**Jay Shepherd**
Professional Corporation
2300 Yonge Street,
Suite 806
Toronto, Ontario M4P 1E4

**BY RESS and EMAIL**

October 7, 2010
Our File No. 20100133

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

**Attn: Kirsten Walli, Board Secretary**

Dear Ms. Walli:

**Re: EB-2010-0133 – Hydro Ottawa 2011 Rates**

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #3, these are SEC's submissions with respect to the preliminary issue of the timing of this cost of service application.

In these submissions, we will first consider the general issues associated with early filing by a utility that is scheduled to use IRM for 2011, then the eight specific reasons the Applicant has provided for the early filing. We then propose a specific resolution that allows the Application to proceed, but under conditions that include deferring implementation (but not consideration) of certain of the requests by the utility.

**General Submissions on Early Filing**

1. ***The Right to Apply.*** The Board has long adopted a policy that a utility can apply any time it wants, for anything it wants, and the Board will respond to the application in a manner that is appropriate and complies with its statutory mandate.

2. The Applicant, in its submissions, appears to suggest (para. 3) that this is a right that utilities have by reason of s. 78 of the Ontario Energy Board Act. Section 78 gives a right, not to applicants, but to the Board, to determine how rates are to be set, and the Board has correctly interpreted that to mean that it has a discretion to use COS, IRM, or other methods for rate-setting in any given set of circumstances.

3. However, the Board also has a long-established practice to listen to any application that a utility files. This reflects, not a utility right, but rather a Board recognition that the situations of individual utilities are complex and varied, and the regulator should maintain maximum flexibility to respond to those

Tel: (416) 483-3300 Cell: (416) 804-2767 Fax: (416) 483-3305
jay.shepherd@canadianenergylawyers.com
www.canadianenergylawyers.com

disparate situations. The Board's practice of maintaining flexibility should not be expanded to give any rights to utilities. That would defeat the purpose of maintaining flexibility.

4. Further, we agree with the Applicant that no Board policy binds either the Board or a Board panel. We have consistently taken the position before this Board that, while policy processes are extremely useful in creating understanding by the Board and all parties, they are not legally binding processes. If Board panels apply Board policies without considering the merits of the policies in individual cases, in our view they are acting contrary to law. This applies whether the policy is one relating to cost of capital, or alignment of fiscal and rate years, or the timing of cost of service applications.

5. One interesting aspect of this Application is that the Applicant seeks to apply the cost of capital, year end, and EDDVARR policies, but ignore the four year IRM policy. The Applicant's view appears to be that Board policies are available for the Applicant to pick and choose, rather like a menu. This is not the case.

6. SEC strongly supports the Board's policy and practice of allowing applications by any utility at any time, and we would not like to see that approach watered down. Not only does it perform the flexibility function that is so important, but it also acts as a relief valve, allowing parties to reach agreements on rates and other issues knowing that if it all doesn't work out, there is a way of getting any problems fixed in a timely manner. Many ADR results would not have been possible but for the knowledge that the relief valve exists.

7. ***Board Control of its Process.*** On the other hand, the Board must retain and vigorously defend its ability to control its own process. The April 20th letter was an attempt to do that, and utilities should not have free rein to ignore it.

8. The Board has eighty or more electricity distributors to regulate, and a number of other utilities and regulated entities. The Board established a method for doing so, 3rd Generation IRM, in which utilities come in every four years for cost of service, and for the intervening three years have their rates set by a formula that provides an incentive for utility productivity initiatives.

9. In this respect, the Board is much like the movie theatre proprietor, whose new feature is very popular. There are, inevitably, lineups. The theatre owner establishes an order of admission (whether queue, or numbers, or whatever), and tries to keep everyone waiting happy with free coffee.

10. Some of the patrons don't want to wait their turn. In rare cases, there is a legitimate reason for the desire to jump the queue. There is some special aspect of their situation (e.g. they are in a wheelchair, and the accessible seats are available now, not later in the evening) that justifies a change in the order of entry. But, most of the time it is simply impatience or failure to accept the need to queue up. When that is the case, the theatre owner quite properly tells those who are impatient to get back in line.

11. In this case, it is submitted that what the Board should be doing on this preliminary point is assessing whether there is anything sufficiently special about the Applicant that should allow them to jump the queue. If there is not, then they should be invited to get back in line. If there is, then in our submission the Board should fashion a remedy that reflects the Board's flexibility, considers what the Applicant really needs considered, but also supports the viability of the Board's queue system and its IRM policies.

**Benefits of an Orderly Process for Electricity Distributors**

12. This is not just a question of the Board being busy, and seeking to prevent an unmanageable onslaught of applications. Fairness and good policy considerations also arise, and those considerations are for the benefit of the utilities and their ratepayers, not primarily for the Board. The Board's decision on this preliminary issue in the case of Hydro Ottawa will send some pretty clear messages about the expectations the Board places on LDCs, and about fairness. The implications of those messages are important.

13. ***Fairness to Those Who Waited in Line.*** At the simplest level, there are LDCs who are due to have their cost of service proceedings considered this year. Most have waited patiently for three years, and now is their turn. They are, in effect, the others waiting in the movie theatre queue. For them, yes the Board is accepting their applications, but the resources of the Board, the intervenors, and others are stretched to the limit. If a large utility like Hydro Ottawa is allowed to add their considerable needs to the mix, inevitably there is less ability to give as much attention to those whose turn has legitimately arrived. A Board case manager has to be assigned to the Hydro Ottawa case, and that means that person has less time to focus on other applications. Those other applications are already being delayed, for example because of the busy regulatory agenda. It is not fair to those who waited to get "short shrift" because Hydro Ottawa is impatient to be heard.

14. Similarly, intervenor groups have finite resources, and often have to decide which applications to take on, and which to pass by. When a large utility unilaterally adds itself to the mix, intervenors have to make hard decisions not to intervene in other applications that they would otherwise pursue. While some might say that is a benefit to those other applicants, in fact it increases the burden on Board staff, and makes it difficult or impossible to resolve their issues through settlement rather than a hearing.

15. In our submission, the decision by a utility like Hydro Ottawa to suck some of the limited air out of the Board's regulatory "room" must be tightly monitored to make sure that it is well justified by their specific situation. Otherwise, it is unfair to those who have in fact waited their turn.

16. ***Supporting Successful IRM.*** At a broader policy level, allowing utilities to jump the queue indiscriminately undermines the ability of IRM to achieve the benefits for which it has been implemented. The nature of IRM is that rates are set in the traditional way, based on cost of service, and then the utility is given an extended period of time to operate within that revenue envelope (with annual formula adjustments). The theory is that utilities will use that opportunity to implement efficiency and productivity measures, since the benefits of those measures during the IRM period go to the shareholder rather than the ratepayers. That is the "incentive" in incentive ratemaking.

17. For IRM to work, utilities must have sufficient time to implement and enjoy the benefits of those efficiency and productivity improvements. The Board has adopted a four year cycle for electricity distributors, precisely to give them the opportunity to do this. For gas distributors, who have more mature businesses and a more business-oriented management, a five year cycle is used. The ratepayers benefit in the interim from stable rates with a built-in stretch factor, and the shareholder benefits from keeping every additional dollar that it can save through good management.

18. If the Board allows utilities to switch to cost of service whenever they feel like it, there is no incentive for the utility's management to make those hard decisions necessary to implement significant productivity improvements. Rather than try to increase shareholder profits using the IRM model, utility management can stick with the easier status quo operational approach, knowing that whenever they feel they need a budget increase, they can come and ask for one from the Board.

19. ***Changing the Corporate Culture.*** This is particularly problematic in the case of the electricity distributors, since just ten years ago most of them were departments of government bodies (mostly municipalities). One of the most difficult tasks that has faced the Board over the last decade has been to assist the LDCs in moving from a government department model of operations to a profit-making business model of operations. In the former case, you improve your fortunes by getting budget increases from your budget-granter (in this case, the regulator). In the latter case, you make better operational decisions, and your margins increase.

20. IRM supports the move to a more business-like approach to running an electricity distributor, and in the process supports the rationalization of the sector. Some distributors have embraced the business model, and have been successful. Municipalities look at their operational success with envy, and in many cases have shown a willingness to consolidate their local utility with the successful distributors to form larger, more economically robust entities. It is an evolution of course, but it is a critical one, and it is powered in part by IRM.

21. The Board, in this preliminary decision, has the opportunity to tell the distributors (all of whom are watching with intense interest, of course) whether it is better to embrace the business-like model of utility operations, or retain the conventional "just ask for more money when you need it" approach. The industry will evolve in the direction in which the Board points.

**What About the Others?**

22. In Exhibit A1/2/2, the Applicant goes on for three pages about Toronto Hydro and Hydro One, and essentially says that if they are allowed to seek cost of service rates any time they want, Hydro Ottawa should have the same right.

23. The most prosaic way of looking at this is "you're letting them jump the queue, why not me too?" How often do you see this in a lineup? We must all have a visceral sympathy when Hydro Ottawa says this, because all of us have fumed at someone else jumping a queue while we were trying to abide by the rules.

24. But we have two other comments about that. First, as the Applicant correctly points out, in neither Toronto Hydro nor Hydro One proceedings did the Board grapple with the question of whether the early cost of service filing was appropriate. The Board had just implemented the four year cycle when Hydro One and Toronto Hydro came in out of sequence, and no consideration had been given to what should happen if utilities "butt in line". The Board panels fell back on the traditional approach, i.e. deal with the application in front of you.

25. The Board, we believe recognizing the potential for this practice to get seriously out of hand, with the bad consequences we have noted earlier, wrote the April 20th letter to signal that the Board is going to police its own process. This is an evolution of the Board's approach to this. The essence of the Hydro Ottawa "me too" argument is that the Board's approach must be static. It never is, and it shouldn't be. The Board implemented the four year cycle, and is now building in additional safeguards to make sure it works properly.

26. Second, if there is an inherent unfairness in letting Toronto Hydro and Hydro One jump the queue, but not Hydro Ottawa, the solution to that is not to invite Hydro Ottawa (and presumably everyone else, to be fair to them too) to jump the queue as well. The solution is to look at whether Toronto Hydro or Hydro One is appropriately put at the head of the line, out of turn. There may be an issue about that, but it is an issue about those utilities, and it has nothing to do with Hydro Ottawa.

27. We note that the issue of whether Toronto Hydro should be applying for 2011 rates, or whether it should have consequences for so doing, has not yet been considered in the EB-2010-0142 proceeding. As to Hydro One, it is planning to file for 2012 distribution rates, and the issue of timing and the four year cycle may arise in that case as well. In neither case has a Board panel, post the April 20th letter, made a decision that their early rebasing is OK.

**Specific Reasons for Early Filing**

28. ***"Wait Your Turn" Board Policies.*** Of the eight reasons that the Applicant gives for filing out of turn, five of them are to accelerate the application of Board policies that would normally not apply to Hydro Ottawa until 2012. Those five are the following:

    a. ***Increase the Cost of Capital*** pursuant to the new policy enunciated in EB-2009-0084. That policy by its express terms can only be implemented by a Board panel in the context of a cost of service proceeding. Hydro Ottawa admits that they do not believe they should have to wait to earn the new ROE, and that is one of the reasons they filed this cost of service application.

    b. ***Align the Rate Year with the Fiscal Year*** pursuant to the new policy enunciated in EB-2009-0423. The Board's policy is that distributors, in a cost of service proceeding, can ask the Board to make rates effective January 1st, although with no guarantee that the request will be granted. Ottawa wants that January 1, 2011, rather than January 1, 2012 as per their normal schedule.

    c. ***Clear Deferral and Variance Accounts*** pursuant to the new policy set out in the EDDVAR Report (EB-2008-0046). The EDDVAR report specifically deals with the requirements that must be met to clear accounts outside of a cost of service proceeding. Hydro Ottawa does not meet those requirements, but wants to clear the accounts anyway, and so is filing for cost of service to get around the policy.

    d. ***Add Smart Meter Capital Costs to Rate Base***, something that can only be done in the context of a cost of service proceeding. Under the Board's policies as they apply to everyone else, Smart Meter costs are recovered through rate riders until it's time for your rebasing, when they are moved to rate base. Hydro Ottawa wants an earlier shift to rate base.

    e. ***Approve the Green Energy Plan***, including the prudence of the planned spending, something that under the Filing Requirements set out in EB-2009-0397 would not be open to Hydro Ottawa until their 2012 cost of service application. They would still be required to spend on renewable generation connections, for example, prior to that time, but would await their COS application to consider the prudence of that spending. Hydro Ottawa does not accept that policy, and elected to filed the plan this year to accelerate consideration of the prudence of their plans.

29. ***Utility-Specific Operational Reasons.*** The Applicant has three reasons for filing early that are based on their specific operational and spending needs and situation:

    a. ***Aging Infrastructure*** problems and the need to invest in capital in response. Hydro Ottawa has complained many times (and again in Ex. A1/2/2) that the incremental capital module does not deal with the needs of a utility with aging infrastructure, so they need to file for cost of service to get more money in their budget to cover this cost. This is a problem – to the extent that it is one - they have known about since 2005, and they have gone through two cost of service proceedings already since that time. Their complaint is really that 3rd

Generation IRM does not give them big enough rate increases to fund the work on their aging infrastructure. We note that the Applicant's infrastructure is, on average, neither the most "aged" nor least "aged" in the province. The infrastructure of every distributor is aging, and the Board, having heard that from the utilities in EB-2007-0673, implemented 3rd Generation IRM in its current form. Hydro Ottawa did not agree with that policy then, and it still doesn't agree with it. This cost of service application is a way to get around it.

b. ***Workforce Planning.*** The Applicant advises that they have both an aging infrastructure and an aging workforce, and they have to invest in increased training and staff recruitment to deal with it. This is a problem that is no different for Hydro Ottawa than for any other LDC, and in fact there are probably some Ontario LDCs in far worse position in this regard than this utility.

c. ***Declining Average Use and Conservation.*** The Applicant says that their load growth is slowing due to conservation and other factors reducing average use. Unsatisfied with the LRAM they already have available to them, and unwilling to wait for the Board's policies arising out of the EB-2010-0060 process on Revenue Decoupling, the Applicant wants to reset its load forecast early to increase rates.

**Analysis and Recommended Outcome**

30. In our submission there is ample evidence on the record to justify the Board declining to proceed with this Application on the basis that it is one year premature. Both the regulatory calendar and support for the IRM regime support that result, and if the Board were to make that decision, we would not consider it inappropriate. That is particularly true since so much of this Application is essential a rejection of Board policies that the Applicant simply doesn't like.

31. But in these submissions, we are recommending a less categorical response. As noted at the outset, SEC does not want the Board to lose its inherent flexibility by taking a hard line against those who jump the queue. However, we submit that it is in everyone's interests, including the utilities, to let the utilities know that they will not be able to sidestep Board policies by taking advantage of that flexibility. Where they have a legitimate reason for filing early, that reason will be addressed in the cost of service context, but the "collateral" benefits they hope to achieve with COS in getting around Board policies will not be available to them.

32. ***Relief/Approvals Available in this Proceeding.*** To achieve this result, it is submitted that the Board should consider the reasons Hydro Ottawa has given for early rebasing, and deal with them separately. We divide those eight reasons into two categories, as above: "Wait Your Turn" Policy Issues, and Utility-Specific Operational Issues.

33. In the case of the Wait Your Turn Policy Issues, it is submitted that, for four of the five, the Board should consider the issues in this proceeding, but order deferral of the implementation of these changes, if approved, until 2012, the year they would have otherwise been available. Those four are the following:

    a. ***Cost of Capital.*** If the Board determines that the new ROE formula should apply to this utility, the increase to the new ROE formula should be deferred until the effective date for rates in 2012. In the meantime, the current ROE embedded in rates should continue. The Board should advise Hydro Ottawa today that their 2012 and subsequent ROE will be the figure established for 2012 under the Board's policy.

b. ***Year End.*** If the Board considers that rate year and fiscal year should be aligned in this case, the Board should determine that 2011 rates are effective May 1, 2011, but the utility is authorized to accelerate their 2012 IRM application so that 2012 rates will be effective January 1, 2012.

c. ***EDDVAR.*** The Board should order clearance of the deferral and variance accounts, but starting in 2012, subject to an application in 2011 (perhaps with the IRM application) to set the final amounts.

d. ***Smart Meters.*** If the Board is satisfied that the smart meters capital costs are appropriate, the Board should order that they be added to rate base as of 2012, and authorize the Applicant to include a special adjustment in their 2012 IRM application to achieve that result.

34. The point of these machinations is to ensure that utilities do not believe they can get around Board policies by early rebasing. Those who jump the queue are treated fairly, and if they have any legitimate reasons for going to the head of the line, those are dealt with immediately (preserving flexibility), but no indirect or collateral benefits (like accelerating their higher cost of capital) will be available. Thus, the flexibility of early rebasing is limited only to those who really need it.

35. On the fifth of the Wait Your Turn issues, the GEA Plan, to be consistent we should argue that the Board not consider it in this proceeding. The problem with that is that then an exception would have to be made in IRM next year, and that is not the best context in which to consider a GEA Plan. The two other options available are to defer consideration of the GEA Plan until the next rebasing after this one, perhaps 2016, or reject this Application entirely so that there is a cost of service application next year. Neither is optimal.

36. We therefore believe that, for purely practical reasons, the Board should consider the GEA Plan in this proceeding in the normal manner, as if the Application were not a year early.

37. The other three issues – the Utility Specific Operational Issues – depend on the evidence:

    a. ***Aging Infrastructure.***

    b. ***Workforce Planning.***

    c. ***Declining Average Use and Conservation.***

38. In each case, these issues may be so severe in the case of Hydro Ottawa that they warrant being dealt with early, or the Board may determine that they can wait or can be handled in an IRM-type rate increase this year. The evidence will determine that with clarity, and it would, in our view, be inappropriate to prejudge the outcome. For example, the Board may determine on the evidence that based on the unique nature of the Ottawa economy, and the success of the Applicant in conservation programs, the utility should not have to wait for the Board's policy on revenue decoupling to be implemented. On the other hand, the Board may determine that the Applicant is in the same boat as everyone else, and should wait for the policy. The evidence should be the basis for that decision.

39. ***Regulatory Costs.*** There is a substantial additional cost for a utility such as Hydro Ottawa to file under cost of service rather than IRM. This Application accelerates those costs by one year. In our submission, those costs, if prudently incurred, should be charged to a deferral account, to be cleared in 2012 without interest. This puts the Applicant, and their ratepayers, in exactly the same position as if they had filed for cost of service on their normal schedule in 2012.

40. ***Timing of Next Rebasing.*** If the Applicant had waited until 2012 for its rebasing, its next rebasing after that would be, assuming the four year cycle continues, 2016. In our submission, Hydro Ottawa should be advised that their appropriate time for their next rebasing remains 2016 (unless there are general changes to IRM in the meantime), so that the Board's indulgence in allowing them to continue with this early rebasing Application does not give them a permanent acceleration down the line. This has the added advantage of giving them an extra year to implement efficiency and productivity measures that will help evolve their corporate culture.

**Conclusion**

41. It is therefore submitted that Hydro Ottawa should be allowed to proceed with this cost of service application, even though it is a year early, but that the collateral benefits they had hoped to achieve by jumping the queue – and their avoidance of the application of Board policies with which they disagree – should be deferred until the time they normally would have enjoyed them, 2012. Further, the additional regulatory costs associated with this early application should be recoverable only when they would have arisen in the normal course, for 2012, and the Applicant should be expected to get back on their normal four year cycle the next time around. Thus, in most respects we are proposing that the Board put the Applicant in the same position as they would have been in if they had filed on their normal cycle, but retaining the flexibility to consider those aspects of the Application, if any, that truly need special treatment.

42. It is submitted that, if the Board adopts the recommendations set forth above, the effect will be to send a message to all Ontario LDCs that the Board values and will defend the flexibility of its processes, but will not allow utilities to use that flexibility to gain benefits that are inconsistent with Board policies.

43. We note that, if the Board adopts these recommendations, the Applicant may wish to elect on its own decision to wait until 2012 for its cost of service application. If the Applicant wishes to withdraw the Application, in our submission the Board should allow them to do so, with no negative consequences other than picking up all of the costs of the Board and the parties to date.

All of which is respectfully submitted.

.

Yours very truly,
**JAY SHEPHERD P. C.**

Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested parties (email)