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June 30, 2009
Our File No. 2090663

Ontario Energy Board
2300 Yonge Street
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Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2009-0077 – Distribution Cost Responsibility – Proposed DSC Amendments

On June 5, 2009 the Board issued a Notice of Proposal to Amend a Code (the "Proposal"), under which specific changes to the Distribution System Code are proposed to respond to the Board's new responsibilities under the *Green Energy and Green Economy Act 2009* (the "GEA"). These are the submissions of the School Energy Coalition on the Proposal.

Distribution Spending Related to Renewable Generation

The GEA imposes new responsibilities on electricity distributors to facilitate the connection of renewable generation in the province, and new responsibilities on the Board to support and regulate those activities.

In the Proposal, the Board has suggested that the capital spending by distributors in meeting those new responsibilities will fall into three categories: connection assets, expansions, and renewable enabling enhancements. In general, we agree with the Board's categorization. In our view, the GEA is mandating a fundamental shift to a different type of electricity grid. That shift involves three types of changes to the distribution system:

- ***Technical Characteristics.*** A distribution system that is simply delivering power to load is configured differently, and has different electrical characteristics, from a system that is both delivering and receiving power at multiple points around the system. Some obvious aspects of this are protection, voltage regulation, and the like. In addition, for some distributors the entire architecture of their system (e.g. hub and spokes) has to be re-thought if significant renewable generation is to be implemented in their area.

- ***Location.*** Until now, the distribution system has been planned and designed to respond to load. As load increased in a certain geographical area, the system expanded in that area to meet that load. Under the GEA, the distribution system now must also be planned and designed to respond to generation. Although there was a small amount of that in the past, for the most part response to generation was limited to the transmission system. Distribution systems were almost entirely load-driven.

- ***Connections.*** Individual generators or groups of generators need to be connected to the grid. This is not new, but the pace will increase, and the GEA requires both distributors and the Board to make it a lot simpler and easier than it sometimes has been in the past.

In our submission, the Board's basic task in this Proposal, in the related EB-2009-0152 proceeding and in the recent introduction of Guidelines in EB-2009-0087, is to regulate the change in the Ontario electricity grid from one that assumes a few large generators and 99% of system planning driven by load, to a new grid that assumes a considerably more distributed generation infrastructure. In doing so, the Board's role is, in our submission, three-fold:

- Ensure that the Board's policies and guidelines do not create unnecessary barriers to the transition, nor send inappropriate signals to the market;

- Give guidance and structure to the activities of distributors in meeting their new responsibilities under the Act; and

- Fairly allocate the costs of the transition between those who should, from a ratemaking point of view, bear those costs.

The Proposal focuses on the third of these roles, but necessarily must consider the first and second as well.

Cost Responsibility vs. Cost Recovery

The Board has proposed that cost responsibility and cost recovery are two different things. With respect, we strongly disagree.

Assigning costs to activities, businesses, classes of people, or otherwise is at the root of many of the Board's activities. In this case, it is clear that there will be incremental costs associated with the transition to a renewable-friendly system. The Proposal appears to start from the premise that the initial decision is responsibility for these costs as between the generator (meaning, in essence, the generator's shareholders) and the distributor. Then, any costs assigned to the distributor must be recovered in a particular way, and that decision can be left for later (as if it were a kind of rate design issue).

In our submission, this is incorrect. It is very unlikely that the shareholder of the distributor will ultimately bear any of the costs not assigned to the generator. Therefore, any decision about responsibility as between generator and distributor is really a decision as between generator and ratepayers. But the ratepayers are not an amorphous mass. The distributor has ratepayers (of various classes), and the region in which the distributor operates has ratepayers, and the province has

ratepayers. In addition, ratepayers pay their share of overall electricity costs through various means – the commodity cost, the regulated distribution and transmission rates, and many statutory and other charges.

As the Proposal correctly points out, the decision whether and to what extent the costs of transitioning to a distributed, renewable-friendly system should be socialized will be made by the government, and that decision has not yet been made. The Board then goes on to suggest that it can decide the pool to be paid for by ratepayers generally, then later the government (and/or the Board) can decide which ratepayers actually pay which percentage of that pool.

Analytically, this means that the Board is not allocating cost responsibility between people. It is, instead, deciding only which costs should be borne by generators. This is not only inconsistent with the Board's normal approach to allocation of costs, but is also a much more difficult exercise, in which it is almost impossible to achieve fairness. The reason is that in taking this approach, the Board, in deciding that a generator should not bear a cost, is not in a position to identify who will bear it instead, and whether it is fairer for that person or persons to bear it than the generator.

Suppose, for example, that a small 2000-customer utility has a single 50 MW wind farm proposal. The cost for system upgrades to allow the wind farm on the system is $5 million, of which under the Proposal $4.5 million would be paid by the distributor, and $0.5 million would be paid by the generator. If these costs are not socialized, then as a result of the incremental local rate base the local distribution customers will pay on average an additional $250 a month for 25 years in their distribution rates.

This, of course, is untenable, and would not in fact happen. What it demonstrates, though, is that until the Board knows what will happen to the costs "assigned" to the distributor, it is not reasonable, in our submission, to carry out that assignment. Just as the result in this example is patently unfair, so the result in any number of other examples will be unfair to a greater or lesser extent. The Board's normal approach is to balance competing interests, but that requires knowing the consequences on both sides of the decision.

Characterization of Costs

In our submission, the optimum first step in the cost responsibility analysis is to identify the nature of the cost. This is similar to the functionalization, classification, and allocation system commonly used to allocated cost responsibility between classes of ratepayers.

In this case, it appears that the bulk of the costs associated with the transition to a distributed, renewable-friendly system are in substance commodity costs. There is a small category of costs that are associated with distribution system and transmission system benefits, but for the most part this spending is about implementing a government policy relating to the electricity commodity.

It is therefore submitted that the first step in determining who should pay these costs is to determine whether there is a benefit to the distribution system (not the ratepayers, the system) or the transmission system associated with the spending. For example, if a particular component of the local distribution system is in poor condition, and must be reinforced to accommodate renewable generation, the improvement in the condition of the system is reasonably considered a distribution

cost. Any proposal from a distributor for system upgrades to accommodate renewable generation (known or anticipated) should specifically identify the improvements to the system that would have value to the customers with or without the new generation. This can be done through a direct quantification of the benefits, or through a comparison of system planning with and without renewable generation.

Once all distribution and transmission-specific benefits have been quantified, in our submission the remaining costs of this policy transition are commodity-related. These can further be divided into two categories:

- Costs specific to an individual project. These costs should be borne by the promoter of the project, as a cost of doing business, the assumption being that the price of the commodity sold already includes these costs. (This matches fairly closely the category of "connection assets" that the Board has already identified. However, we have seen a draft of the submissions of VECC on this point, and we agree with them that both the clarity of the definition, and the potential for "ownership gaming" should be addressed by the Board before this category is finalized.)

- Costs related to renewable generation generally. This will include most expansion and renewable enabling improvements. These costs should be socialized through the cost of the electricity commodity in Ontario.

We note that the last category of people that should bear these costs is the ratepayers of the local distributor. There is no reasonable argument that they alone are the beneficiaries of this spending. Therefore, unless it is assumed that renewable energy projects will be evenly distributed in the franchise areas of all distributors on a pro rata basis (not very likely), allocation of system transition costs to the local ratepayers will be inherently unfair in all scenarios.

Based on the above analysis, it is our submission that the Board's Proposal is premature, in that it seeks to allocate costs between various parties without having sufficient information. Once the Board knows the government's decision with respect to socializing system transition costs (whether in the commodity price, or through other means), the Board is then in a position to determine what costs should be borne by the generators, what costs should be treated as improvements to the local distribution system, and what to do with any remaining unallocated costs.

Specific Alternative Comments

If the Board, after receiving all submissions, determines to proceed with the Proposal, with or without modification, prior to knowing the government's policy decisions on cost responsibility, we have the following additional comments:

1. We have noted above our concern, which we share with VECC, that the definition of "connection asset" needs to be clarified.

2. VECC has also pointed out the potential that generators will be able to game the rules by proposing more than one project, owned by different entities, in the same area, thus reducing the scope of the "connection assets" related to the projects. In this regard, we note that, under

RESOP, the size limits already mean that projects with common promoters are often structured with separate ownership and configuration to fit within the government's policies.

3. The Board has proposed that spending included in approved plans should be entirely the responsibility of the distributor. We strongly support the Board's emphasis on approved plans, and in the context of a cost responsibility policy more consistent with what we have proposed above, we would support guidelines under which essentially all system transition costs are expended pursuant to approved plans.

4. However the premise of the Board's proposed cost assignment – that capital spending plans generally do not contemplate specific projects – is, in our view, not correct. Distributors will make system plans just as they do today, by talking to their customers and finding out what their likely system needs are in the future. When it comes to generation, it is easier still, because in most areas of the province where there is significant renewable resource availability, there are already multiple companies investigating future projects. Distributors will in fact estimate which specific projects will go ahead, and will design their plans accordingly.

5. The approved plans exemption also creates some unintended incentives.

    a. For the generator, it is incented to delay its official project finalization as long as possible, while making clear to the distributor that it is planning to build, so that the distributor will be forced to include related capital costs in an approved plan, reducing the financial responsibility of the generator. (For many generators, because of the long lead times for equipment, project delays of this type are not on the critical path, so they cost nothing.)

    b. For some distributors, they will be willing to have their ratepayers pay additional costs, and so they will include costs sufficient to integrate a specific project in a general plan.

    c. For other distributors, they will prefer that costs be borne by the generator rather than their ratepayers, so they will be incented to either i) get plans approved that do not contemplate the attachment of those delaying generators, or ii) delay plan approval as long as possible. In the latter case, the result is a waiting game between generator and distributor, exactly contrary to the government's policy of motivating rapid deployment of renewable generation.

6. The extent to which costs are allocated to the generator is – as the Board correctly points out – a signal to the generator. As one of the Board's goals in this is to maximize the long-term efficiency of siting decisions, it is clearly critical that the formula for allocation of costs to the generator be accurate and predicable. That formula cannot, however, be values-neutral, because the Board's view of market efficiency will govern the signals it sends. There are multiple possible approaches to market efficiency, each reflecting particular policy goals:

    a. One perspective is that efficiency is achieved if the overall economic benefits of distributed renewable generation in the province are maximized. If that is the case, then clustering would not be promoted (e.g. generators could not share connection costs), but

proximity to load would be promoted (e.g. generators would pay a larger proportion of lengthy connecting lines and system).

b. Another perspective is that efficiency is achieved if the total renewable generation is maximized. In that scenario, generator responsibility has to be kept to a minimum, and location should not impact generator cost as much.

c. Still another perspective is that efficiency is achieved if the maximum renewable generation is added at the lowest overall cost. In this cost/benefit approach, clustering would be promoted, as would proximity to load, but overall cost to generators would still be kept as low as possible.

d. Of the many more approaches, the most obvious is efficiency based on simple cost causality, i.e. a purer economic test. This would tend to increase cost allocation to generators, at the expense of lower uptake.

Before finalizing the allocation of costs to generators – both the overall levels and the methodology for calculation – it is in our submission critical that the Board determine which efficiency metrics it is seeking to achieve, so that it can design its cost allocation with that goal in mind.

Conclusion

In our respectful submission, the Board should delay implementation of the proposed changes to the DSC until the government enacts regulations under section 79.1 of the Act relating to socialization of these costs, and determines whether any regulations are imminent under section 88(1)(g.6.0.1) of the Act. In the meantime, in our submission it would be useful for the Board, perhaps as part of the EB-2009-0152 proceeding, to establish policies dealing with the market efficiency goals it seeks to achieve in its regulation of GEA-driven investments. Those investments will, it is submitted, be substantial, and the Board's market signals may have a significant impact on their direction.

All of which is respectfully submitted.

Yours very truly,
SHIBLEY RIGHTON LLP

Jay Shepherd

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