Sack Goldblatt Mitchell LLP *Lawyers*

20 Dundas St. W., Suite 1100, P.O. Box 180 Toronto ON M5G 2G8
T 416.977.6070 F 416.591.7333 www.sgmlaw.com

# FAX COVER PAGE

| TO: | FAX NO.: |
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| Ms. Kirsten Walli<br>Ontario Energy Board | (416) 440-7656 |

**DATE:** February 4, 2010

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**FROM:** Steven Shrybman

**DIRECT DIAL:** 613-482-2456

*(Please call Lynn Ritchie at 416-979-6421 if you do not receive the entire transmission)*

**RE:** Board File EB-2009-0411

**MESSAGE:** Please see attached.

ORIGINAL DOCUMENTS: Will follow by ☐ mail ☐ courier – OR - ☒ Will not follow unless requested.

Sack Goldblatt Mitchell LLP *Lawyers*
20 Dundas St. W., Suite 1100, P.O. Box 180 Toronto ON M5G 2G8
T 416.977.6070 F 416.591.7333 www.sgmlaw.com

Steven Shrybman
Direct Line: 613-482-2456
sshrybman@sgmlaw.com
Our File No. 10-61

February 3, 2010

**Via Facsimile**

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
17th Floor
2300 Yonge Street
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

**Re: Board File EB-2009-0411**

It has just come to my attention that there were some minor citation errors in the submissions we made on behalf of the Council of Canadians in the above noted proceedings.

I trust that it is possible to file this errata sheet to those submissions.

- The date at the top of the document should have been January 22, 2010 and not 2009.
- On the first page of our submissions the reference to s. 5(1) of Schedule A, should have been to s.6(1) to Schedule A to the *Green Energy Act*.
- In addition, reference to municipalities in point iii) on that page should have been to "distributors and transmitters", and in point iv), to "distributors".
- Finally, footnote #3 has been added to page 2 to indicate that: "The term "municipality" is used to indicate municipally owned entities such as local distribution companies."

We apologize for any confusion these errors may have caused.

A corrected copy of our submissions is attached. Two hard copies will follow by mail.

Sincerely,

S. Shrybman per

Steven Shrybman
SS:lr/cope 343
Encl.

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In the Matter of Proposed Amendments to the Distribution System Code (DSC)
and the Affiliate Relationships Code (ARC) for Electricity Distributors and Transmitters

Board File No. : EB-2009-0411

**Submissions of the Council of Canadians**

Jan. 22, 2010

## Proposed DSC and ARC Amendments Fail to Reflect GEA Policy and Regulatory Reforms

Recent reforms implemented by the *Green Energy Act* (GEA) represent a welcome and overdue departure from policies of privatization and de-regulation that represented the Harris Government's agenda for Ontario's electricity sector. In many ways, the *Green Energy Act* repudiates those policies by re-establishing the key role that government direction and regulation must play if the electricity sector is to meet the needs of Ontario consumers, and do so in a manner that begins to meet pressing environmental imperatives.

These reforms not only provide the Minister and his colleagues with sweeping new powers to ensure that renewable energy and conservation goals are met, but also foresee a much expanded and more proactive role for municipal entities in achieving green energy goals. Thus:

i) municipalities may now be required to develop energy conservation and demand management plans [s. 6(1) of Schedule A to the GEAct];

ii) amendments to the Ontario Energy Board Act [s. 27.2] also empower the Minister, with Cabinet approval, to issue directives to the Board setting out conservation and demand management targets to be met by distributors;

iii) distributors and transmitters may be required to play an important role in local system planning and the Board has recently asked for comments on proposed requirements for distribution system planning;[1] and

iv) under the Act, distributors may establish certain renewable generation facilities and may do so as public not-for-profit entities.[2]

[1] EB-2009-0397. Filing Requirements: Distribution System Plans under the *Green Energy Act*.

In fact, the new roles and capacities assigned to municipal utilities represent a sea-change in the traditional role that local government entities have played in meeting the energy service needs of their constituents and the province. In the past, the role of municipal electric utilities was circumscribed by the broad mandate and regulatory authority of Ontario Hydro. In a system dominated by large central generation facilities connected to load centres by a high voltage transmission system, municipal utilities were primarily relegated to providing local distribution services. As Ontario Hydro was dismantled, Harris government reforms also sought to limit the role of publicly owned municipal utilities, in part by limiting their ability to own and operate generation facilities.

It is only with present reforms that municipalities[3] are empowered, and indeed may be compelled to play a proactive role in meeting the energy service needs of provincial consumers. These reforms point to the emergence of new paradigm for the power system of the province – one in which local planning, distributed generation, renewable power, aggressive conservation and demand management are driving forces. In this new paradigm distributors will be responsible for the kind of planning that used to be required for the grid but which was abandoned by the previous government and then subsequently reinstated by the IPSP process (now suspended).

At the same time the responsibilities of the Board have been substantially expanded to include the following Board objectives:

- To promote the conservation of electricity.
- To facilitate the implementation of a smart grid in Ontario.
- To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities.[4]

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[2] Section 144 of the *Electricity Act* is amended by adding the following subsections:

*Exception, renewable energy generation facilities*

*(2) Despite subsection (1) and section 143, a municipal corporation, a municipal service board, a city board or municipal services corporation established by a municipal corporation may, subject to the prescribed rules, generate electricity by means other than through a corporation incorporated under the Business Corporations Act if,*

*(a) the generation facility is a renewable energy generation facility that does not exceed 10 megawatts or such other capacity as may be prescribed by regulation; or*
*(b) the generation facility meets the prescribed criteria.*

[3] The term "municipality" is used to indicate municipally owned entities such as local distribution companies.

[4] S. 1(1) of the *Ontario Energy Board Act*, as amended by Bill 150.

These reforms reflect an important dimension of the current paradigm shift in electricity policy which moves away from a model of exclusive grid-generated electricity to one in which distributed generation (DG) plays a key role.

This is the context in which the DSC and ARC must be viewed, but unfortunately proposed reforms fail to do so. Because both codes were developed to reflect a policy and program agenda that was fundamentally different than the one engendered by GEA reforms, they represent an entirely inadequate foundation for regulating the relationships between distributors and distributed generators. However, rather than reflect an understanding of the need to fundamentally overhaul rules that were fashioned at a time when municipal entities were to play very limited role, proposed reforms seek to tinker with these codes.

*The Arc Code*

What we've learned from over ten years of restructuring in Ontario is that electricity systems need to be planned. To do otherwise simply creates unnecessary transactions costs and opportunities for rent extraction. The ARC exemplifies both problems. Without contributing anything toward increased reliability or productivity the ARC has simply increased costs. For example, several distributors have been led to create shell organizations ("virtual distributors") to comply with the ARC. In some instances distributors have tendered for functions which are more efficiently carried out in-house thereby creating rents for the winners of the tenders.

To extend existing ARC restrictions to generation is not to "level the playing field" but to create unnecessary costs while biasing the process to the wasteful connection of private generation in locations that add rather than lower costs. In contrast, a planned approach to local generation can lower overall costs, e.g. by locating generation to defer or eliminate the need for new distribution stations or match reactive power with the needs of loads to reduce losses and the installation of static capacitors.

In effect the Board is attempting to renovate a regulatory structure that is obsolete and which must now be replaced, not fine tuned. The ARC was created when government policy actively promoted the corporatization and privatization of the electricity distribution sector, and planning was, according to that market model, simply unnecessary. Under that construct, the role of public ownership was to diminish, even disappear. Fortunately this regressive approach has now been abandoned and replaced by a very different agenda that requires publicly owned distributors to play a proactive and central role in meeting local and provincial energy service needs.

The problem with the conception of present reforms proposed for the ARC and DSC codes arises from a failure to ask a basic question which is whether, given the new mandate and obligations of the Board and distributors, the application of the ARC to distributors who own and operate generation facilities still makes sense. In our view, for the reasons noted above, it does not. While it is necessary to regulate commercial relationships as these arise among distributors and private generators, the starting point for devising such controls should not be codes devised in a very different context and for very different purposes. Alternatively, rather than adjust ARC requirements in an attempt to reflect the new realities of DG owned by distributors, it would make more sense in our view to simply exempt DG from the ARC entirely.

*The DSC Code*

Similar problems exist in trying to adjust the application of the DSC without re-examining its genesis. As noted, the DSC was created as a codification of the system that existed under Ontario Hydro and which in many ways discouraged distributed generation. Present proposals to reform the DSC require distributors to create accounting transactions to mirror the connection provisions for private generators. For example, the section on security deposits requires a distributor's affiliate to create a security deposit account for which the distributor is the beneficiary and then return the funds to the affiliate's account once the connection is complete. Moreover, compliance with these fictional accounting procedures can materially influence the allocation of system resources.[5]

These transactional requirements make sense when a private generator seeking to connect to a distribution system but do not for generators and distributors that are effectively subject to common and public ownership.

Present proposals acknowledge that mirroring the capacity allocation process for private generators does not make a lot of sense but fail to acknowledge that the real issue is that efficiency and reliability are best served by planning the locations of distributed generation. In our view, the capacity allocation process is a wasteful and inefficient way to accomplish the ends of the *Green Energy Act* with regard to renewable generation.

Rather than treat distributor-owned distributed generation "as if" they were private, a more far-reaching approach is required. In this approach the distributor would be charged with not "connecting" facilities but planning them. In our view, the Board should revise its approach to present reforms and allow further consultation when current rules, to the extent they remain relevant, are reformulated to reflect the new era of distributed generation that is the central feature of current government energy policy.

**The failure to integrate the DSC with Distribution System Planning**

The essential thrust of proposed reforms to the DSC is described as the "*General Obligation of Equal Treatment (new section 2.1)*"

> It is the Board's view that, for the purposes of the DSC, distributors should be required to treat their own generation facilities in the same manner as they would treat generation facilities owned by third parties. This is consistent with the requirement to provide non-discriminatory access, and will ensure a level playing field for all generators and generation

[5] *6.2A.4(e) iv. in lieu of the permission to revoke the standard offer to connect, if the distributor has not satisfied the obligation to provide any required deposits (as defined in section 6.2A.3) in the manner specified in section 6.2A.3(b) within 60 days of the date on which the distributor completes the standard offer to connect, the distributor shall terminate the connection process in relation to its generation facility and the capacity allocated to that facility shall be removed. The distributor shall not thereafter connect the generation facility except further to the preparation of a new application for connection as set out in section 6.2A.3(d);*

> proponents. Moreover, this approach will ensure the timely connection of all generation facilities, whether owned by a distributor, an affiliate or another third party, and therefore support the Board's new objective of promoting the connection of renewable generation. The Board is therefore proposing to amend the DSC to specifically prohibit a distributor from providing favoured treatment or preferential access to the distributor's system or services for generation facilities that are owned and operated by the distributor.

The specific reform being proposed reads as follows.

> ***2.1 Distributor-owned Generation Facilities***
>
> *A distributor shall not, in respect of any matter addressed in or under this Code, provide favoured treatment or preferential access to the distributor's distribution system or the distributor's services for any generation facilities that are owned by the distributor.*

The problem with this proposed wording is that it fails to qualify this equal right to access the distribution system by reference to any plan for that system. But we know that the scale, character and location of generation facilities can have an enormous bearing on the relative costs and efficiencies of a local power system. This is why electricity systems must be planned. Yet by providing all would-be generators with an effectively unqualified right to access the grid, this proposed amendment to the DSC would abdicate important 'planning' decisions to the market. We know, however, that what may make sense for an individual investor might very poorly serve system requirements or the interests of consumers.

The importance of local system planning has been acknowledged by the Board in a consultation concerning capital investment planning that was initiated by the Board shortly after the present consultation. As explained by the Board's letter of Dec. 18, 2009, introducing that consultation:

> The Board recognizes that distributor system planning must take into consideration inter-related regulatory requirements, including new requirements required under the *Green Energy and Green Economy Act* ("GEA"). A number of the Board's regulatory requirements and initiatives affect the capital investment planning process. These include distribution system planning to accommodate renewable generation and smart grid development, the implementation of system reliability standards, the Board's continuing interest in asset management practices.
>
> The Board also recognizes the need for coordination of these related requirements and initiatives to ensure that capital investments are undertaken in respect of clear objectives and are focused on cost-effective infrastructure development. The two objectives of, first, providing consumers with an appropriate level of reliability and, second, supporting the government's policy objectives as reflected in the GEA remain central to the Board's work in this area.

The importance of planning to sound and efficient asset management was also underscored by a report prepared for OEB last year. It explained that:

> The fundamental principles of asset management are to most effectively manage the business assets in order to optimally meet the requirements of all stakeholders. This includes the need to meet the short term aspirations of the business with the long-term need for flexibility and sustainability in the business. These principles require asset management practices to balance cost, performance and risk; and to align the organizational objectives with investment decisions.
>
> Investments in electricity network infrastructure occur over extended periods, typically decades. The design life of the primary assets employed within such networks is typically in the range of 40 – 60 years, so many utilities are now entering a significant asset renewal phase. ....
>
> The importance of adequate asset management processes, systems and implementation will become increasingly relevant in future years to ensure that uneconomic investments can be avoided without jeopardizing overall network integrity or the flexibility required where facing an uncertain future. It is therefore appropriate for regulators to seek evidence of asset management competence when assessing investment submissions from utilities. Such assessments provide assurances that the utilities understand and have prioritized their investment plans, that the investment requirements are not overstated, that the benefits of innovation are not foregone, and that customer risk exposures are properly considered.[6]

It is entirely inconsistent with these principles of planning and prudent assessment management to leave system design, staging and costs at the mercy of private investment decisions by those who have no responsibility for ensuring that power systems are efficient and reliable.

**The Failure to Account for NAFTA Risks**

The other problem with creating such an unqualified right of access arises from the fact that such rights may now be enforced under the North American Free Trade Agreement (NAFTA) investment rules by US and Mexican investors. It is beyond the scope of these submissions to explicate this risk other than make the following brief points:

> *Under NAFTA investment rules, foreign investors have the right to the most favourable treatment (National Treatment) accorded by government to any domestic investor, which in this case would include a local distribution company;*[7]
>
> *That right may be asserted by way of a claim for damages that would be determined by an international arbitral tribunal;*
>
> *While NAFTA investment rules clearly bind the Board, it is not clear that local distribution companies – as wholly owned public entities – are directly bound by this National Treatment obligation, but present reforms may determine that question.*

[6] KEMA Inc: Leveraging Network Utility Asset Management Practices for Regulatory Purposes, November 2009.

[7] NAFTA Article 1102

These NAFTA related risks are a consequence of privatization and there are several examples of these rules being invoked to challenge public policy and regulatory initiatives by Canadian governments including those by Ontario.[8] It would therefore be imprudent in our view to construct electricity system rules without taking these risks into account, yet we can find no evidence that this has taken place.

The formulation of Rule 2.1 may well create exposure to NAFTA based claims where none previously existed. This underscores the importance of clearly qualifying the character of the entitlement it proposes to establish so as to minimize this risk.

**Amending Provision 2.1**

In our view, proposed provision 2.1 should be amended to provide as follows:

> Subject to the requirements of any distribution system plan prepared and filed in accordance with the requirements of the GEA, and taking into account the obligation of the distributor to ensure prudent and efficient capital asset management, *A distributor shall not, in respect of any matter addressed in or under this Code, provide favoured treatment or preferential access to the distributor's distribution system or the distributor's services for any generation facilities that are owned by the distributor.*

***Present ARC and DSC Reforms are Premature***

It is apparent from our comments that, apart from needing to be reformulated to reflect the fundamental shift of Ontario energy policies for the electricity sector, that reforms need to be integrated with local distribution system planning. In light of the fact that the rules for such planning are only now being developed, it is simply premature in our view to consider reforms to the ARC and DSC, which can only properly be devised when the requirements of local planning are settled.

Submitted: Jan 22, 2010

On behalf of the Council of Canadians

Steven Shrybman
Sack Goldblatt Mitchell LLP

[8] A record of NAFTA investor claims can be found at http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/gov.aspx, for examples of claims involving measures taken by the government of Ontario, see Gallo v. Canada, and GL Farms v. Canada.