part of an effective compliance function. That said, despite the high number of public complaints against electricity retailers, we noted little enforcement action against retailers with repeat offences. Since July 2003, the Board has issued only four enforcement orders in 2009 and just one in 2010. In total, three retailers were fined about \$500,000 and had special licence conditions imposed on them. The Board indicated that enforcement actions are a costly and resource-intensive process.

### RECOMMENDATION 3

To ensure that consumers are protected and that they have the information they need to understand their electricity bills, the Ontario Energy Board should:

- review its current educational and communication programs and make the appropriate adjustments to meet consumer information needs;
- consider initiating limited proactive compliance reviews focusing on high-risk areas;
- work with utilities to streamline reporting requirements, including the timing and frequency of reporting; and
- determine whether appropriate deterrent actions in those areas that have generated frequent legitimate consumer complaints can be implemented.

### BOARD RESPONSE

The Board appreciates the Auditor General's recognition of its consumer education materials, and it commits to enhancing them to meet changing consumer needs.

The Board agrees that proactive compliance is an important part of a robust monitoring and compliance program. The Board has included a commitment to this in each of its business plans since 2004 and has undertaken focused proactive compliance reviews based on a risk assessment that includes reviewing consumer complaints. The Board's compliance philosophy focuses on bringing industry players into compliance through a multi-faceted process that includes enforcement action where appropriate. With the passage of the *Energy Consumer Protection Act, 2010* (Act), the Board has established a Consumer Protection Business Unit that is focused on ensuring that industry licensees are adhering to consumer protection requirements. The Board has conducted detailed compliance inspections of all active retailers and has recently initiated enforcement actions relating to allegations of failure by retailers to meet the requirements of the Act and related regulatory requirements.

The Board has worked to streamline its reporting requirements and will further review them in consultation with the industry and other stakeholders. In the past two years, the Board has taken steps to assist distributors by enhancing its electronic filing system to facilitate reporting, as well as by providing definitions and guidance that promote a common understanding of the reporting requirements.

## PERFORMANCE MEASURES

Performance indicators can be defined as measurable outcomes that are within an entity's control and clearly linked to its objectives. Since the 2004/05 fiscal year, the Board has developed and published an annual business plan with associated performance measures. The business plan identifies the Board's strategic objectives and the management initiatives to support them. It also sets out the activities that the Board intends to undertake over the next three years to achieve its objectives, and how it will measure its success. The Board's actual performance vis-à-vis these performance measures is independently reviewed by an external auditor.

We concluded that this process was well structured and offered the potential to be an excellent performance-reporting mechanism. However, to take full advantage of this process, the Board's performance measures need to be more results- or outcome-based, rather than process-oriented or output-based. For example, the Board's measures looked at whether "Regulated Price Plan prices have been adjusted as required" and whether "filing guidelines for cost-of-service applications will be updated." The challenge with process-oriented or output-based measures is that they often provide little evidence as to the actual achievement of the Board's strategic objectives. We acknowledge that in its 2011–2014 Business Plan, the Board recognized the value of moving toward outcome-based performance measures. However, no such measures had been developed at the time of our audit.

One of the Board's performance measures is its own internal costs, which have been increasing over the last 10 years although they have remained more stable over the last three years. In addition to the Board's operating expenses, the cost of regulation also includes such other expenses as the cost of intervenors and costs incurred by applicants seek-

ing approval for price increases. However, neither cost has been included in its cost calculations. Because all regulatory costs are ultimately passed on to the same electricity consumers that the Board is mandated to protect, we believe that these costs should also be reflected.

### RECOMMENDATION 4

To improve the reporting of the effectiveness and costs of its regulatory activities, the Ontario Energy Board (Board) should develop more results-based or outcome-based performance measures that are aligned with its strategic objectives and mandate, and summarize and report all of the costs associated with the Board's regulatory processes.

### BOARD RESPONSE

In its most recent business plan, the Board expressed its commitment to moving to outcome-based performance measures. The Board is working toward the establishment of a robust performance-assessment framework that will include the collection and assessment of indicators and data relating to the impact of its decisions and policy initiatives over time. The Board appreciates the Auditor General's conclusion that its current performance-measurement process is well structured and will continue to use that process in the interim to confirm achievement of its business-plan initiatives.

The Board will, in addition to reporting on its own costs, report on cost awards paid to intervenors. The Board will explore whether information on utility regulatory costs can be readily provided by the utilities at a cost that is commensurate with the benefits of enhanced reporting.