EB-2009-0411

IN THE MATTER of the *Ontario Energy Board Act 1998*, Schedule B to the *Energy Competition Act*, 1998, S.O. 1998, c.15;

AND IN THE MATTER OF a proposal by the Board to amend the Distribution System Code and the Affiliate Relationships Code for Electricity Distributors and Transmitters.

SUBMISSIONS

OF THE

SCHOOL ENERGY COALITION

1. On December 10, 2009 the Board issued a Notice under section 70.2 of the Act describing proposed amendments to the Distribution System Code and the Affiliate Relationships Code for Electricity Distributors and Transmitters, in both cases relating to the ownership of qualifying facilities by distributors or their affiliates, and has sought comments on the Proposal from stakeholders. These are the submissions of the School Energy Coalition.

2. Our submissions are organized as follows. First, we provide some context with respect to our interest in the issues, and some concerns we have of a general nature. Then, we respond to the proposed amendments by category, as set out in the Notice.

3. We note that the issues that arise on this matter are far-reaching, as we discuss below. We have in these submissions attempted to raise some of the issues the Board should, in our view, address, but it would appear to us that further review and analysis is required, after consideration of the submissions in this proceeding, before a more comprehensive set of amendments can be put forward by the Board.

4. Given the scope and impact of the Board's approach to these ssues on the growth of renewable generation in Ontario, these submissions can only highlight some of the concerns that should be addressed. We cannot cover everything in the time frame and scope of this proceeding. A fuller debate on the issues, beyond this consultation, may be required. We have comments on that possibility below.

Context – the Interest of Schools

5. School boards are interested in the rules related to generation activities by LDCs and their affiliates in three distinct but ways, all of them with potentially material consequences.

6. ***As Ratepayers – the Hidden Cost/Subsidy Issue.*** Whenever a regulated utility engages in activities outside of its regulated business – whether directly or through an affiliate – schools, like all ratepayers, are concerned with whether all of the costs of the unregulated activity are being borne fully by that activity, or whether some of them are indirectly appearing on the regulated side, buried in rates.

7. This has the same impacts for schools as for other ratepayers. To the extent that costs that should be in the unregulated activity are misallocated to the regulated activity, our regulated rates are higher than they should be, and are no longer "just and reasonable". In our capacity as distribution customers, it is self-evident that we should not be paying costs that don't provide us with any benefit.

8. ***As Ratepayers – the Competitive Marketplace Issue.*** The same issue of subsidy also affects ratepayers on the other side of the coin. Where, as here, the issue arises of whether costs are properly borne by the distribution business, or by the generation business, that affects the competitive market for the commodity. If distributors or their affiliates have a cost advantage, they will have more ability to, for example, source equipment such as solar panels relative to their private sector competitors.

9. Anything that makes market entry or participation more difficult for otherwise competitive private sector companies will ultimately either limit the amount of renewable energy generated, or place upward pressure on prices, or both.

10. ***As Hosts and Generators – the Competitive Marketplace Issue.*** For some technologies, Ontario's 5,000 schools expect to be significant participants in the generation of renewable electricity through qualifying facilities, whether solar, wind, or otherwise. In some cases, schools will be generators themselves, while in others the school buildings will be hosts for generation facilities operated by others.

11. In a similar way to the impact on ratepayers, anything about the relationship between the regulated business of the distributor, and the unregulated generation activities of the distributor or its affiliates, that gives the distributor/affiliate generation an unfair advantage, will limit competition in the marketplace, affecting schools as hosts or generators.

12. This is not just a matter of price or cost impacts, and cross-subsidization. Of potentially greater impact may be non-financial advantages enjoyed by the LDC-sponsored generation business.

13. For example, right now schools are being approached by a number of private sector developers to either provide their roofs as host sites for solar PV installations, or joint venture with developers to exploit that natural resource. Schools will gain maximum benefit

if the developers approach them in the context of a highly competitive market, and in fact the strategy that individual schools boards and their organizations are designing right now is based on maximizing that competition to get the full benefit.

14. The theoretical potential for solar generation on the roofs of schools could produce under the GEA programs revenue of more than $200 million per year, of which 10-25% could be kept by school boards. Although the actual penetration will of course be much less, the potential is in any case significant.

15. But if the local distributor is able to say (or imply), for example, that its projects will go to the head of the line for the purpose of interconnection or system upgrades, or is able to say that the paperwork will go more smoothly with their projects since everything is under one roof, or is able to identify (in a way that their competitors cannot) which schools match the optimum system configuration most closely, and so are the best sites to develop, that will give the distributor/affiliate generation a competitive advantage. In the normal course, that will reduce the ability of other players to enter or remain in the market, and will thus reduce the level of competition in the market. The effect on school boards is that there will be less ability to select between providers, and therefore the ability of school boards to actually complete projects, and/or the price paid to schools for their involvement, will be reduced.

16. It is therefore critical to school boards, as hosts and generators, that the ability of all parties to participate in the development and implementation of qualifying facilities not be constrained by anti-competitive factors.

17. ***Policy Implications.*** It follows from the nature of school boards' interest in this subject that we believe achievement of the goals of the GEA will require that the Board exercise vigilance in ensuring competition is allowed to flourish in the generation sector.

18. In this context, it is important to note that the decision to allow distributors to own generation was made by the government, and is a matter of government policy. It does no good to question whether it is a good policy, if indeed any party doubts its appropriateness. This Board is mandated to implement that policy. Simple as that.

19. That having been said, this Board must determine how best to interpret that policy, and in that context must, in our submission, be guided by the goals articulated in the GEA.

20. Some distributors may take the view that the government, by giving them the ability to own generation, is intending to give them the right to exploit their natural advantages as monopoly/regulated distribution providers to compete effectively in the generation markets. They would argue, on this theory, that giving them this advantage will allow them to deliver increased amounts of renewable generation in a timely manner, thus achieving the primary goal of the GEA.

21. In our view, this is not correct. We believe that renewable generation in the province of Ontario will be maximized – and the benefit the people of Ontario will enjoy from that generation will be maximized – if the generation marketplace is allowed to be fully

competitive, and market inhibitors are not allowed to creep in and disrupt that competition. This is the way to achieve the government's goals. It is submitted that the government could not have intended to give a competitive advantage to the distributors, because that would be inconsistent with a goal of expanding renewable generation in Ontario.

22. In our submission, the Board's role in implementing this government policy should be guided by the need to maintain viable competition. This Board is the one entity that has both the responsibility and the ability to ensure that the market is not skewed, and to ensure that market forces are allowed to operate fully in the public interest. It does so, it is submitted, in part by insisting that the distributors, whether operating directly or through affiliates, compete on a level playing field with other market players. Advantages, whether through hidden subsidies, through access to information, or through preferential treatment for interconnect or other purposes, should be limited where they produce market unfairness.

General Comments on this Notice and Consultation

23. ***Reprise of a Past Debate.*** It is perhaps appropriate to note that the inherent problems associated with regulated utilities owning generation, either directly or through affiliates, has been much debated throughout North America, but specifically in Ontario in the 1980s and early 1990s. At that time, Ontario Hydro was essentially the only generator of electricity in the province (a few LDCs and private companies had small plants), yet it was also the system planner and operator, the main transmitter, the distributor in much of the province, and the regulator of the rest of the distributors. The conflict of those roles was a barrier to private sector entry into the generation business in this province.

24. At that time, of course, part of the issue was an emotionally charged debate about public power vs. private power, and whether anyone should be allowed to make a profit producing electricity in Ontario. For example, in 1986 former senior Hydro executive Hedley Palmer referred, in an OEB hearing, to Hydro staff who had "packs on their backs" about the entry of the private sector into "their" generation sector.

25. That policy debate has been put to rest in a fairly decisive manner, with successive governments instead developing a hybrid public/private model, but with the public sector entities involved effectively expected to act like private sector players. (It is, of course, far more complex than that, but in our submission that is the essence of the current market structure.)

26. But in addition to the policy debate, there were also the same practical problems that the Board is being presented with today, and perhaps more. Distributors and transmitters could, if so inclined, essentially stop private developers from producing electricity from small hydro, gas cogen, and the like, through their control of the system and the interconnection process, and through internal cross-subsidies that made publicly generated power appear cheaper.

27. The Demand/Supply Hearings in 1989-1993 provided a forum for the debate of those problems. Although apparently not actually resolving anything – in the sense that the Applicant Ontario Hydro withdrew their proposals before a decision was rendered – in fact the DSP Process put this very debate out in public view: How can public sector and private sector generators both participate in the generation market when the public sector participants have monopoly advantages that reduce competition? This debate led directly to major changes in government policy. Ultimately, the government stepped in after the end of the process and started to make significant policy decisions for a newly-structured electricity sector.

28. The main point of this "history lesson" is that Ontario is finally starting to reap the benefits of an active private sector building renewable energy facilities in the context of a supportive government policy environment. The "greenness" of the generation is of considerable importance, but the competitive market paradigm cannot be forgotten in the discussion. It is, in our submission, important that this Board as regulator continue to support that paradigm, and require the electricity distributors – themselves now for-profit entities as a result of government policy decisions – to participate in this market fairly and without any advantages arising out of their regulated status.

29. Further, it is our submission that, in determining how electricity distributors should participate in the generation market, the Board should build on the public dialogue on these same issues two decades ago, and not allow a shift back to the previous situation in which anti-competitive practices were not properly constrained..

30. ***Scope of the Stakeholder Input.*** The second thing that arises out of recognition that we have had this debate before is that there are important stakeholders whose input would be of assistance to the Board, yet they may not be involved in the current consultation.

31. When we look at the list of intervenors currently involved in this consultation, we note that there are no generators or generator organizations involved.

32. We are not in any way suggesting that the Board's notice is faulty. Further, we fully understand that when the Board puts information out for stakeholder input with proper notice, as it has in this case, it is the responsibility of stakeholders to participate in those proceedings that could affect them.

33. That having been said, another important role of consultation is to assist the Board in getting input from as broad a cross-section of stakeholders as possible. In this situation, it would appear to us that the Board would be materially assisted if generator representatives were participating, pointing out the kind of specific concerns that so informed the debate twenty years ago. Without that input, we are concerned that the Board's final determination of these Code amendments will be based on incomplete information, and will not be as comprehensive and thorough as the Board would like them to be.

34. We therefore recommend that the Board, before finalizing Code changes relating to these matters, proactively seek further input from all stakeholders, including generator

representatives, perhaps through a technical conference or similar means, so that all parties can benefit from a true dialogue between all those who may be affected by these rules, and particularly their potentially anti-competitive impacts.

Conceptual Approach to the Issue

35. The Board has proposed that the starting point of this analysis is its view: "The Board does not believe that the ARC should drive business decisions by creating incentives that favour one ownership structure over another".

36. We agree in general with that principle. However, we believe that the appropriate approach is to start with a set of rules in the Distribution System Code that protect the ratepayers and prevent the distributor from providing cross-subsidies, or engaging in anti-competitive practices, relating to their direct ownership of qualifying facilities. Since the ARC already does similar things with respect to affiliates, those hypothetical DSC changes should in effect seek to mirror the ARC rules, but within the context of internal distributor operations. Then, the ARC should be reviewed to see if any of its rules are not required for qualifying facilities in order to match the newly-created DSC changes with the ARC protections.

37. What the Board proposal does, we think, is the opposite. The analysis in the Notice appears to start by looking at what ARC rules should not apply, assuming that the distributor is now allowed to do this inside the utility anyway, where there would presumably be no natural protections. Thus it has the effect of diluting the existing protections, rather than adding equivalent protections where the generation is owned by the utility.

38. The result, in the Board's proposal, starts from its conclusion that "*the fact that distributors may now own and operate qualifying facilities calls into question the continued need for certain provisions of the ARC in related to activities associated with qualifying facilities*." We do not agree with that conclusion. In our submission, the government in allowing distributor ownership of qualifying facilities did not intend to stifle competition in the renewable generation sector. If our conclusion is correct, then it follows that any protection that was already necessary in the ARC is now, for distributor-owned qualifying facilities, necessary in the DSC.

39. Based on this conceptual approach, we start with the review of changes to the DSC, to see what should be added to provide ratepayers and the marketplace with ARC-like protections in situations where the utility owns the generating facility. Then, we look at ARC to see whether amendments to ARC provisions are indicated to achieve the Board's neutrality goal.

Amendments to the Distribution System Code

40. In our submission, the following protections are the minimums that should be introduced into the DSC in the case of a distributor owning and operating a qualifying facility. Many of these protections are already implicit, but all should be made explicit:

a. The unregulated activity of generation should bear the fully-allocated direct and indirect costs arising out of that activity. This should include the appropriate amount of all shared costs, and the full amount of any incremental cost to the regulated operations arising out of carrying on the generation activity. By way of example:

   i. If a distributor has personnel that work on both generation and distribution activities, the fully-loaded costs of those personnel, including indirect costs and related overheads, should be allocated between the activities using an appropriate cost driver.

   ii. If the distributor's cost of capital is higher because of the added risk associated with generation activities, all of that incremental capital cost should be borne by the generation side, including the incremental cost of the distribution capital caused by the higher corporate risk level.

b. The distributor should not be permitted to share internally information that would have value to the generation business if that information arises out of the distribution business. The exception should be when equal access to the same information is available to the private sector, at the same time and on the same terms.

c. The distributor should not be permitted to give preferential treatment to customers, suppliers, or anyone else, relating to its distribution operations, in a manner that benefits its generation operations.

d. The distributor should not be able to communicate to any person, directly or indirectly, any statement that it is better, easier, or preferable for that person to deal with the distributor's generation operations compared to the generation operations of any of its competitors.

e. Employees who work on the generation business should not be allowed to work on the distribution business, and vice versa, where:

   i. The employee has access to non-public information relating to distribution operations that could benefit generation operations;

   ii. The nature of the employee's duties includes dealing with the public, and there is a risk of public confusion about the regulated vs. unregulated operations and their relationship;

   iii. The employee's responsibilities require him or her to place a priority on the generation business over the distribution business, or

   iv. The sharing of employees would confer any other unfair competitive advantage on the distributor's generation busines, other than economies of scale.

f. Funds put at risk in generation operations should be structured to ensure that the operational and financial integrity of distribution operations are not reduced in any way.

g. Decisions with respect to the distribution business should not be made in a manner that confers a benefit on, provides a competitive advantage for, or supports the business plan of, the generation business unless the competitors of the generation business have equal access to the same benefit, advantage or support. For example, system planning decisions, such as those with respect to the reinforcement of the distribution system, should not be made in a manner that will reinforce a section needed by a distributor-owned qualifying facility, in preference to a section needed by a competitor-owned qualifying facility.

41. The proposed amendments include a general obligation of equal treatment, and we believe this is an excellent addition to the DSC. It specifically speaks to item (c) above, but it also may have implications for other fairness requirements, such as (g).

42. With respect to the proposed amendments to Section 6.2, we have the following more specific comments:

a. Proposed 6.2A.2 appears to us to exempt distributor-owned facilities from a number of DSC requirements where it should not. For example:

i. Inapplicability of section 6.2 appears to be inconsistent with new 6.2A.1.

ii. A number of the sections deal with payment amounts and arrangements. By the wording of new section 6.2A.3, it would appear that those sections should continue to apply, but with the changes set out on the latter section. By exempting them, it appears to us that some of the payment obligations will not arise at all, as opposed to being satisfied in a different way.

iii. A number of the sections deal with the contents and timing of information flow between distribution business and generation business. We are concerned that making them inapplicable may imply that the information that a generation business either provides or receives from the distribution business would be different in the case of distributor-owned generation. It may be better to leave these sections applicable, but with the appropriate adjustments to wording to reflect that the substance still applies, but the mechanics may be different.

iv. The inapplicability of section 6.2.18I implies that interest should not be calculated in the same way for distributor-owned generation. While this would appear to benefit other generators at the expense of distributor-owned generation, we are concerned that this difference will then be used by

generators to demonstrate that a level playing field is not intended, and thus impact the interpretation of other provisions.

b. There are a number of places where documents have to be created and/or information exchanged between generation and distribution business. The Board has proposed retention requirements. We believe that fairness can only be assured if those documents, and that information disclosure, is made public through filings with the Board. This additional transparency is appropriate where the exchange of information could otherwise have an impact on fair competition.

43. Generally speaking, the proposed amendments to the DSC deal only with the problems identified in paragraphs 40 (b) and (c) above. The other problems we have identified have either not been addressed, or addressed only indirectly. While some of the issues we have raised – cost allocation, for example – may appear obvious, it is submitted that the DSC amendments would be significantly improved if each of those issues were clearly reflected in new or revised DSC provisions.

44. Because in our view there are quite a number of additional provisions required, we have not enumerated them individually. The Board, it is submitted, should canvas each of the issues of concern and ensure that an express DSC provision clearly addresses that concern.

Amendments to the Electricity ARC

45. It follows from our comments above, and the philosophical approach we believe should be taken, that we believe the amendments to the ARC that the Board has proposed inappropriately limit the protections for the ratepayers and for the marketplace that the ARC is intended to deliver.

46. ***Employee Sharing.*** In our submission these changes are inappropriate, and should not be implemented. Distributors should be allowed to share employees in the same circumstances as they share employees with non-qualifying facilities. To provide for any other rule, it is submitted, can only be appropriate if the government's policy is intended to reduce competition for renewable generation. We do not believe that to be the case.

47. ***Affiliate Contracts.*** The proposed amendments suggest removal of the five-year limitation on affiliate contracts. This, in our submission, is a considerably more complex issue than can be handled by a simple exemption.

48. By way of example, can the distributor agree to provide electricians and other trades for the generation affiliate on the basis of fully-allocated costs, with a reasonable escalator over twenty years? This change implies that result is allowed. If that is true, the generation affiliate would cost protection for twenty years. In the rapidly growing area of renewable generation, that is a valuable insurance policy, and a competitive advantage.

49. In our submission, the competitive markets would not make long-term contracts available for most goods and services to competitive generation companies, except in quite unusual circumstances. If that is true, then there is no reason why the generation affiliate of the distributor should have a long-term contract from the distributor. Why should the generation affiliate be protected from normal market risks because of its status as an affiliate?

50. The opposing view, of course, is that the goal is to make the choice of ownership between distributor and affiliate neutral, i.e. not influenced by these rules. While we agree with that goal, we do not agree that giving the affiliate a market advantage over their competitors is the way to achieve it.

51. The better way, as we have indicated earlier, is to ensure that all cost impacts of distributor-owned generation are reflected in the costs of the generation business. This would include, for example, the incremental salary and related costs that would arise if the utility's skilled trades people are more expensive because of their renewable energy training. In effect, if the North American expansion of renewable energy over the next twenty years causes certain types of costs – like those for specially trained personnel – to increase, anyone who participates in that market will have to deal with that cost pressure. The utility's generation business, whether in the distribution company or in an affiliate, should not have a competitive advantage by having the distribution business either take or share this risk.

52. The same conclusion should arise with respect to every aspect of affiliate contracts.

53. We therefore propose a different rule. The different rule should be that, for <u>any</u> affiliate business, the five year limit should not apply if the distributor can demonstrate that contracts for a longer period are available in the marketplace on terms comparable to those proposed by the distributor for its affiliate. If the market makes a distinction between suppliers to qualifying facilities and suppliers to other generation or other businesses, and the distributor can meet the onus of demonstrating that, then ARC should make the same distinction. If the market imposes risks or common terms, those risks and terms should apply equally to renewable generation projects in distributor affiliates.

54. ***Business Case.*** We understand that, if a distributor were to be purchasing power from a renewable generation affiliate, the business case exemption should be waived. Since that is not the case for a qualifying facility, we do not see a situation in which this exemption is appropriate.

55. For example, suppose that a distributor has its group CFO working for the generation affiliate. Should the distributor be allowed to purchase services related to the CFO's office without any analysis of the cost and the alternatives? What about treasury, or risk management?

56. A review of the details of section 2.3.2.3 of the ARC makes clear what is being exempted in the proposed change: the entire process of analyzing options, a process that is there precisely to protect the ratepayers.

57. In our submission, there are no circumstances in which a distributor should enter into a substantial contract to acquire goods, services, resources or asset use from an affiliate without first doing its homework, and the business case requirement is the Board's method of ensuring this obligation is clear. There is nothing in the nature of a generation affiliate that operates qualifying facilities that would remove the reason for this ratepayer protection.

58. ***Transfer Pricing.*** We do not understand the purpose of this exemption. We do not see why a distributor would be allowed to (or want to, for that matter) pay in excess of market for services from a generation affiliate, as the exemption from section 2.3.3.1 of the ARC would say. Nor do we see why a distributor should be allowed to provide services to a generation affiliate at a lower price than the affiliate would be required to pay in the open market, if a market price exists. Both of these situations would amount to a subsidy by the distributor's ratepayers of the generation affiliate. That is both anti-competitive and unfair to the distributor's ratepayers.

59. In our submission, proposed new section 2.3.4A should not be implemented.

60. ***Financial Transactions with Affiliates.*** The effect of the proposed new sections 2.4.1A, 2.4.1B, and 2.4.3 is, it is submitted, that distributors would be allowed to increase their cost of debt through increasing their overall risk level, all for the purpose of having sufficient capital to fund the riskier generation business. This would necessarily increase rates, and in our submission those resulting rates would not be just and reasonable.

61. It is submitted that a more appropriate approach is to allow financing by the distributor of renewable generation affiliates, but place the onus on the distributor to demonstrate that the rate being charged to the affiliate for debt, or the return on equity from the investment in the affiliate, fully compensates the distributor's ratepayers for the additional cost of capital in the distributor resulting from its increased risk profile.

62. This, of course, assumes that it is the distributor that is doing the financing. It would be preferable, it seems to us, for any financing of the generation affiliate to come from a common parent company or third parties, rather than directly from the distributor. However, to maintain neutrality between distributor-owned and affiliate-owned generation, a rule such as the one we have suggested would produce a fair result.

63. ***Equal Access.*** This proposal is, in our view, inappropriate and should not be implemented. It would be directly contrary to the concern we have expressed in para. 40 (d) above, and provide a clearly unfair advantage to the generation affiliate over its competitors.

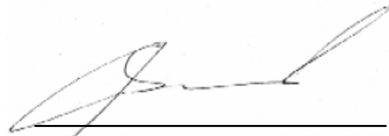
64. We note that the Board's explanation on this point, on page 7 of the Notice, appears to imply that giving the distribution affiliate an advantage "will support the Board's new objective of promoting renewable generation". In our submission, the opposite is true. If the Board implements provisions that provide advantages to distributor affiliates, that will be anti-competitive, and there is little doubt that reduced competition in the market will ultimately reduce the amount of renewable generation in Ontario, and increase its cost.

Conclusion

65. We hope these submissions are of assistance to the Board, and would like to continue to be involved in the Board's consideration of this issue going forward.

66. The School Energy Coalition submits that it has participated responsibly in this process, with a view to assisting the Board in an efficient manner, and therefore requests that the Board order payment of its reasonably incurred costs of that participation.

Respectfully submitted on behalf of the School Energy Coalition this 22nd day of January, 2010.



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