ONTARIO ENERGY BOARD

RENEWED REGULATORY FRAMEWORK FOR ELECTRICITY

BOARD FILE NOS: EB 2010-0377, EB 2010-0378, EB 2010-0379, EB 2011-0004, EB 2011-0043

WRITTEN SUBMISSIONS OF THE MID-SIZE DISTRIBUTOR GROUP

Bluewater Power Distribution Corporation, Enwin Utilities Ltd., Erie Thames Power, Essex Powerlines Corporation, Greater Sudbury Hydro Inc., Guelph Hydro Electric Systems Inc., London Hydro Inc., and PUC Distribution Inc.

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EXECUTIVE SUMMARY

1. The Mid-Size Distributor Group (the "MSDG") currently includes the following distributors: Bluewater Power Distribution Corporation, Enwin Utilities Ltd., Erie Thames Power, Essex Powerlines Corporation, Greater Sudbury Hydro Inc., Guelph Hydro Electric Systems Inc., London Hydro Inc., and PUC Distribution Inc.. This report expresses the unanimous views of the MSDG.

2. The MSDG believes that the costs of regulatory compliance for small and medium size distributors is excessive. This OEB initiated review is the ideal opportunity to take stock of the regulatory processes, for the ultimate benefit of our customers. For that reason, MSDG is proposing measures that would significantly reduce costs by streamlining regulatory processes, without the OEB losing the level of control necessary to satisfy its objectives. Through the process proposed, the Board would retain its scrutiny of capital costs, control of O&M costs, oversight of performance and ROE.

3. The principal mechanism for achieving this renewed regulatory framework is "regulation by exception" as described in paragraphs 50-56, below. The "regulation by exception" proposal seeks to replace both Cost of Service and Incentive Rate making with the following key elements:

- The introduction of a range of permissible increases to O&M costs set by the OEB on an annual basis;
- The implementation of approved long term capital plans consistent with multi-year plans discussed during the consultation, with rate base and amortization being updated annually to highlight variance from the approved plans;
- The introduction of a mechanism for the OEB to call utilities in for full rebasing based on performance, or to ensure that ROE does not exceed a reasonable level; and

- Likewise, utilities could seek a full Cost of Service review if the approved annual increase would be insufficient.

4. During the process of implementing our proposals, the status quo requires three significant changes, beginning almost immediately.

5. First, the Cost of Service process must be improved by the abandoning what has come to be known as the “envelope approach”. This approach appears to be in the interest of decision-making efficiency, but it creates an inappropriate starting point for the subsequent IRM years.

6. Second, IRM, and in particular Benchmarking, requires serious re-consideration including the possibility of abandoning Benchmarking as being a costly exercise with limited prospect of achieving its intended objectives. Given the complex and highly technical nature of Benchmarking, we suggest a working group be established to evaluate Benchmarking, to determine if there is a workable design.

7. Third, the OEB should acknowledge that distributors may face unique circumstances that warrant a significantly different approach for each. Therefore, we propose that any process established by the OEB should allow for “off-ramps” whereby a distributor will have the opportunity to seek Board approval for an increase driven by local circumstances affecting capital, load or reliability.

8. If we can limit cost increases to consumers through more efficient regulation, we can expect consumers to benefit from lower rates, in two ways. First, a more efficient regulatory environment would reduce O&M for utilities and the regulator. Second, by providing a higher level of predictably in the regulatory system, we can expect a positive effect on distributors’ risk profiles. A lower risk profile will decrease the distributor’s cost of capital, at a time when the electricity distribution industry is becoming more capital intensive. Through this process, we can create opportunities for distributors to provide lower rates to our customers.

9. We now turn to our detailed comments on the issues the OEB has identified for written comment.

1. What is your vision for a sustainable and long-term regulatory regime?

10. The members of the Mid-sized Distributor Group ("MSDG group") share a common vision for a Renewed Regulatory Framework for Electricity. The challenge is to create a new regulatory framework that is better than the existing one. This will require moving to significantly more light-handed regulation, while maintaining the essential safeguards. The key elements of this new framework will be as follows.

The integrity of Cost of Service must be maintained

11. The OEB Chair stated verbally in her closing remarks "*It is not cost plus*" (Transcript, Friday, March 30, 2012 at page 108). "Cost plus" is a short form for whatever cost the entity incurs plus its profit. We would agree with the Chair that the cost must be prudent and necessary in order to be justifiably passed on to customers. In other words, "*it is not <u>automatically</u> cost plus*".

12. For the OEB's regulatory control to remain intact, there must be some sort of constraint on two factors: the permitted return on equity and the O & M costs. However, despite the Board's obligation to ensure that rates are just and reasonable, there is nothing in the legislation that requires the Board to satisfy itself that rates are just and reasonable in any particular way. It can do so in a way that is costly and time-consuming, or streamlined and efficient.

13. This brings us to an OEB practice that has come to be known as the "Envelope Approach" to Cost of Service. It is trite to suggest that, notwithstanding the difference between regulatory regimes, *"all of the methodologies are based on providing an opportunity (but not an assurance) for the regulated firm to recover its costs and earn a just and reasonable return on capital investments"* (Fundamentals of Energy Regulation, Lesser and Giacchino, 2007, Public Utilities Reports, Inc. at p.45). A Cost of Service process that includes what is essentially a

general "cap" on costs through the "Envelope Approach" precluded the opportunity to prove the need for the full costs required. That shortcoming is exacerbated over the next three years when the utility faces further indexing and caps through the IRM process, on a base that is, itself, capped with reasons related to external factors (i.e. inflation or benchmarking) rather than the prudence of the cost claimed. If the base is wrong the superstructure erected on top of the base will be even more wrong.

14. The MSDG group recognizes that the OEB faces considerable pressure to carry out its mandate with limited resources. On its own, and if properly documented through the Filing Guidelines, we might applaud the creativity of the "Envelope Approach" in dealing with Cost of Service in the face of a significant workload for the OEB and the LDCs it regulates. However, in the context of a subsequent IRM Regime and with no guidelines, the applause will be muted.

15. We note that the OEB carried out a review of the gas industry in 2005, at the conclusion of which the Board recognized that Cost of Service plays a valuable role in an Incentive Rate Making environment. At page 25 of the Board Report, entitled "Natural Gas Regulation in Ontario: A Renewed Policy Framework", March 30, 2005 the Board concluded *"Each IR Plan must begin with a robust set of cost-based rates, based on a thorough and transparent review".* To the extent that a Cost of Service review <u>following an IR Plan</u> is valuable to consumers to ensure that the next set of rates are minimized to the level achieved during the IRM period, so is a Cost of Service review valuable to utilities <u>going into an IR plan</u> to ensure rate minimization has not <u>already</u> been imposed through an artificial cap or "envelope" on the costs claimed for recovery.

16. If the Board intends to keep its Incentive Rate-Making regime, the effectiveness of that regime depends upon a comprehensive and fair Cost of Service regime. Therefore, the OEB should, as part of this proceeding, either endorse the "Envelope Approach" (with reasons and guidelines) or declare that it has abandoned it. To conduct a review of the regulatory framework

without addressing what may not be official OEB policy, but appears to have become OEB practice, would be a significant oversight.

Incentive Rate-Making must be a "Made in Ontario" Solution for Electricity:

17. Incentive Rate-Making is not used by all regulatory agencies, and even its users may implement it differently. There are serious concerns with this type of rate-making because unless careful controls are in place, it could be creating perverse incentives in the longer term, resulting in underspending or underinvestment, or both. Over time, this will create a maintenance or capital investment deficit, and then a massive price shock when the inevitable and more costly catch-up spending must be undertaken, and billed to customers.

18. Assuming that Incentive Rate-Making can work well, it does so only in an environment that is stable and mature. As Dr. Adonis Yatchew stated "It becomes rather more difficult in settings where there are cost pressures and changing responsibilities, changing roles, which is what is happening to the wires segment of the electricity industry" (Transcript, March 29, 2012, at page 166). While it is possible to make IRM function in an environment subject to turbulence created by several different actors (OEB, IESO, OPA, ESA, Measurement Canada) and various government directions (Green Energy Act, Smart Meters, Ontario Clean Energy Benefit), the challenges to implement such a system successfully are significant.

19. Given the uniqueness of Ontario's hybrid electricity market, if the IRM process is to be preserved, it needs to be a "Made in Ontario" solution for the electricity distribution industry.

20. There has been much conjecture as to why IRM has worked in the recent past for the gas industry in Ontario but has worked less well for electricity. Several speakers addressed this issue and we note some of those comments along with our own view of why IRM has been challenged to work for electricity distributors to date:

(a) Relative maturity of regulation of the industries. Gas utilities have been regulated by the OEB for 40 years, whereas the electricity distributors are still evolving from their previous lives as political commissions. The transition has contributed to material cost increases beyond the control of management, making it difficult to function in an IRM environment. Two clear examples are:

(i) LDCs have had to create regulatory departments they never had before, and giving them increasing obligations, which also increases demands on most other departments (Engineering faces new reporting, Customer Service must respond to customer demands in a complex industry, and the Information Technology Department must be prepared to respond to ever changing rules and requirements).

(ii) LDCs are still catching-up on historically depressed capital and O&M spending of the 1990s, when Commissions harvested the asset in an effort to keep rates artificially low (in fact, frozen for most of the 1990s).

(b) The continued degree of instability in electricity versus gas. Both industries face minor variations and those can be managed. However, turbulent change is the new “norm” for electricity in a politically charged environment. It is both the volume and the rate of change that creates a material difference between the two industries and means that IRM works less well for electricity, if at all.

(c) The design of IRM is different. In 2005, the OEB carried out a lengthy consultation with the Gas Industry following the first less-than-successful implementation of IRM. The same degree of consultation has not taken place with the electricity industry. The result is a design that is likely to be less effective; for example, the term of IRM in gas versus electricity represents a significant difference in the design that likely contributes to the difference in efficacy of the processes.

(d) Gas and electricity are simply different industries. That impacts the ability to manage within an IRM environment. For example, there is a different mix of assets with a different year of installation, lifespan, cost and degree of complexity. Reliability is achieved in different ways and with different cost structures. LDCs also have an obligation to serve that means all customers must be served regardless of economics.

21. The OEB Chair, in her closing remarks, stated that the starting points for gas and electricity may explain the differences in efficacy of IRM (Transcript, March 30th, at pages 108-9). Without ascribing meaning to that comment we would suggest that it is an acknowledgement of two possibilities. First, that if IRM is to be redesigned, it should specifically address the context and history of the electricity industry for a Made in Ontario solution. Second, that even if all of the design issues could be addressed through a revised IRM, the OEB must

still address the starting point going into IRM, and that could be in the form of a recommitment to a fulsome COS process or delaying further IRM until electricity has completed its transition.

22. If the OEB seeks to create a Made in Ontario IRM process, then we must acknowledge our own history and recognize the differences between our jurisdiction and those from whom we seek to borrow regulatory practices. We also must acknowledge the differences between the gas and electricity industries.

23. The remainder of this submission will speak to the need to reduce the regulatory burden, abandon benchmarking, and adopt a "One-Size Does <u>Not</u> Fit All" approach that would lead to regulation by exception. However, before leaving the discussion of the current regulatory regime, we note that the IRM process should include:

(a) A stable starting point, which means a Cost of Service approval representing a full and fair assessment of the utility's cost of doing business. Without such a base, IRM is simply inappropriate.

(b) If IRM is to continue, then further consultation is required on the design of IRM. Any redesign must address the list of differences noted above between gas and electricity, as well as the differences between Ontario and any other jurisdiction whose design we seek to borrow.

(c) IRM should be optional to LDCs that could, as an alternative, file a multi-year Cost of Service Application or similar mechanism such as a price commitment.

(d) Off-ramps should not be limited to capital requirements, but should be available from any process (IRM, multi-year COS or price commitment). For example, a streamlined off-ramp should be available for costs related to government initiatives that impact LDCs, and also, to permit LDCs to be more responsive to local circumstances such as lost load or significant reliability issues.

This is our Once in a Decade opportunity to Reduce the Regulatory Burden:

24. Our use of the term "regulatory burden" in these submissions is not intended to be derogatory of the work of the Board. The term "regulatory burden" has been widely used in a number of contexts, including by Industry Canada, which accepted the following definition of the term:

> The burden of government is the intervention and interference of government in the operations of a business…it is the cost involved in complying with regulatory requirements, collecting taxes and responding to information demands from government…
>
> From a firm's point of view, compliance costs are important and comprise the collection of requirements imposed by all orders of government through legislation, regulations or administrative policies. This includes the costs of meeting the requirements of the regulatory system, including the administration and paperwork costs. Often, the compliance aspect of regulatory burden is referred to as paper or information burden. The focus here is on regulatory requirements and what additional cost they impose on businesses beyond normal commercial activities.
>
> The macro approach recognizes that regulations are needed to achieve a range of economic and social objectives. Businesses bear a portion of the costs but they also benefit from them. <u>The regulatory burden not only includes the compliance costs described above but also disincentives and other factors that may adversely influence business' productivity and competitiveness.</u> For instance, the efficiency costs and, perhaps, transfer costs would be considered. <u>An efficiency cost reflects the value of the resources forgone (the value of the product or service lost) due to the regulation.</u> A transfer cost refers to the redistribution of income or wealth in direct response to a regulation.
>
> For policy purposes, the question to ask when examining regulations from a firm-level perspective is <u>whether the regulations are most efficient and impose the least cost.</u> For instance, if many of the requirements appear to overlap, attempts could be made to rationalize the requirements. Similarly, confusion over how to fill out a form suggests efforts should be made to simplify the forms in user-friendly terms and/or provide clearer guidelines. From a macro perspective, i.e., when evaluating the regulatory framework, the question is whether it is achieving the government's economic and social purposes and whether the costs are allocated in a manner consistent with those objectives.
>
> (*Industry Canada, Small Business and Regulatory Burden*, http://www.ic.gc.ca/eic/site/sbrp-rppe.nsf/eng/rd01339.html, underlining added and footnotes omitted.)

25. Through the use of the term "regulatory burden" the MSDG group is trying to convey that inherent in any regulation, there are associated costs of compliance, including the use of management time. Every regulatory regime has the potential to add one layer of regulation at a time, with the ultimate result being an encrustation of layers creating an overall cost of regulation that is unnecessarily high. Unless this cost is consciously constrained, it may reach the point of exceeding the benefit to consumers. We do not know whether Ontario has reached that crossover point, but the OEB has created the opportunity, through this RRFE process to ask, reflecting the above quotation from Industry Canada:

(a) Is the regulatory regime currently in place the most efficient possible?

(b) Does the regulatory regime address the priorities of customers and the legislature's economic and social objectives?

26. The MSDG acknowledges that it is beneficial to LDCs to be able to point customers to the fact that our rates are regulated by the OEB. However, that benefit comes with a cost, and like all costs incurred by distributors, these costs must be examined critically against the benefits. Therefore, it is prudent to consider whether the regulatory burden currently imposed on distributors is providing sufficient benefit to the consumer, at an appropriate cost to the distributor. The OEB ought to assess each and every component of its current regulatory environment to determine if each component is prudent and necessary.

27. An example of a regulatory activity that may be excessive is the recent requirement that LDCs with facilities owned by Loblaws submit applications under section 86 of the OEB Act. These applications are meant to protect the public interest where sales of distribution assets will impact the public. However, these applications have been required to be filed not only when there is material impact on the public, but even in the absence of such impact, where the only parties affected are the LDC and Loblaws, and where the value of the transaction is less than $2,500. The cost of preparing such an application will be well in excess of $2,500. The only possible result is a net loss in consumer welfare.

28. Numerous parties to this proceeding have highlighted the fact that distribution charges represent a relatively small – and shrinking – proportion of the total electricity bill. The forecast cumulative increase in distribution rates for residential consumers over the next five years is approximately 6% (Bruce Sharp, Transcript March 30, p. 41). This demonstrates that the Board cannot fix “price shock” by increasing the regulatory burden on electricity distributors in an effort to put downward pressure on their rates, because the projected price increases are not

being caused by electricity distributors. It also demonstrates that if the OEB is concerned about total bill impact "because that is the way the consumer looks at it" (Transcript, OEB Chair at page 106), then even in a worst-case scenario, distribution rate increases are projected to be approximately 1% annually.

The value of Benchmarking depends on data and design, and this is our opportunity to ask whether it is worth the effort:

29. It is clear that the OEB intends that Benchmarking will play a significant role in the future regulatory environment. But should it? The MSDG would agree that collecting some kinds of information about performance is a useful tool for management. However, reliance on that information to create rewards and punishments runs a high risk of distorting normal management conduct in unproductive ways (Frank Cronin, Transcript March 29, p. 155-6). In the absence of any data evidencing that Benchmarking is achieving desired objectives, serious consideration should be given to phasing out both the Benchmarking and the incentives based on the current performance measures.

30. Benchmarking is not the only tool available to the OEB to regulate LDCs of varying sizes and circumstances. The wide variation among LDCs in Ontario (history, mix of assets, age of infrastructure, size, growth patterns, density and urbanization of service territory, etc.) may mean that tool will always be a challenge to implement. René Gatien of Waterloo North Dumfries Hydro, quoting an accountant on his Board of Directors, said it well during the consultation, when he noted that just as it is difficult to understand a company's business fully without reading the notes to its financial statements, it is difficult to understand individual LDCs without examining their differences in detail (Transcript, March 29 at page 207). Currently, the OEB's Benchmarking does not do that.

31. If reliable Benchmarking was easy, a clear and meaningful process would already be in place and would be enjoying broad-ranging support from stakeholders. During the Stakeholder

Consultations for this proceeding, we saw evidence that the debate still lives concerning the proper methodology, the availability of data and appropriate use of Benchmarking results.

32. Benchmarking highly heterogeneous groups such as the Ontario LDCs will probably result in false comparisons and wrong conclusions. To rely on the results of such Benchmarking may lead to punishing the more efficient and rewarding the less efficient, causing distortions, the inefficiencies of which will compound over time.

33. If the OEB intends to retain Benchmarking, but to implement changes to it, then the Board will need to establish a working group involving utilities, OEB staff, intervenors and other stakeholders to explore methodologies and potential "outcomes" to be measured. The concept of "outcomes" is difficult to address in the abstract, while the range of options for measuring performance are wide and highly technical. It is impossible for these policy and technical issues to be addressed adequately through a consultation process alone, without a working group to explore the details. We would see this working group being tasked with the role of developing a Strawman of potential "outcomes", methodologies and proposed uses for Benchmarking.

Multi-year capital plans:

34. The members of the MSDG generally support multi-year capital plan approvals, not as and end in itself, but as the means of reducing regulatory burden during the lifetime of the capital plan. We note that during the consultation there did not seem to be consensus on the form that the multi-year plan would take, or how such a plan would be used.

35. We would support a process that treats the capital plan as either (i) pre-approved and subject to annual true-up through rates or (ii) approved in principle with annual updates to be provided for review by the OEB.

36. Either method requires some level of review by the OEB, but the regulatory process can be streamlined by having the approval performed by OEB staff with a mechanism to seek

review by a panel of Board members if necessary. Capital investment plans are best reviewed by a skill set that is not usually found in the rate review process. It is an area that would benefit from OEB staff with appropriate electrical engineering and accounting expertise, dedicated to the review. We would support an off-ramp for unforeseen circumstances, as well as a creative approach for sharing savings for certain types of investments (more appropriate for material investments outside of infrastructure renewal).

37. We would welcome the opportunity to provide comment on a detailed proposal to be put forward following this proceeding. At this stage, we would make the following suggestions to assist the OEB as it develops a proposed mechanism.

38. LDC's capital plans normally provide for (i) infrastructure renewal, (ii) expansion of the distribution network, (iii) service enhancements, (iv) compliance with government imposed programs such as smart meters and the smart grid. The analytical tools associated with each type of planning are very different. For example, infrastructure renewal is based on asset management plans; grid expansion is based on forecasts of customer growth; and service enhancements are based on cost-benefit analysis. The compliance costs of usually unforeseen government imposed programs can be the most difficult to estimate. The weight of each of these elements in an LDCs Capital Plan should dictate the nature and the level of review required. An LDC whose plan emphasizes renewal requires less review, provided a credible asset management plan is filed with the OEB.

Economies of Scale:

39. This is a time for objectivity, not the "same-old, same-old" unverified assumptions about economies of scale. As an industry, the issue of consolidation has been the subject of regulatory proceedings in the past (RP-2004-0020), as well as individual studies of mergers at the utility level. In recent days we see the Minister of Energy having appointed a task force to study the topic yet again, based on the standard <u>assumption</u> that "bigger is better". There is no

proof of that economies of scale continue to exist, and can be captured, to result in savings, in utilities of any particular size. Furthermore, there is no proof that the probable decline in service quality associated with coerced mergers will lead to a happier customers.

40. Indeed, in many cases costs actually increase. In most LDC mergers, the number of employees required to climb poles and repair lines remains the same, as does the capital spending on poles, lines, transformers, vehicles, etc.. However, with different unionized workforces, the wages and salaries of the various labour forces will always rise to those of the highest-paid employees, resulting in higher wage, fringe benefit and pension costs. If the LDCs are not immediately adjacent to each other, or have large rural or suburban service territories, again, there will be few opportunities for any significant savings.

41. Furthermore, looking at cost savings is only one side of the equation, which completely ignores consumer outcomes and consumer satisfaction. For example, in small utilities such as those in Northern Ontario, everyone in town knows the manager, and therefore, knows who to call if there is an outage. That may be one reason why outages in such utilities tend to be unusually short, and service quality high. However, if these small utilities were merged with the much larger utility in a nearby large city and the merged utility got rid of the manager in small town, that small saving in salary and overhead would result in considerably reduced service quality and customer satisfaction.

42. Certainly, the OEB has no jurisdiction to "force" mergers, and it has generally taken the view that its role is to reduce the burden of mergers on consumers, rather than to implement rules that encourage mergers.

43. Among regulatory economists there is a common recognition that economies of scale do not continue as a downward-sloping line, infinitely, but follow a U-shaped curve. Regulatory burden can distort that curve, making efficient mid-sized utilities appear less efficient because of an onerous regulatory regime. A costly regulatory regime will have a disproportionately larger

cost impact on small to mid-sized utilities than on the larger utilities. It is important, therefore, to get the burden right so as not to create an artificial rationale for industry consolidation, merely to spread the burden of excessively costly regulation over a larger customer base.

Economies of Scope:

44. There is evidence that economies of scope create better opportunities for efficiencies than economies of scale. In the words of Frank Cronin, the savings associated with economies of scope “swamp” the savings associated with economies of scale (Transcript, March 29, 2012, at page 172, line 13). However, the Affiliate Relationships Code (“ARC”) is to some degree a barrier to the realization of economies of scope.

45. A full view of the regulatory framework, such as the OEB has initiated with this proceeding, should include a review and modernization of its ARC, to provide direction to LDCs and OEB Staff on opportunities to find efficiencies through economies of scope, of benefit to both customers and shareholders.

46. Allocating 100% of the benefit of economies of scope to customers creates no incentive to engage in the difficult work required to achieve economies of scope in the real world. Thus, it is not in the customer’s long-term interest to fail to share the benefits of economies of scope among customers and shareholders. Perhaps a departure from fully-allocated costing and non-distribution revenue flowing to the exclusive benefit of customers would facilitate creativity and new opportunities for shareholders and ratepayers. Facilitating these opportunities would allow the ratepayers to share in benefits; rewarding ratepayers with 50% of something is better than dampening creativity and giving ratepayers 100% of nothing.

47. Finally, we note that sections 71 and 73 of the OEB Act contain an unfair and inappropriate prohibition of activities for affiliates of municipally owned LDCs. For example, the restriction against operating water and wastewater treatment and distribution systems that are owned by municipalities that do not have shares in the LDC creates an arbitrary restriction.

While these legislative restrictions are beyond the power of the OEB to remove, the OEB can (i) recommend legislative changes to the Province and (ii) provide guidance on the meaning of the phrase "use more effectively the assets of the distributor or an affiliate", consistent with the OEB's mandate to protect consumers, in the broadest sense of the word.

One-size does not fit all:

48. The MSDG is confident that a careful cost-benefit analysis of the current and the proposed regulatory framework will demonstrate that "one-size does not fit all". If the OEB identifies the problem to which a proposed regulation is responding, it might determine that a more light-handed approach is appropriate. For example, if the OEB has identified regional planning as a weakness because of a few circumstances in the GTA, then in identifying the problem to which it is responding in detail, it might limit the increased regulatory burden to larger, faster growing LDCs in the GTA.

49. Other regulatory agencies in Canada have faced similar challenges in terms of regulating a diverse group of industry participants. Their experience can serve as useful precedents for the OEB in implementing a new regulatory framework. Specifically, the telecommunications industry's regulatory regime may be instructive. The Canadian Radio-Television and Communications Commission (the "CRTC") acknowledged, some 16 years ago, that the full-scale regulatory process used for the largest carriers would result in a regulatory burden that was too large for small incumbent local exchange carriers. (Telecom Decision 96-6 http://www.crtc.gc.ca/eng/archive/1996/DT96-6.htm and renewed in Telecom Regulatory Policy CRTC 2011-291 http://www.crtc.gc.ca/eng/archive/2011/2011-291.htm). As a result, the CRTC established a separate regulatory framework for these smaller entities that would allow for lighter regulation than that imposed on larger entities.

50. Similarly, the OEB could implement a system of light handed regulation for all electricity distributors with fewer customers than a specific number set by the OEB, for example, 200,000

customers. By doing so, the OEB could ensure that the regulatory burden imposed is appropriate and commensurate with the size of the distributor.

Regulation by Exception:

51. Significant efficiencies can be achieved in the Board's regulation of rates by taking a "regulation by exception" approach to some of the activities it regulates. This could be seen in two scenarios:

(a) An enhanced set of performance objectives could be established with a specified acceptable range of results. Provided that an LDC maintains its performance within this range, then the OEB would defer to the LDC's operational decisions in its rate review. LDCs would have an economic interest in ensuring that the correct information data is gathered and submitted to the OEB.

(b) Additionally, LDCs within a reasonable band of rates (to be determined by the OEB), could seek an increase to their rates by some specified percentage (also to be set by the OEB) without requiring a full Cost of Service hearing.

52. The Board could then, on a regular basis, initiate a general consultation process inviting stakeholders and experts to submit evidence on the body of performance standards and the limits and ranges applied to ensure that LDC results provide the outcomes that consumers want and are willing to pay for.

53. By way of example, the OEB could determine that the allowable increase in rates in a given year would be Y% on a utility's O&M embedded in existing rates. An LDC that can live with that level of increase would submit an application as determined by the filing guidelines (including an O&M Budget based on the Y% increase, reliability data, and an updated load forecast) and the application would be reviewed on a streamlined basis. Any LDCs that could not to operate with a Y% increase would submit for a full Cost of Service review.

54. This process is intended to replace both Cost of Service and IRM. It would be anticipated, therefore, that the value for Y% would be greater than the resultant increases under the existing IRM process.

55. This process would be complemented by a multiple year Capital Planning process, as discussed at paragraphs 34-38, above. The approved Capital Plan would be updated annually as part of the streamlined filing and that update would impact Rate Base and Amortization, which would automatically be incorporated into rates.

56. It would be anticipated that a slim minority of LDCs would chose the full Cost of Service application process. Certainly, once they have chosen that route and achieved an acceptable result (or at least been satisfied that they had a genuine opportunity to present their case) the need for future Cost of Service applications would be avoided if the value of the annual increase is “right”. We are not, at this time, suggesting a value for the Y% increase, but we believe there is a “right” answer and we welcome the opportunity to explore that issue further.

57. One final note is that the OEB would reserve the right to designate certain LDCs as requiring a full Cost of Service application. That might be for reasons related to operations, reliability, customer service, capital planning, or financial performance (superior or inferior).

2. What changes would be needed to evolve planning, mitigation, and performance policies towards your vision?

58. The submissions set out above provide our general vision of a renewed regulatory framework. Thus far, we have addressed, in a general way, the changes required to work toward our vision. Beyond these general submissions, we now provide some more specific comments.

(a) **Resuming the Board’s Role in Contribution to Policy**: The OEB has been given the discretion to be more than a passive implementer of provincial legislation and directions. The OEB also has unique expertise at a practical level, not normally found within government ministries. On the theory that no one – not even the Minister – has a monopoly on good ideas, the time has come for the Board to resume its traditional role in contributing to Provincial energy policy. In that role, the Board can make recommendations for policy reform. As an example, we noted, above, that Section 73 (1) contains an unreasonable restriction on municipally-owned distributors that is not in the long-term interest of electricity customers. If the OEB agrees, then it should recommend that change in the legislation to the Minister of Energy. A regulator willing to provide policy recommendations has again become necessary, to deal with regulation of a complex industry like electricity in Ontario.

(b) **Public education**: The electricity industry bears little resemblance to the industry that it was even 20 years ago. If the OEB believes there is value to increased engagement with the public, then public education must become a significant priority. LDCs in Ontario have an intimate relationship with their customers, many of whom have been customers through several generations of the same family. We are uniquely positioned to carry out that public education, but we cannot do it alone. For example, Board member Somerville referred to the OEB providing regulatory approval analogous to the *"Good Housekeeping Seal of Approval"*. That concept certainly has merit, but only the OEB can establish and demonstrate the value of that seal, through direct engagement of the public. The LDCs can be your collaborators in this endeavour.

(c) **Enforcement**: We are all poorly served by LDCs that fail to meet their filing requirements. Where an Applicant continually fails to meet an expected and understood standard for data quality in an application, the Board should deal directly with that Applicant, to correct the situation. Additionally, the Board may consider making compliance with a minimum quality of application as a factor in performance by the LDC. If the Applicant were to fall below the acceptable standard, the Board could determine that a Regulatory Exception had occurred and "Off-Ramp" the applicant from a more streamlined process to a more detailed and controlled one. This approach would be more efficient than placing a heavy burden on all LDCs, when the targets of that burden are the exception rather than the rule.

(d) **Data:** A general principle of design in information systems is to capture data only once, and to use that data through all processes. This principle applies to the variety of data that is captured by the OEB through the RRR process. Once the data has been given to the Board, we would encourage the Board to investigate the potential for using the RRR data to pre-populate rate applications. Applicants would review the pre-populated data, and make changes only where changes are required. This would reduce the problems of inconsistent data being inconsistent primarily because they were assembled and submitted at different times.

As a means of presenting a part of the Board's consideration for a renewed regulatory framework, Board staff prepared a strawman that summarized some of its potential key elements. In providing their comments on the issues, the Board would be assisted if stakeholders also provided comments on the strawman.

59. We believe that we have addressed this issue above, and, in the interest of avoiding repetition, we choose to leave this question with no direct response.

3. Planning (EB-2010-0377)

How do we optimize planning across the sector to ensure that investment decisions achieve the level of reliability and quality of supply that consumers demand and are paying for?

60. The MSDG believes that planning across the sector is presently very good, and should remain unchanged. Supposed "improvements" to the process would increase the regulatory burden for everyone, while being unnecessary for the majority of LDCs. A limited number of

specific LDCs that now require extensive capital investment could follow a more rigorous process.

61. Long-range capital planning is one of the prime examples of an area where one-size regulation does not fit all.

How might coordinated regional planning between utilities and third parties (e.g., municipalities) promote the efficient and cost-effective development of infrastructure and enhanced regulatory predictability, while maintaining reliability and system integrity? What are the implications, if any, for distribution network investment planning?

62. The members of the MSDG are municipally owned. Our relationship with municipalities as our shareholders already provides a high level of coordinated regional planning, particularly given the role of the municipality as an urban planner. Our municipalities are also the vehicle through which we learn about and respond to economic development issues facing our communities. No further incentives are required for the members of the MSDG to encourage a greater degree of planning coordination between municipalities and LDCs. Any process that would seek to formalize that relationship beyond the status quo would add to the burden with no real benefit to customers or the regulator.

How might the Board facilitate regional planning and the effective execution of the resultant plans as appropriate?

63. Coordination is currently adequate between adjacent LDCs and the transmitter. It is not clear what the Board can do to improve the current situation with any further effort.

64. If there are examples (perhaps in the fast-growing GTA municipalities), then we suggest again that this is an area where one-size does not fit all. Any process that would seek to force regional planning on every LDC, even where it is not a major priority, would add to the burden with no real benefit to customers or the regulator.

If we revise cost responsibility under section of the Transmission System Code in respect of transmission line connection facilities to pool the costs, should the pooling be on a province-wide basis, a regional basis, or some combination? Should the cost responsibility rules for industrial customers and distributor customers be the same? Why or why not?

65. The MSDG includes some utilities with significant growth in demand, requiring regional planning, as well as other utilities with declining load, whose priorities are more focussed on infrastructure renewal. In that way, we are a forum in which this discussion can take place with both sides well represented.

66. Any form of Regional Planning that imposes costs on a province-wide basis is, effectively, a transfer of wealth from one region to another. That does not end the discussion, but provides the context for the OEB's decision.

67. In that regard, there was discussion during the March 29th session that no changes to legislation or OEB guidelines are required to permit Hydro One to file for recovery of costs that have traditionally been considered customer/LDC driven. We support Hydro One seeking recovery for a local line that has a province-wide transmission benefit. However, we note that is not a "blank cheque" because Hydro One continues to bear the burden of proving the investment is prudent in light of the other demands on its resources and that there are no more efficient alternatives to the investment.

How can the Board satisfy itself that multi-year investment plans are appropriate?

68. Given the four types of investment discussed earlier in this submission (renewal, expansion, enhancement, government mandated), the answer depends on the mix of investment types for any particular LDC.

69. Each LDC should provide adequate justification for its investment plans. The OEB should not impose rigid rules, but rather, set out its minimum expectation in data requirements on the vintage of equipment proposed to be purchased, its expected life span, and the likely effect on system reliability if the investment plan is approved, and implemented as approved.

How should smart grid investments be treated (i.e., as part of rate base, or based on type of activity/asset)?

70. Smart Grid investments should not be imposed on any LDC. Rather each LDC should be permitted to determine the level of investment that would benefit its customers. If the level of investment is not material on an annual basis, then the investment should be justified and reviewed in the context of regular rate base review.

What empirical and qualitative tools and methods might be used to inform: (a) utility planning processes; (b) utility applications to the Board; and/or (c) the Board's review of utilities' plans?

71. This is a complex set of questions which cannot be answered without detailed study. There is insufficient time to conduct such a study within the RRFE consultation process. This is probably a set of issues on which the Board would wish to retain expert consultants and to conduct a separate consultative process.

4. Performance & Incentives (EB-2010-0379)

What outcomes for customer service and company cost performance should be established?

72. As suggested earlier, we believe that it is incumbent upon the OEB to examine whether the benefits of Benchmarking outweigh the costs, including the likelihood of creating perverse incentives through reliance on inaccurate Benchmarking results in the rate setting process. The OEB should address this issue specifically in its decision arising from this RRFE proceeding.

73. If the OEB is to continue Benchmarking, which is not recommended, then the issue of how to make this exercise meaningful falls within the purview of experts and warrants a separate working group . At the highest level, the outcomes should address the balancing of an LDC's costs with its:

(a) Reliability
(b) Service response times
(c) Implementation of provincial mandates

The measurement of both costs and outcomes must take into account all of the significant variables that can affect any of the final numbers. Furthermore, any financial outcomes resulting from Benchmarking should recognize, and accurately adjust for, all relevant differences between LDCs. Moreover, we do not support an exercise in Benchmarking based solely on O&M. Otherwise, the influence of the benchmarking process on rates can distort the rates that would otherwise be approved by the Board, resulting in rates that are not just and reasonable.

74. The Benchmarking issue demonstrates the difficulty of comparing LDCs on financial criteria alone. It highlights the danger in making the unwarranted assumption that ranking utilities on the basis of cost, while making only a few of the corrections required to provide an "apples to apples" comparison, will provide accurate rankings that can reasonably be relied upon for rate making purposes. If Benchmarking is to be continued, these issues need to be addressed through a working group.

What standards and metrics for customer service and company cost performance should be established in regard to these outcomes? How do the performance benchmarks that are in place today relate to your proposed metrics?

75. We do not support the imposition of any standards or metrics until after there has been a comprehensive review of Benchmarking that results in full recognition of the differences between LDCs, permitting a real “apples to apples” comparison. This can be addressed through the working group mentioned above.

What are the characteristics of a “high-performing regulated entity” (i.e., what specific metrics can be used to evaluate the level of performance of the regulated entity)?

76. If the Board is willing to spend the time and money necessary to make its Benchmarking process sufficiently reliable to provide an “apples to apples” comparison, it may well find that many, if not most Ontario LDCs are “high-performing” in meeting their customers’ service quality expectations at a cost that these customers consider affordable. Unless and until that has been

done, we cannot support the imposition of any metrics, for the reasons outlined in the previous paragraph.

What incentives, if any, are appropriate to reward utilities for cost-effective and efficient performance, including appropriate rewards for exceeding standards for customer service, and company cost performance? What incentives, if any, are appropriate for the purposes of rewarding performance with regard to multi-year capital programs?

77. Customers are well served if a utility meets their expectations. There does not appear to be any reason to provide "incentives" to exceed those expectations, given that incentives are financial, and therefore, have a cost which must eventually be collected from customers. In the short term, LDCs may be incentivized to remove controllable inefficiencies in their operation. However, if the Board's idea of what constitutes an inefficient utility is the result of the seriously flawed Benchmarking process there is a real risk that the incentives offered will be more of a punishment than a reward, and maybe a punishment administered to the wrong LDC. Thus, to the extent that the concept of incentives is part of the superstructure that rests on the base of Benchmarking, it is premature to consider such incentives for the reasons set out in paragraph 75, above.

78. It will also prove to be very difficult to reward performance following the adoption of multi-year capital programs. We encourage the discussion of these issues by the working group mentioned earlier.

How might the Board enhance the alignment of customer and company interests through the use of incentive mechanisms?

79. Please see our comments in paragraphs 75-78 above. We also provide the general comment that no new regulatory tool should be implemented without asking "What is the expected benefit of increased regulation in this area?".

5. Rate-setting & Mitigation (EB-2010-0378)

How might the Board align rate-setting with multi-year investment plans? Do you have a preferred approach, and what are its benefits and disadvantages?

80. Rates should be adjusted annually to recognize the increase in rate base that occurs from capital investments. The annual adjustments should be set in the rate order for each interim year. If capital expenditures are more than 10% below what was in the approved capital plan, a corresponding adjustment would be made to the rate increase. If capital expenditures are more than 10% above the capital plan the LDC would have the option to apply for a higher increase than was previously approved. Allowing for annual rate adjustments due to an annually increasing rate base avoids the large one time increase that now occurs when rates are rebased. It also treats the shareholder more fairly, as currently there is no return on incremental investment until rates are rebased.

Should the Board amend the ICM rules as proposed by some participants to provide for an interim solution? If so, how? What are the implications of such an interim change in the context of the longer-term RRFE approach of incorporating multi-year capital plans in rates?

81. None of the members of the MSDG feel that this should be an OEB priority at this time.

How might further benchmarking be used to: (a) help determine appropriate cost levels; (b) achieve further efficiencies; and/or (c) assist in managing cost increases?

82. The most appropriate use of Benchmarking as it exists today is as a “screening tool” to determine the level of scrutiny. It would appear that the “Envelope Approach” seeks to use Benchmarking as a means of setting some sort of “appropriate” cost level. In addition to our comments on the Envelope Approach set out above, we would add that the quality of data and methods of analysis employed do not justify that extended use of Benchmarking.

83. As indicated in a previous response, Benchmarking can be a useful management tool. However, just as a financial statement is meaningless without the notes, Benchmarking is meaningless unless close attention is paid to the explanations. Benchmarking is most relevant to identify outliers. That should be the extent of the Board’s use of Benchmarking – if it is to

continue at all. That is not to suggest that outliers are automatically underperforming utilities. They may have a valid reason for their consistently higher costs. We support the notion that they should be required to prove their costs in a more rigorous Cost of Service process.

How might the Board's approach to the application review process be proportionate to the characteristics of the application (including quality) and the performance of the applicant?

84. We have addressed this issue at various points in our submission. To reiterate, we support the notion that one-size does not fit all and more rigorous review should be provided for utilities which:

(a) Fail to meet OEB filing guidelines in a material way, either for O&M or Capital Plans;

(b) Have rates (not just O&M per customer) that have a materially different customer impact;

(c) Have Capital Plans either 10% higher for the following year, or materially different in nature, than previously approved;

(d) Require, for any reason, rate increases greater than the top of the range previously approved by the Board.

To support the cost-effective and efficient implementation of Board-approved network investment plans by transmitters and distributors and to help mitigate the effects of any unavoidable and significant bill impacts, what mechanisms might be appropriate?

85. Allowing for an increase in rate base over a three year period because of necessary capital investments and delaying recovery until rates are rebased is a major cause of significant bill impacts. The OEB should allow for rate increases that account for capital investment on an annual basis to spread the bill impact over multiple years.

5. Other

In light of what you heard at the March 28-30, 2012 Stakeholder Conference, what are your priorities for the Board's development of the RRFE and how might the Board manage the transition to the renewed regulatory framework in a manner consistent with your priorities?

86. Our priorities are as follows:

(a) Overall Process review to capture some or all of our suggested changes in paragraphs 3-8.

(b) COS process: The OEB should confirm its commitment to full and fair review of COS applications.

(c) IRM process: Establish a working group to explore the design of IRM as well as Benchmarking which are technical issue that require wide stakeholder involvement.

(d) Capital Plans: identify the challenges being faced for capital investment, and the potential responses, keeping in mind that one-size does not fit all.

(e) Conduct a through and documented assessment of each layer of regulatory requirement, and either confirm that the benefits outweigh the costs, or identify strategies to reduce the cost, remembering, again, that one size does not fit all.

(f) Two examples of issues not currently included as part of this review, but that ought to be, is (i) an assessment of whether benefits to customers could be provided through an updating and simplification of the Affiliate Relationship Code, and (ii) amendment or repeal of section 73(1) of the OEB Act.

Are there other key issues that should be considered in the development of the RRFE?

87. The OEB is interested in taking a total bill approach from the customer's perspective. Some consumer groups suggested that C&DM was key to protecting customers from "price shock". A forum to discuss the OEB's approach to approving (or perhaps more accurately, not approving) C&DM programs ought to be initiated.

88. The OEB has commenced a process to consider revenue decoupling. That process appears to be on-hold but we support such an initiative and suggest it be revived.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 20 TH DAY OF APRIL, 2012

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