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

BY EMAIL and RESS

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

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2010-0377-8-9, EB-2011-0043 – Renewed Regulatory Framework

We are counsel for the School Energy Coalition. Pursuant to the Board's letter of November 8th and subsequent communications in this consultation, we are providing preliminary questions relating to certain of the subjects being discussed next week.

General

Implicit in many aspects of these policy development processes is the assumption, made explicit in a number of the papers and in the Board's FAQs relating to this consultation, that there is substantial upward pressure on capital spending by distributors and transmitters, and the result could be material rate increases.

It would appear to us that there are four main drivers of capital spending in this sector:

- ***Aging Infrastructure.*** Existing capital assets have to be replaced at current costs.
- ***Changes in System Structure.*** Policy and other imperatives create a need to redesign the transmission and/or distribution infrastructure, e.g. to accommodate distributed generation or to implement the smart grid.

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

- ***Load and Customer Growth.*** Additional demands on the system produce a need for additional capital assets to serve that demand.

- ***Productivity Initiatives.*** Utilities invest in capital-intensive solutions that decrease future costs.

With respect to the latter two, generally speaking these capital investments are expected to at least pay for themselves over time through increased revenues or reduced future costs, so they cannot be material causes of upward pressure on rates.

With respect to aging infrastructure, inflationary increases in rates should generally cover the cost of replacing old assets with new, assuming the replacements are like for like. Further, if rate increases are less than inflation due to productivity assumptions, those assumptions were based on empirical data that included capital costs in any case, so the result should be neutral. That is, productivity is not limited to operating costs. Capital spending is also a fruitful area for productivity gains.

Costs to replace aging infrastructure should thus only be incremental, and cause upward pressure on rates, for three reasons:

- Costs to replace infrastructure assets have on average risen at a rate greater than inflation over the last several decades that the existing assets have been in place.

- Replacement assets upgrade the system at the same time, i.e. not like for like replacements.

- There was a past buildout of the province's electricity infrastructure that is all aging at the same time, leading to a "lump" in current replacement spending.

This leads to the following questions (which may relate primarily to EB-2010-0377, but also have relevance in the other four consultations):

1. What data is currently available with respect to the expected costs to change the design of the province's transmission and distribution infrastructure? Does the Board have studies – whether of the domestic system or comparative analysis with systems in other jurisdictions – that can assist in determining the costs ratepayers are facing under this category? If there are gaps in the information available, what research is contemplated by the Board to gather this information?

2. What data does the Board have with respect to short or long term cost trends for infrastructure assets? Again, if the data available to the Board currently is insufficient, what steps are contemplated by the Board to augment that data?

3. Does the Board have any empirical evidence that there was "lumpy" spending on electricity distribution or transmission infrastructure in the past that is now reaching end of life? For example, does the Board have any studies of past capital spending patterns by asset category, or does the Board have any aggregated data on vintages of existing assets by category? In the latter case, does the Board have any data on comparative asset vintages

in other jurisdictions, and steps being taken to deal with those assets elsewhere? In each of these cases, if there is insufficient data at present, what steps should the Board take to gather additional information so that it can a) anticipate the size and timing of any upcoming "lump" of replacement spending, and b) smooth the response so that rate impacts are minimized today, and the problem is not repeated 30-50 years from now?

4. Does the Board have any tools or models that would help disaggregate replacement spending into a baseline and an upgrade component? If the Board does not have those tools currently available, are they available in the broader electricity sector, or can tools from other sectors be adapted for use here?

In our view, the answers to these questions, and thus obtaining a comprehensive set of empirical data, are essential preconditions to developing a robust policy response. Clear understanding of the nature and extent of the problem is critical to creating the best solution.

Performance Measurement – EB-2010-0379

The following questions arise out of the Staff Discussion Paper on Defining and Measuring Performance of Electricity Transmitters and Distributors, but contemplate that either Staff or outside consultants might answer them.

5. How is this consultation related to the development of 4th Generation IRM? Is it reasonable to expect that this process will result in a proposal for 4th Generation IRM, or components of it? Alternatively, are such proposals to be considered out of scope?

6. [p. 11] What techniques can be used to take the additional data currently available in Ontario and either a) clean it up, or b) supplement or validate it, so that TFP can be estimated based primarily on Ontario data?

7. [p. 14] Can Staff provide a list of the uses to date of the alternative cost recovery mechanisms set out in the Board's EB-2009-0152 Report, and any requests for application of those mechanisms that the Board has denied?

8. [p. 19] What are the views of Staff, consultants, and other parties of the value of making the Board's audits public either at the end of the audit process, or even when the draft is provided to the audited entity? Would public disclosure increase the motivation of the utility, its board of directors, and its owners, to improve performance?

9. [p. 23-4] What are the views of Staff, consultants, and other parties on the use of higher level comparisons between utilities (Dx revenue per customer, or average rates by customer class, or PP&E per customer, for example) as diagnostic tools to identify areas where problems may exist? To what extent should utilities be encouraged to use similar comparisons in their own internal assessments, budgeting, and planning?

10. [p. 27] Does Staff believe that, as a general direction, expansion and enhancement of the outcomes-based approach to ratemaking is appropriate?

11. [p. 31] Is it appropriate to assign each potential performance measure considered for Ontario to one of three categories:

    a. ***Binary or Threshold.*** There is a measured requirement, that is either met or not, e.g. most SQIs.

    b. ***Variable.*** There is a metric, and performance is judged through a formula based on the quantity of the metric relative to either past performance, or the performance of peers, e.g. OM&A per customer.

    c. ***Indicative.*** There may or may not be metrics to assist the analysis, but performance is assessed by the Board using judgment and experience, in a non-formulaic way, e.g. compensation levels.

12. [p. 34] The productivity factor in the current 3rd Generation IRM was based on empirical analysis, with the intention that rebasing would be an opportunity to share incremental productivity savings. Instead, in general rebasing applications have sought substantial "catch-up" rate increases. What information has been gathered, or could be gathered, to determine the reasons for this unintended result?

13. [p. 36] Does the "understandability" criterion in the CAMPUT paper necessarily rule out econometric solutions? (If the authors of the paper are involved in this consultation, their views on this would be particularly helpful.)

14. [p. 36, fn. 28] Is it appropriate to use high-level comparison metrics, such as average Dx bills per customer by class, or Dx revenue per customer, to avoid or minimize the "you get what you measure" problem? What are the advantages and disadvantages of measuring the ultimate outcome, rates?

15. [p. 39] Does Staff agree that, consistent with the market proxy principle of economic regulation, utilities should be encouraged to either reduce real prices, or increase the value of their services, in both cases while maintaining quality, as their primary goal?

16. [p. 49] What are the views of Staff, consultants and parties on the possibility that every request for a rate increase should include a credible plan for getting rates back to, or below, the current level over time?

17. [p. 57] What are the methods being used by Ofgem, or available for use by the Board, to establish the "baseline level of costs and outputs"?

18. [p. 59] How do you avoid penalizing early adopters and top performers, and being too lenient with poor performers, when a company's benchmark is its own past performance?

19. [p. 68] How does a balanced scorecard compare with the market's control of the actions of companies in competitive markets? Can a balanced scorecard be set that closely mimics competitive market responses? What techniques are available to do this, and what research has been done in this area?

20. [p. 68] Do regulators who use customer satisfaction surveys or similar metrics in benchmarking utilities place any limitations on advertising activities by those utilities or their owners?

21. [p. 71] To what extent would a "streamlined" application be equivalent to a decision not to review all or part of the revenue requirement or rates of the Applicant?

22. [p. XII] How do price, or rate levels, figure into the Ofgem balanced scorecard approach?

The following additional questions arise out of the PEG Concept Paper on Defining, Measuring and Evaluating the Performance of Ontario Electricity Networks, but contemplate that either Staff or the consultants might answer them.

23. [p. 10] Is it correct that symmetry of ESMs mitigates utility risk, but also can reduce utility incentives for financial performance, whereas adding asymmetry to ESMs will increase downside risk, and indirectly create a performance incentive?

24. [p. 11] Is it reasonable to conclude from PEG's paper that all benchmarking plans will a) result in winners and losers, and b) include at least some unpredictable or unintended results? To what extent should plans include explicit statements of desired and measureable outcomes, and specific feedback loops or adjustment factors that are responsive to variations from those desired outcomes?

25. [p. 12] Has any work been done, either in other jurisdictions, or in the academic analysis of the subject, on IRM designs that use variable ESMs over time, e.g. increasing ESM sharing percentages as a way of justifying longer term plans?

26. [p.25, fn. 10] Is there a function that can be used to measure the impact of regulatory costs on the efficiency of the regulatory process? For example, presumably zero regulatory costs in a monopoly sector is highly inefficient and increasing costs from zero will improve regulatory efficiency. At some point, increasing the level of regulatory costs must cease to improve efficiency, and start to reduce it. What information is available to help the Board determine when that optimized point arises?

27. [p. 26, fn. 13] Does PEG believe that "the assumption that technological change is exogenous" should be challenged by the regulator through policies that promote utility R&D? What are the potential impacts of such a policy direction?

28. [p. 34] Do PEG or Staff have any data on the extent to which transmission assets that are deemed to be distribution assets affect the comparability of the financial information of distributors? Is it possible to revise the regulatory reporting requirements for distributors so that information on transmission assets deemed to be distribution assets are disaggregated for reporting purposes?

29. [p. 41] How will the gathering and analysis of time series data be affected by the transition to International Financing Reporting Standards? Has PEG identified or developed any methods of adjusting data to maintain consistency over time in the face of this change?

30. [p. 44] Figure One does not provide a decay pattern in which decay accelerates over time. This would appear to us to be a common pattern for many network assets. Is this correct? If so, how should this be factored into the analysis? Can analysis of maintenance costs by age of assets provide a proxy for this effect?

31. [p. 58] If firms in competitive markets are, generally speaking, price takers, is it reasonable to conclude that, in pursuit of the "market proxy" ideal, a goal of utility regulation should be – as much as possible - to set rates and therefore revenue requirement based on a common externally-determined level (a kind of rate benchmark), and then adjust for local input disparities, rather than set rates on a cost of service basis? Put another way, should the Board consider phasing out the cost of service paradigm over the longer term?

32. [p. 77] Please provide an example of how the Board could "capitalize the value of savings" in order to improve the persistence of utility rewards.

33. [p. 79] Is it appropriate to consider one or more pilot projects to test whether innovative but untested rate formulae, such as the X factor-ROE tradeoffs, produce the desired results and/or have unintended consequences?

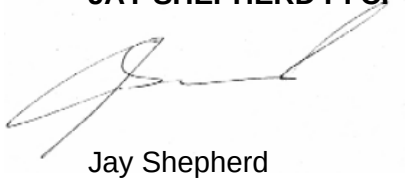
34. [p. 111] Please describe the advantages of using a single highly comprehensive benchmark in ratemaking, vs. using multiple non-correlated specific benchmarks. Can either approach be used to get the same result?

Conclusion

SEC will have additional questions at the stakeholder conference, on these subjects and others, but felt it would be most useful that these particular issues be provided in advance.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties