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February 10, 2012

**Via Courier**

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street, Suite 2700  
Toronto ON  
M4P 1E4

Dear Madame:

**Re: Board File No.: EB-2010-0377; EB-2010-0378; and EB 2010-0379  
Correspondence**

Attached please find two hard copies of correspondence filed by the Intervenor DRRTF in the above noted matter. An electronic version has been filed on RESS.

Sincerely,

*signed in the original*

George Vegh

GAV:mt  
att.



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February 7, 2012

Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street  
27th Floor  
Toronto ON M4P 1E4

**Attention: Rosemarie T. Leclair**  
**Chair and Chief Executive Officer**

Dear Ms. Leclair:

**Re: Renewed Regulatory Framework**  
**Board File Numbers: EB-2010-0377; EB-2010-0378; and EB-2010-0379**

**Introduction**

This letter is written in my capacity of Chair of the Distribution Regulation Review Task-Force (the “DRRTF”). The DRRTF is an initiative of the leading gas and electricity distribution utilities in Ontario aimed at encouraging thought and discussion on how the OEB’s approach to regulating energy distribution can be enhanced. These utilities are: the Coalition of Large Distributors (which consists of Enersource Hydro Mississauga Inc., Horizon Utilities Corporation, Hydro Ottawa Limited, PowerStream Inc., Toronto Hydro Electric System Limited, and Veridian Connections Inc.), Enbridge Gas Distribution Inc., Hydro One Networks, and Union Gas Limited.

The DRRTF has been an active supporter of the Board’s Renewed Regulatory Framework for Electricity Distributors and Transmitters (“RRFE”) and appreciates your leadership in recognizing the need “to consider how existing regulatory approaches and tools may need to be adapted to ensure that public policy goals are met in a cost effective manner.”<sup>1</sup> The release of Board staff papers on November 8, 2011 provided some topics to stimulate thought and discussion in this regard.

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<sup>1</sup> Letter from OEB to Stakeholders, November 8, 2011, Attachment A.

In public appearances, you have indicated a willingness to hear from sector participants on this process. To this end, and for the purpose of providing constructive suggestions on how to move forward with this important initiative, the DRRTF offers the following for the Board's consideration:

The staff papers have provided a useful contribution by stimulating discussion. The RRFE could now benefit from more formal direction from OEB leadership on how the purposes and goals of the RRFE should be prioritized and addressed. As will be addressed in further detail below, the DRRTF suggests that the first priority be to provide clarity and direction on the treatment of capital investment for rate making purposes.

Further, the process and the timeline of this initiative should be commensurate with the importance of the issues being considered. The DRRTF suggests that the process be made flexible enough to permit the immediate treatment of issues that are either sufficiently important (such as the rate treatment of capital investments) or discrete (such as the treatment of s. 6.3.6 of the Transmission System Code (the "TSC") in the context of regional planning and rate mitigation). Other longer term issues, such as investment planning (including on a regional basis), smart grid investments, and performance measurement, will likely take a much longer time to address. A potential timeline for the treatment of longer term issues to be addressed in the framework review is attached for your consideration. This schedule incorporates the recently announced "round table" discussions.

### **Treatment of Capital Investment**

With respect to the treatment of capital investment for rate making purposes, the DRRTF respectfully submits that there would be value in a generic review of this matter to commence as soon as possible and be completed in time for rate applications filed in 2012 for implementation in the 2013 rate year.

First, the issue of capital investment is perhaps the most pressing issue in the sector. As you have observed, "one of the major challenges facing the sector today and the most significant driver of costs is the scale of capital spending expected over the next few years from most utilities – generators, transmitters and distributors alike – to renew and modernize the system and provide for new demand."<sup>2</sup>

It is worth noting that the consideration of how to treat capital investment made during the term of an Incentive Regulation Mechanism ("IRM") regime was initially addressed in a very different context. The focus at that time was in developing a module that works within the broader IRM framework, which formed the context for the Incremental Capital Module ("ICM"). In other words, the discussion focussed primarily on technical issues under the rate regime. It did not adopt the Chair's proposed "outcomes" based approach and therefore did not even address the state of infrastructure in the sector.

Second, the Board has now had several years experience with the ICM and all parties can learn from that experience to address this issue in a systematic way.

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<sup>2</sup> Rosemarie T. Leclair, Chair & CEO, Ontario Energy Board, Remarks for the Ontario Energy Network, November 21, 2011, p. 7.

Third, there is considerable uncertainty as to how the current ICM is to be applied. Board panels have taken different positions on this issue. Some clarity on this issue would be very helpful.

With respect to the need for clarity, the Board's initial description of the ICM stated that the criteria for eligibility for the ICM as being driven by materiality, need and prudence. With respect to proving need, the Board stated that "Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived."<sup>3</sup>

In its first major decision applying the ICM, the Board panel added an additional requirement. It stated that an ICM applicant must also provide "a demonstration that the distributor is facing extraordinary and unanticipated capital spending requirements, i.e., something other than the normal course of business".<sup>4</sup> Thus, this decision added the requirement that capital spending be "extraordinary and unanticipated" in order to be eligible under the ICM.

In another decision, the Board panel said expenditures must be "extraordinary" in order to meet the need requirement. That decision later applied a criterion of "incremental" and "non-discretionary".<sup>5</sup> However, the decision did not refer to the requirement that the expenditure be "unanticipated".

The Board has continued to apply different criteria. Thus, in two decisions, panels applied the following test:<sup>6</sup>

"Applicants must demonstrate that the amounts exceed the Board's materiality threshold and clearly have a significant influence on the operation of the distributor, must be clearly non-discretionary and the amounts must be outside the base upon which rates were derived. In addition, the decision to incur the amounts must represent the most cost-effective option for ratepayers."

In its most recent decision in this area, a Board panel stated that "The Board's thinking in this area has evolved."<sup>7</sup> In that case, the panel referred to types of facilities that have been approved, suggesting that facility choice is a relevant criterion.<sup>8</sup> In addition, it stated that the Board had approved ICM projects that were "discrete, material, and non-discretionary".

The point here is not to criticize different panels for taking different approaches. Rather, it is to point to the fact that this is a complicated and important issue that requires a generic consideration to provide greater certainty to the sector.

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<sup>3</sup> Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, July 14, 2008, s. 2.5; see also, Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, September 17, 2008, Appendix B.

<sup>4</sup> Hydro One Networks Inc. Decision, May 13, 2009 (EB-2008)-0187), at p. 9.

<sup>5</sup> Oshawa PUC Decision, June 10, 2009 (EB-2008)-0205, at pp. 3 and 15.

<sup>6</sup> See Guelph Hydro Electric System Inc., Decision, May 13, 2009 (EB-2008-0205(corrected)) June 10, 2009 at p. 8; and Oakville Hydro Electricity Distribution Inc., Decision (EB-2010-0104), June 10, 2009, p. 11.

<sup>7</sup> Toronto Hydro-Electric System Limited (EB-2011-0144), Decision, January 5, 2012, p. 22.

<sup>8</sup> The decision referred to the fact that municipal transformer stations have been funded through ICM and suggested that an IRM application that requested funding for similar facilities would be "directly analogous to projects that the Board has previously approved under ICM for other distributors." (at p. 22).

The DRRTF recognizes that the treatment of capital investment is part of the general framework issues that may be addressed in the RRFE. However, the staff papers do not capture the urgency or specificity of the need to provide direction on this matter. Thus, while the Chair has characterized this as a “critical time for consumers”, the staff papers do not seem to reflect that urgency. Rather, they seem to suggest that actual rate issues are not to be included in the RRFE, stating that “policies that are developed in this consultation may, as necessary, inform the development of the next generation IR framework.”<sup>9</sup>

The DRRTF agrees with your assessment in this regard and respectfully suggests that the issue of the regulatory treatment of capital investment should be addressed on a priority basis in a manner that leads to concrete results in terms of rate treatment for customers and utilities, and should not be put off into an uncertain future time. Further, the result of this review should lead to a sustainable regulatory approach to capital investment, one that should endure through, and be integrated with, the next generation of rate regulation (in whatever form that takes) all in a manner that does not compromise the need for prudence reviews of proposed capital projects. It therefore requests that the Board commence a generic review of the rate treatment of capital investment.

## Process and Timeline

As indicated, the DRRTF respectfully suggests that the RRFE could benefit from clear direction on the goals, process, and timeline for review. The following potential approach to providing this direction is suggested as an illustration of this point:

1. A “Statement from the Chair” or some other document that reflects the urgency surrounding this initiative and sets out:
  - The purpose and goals of the review;
  - What it is meant to achieve;
  - That the review should lead to an open discussion of whether there should be fundamental reconsideration of current regulatory practices; and
  - To clarify the role of staff as providing support and analysis of potential approaches so that staff can facilitate, and not limit the scope of, Board and stakeholder discussion.
2. Clarification (whether in this statement or other public document) that:
  - A prioritization of topics so that some topics can be immediately addressed because they are either sufficiently important (such as the rate treatment of capital investments) or discrete (such as issues related to s. 6.3.6<sup>10</sup> of the TSC in the context of regional planning and rate mitigation). Other longer term issues, such as

<sup>9</sup> Staff Discussion Paper on Mitigation for Electricity and Transmitters & Distributors, p. 7.

<sup>10</sup> Section 6.3.6 states “A transmitter shall develop and maintain plans to meet load growth and maintain the reliability and integrity of its transmission system. The transmitter shall not require a customer to make a capital contribution for a connection facility that was otherwise planned by the transmitter, except for advancement costs.”

investment planning (including regional planning), performance measurement, and smart grid investment, will likely take some time to address. A potential schedule for the treatment of immediate and longer term issues to be addressed in the framework review is attached for your consideration. This schedule incorporates the recently announced “round table” discussions.<sup>11</sup> A proposed break down between fast-tracked and longer term issues is as follows:

- Fast Tracked:
  - Rate treatment of capital investment;
  - Issues related to s. 6.3.6 of the TSC; and
  - Rate Mitigation (status quo until framework is settled);
- Longer Term Issues:
  - Investment Planning, including:
    - how investment plans can be used to provide a framework for longer term utility initiatives that can guide stakeholders and the Board;
    - how investment plans should be coordinated and integrated on a regional basis; and
  - how investments in smart grid technology can be evaluated, including developing the evaluative criteria and dividing line between smart grid investments aimed at (i) achieving provincial goals respecting conservation and renewable power, on the one hand; and (ii) the replacement of old assets that serve in-franchise utility customers with new assets that use current technology, on the other;
  - Performance Measurement, including how the Board’s regulatory oversight will be proportionate by reference to utility performance.

An indicative timetable and process that allows for a more complete review of the longer term issues is attached. The “fast tracked” issues can be addressed while this longer term review is being carried out.

## Conclusion

The DRRTF continues to actively support the RRFE and appreciates your leadership in recognizing the need “to consider how existing regulatory approaches and tools may need to be adapted to ensure that public policy goals are met in a cost effective manner”. The release of

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<sup>11</sup> Letter from OEB re: Renewed Regulatory Framework for Electricity Update on Consultation Process, February 6, 2012; see also: Rosemarie T. Leclair, Chair & CEO, Ontario Energy Board, Remarks for the Northwinds Professional Institute Cambridge, Ontario, January 26, 2012, p. 4.

Board staff papers aimed at stimulating discussion on November 8, 2011 provided some topics to stimulate thought and discussion in this regard.

In public appearances, you have indicated a willingness to hear from sector participants on this process. To this end, and for the purpose of providing constructive suggestions on how to move forward with this important initiative, the DRRTF's suggestions in this letter are offered in that spirit.

Sincerely,

*signed in the original*

George Vegh,  
Chair, Distribution Regulation Review Task-Force

c: Norm Ryckman – Enbridge Gas Distribution Inc.  
Gia DeJulio – Enersource Hydro Mississauga Inc.  
Indy Butany-DeSouza – Horizon Utilities Corporation  
Ian Malpass – Hydro One Networks Inc.  
Jane Scott – Hydro Ottawa Limited  
Colin Macdonald – PowerStream Inc.  
Colin McLorg – Toronto Hydro Electric System Limited  
Mark Kitchen – Union Gas Limited  
George Armstrong – Veridian Connections Inc.

## Framework Review Time Frame

February, 2012  
Chair's Statement  
Addressing Prioritization of  
Issues

March, 2012  
3 Day Round Table  
Presided over by Chair.  
Day 1 – Visioning Day:  
Consumers;  
Day 2 – Visioning Day:  
Industry;  
Day 3 – Technical Day:  
(regulatory representatives)

May, 2012  
Chair (or Board) releases  
Report Directing Staff –  
facilitated working groups  
to make “straw man”  
recommendations on  
specific topics for  
stakeholder comment.

July, 2012  
Working Groups report to  
Board with  
Recommendations. The  
Report is to be drafted by  
Staff with stakeholders  
providing oral presentations  
to Board Members.

September, 2012  
Board issues formal notices  
of proposed codes or  
guidelines for comment

December, 2012  
Board Finalizes Framework

