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BY EMAIL and RESS

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Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Renewed Regulatory Framework

We represent the School Energy Coalition. Like the Distribution Regulation Review Task Force (“DRRTF”), which wrote to the Board on February 10, 2012, SEC considers the issues being dealt with through the Renewed Regulatory Framework to be of material importance, and therefore would like to raise some questions to assist the process. We also would like to provide some further context to the thoughtful comments provided by Mr. Vegh in his letter.

Our questions, which focus on the regulation of electricity distributors, are the following.

Causes of Capital Spending Pressures

On December 2, 2011 we sent a letter with preliminary questions for the Stakeholder Conference. Of particular concern was the series of questions relating to the reasons for the capital spending pressures being posited by the electricity distributors. A copy of that set of questions is annexed to this letter.

We agree with DRRTF entirely that the question of capital investment should be tackled as a separate and urgent matter, but we believe that step one in that process must be to develop a solid base of information on the infrastructure renewal set of issues.

As we have previously noted in more detail, we are hard pressed to understand how the Board can develop a rate plan for electricity distributors with a special capital spending component, if the Board



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does not first gather data and analysis on the reasons for the current deficiencies in capital stock. The solution to a need to introduce new technologies is likely to be quite different from the solution to past underinvestment (general or cyclical) in infrastructure. It is perhaps trite, but knowing the nature of the problem is a critical driver in finding a good solution.

We note as well that schools, like other ratepayers, are not opposed to spending on needed infrastructure. Reliability and quality are at least as important to us as price, and schools in particular have a unique understanding of the long-term importance of prudent infrastructure investment. But it is not enough to say “There are a lot of things that are old, or broken, so we have to spend more money.” No distributor will ever have a brand new system. Capital spending is about prioritization, and that in turn is facilitated by a thorough understanding of the problems being addressed.

Like other ratepayers, schools are more than willing to bear the additional cost for utilities to catch up, or to introduce new systems, or to solve asset condition problems, but we need to know the reason we are being asked to pay. Every dollar a school board has to deliver to a utility for its infrastructure spending is a dollar that school board cannot spend on their own infrastructure renewal. Those dollars will not willingly be diverted from school infrastructure to utility infrastructure unless and until the reasons for the utility capital needs are fully understood.

We further note that the requirement to understand this issue more fully is particularly urgent in light of the recent Conference Board of Canada Report, “Shedding Light on the Economic Impact of Investing in Electricity Infrastructure”, February, 2012. That report, sponsored by the CEA, and relying on previous Conference Board studies, estimates that the need for distribution infrastructure spending in Ontario over the next 20 years is about \$21 billion (exclusive of Green Energy Act spending).

According to the Board’s published data, Ontario’s electricity distributors made capital investments of just over \$1.8 billion in 2010, the latest year for which there is full data available. This fact suggests that the current spending levels may already well exceed the most recent independent projection of need. If the Board is to act on the basis that additional spending is required, it appears to us that an investigation of this apparent disjunct – through a review of the empirical data underlying the proposed need for incremental spending - would be required first.

Experience of Distributors under 3rd Generation IRM

After four years under 3rd Generation IRM, it is clear that some distributors did well under that structure, and others found it more of a challenge. It is important, in our view, for the Board to learn from that experience, so that the design of IRM going forward is improved by that knowledge.

To this end, we are hopeful that the Board will engage experts to identify correlations, if any, between utility attributes and IRM results. For example, did 3rd Generation IRM work best for utilities with fast growth, or ones in rural areas, or smaller utilities, etc. How did those 3rd Generation experiences track relative to variables like percentage of commercial or industrial load, or success of DSM programs, or relative modes of governance?

There are a number of factors that may have driven the success of distributors under the current system, some within their control, and some external. It may be possible to identify those factors and their



impacts through empirical analysis, or through survey information, or other means, but in our view knowing what worked and what didn't, and why, is very important to both distributors and ratepayers.

Expectations for Future Electricity Distributors' IRM

Ontario's two large gas utilities have been under IRM since 2007, and prior to that experimented with other versions of IRM. In general, both Enbridge and Union have flourished over the last six years, while the ratepayers still had stable rates with low increases. At what point is it reasonable to expect that the electricity distributors will respond to IRM in a similar way?

This is not, in our view, a simple question. In order to set reasonable expectations for electricity distributors, it is necessary to understand why the gas utilities did as well as they did. Was it a function of their specific IRM design? Was success dependent on their larger size, and therefore greater ability to respond to the Board's regulatory price signal? Is this just a function of the corporate maturity of the organizations, i.e. the length of time they have spent under for-profit regulation? Are there different management or regulatory practices at the gas utilities that allow them to handle IRM more effectively?

This is a particularly a propos time to be making this connection, because the gas distributors' rebasing applications are in front of the Board right now, and the next generation of gas IRM will be developed in the coming months. The Board is in a position to use that coincident timing to advantage by taking lessons from gas to apply to electricity.

Timing

The DRRTF letter sets out some proposals for the timing of this review process. Overall, the timing proposed is quite aggressive, but assuming that some time is built into the front end of the process to deal with the questions above, in general we agree that an accelerated process is a good idea.

The proposed Statement Addressing Prioritization of Issues probably cannot occur in February, given meetings scheduled the week of February 27th to March 2nd to consult on that and other points, but a March statement from the Board to that effect would still be a good way to speed up the process. The proposed December 2012 target end date for new guidelines or procedures is, in our view, a reasonable target for at least the bulk of the changes being discussed.

However, the letter also proposes that new rules with respect to capital investment be put in place in time for 2013 rates. This is not, in our view, realistic. The two gas utilities have both already filed their 2013 rate applications. For many of the larger electricity distributors, their applications will be filed in the March through May period, and the latest cost of service applications will be filed in August or September. There is no reasonable likelihood that a proper review can take place dealing with billions of dollars of proposed new capital spending on a schedule consistent with those filing deadlines.

In our view, therefore, it is more appropriate to target the capital investment changes to be implemented for 2014 rates. This will still require an accelerated process, of course, but we believe that if utilities have the Board's guidelines for the capital component of the next generation of IRM by December of 2012, many utilities will be able to incorporate those guidelines into the applications they are filing in the spring and summer of 2013, i.e. for 2014 rates.



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Conclusion

In our view, the answers to questions in the three areas described earlier will help the Board to develop an approach to the regulation of the electricity distributors going forward that provides cash for needed spending, but still fully protects the interests of the ratepayers.

We agree with the DRRTF that an accelerated process should be implemented to deal with these issues of regulatory approach and structure. As is the Board's normal practice, an accelerated process does not mean taking shortcuts and doing a less than thorough job, but we see no reason why, if this process is given a high priority by all concerned, well-thought-out solutions, with a solid empirical basis, cannot be identified and implemented by the end of this calendar year.

All of which is respectfully submitted.

Yours very truly,

JAY SHEPHERD P. C.

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cc: Wayne McNally, SEC (email)
Interested Parties

Excerpt from December 2011 Questions:

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.
- ***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.