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File No. 01009188-0006

Toronto, January 26, 2011

BY EMAIL AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
27th Floor
2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms. Walli:

RE : In the Matter of a Proceeding Initiated by the Ontario Energy Board pursuant to a Notice of Proceeding dated October 29, 2010 –Argument-in-Chief of the Electricity Distributors Association on behalf of the Affected Electricity Distributors
Ontario Energy Board File No: EB-2010-0295

We are the solicitors for the Electricity Distributors Association (the "EDA").

Please find enclosed the Argument-in-Chief of the EDA on behalf of the Affected Electricity Distributors. Two hard copies will follow by courier.

Yours very truly,

Alan Mark

AM:lr
Enclosure

cc. Jennifer Teskey

EB-2010-0295

IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to determine whether the costs and damages incurred by electricity distributors as a result of the April 21, 2010 Minutes of Settlement in the late payment penalty class action, as further described in the Notice of Proceeding, are recoverable from electricity distribution ratepayers, and if so, the form and timing of such recovery.

ARGUMENT-IN-CHIEF OF THE ELECTRICITY DISTRIBUTORS ASSOCIATION ON BEHALF OF THE AFFECTED ELECTRICITY DISTRIBUTORS

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Attn: Board Secretary, Kirsten Walli
Email: boardsec@oeb.gov.on.ca

I. NATURE OF PROCEEDINGS AND OVERVIEW

1. On October 29, 2010 the Ontario Energy Board (the "Board") issued a Notice of Proceeding on its own motion to determine (i) whether Affected Electricity Distributors (as defined in the Notice of Proceeding) should be allowed to recover from their ratepayers the costs and damages incurred in the Late Payment Penalty Class Action ("LPP Class Action"), and if so, (ii) the form and timing of such recovery. This proceeding was commenced pursuant to sections 19 and 78(2) of the *Ontario Energy Board Act, 1998.*

2. The Board convened a generic hearing to address the following issues:

(a) as a threshold question, whether Affected Electricity Distributors should be allowed to recover from ratepayers the costs and the damages incurred in the LPP Class Action; and

(b) if the answer to the first issue is yes, what would be an appropriate methodology to:

(i) apportion costs across customer rate classes; and

(ii) recover such allocated costs in rates.

3. The Board directed all Affected Electricity Distributors to collectively file evidence on these issues. On November 8, 2010, the Electricity Distributors Association (the "EDA") filed evidence on behalf of all Affected Electricity Distributors seeking recovery of their proportionate share of their costs and damages incurred in the LPP Class Action (the "Costs"). Toronto Hydro Electric System Limited ("THESL") filed supplemental evidence on November 12, 2010.

4. The Board has directed that the EDA file argument on behalf of the Affected Electricity Distributors seeking recovery and that THESL file argument in relation to its supplemental evidence.

5. The EDA submits that:

(a) Affected Electricity Distributors should be permitted to recover the Costs from ratepayers. The Costs were reasonably and prudently incurred. They were incurred

in connection with the late payment penalty regime which was established by the Government of Ontario and imposed on utilities by binding regulatory directives, including rate orders of the Board. It was reasonable to defend the Class Action and the settlement was reasonable. Moreover, as the LPP revenues which were in dispute benefited ratepayers when they were received, it is appropriate that the Costs be recovered from ratepayers;

(b) for both cost of service Affected Electricity Distributors and those on the Incentive Regulation Mechanism, the recovery of each Affected Electricity Distributor's portion of the Costs should be through a monthly fixed charge rate rider on distribution rates over 12 months, from May 1, 2011 to April 30, 2012. The Costs should be recovered from customers using a per customer charge. THESL's circumstances may warrant a different apportionment across customer classes or recovery on a volumetric basis.

II. WERE THE COSTS PRUDENTLY INCURRED AND THEREFORE RECOVERABLE?

6. Costs associated with the regulated business are recoverable from ratepayers if they were prudently incurred.

7. It is submitted that the Costs were prudently incurred.

i. The Costs Arise from a Prudent Policy Mandated by Regulatory Order

8. Prior to 1998, electricity distribution in Ontario was undertaken primarily by municipally-owned hydro electric utility commissions ("MEUs"). Ontario Hydro was the regulator of rates charged by MEUs pursuant to section 113 of the *Power Corporation Act*. The *Power Corporation Act* made it an offence to charge rates other than those approved by Ontario Hydro. Following industry restructuring in 1998, MEUs were converted to business corporations known as local distribution companies ("LDCs") pursuant to section 142 of the *Electricity Act*, 1998. Since April 1, 1999, electricity rates and charges have been approved by the Board pursuant to Section 78 of the *Ontario Energy Board Act*, 1998. That section prohibits charges for the distribution of electricity except in accordance with an order of the Board.

9. As discussed by the Board in its decision in ED-2007-0731 dated February 4, 2008 (the "Enbridge Decision"), the late payment penalties (the "LPPs") which were the subject of the LPP Class Action originated in the late 1970s with a task force operating under the auspices of the Ministry of Energy. The task force developed a set of guidelines that were introduced in the Ontario legislature in 1978. Pursuant to these guidelines, Ontario Hydro required all MEUs to implement a one time late payment charge of 5% of the outstanding amount. After April 1, 1999, Board rate orders continued the LPPs.

10. These LPPs were intended to protect innocent customers from the costs incurred because of late payments by other customers. They were intended to compensate for financial and administrative costs actually incurred and were considered to be in the public interest.

11. The MEUs and LDCs did not profit from LPP revenues. The forecast revenues from the LPP charges were used to reduce the revenue requirement for purposes of setting distribution rates.

12. Accordingly, it is submitted that it was reasonable for the Affected Electricity Distributors and their predecessors to charge LPPs and thus any costs associated therewith are properly recoverable from ratepayers. As the Costs represent costs associated with the LPPs they are properly recoverable from ratepayers unless they themselves were not prudently incurred.

13. It is further submitted that there is no material difference between the facts of this case and the facts which underlie the Enbridge Decision. As such, the same result should apply and recovery from ratepayers should be approved.

ii. It was Prudent and Beneficial to Ratepayers to Defend and Settle the Class Action

14. In 1981, the Federal Parliament amended the *Criminal Code* (section 347) to render it a criminal offence to receive an interest payment with an effective rate of interest exceeding the annual amount of 60%. The provision was intended to deal with "loan sharking" and it was not thought to be generally applicable to commercial transactions. The Board rejected submissions made to it from time to time alleging that LPPs violated section 347.

15. In 1994, class actions were commenced against the Consumers Gas Company Limited (the "Garland Action") and against Toronto Hydro (the "Pichette Action") alleging violation of the *Criminal Code*. Both actions alleged that an LPP constituted interest as defined in section 347 and, depending on the amount of the bill and the payment date, the LPP could result in an effective rate of interest in excess of the proscribed rate of 60%. The plaintiff in each case claimed unjust enrichment and restitution on behalf of a plaintiff class for the offending LPPs collected by the defendant utilities. A similar class action was also commenced against Union Gas (the "Union Action").

16. The Pichette Action and the Union Action remained dormant while the Garland Action was litigated, although Toronto Hydro and Union Gas were permitted to intervene in the Garland Action and their counsel appeared in the litigation. In 1998, a new class action was started against Toronto Hydro for restitution of LPPs, this time naming Toronto Hydro as the proposed representative defendant on behalf of a class described as "all municipal electric utilities in Ontario which have charged late payment penalties on overdue utility bills at any time after April 1, 1981" (the "Griffiths Action").[1] By agreement, the Griffith Action, like the Pichette Action was held in abeyance while the Garland Action was litigated.

17. As noted by the Board in Enbridge Decision, it was reasonable to defend the class action. At the time the LPP Class Action was commenced, there was no judicial decision supporting the plaintiffs' position. Indeed, the Superior Court of Ontario, at first instance, and the Ontario Court of Appeal both granted summary judgment in favour of the defendant in the Garland Action. It was not until 1998 that the Supreme Court of Canada ruled that late payment penalties did constitute interest within the meaning of section 347 of the *Criminal Code*.

18. The 1998 decision of the Supreme Court of Canada in the Garland Action did not dispose of all issues in the litigation and the Garland Action continued to be litigated. Pending resolution of the remaining issues, this Board did not see fit to require a change to the LPP policy. (See the Enbridge Decision, p. 11). As well, there remained other defences available to LDCs, including

[1] The former retail district of Ontario Hydro does not fall within this definition. Accordingly, while the same LPP policy was applied in the retail district, it is not a member of the defendant class and is not participating in the settlement.

ones which were unique to electricity distributors and which would not be resolved in the Garland Action. If, as the Board held in the Enbridge Decision, it was reasonable for Enbridge to maintain the LPPs following 1998 and pending final resolution of all issues in the Garland Action, it was manifestly reasonable for the LDCs to await resolution of the remaining issues in the Garland Action and resolution of the additional, unique issues in the Pichette and Griffiths Actions.

19. Notwithstanding that it was prudent for the LDCs to maintain the LPPs, LDCs migrated to new, non-offensive late payment policies, and all LDCs had stopped charging LPPs by the end of the first quarter 2002.

20. It was reasonable for LDCs to continue to defend the class action even after they ceased charging LPPs. While in 2004 the Supreme Court of Canada disallowed all of the other defences asserted in the Garland Action, there remained the additional defences available to the LDCs in the Pichette and Griffiths Action. Further, it is evident from the terms of the settlement in the Pichette and Griffiths Action that the continued expenditure of legal fees in the defence of the LPP Class Action ultimately produced a settlement which was advantageous.

21. Given that the Supreme Court of Canada had dismissed virtually all of the defences available to the LDCs, and given that the viability of any remaining defences was highly uncertain, it was reasonable to settle the LPP Class Action. The settlement was for a fraction of the potential liability of the LDCs and, on a comparative basis, more favourable than the settlement in the Garland Action and the settlement in the Union Action. In the absence of a settlement, significant further legal costs would have been incurred.

22. It is therefore submitted that it was reasonable for the LDCs to maintain the LPPs as long as they did, and it was reasonable for the LDCs to defend the LPP Class Action and it was reasonable to settle the LPP Class Action.

iii. Are the Costs Reasonable?

23. The Costs consist of:

- $17,037,500, being the amount being paid to settle the LPP Class Action, inclusive of damages, interest, costs and taxes (the "Settlement Amount");

- the costs of a court mandated notice program to notify plaintiff class members of the settlement; and

- defendants' legal fees and costs incurred and estimated to be incurred in the litigation and these proceedings.

The estimated total of these costs is $18,382,125.00 (the "Allocated Amount") [2]. The amount sought to be recovered from ratepayers is $17,690,907.53 (the "Updated Recovery Amount").[3]

24. As noted above, the Settlement Amount represents a fraction of the potential liability in the Pichette and Griffiths Action, and was favourable in comparison to the settlements involving the gas utilities. The settlement resulted from protracted, arms length negotiations with the assistance of an experienced judicial mediator and was approved by the Court as being fair and reasonable. The legal fees claimed in connection with the LPP Class Action are modest having regard to the amount of time the litigation was outstanding, the amounts in issue and the complexity of the issues.

25. It is possible that legal fees, costs and taxes to be incurred to the end of the administration of the settlement and this proceeding have been overestimated or underestimated. It is not expected that any such variance would be material. Any undisbursed amounts will be returned to LDCs to be maintained in a variance account as proposed below.

iv. LPP Revenues Benefited Ratepayers

26. In considering whether recovery of the Costs through rates should be permitted, it must be borne in mind that LPP revenues, when collected, benefited all ratepayers by reducing the revenue requirement and, hence, electricity rates. It is therefore reasonable that ratepayers should bear the Costs.

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[2] Filed with the Board on December 16, 2010
[3] Hydro One Networks Inc., Hydro One Remote Communities Inc. and Orillia Power Distribution, while participating in the settlement, do not seek recovery from ratepayers.

III. PROPOSED METHOD OF RECOVERY FROM CUSTOMERS

27. It is proposed that the Allocated Amount be divided amongst the Affected Electricity Distributors based on each LDC's total service revenue for the period of time over which it had exposure to pay damages to the plaintiff class in the litigation. As it is prohibitively costly, if not impossible, to calculate the offending LPP revenue of any particular utility, service revenue is an appropriate proxy for allocating the settlement costs amongst LDCs. Furthermore, this allocation methodology was approved by the LDCs and the Court as being a reasonable method of allocation and it is the basis upon which the LDCs will actually pay the Allocated Amount.

28. LPP revenues, when received, were considered general revenues and were applied to mitigate the rates of customers. Therefore, a per metered customer charge is a reasonable proxy for the apportionment of the Allocated Amount across all customer classes. It would be impossible to determine which customers paid the offending LPPs and, in any event, that question is only relevant to how the settlement proceeds should be distributed, not how the cost of the settlement should be paid. It would also be impossible in many cases to determine how LPP revenues were distributed over customer classes during the relevant time period. Differences in class composition and allocation methodologies would also preclude a universal answer. Having regard to the amounts in issue, the bill impact (generally under $.50 per month) and the benefits of simplicity, a per customer charge is appropriate. In the case of THESL, where the bill impact would be more significant due to it proportionately larger liability because of circumstances unique to it, the alternatives suggested by the THESL supplemental evidence might be appropriate.

29. The recovery of each Affected Electricity Distributor's portion of the Allocated Amount should therefore be through a monthly fixed charge rate rider on distribution rates over the 12 month period from May 1, 2011 to April 30, 2012.

30. It is proposed that the per customer charge be determined by dividing the Allocated Amount by each Affected Electricity Distributor's total number of metered customers as set out in the Board's most recent yearbook of electricity distributors. As the resulting monthly

customer charges will typically be less than $.50 per bill, it is proposed that the recovery be over a period of 12 months.

31. In case where the impact is relatively higher, it could be appropriate to lengthen the period of recovery.

32. Given the timing difference between when the Updated Recovery Amount will be recovered from customers (over a 12 month period) and when each LDCs' portion of the Allocated Amount is payable (June 30, 2011), it is proposed that any differences between each Affected Electricity Distributor's portion of the final allocated amount actually paid and the amount billed to customers be recorded in an appropriate variance account and interest be calculated in accordance with standard Board practice. Any residual balance in the variance account upon the expiry of the rate riders and finalization of the revenues obtained therefrom would be subject to future disposition.