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File 20242

VIA *RESS* FILING AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli

Re: Renewed Regulatory Framework for Electricity Transmitters and Distributors – Approaches to Mitigation for Electricity Transmitters & Distributors (EB-2010-0378)

The Power Workers' Union ("PWU") represents a large portion of the employees working in Ontario's electricity industry. Attached please find a list of PWU employers.

The PWU is committed to participating in regulatory consultations and proceedings to contribute to the development of regulatory direction and policy that ensures ongoing service quality, reliability and safety at a reasonable price for Ontario customers. To this end, please find the PWU's comments on the RRFE's initiative on the Approaches to Mitigation for Electricity Transmitters & Distributors, EB-2010-0378.

We hope you will find the PWU's comments useful.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson
RPS:jr
encl.
cc: Judy Kwik
John Sprackett

List of PWU Employers

Algoma Power
AMEC Nuclear Safety Solutions
Atomic Energy of Canada Limited (Chalk River Laboratories)
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power – Mississagi Power Trust
Bruce Power Inc.
Atlantic Power - Calstock Power Plant
Atlantic Power - Kapuskasing Power Plant
Atlantic Power - Nipigon Power Plant
Atlantic Power - Tunis Power Plant
Coor Nuclear Services
Corporation of the City of Dryden – Dryden Municipal Telephone
Corporation of the County of Brant, The
Coulter Water Meter Service Inc.
CRU Solutions Inc.
Ecaliber (Canada)
Erie Thames Services and Powerlines
ES Fox
Great Lakes Power Limited
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kincardine Cable TV Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
Lake Superior Power Inc. (A Brookfield Company)
London Hydro Corporation
Middlesex Power Distribution Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Waste Management Organization
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Sioux Lookout Hydro Inc.
Sodexho Canada Ltd.
TransAlta Generation Partnership O.H.S.C.
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

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1 INTRODUCTION

On December 17, 2010 the Ontario Energy Board ("OEB" or "Board") initiated a consultation on the development of a Renewed Regulatory Framework for Electricity transmitters and distributors ("RRFE"). The Board's November 8, 2011 Notice states that the Board's objective for the RRFE is to "encourage and facilitate greater efficiency through a focus on performance-based outcomes and a disciplined, long-term approach to investment planning" to help ensure the reliable and cost-effective delivery of electricity to Ontario consumers.

According to the attachment to the Board's March 20, 2012 letter to stakeholders, the RRFE consultation will lead to the development of Board policies for a RRFE which will:

- **Establish performance outcomes that reflect consumers' expectations and encourage enhanced utility productivity;**
- **Provide for efficiently planned investments in grid sustainment, expansion and modernization that consider pace and prioritization;**
- **Align rate setting cycle and investment planning horizon and provide for efficient recovery of costs;**
- **Increase efficiency in the regulatory process through greater focus on outcomes; and**
- **Consider the total bill impact on consumers.**

The consultation consists of five initiatives, one of which is on *Approaches to Mitigation for Electricity Transmitters & Distributors (EB-2010-0378)* ("Mitigation"). In its October 27, 2010 announcement on the RRFE the Board states that it will review its rate mitigation policy.

On November 8, 2011, the OEB released a staff discussion paper entitled *Staff Discussion Paper on Approaches to Mitigation for Electricity Transmitters & Distributors* ("Mitigation Discussion Paper") that solicits comments on a range of approaches to help utilities and the Board mitigate the effects of rate and/or bill impacts. Along with the Mitigation Discussion Paper, the Board issued a May, 2011 supporting paper prepared by Navigant Consulting Ltd. ("Navigant") entitled *Transmission and Distribution Rate Mitigation Measures for Ontario* ("Navigant Report"), which provides a summary of research and expert advice.

2 POWER WORKERS' UNION'S VISION AND CONTEXT FOR THE RRFE

The Power Workers' Union ("PWU") appreciates the opportunity provided by the Board for stakeholders to share their views on the RRFE. The PWU's views on the RRFE stem from its energy policy statement:

> **Reliable, secure, safe, environmentally sustainable and reasonably priced electricity supply and service, supported by a financially viable energy industry and skilled labour force is essential for the continued prosperity and social welfare of the people of Ontario. In minimizing environmental impacts, due consideration must be given to economic impacts and the efficiency and sustainability of all energy sources and existing assets. A stable business environment and predictable and fair regulatory framework will promote investment in technical innovation that results in efficiency gains.**

The PWU's vision for a sustainable and long-term regulatory regime for the electricity utilities is one that focuses on customer value and establishes appropriate and transparent incentives based on Ontario utility data to achieve performance levels that align with customer expectations.

To achieve this vision it is necessary to recognize customer value as the key input to the regulatory framework. This key input would be obtained through robust customer Willingness to Pay ("WTP") surveys that will establish the utilities' service quality (i.e. customer service and system reliability) standards and provide the context for the utilities' network investment planning and the regulatory framework.

The OEB and utilities will need to educate customers to build an understanding of the value and cost of electricity services and the impact of Government energy policy on them. Customer WTP surveys will form the basis for utilities' asset management and investment planning thus incorporating customer value into the utilities' determination of service quality standards and cost. Regulatory incentives and benchmarking based on empirical analysis of Ontario utility data would be used to achieve service quality and total cost performance. Standards for asset management best practices would ensure system sustainability while mitigating time and cost of regulatory review processes. To enhance the sustainability of the regulatory framework, issues that utilities are or will face (e.g. aging assets, aging workforce) should be addressed expeditiously. The framework needs to recognize that customers are unlikely more able to accommodate rate increases in the future than they are today and that postponing maintenance and capital investments to mitigate rate increases today compromises future service quality and results in higher future rate increases. Therefore bill impact mitigation will be limited to ex-post mitigation.

The PWU addresses *Approaches to Mitigation for Electricity Transmitters and Distributors* in the context of its vision and context for the RRFE set out above. In addition the PWU provides comments on issues set out in the April 5, 2012 correspondence from the Board as well as questions posed in the Performance Discussion Paper.

2.1 PWU Position on Mitigation

In addressing the above RRFE context, the initiative on Mitigation needs to:

- Develop rate mitigation that mitigates rate shock and holds the utilities financially harmless, including their financial risk profile;
- Apply utility mitigation to costs over which utilities have direct control (i.e. the utilities rate increase);
- Generate awareness and appreciation for the value of electricity through customer education;
- Consider the impact of mitigation on the pricing signal;

- Use customer valuation based on WTP surveys to establish a rate impact threshold;
- Ensure that utilities are able to recover all just and reasonable, and prudently incurred costs; and,
- Through research develop a rate design that will facilitate consumer load shifting (i.e. Critical Peak Pricing) and bill mitigation.

The PWU applauds the OEB for explicitly addressing mitigation in the RRFE. The PWU believes that the issue of total bill impact should be considered through the Board's integrated policy framework for the electricity sector and not in the review of individual rate applications. While the RRFE should provide utilities with direction and guidance on the Board's expectation on the efficient management of their network investment planning, it should also provide for mitigation mechanisms to avoid rate shock in circumstances where the approved network investment plan results in significant bill impact. However, mitigation should not be used routinely, but on an exceptional basis. Routine mitigation covers the price signal to the customer for the efficient use of electricity service. In the PWU's view, there is the need for the Board and utilities to help customers understand the value of electricity services and, through ongoing communications, educate them on the value and cost of electricity service and the impact of Government policy on them and, the reasons for the rate increases.

Customer valuation of services should be determined through WTP surveys that will determine the level of service that customers are willing to pay for. Where rate increases reflect just and reasonable costs for the provision of services at levels that meet customers' valuation of electricity services mitigation should not be required. Where cost increases are related to government energy policy (e.g. *Green Energy and Green Economy Act*) and are incremental to the costs required to maintain service performance at levels valued by the customers, ex-ante mitigation through the phasing of the policy-related incremental work is appropriate. Ex-ante mitigation in these instances will not reduce the economic efficiency of utilities' network investment plans.

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3 TOTAL BILL IMPACT

In the *2006 Electricity Distribution Rate Handbook: Report of the Board* ("the 2006 EDR Report"), the Board indicated that it considers diligence respecting rate increases to be a core responsibility of distributors, but recognizes that there are elements of the customer bill that are beyond the control of the distributor:

> **The Board considers that diligence respecting rate increases is a core responsibility of the distributor. It is a fundamental element of customer relations to manage the expectations of consumers and to remedy, where possible, and to the extent reasonable, hardship occasioned by material increases in rates.**
>
> **It is important to recognize at the same time that there are limitations on the ability of a distributor to cure these situations.**
>
> **First, a distributor has to act in a manner that is non-discriminatory as between individual customers and classes of customers.**
>
> **Second, a significant portion of the customer bill derives directly from the price of the commodity itself, and other elements that are beyond the control of the distributor. The distribution charges, which are set by the Board through the Handbook process currently, represent approximately 25% of the bill received by customers.**

In order to guide distributors' development of mitigation proposals, the Board provides some guidance in the 2006 EDR Report.

> **….As a general rule, the Board does not favour mitigation plans which are dependent on imposing otherwise unwarranted increases on one customer class in order to reduce increases for another.**
>
> **The Board also considers that mitigation plans that are predicated on reductions in the revenue requirement are problematic. Revenue requirement reductions should inure to the benefit of all customers within the franchise, and should form part of the basic rate application, not a response to hardship cases. It is important that a distributor not compromise its overall ability to deliver reliable service to the service area in order to address discrete instances of hardship.**
>
> **A distributor may choose to reduce its regulated rate of return in order to address situations requiring mitigation plans. This approach may be a useful tool in dealing with hardship increases. Such a course of action should be prudently considered in light of the medium and long-term financial health of the organization and its ability to provide reliable service.**

In the Decision on Hydro One's 2009/2010 transmission rates application (EB-2008-0272), the Board notes the adverse impact of *ex-ante* mitigation on the economic efficiency of asset management plans and on volatility in spending:

> **…Another tenet of rate making is to avoid rate shock through the smoothing of the applicant's spending programs in appropriate cases. An adverse consequence of reducing the applicant's spending to match an economic downturn would be to reduce the economic efficiency of asset optimization plans and to introduce inappropriate volatility in spending.**

The PWU is sympathetic and sensitive to the total bill increases resulting from the Ontario Government's energy policy (i.e. *Green Energy Act*) that consumers have and will continue to experience. The PWU agrees that the Board should be informed of total electricity bill impacts that emanate from all sources. The concern is the manner and extent to which the Board might make use of such information in its review of and decision on an individual utility's rate application.

In the Decision on Hydro One's 2010-2011 distribution rates application (EB-2009-0096) the Board made reference to its objective to protect the interests of consumers but in doing so recognized that the commodity portion of the bill is beyond the control of the applicant.[1] Indeed the objective of protecting the interests of consumers, in its entirety, is with respect to prices and the adequacy, reliability and quality of electricity services. The OEB's second statutory objective with respect to electricity also comes prominently into play:

> **To promote the economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.**

In giving effect to the Board's objectives, section 78(3) of the *Ontario Energy Board Act, 1998* provides the Board with the following authority:

> **The Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity or such other activity as may be prescribed and for the retailing of electricity in order to meet a distributor's obligation under section 29 of the *Electricity Act, 1998*.**

In the Staff Discussion Paper on Distribution Network Investment Planning, Board staff proposes to make 'total bill impact' an important consideration in distribution network investment planning. The PWU believes that this is inappropriate and inconsistent with

[1] OEB. EB-2009-0096. Decision with Reasons. Hydro One Distribution Rate Application April 9, 2010. Page 13.

this initiative's stated objective of ensuring that network plans are 'demonstrably economically efficient and cost-effective, and paced so as to match required expenditures with fair and reasonable rate adjustments and **predictable changes to the elements of customer bills affected by the plans'** [Emphasis added].

The fact is that distributors do consider bill impact in their planning process, including the prioritization of investments. Typically the prioritization process results in a portfolio of individual investments across all work categories that together make up a preliminary Investment Plan for the distributor. The preliminary Investment Plan is then reviewed by Senior Management who may further modify it resulting in a prioritized Investment Plan proposal that effectively meets the distributor's business objectives and represents a balance among customer and distribution system needs, costs, and risks. The proposed Investment Plan is then recommended to the company's Board of Directors for approval. It is therefore clear that distributors already consider bill impact relating to factors in their control. To require distributors to consider total bill impact resulting from factors beyond their control not only will put additional work load on distributors but will also put pressure on their planning process and decisions possibly resulting in sub-standard investments.

Under the Board's various filing requirements, distributors are already providing the necessary information required to ensure that only reasonable and just rates are approved. To require distributors to use total bill impact that is beyond their control in their planning process or to disapprove work plans proposed under such filing requirements on the basis of total bill impact not only raises questions about the board's jurisdiction and mandate but also puts the Board in conflict with its other objectives, for example, facilitating the implementation of the government's green energy policy. The Board should not attempt to control prices that it has no jurisdiction over (e.g. electricity from wind) through its jurisdiction over distribution and transmission rates.

If all steps are taken to ensure that rates are as low as possible before rate increases are requested, the utilities should have the right to recover costs that they are responsible for and that the Board finds to be just and reasonable. As such, in the

absence of any evidence that a utility's proposed costs are not just and reasonable, there would be a lack of prudence in requiring a utility to cut such costs in consideration of factors beyond the utility's control. How does concern for the total bill impact related to a large degree to line items that are not the responsibility of the utility override the Board's objective of allowing the utility to recover its just and reasonable costs? The PWU submits that it does not.

The PWU recognizes that the Board, by virtue of its jurisdiction and mandate, is confronted by a number of competing objectives in discharging its duties. These competing objectives include the promotion and implementation of government policy, the promotion of the reliability and safety of the system, the financial well-being of the utilities, and consumer rate impacts. However, once the Board has set just and reasonable rates for a utility the Board is under a statutory obligation to permit the utility to recover its prudently incurred costs. Nothing in the Board's statutory objective of protecting the interests of the customers with respect to price derogates from this responsibility.

This precise issue was considered by the Board in its recent development of its Cost of Capital policy (the "Report").[2] In the Report, the Board considered the application of the "Fair Return Standard" for a utility's invested capital. The determination of a utility's return is but one specific example of its overall revenue requirement. In the Report, the Board notes and relies upon the decision of the Federal Court of Appeal in *TransCanada PipeLines Limited v. National Energy Board et al*. [2004] F.C.A 149 which provided that:

> **... If the… [Board] does not permit the utility to recover its cost of capital, the utility will be unable to raise new capital or engage in refinancing as it will be unable to offer investors the same rate of return as other investments of similar risk. As well, existing shareholders will insist that retained earnings not be reinvested in the utility**[3]

[2] OEB. EB-2009-0084. Report of the Board on the Cost of Capital for Ontario's Regulated Utilities. December 11, 2009. Page 19. Paragraph 2.
[3] *TransCanada PipeLines Limited v. National Energy Board, supra, 12*

In the Report, the Board specifically considers how the obligation to ensure that the utility recovers these costs is to be balanced against the interests of consumers:

> **Second, the Board agrees with the National Energy Board which stated that "[i]t does not mean that in determining the cost of capital that investor and consumer interests are balanced." Further, the Board notes that the Federal Court of Appeal was clear that the overall ROE must be determined solely on the basis of a company's cost of equity capital and that "the impact of any resulting toll increase is an irrelevant consideration in that determination. This does not mean however, that any resulting increase in tolls cannot be considered by a tribunal in determining the way in which a utility should recover its costs." The Federal Court of Appeal also stated that:**
>
> > **It may be that an increase is so significant that it would lead to "rate shock" if implemented all at once and therefore should be phased in over time. It is quite proper for the Board to take such considerations into account, provided that there is, over a reasonable period of time, no economic loss to the utility in the process. In other words, the phased in tolls would have to compensate the utility for deferring the recovery of its cost of capital.[4]**

A utility is entitled to the recovery of its prudently incurred costs of providing regulated services. The utility cannot be denied the ability to recover these costs on the basis of the impact that those costs may have on customers. The existence of an undesirable rate impact does not convert a prudently incurred fair return cost into an imprudently incurred fair return cost. Rate impact mitigation is appropriate when addressing the *manner* of cost recovery (e.g. through the use of interest bearing deferral accounts), not the fact that the costs are recovered. The same analysis applies to all of the utility's other prudently incurred costs.[5] Once the Board has determined that those costs are prudently incurred, it must permit the utility the opportunity to recover those costs, subject to the application of deferral mechanisms that result in "no economic loss to the utility in the process".

Bill impacts in light of categories of costs fall into two categories. The first category are costs over which the Board has no jurisdiction, for example, electricity market commodity costs, the costs of the "global adjustment" and the impact of HST on electricity bills. To deny a utility recovery of otherwise prudently incurred costs by

[4] Cost of capital Report, *supra*, p. 19
[5] *Natural Resource Gas Ltd. v. Ontario Energy Board*, 2006 CanLII 24440 (ON C.A.) at para. 28; *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board),* 2006 SCC 4, [2006] 1 S.C.R. 140 at para. 63-65

virtue of the impact of these factors would result in the Board attempting to do indirectly, that which it has no statutory authority to do directly – that is, to regulate the cost of the electricity commodity, the global adjustment or the HST.

The second category of costs is the costs over which the Board does have regulatory authority – e.g. distribution costs. It is arguably even more inappropriate for the Board to base any disallowance based on the rate impact of these costs, which based upon a prior determination by the Board are the basis for just and reasonable charges.

The PWU submits that it would be improper for the Board to seek to address total bill impact through a short-term rate objective that places undue burden on future rates and future rate payers. Delaying investments in network systems to reduce total bill impact creates intergenerational inequity that burdens future rate customers with a disproportionate share of the cost that will likely have increased as a result of delays (i.e. current customers are "free-riding" because they are not paying their proportionate share of the cost to maintain the system). The OEB's objective of protecting the interests of consumers includes the prices paid by consumers as well as the adequacy, reliability and quality of electricity services received by consumers. A utility is entitled to the recovery of its prudently incurred costs of providing regulatory services. To deny a utility the recovery of its prudently incurred costs would compromise its ability to sustain adequacy, reliability and quality of electricity services.

4 VALUE FOR SERVICE

The Ontario electricity industry is currently faced with many challenges including the need for significant levels of investment for the renewal of assets, new investment in generation, costs related to the *Green Energy and Green Economy Act* (e.g. accommodation of non-dispatchable renewable generation; smart grid; smart metering; conservation and demand management); and, increased regulatory burden.

Electricity prices in Ontario are expected to increase by approximately 46 per cent in the next five years and 100 per cent in the long term.[6] About 44 per cent of the price increase is attributable to improving the electricity capacity in nuclear and gas generation, and to transmission and distribution. The remaining 56 per cent of the price increase is due to investment in new, clean renewable energy generation.[7]

In the Mitigation Discussion Paper the Board has indicated that avoidance of volatility is not necessarily paramount. For example, rate stabilization has not been accepted as a rationale for early re-basing,[8] and has also been rejected where it might result in consumers failing to appreciate the direct and unavoidable consequences of utility activities, including infrastructure investment.[9]

Given these challenges it is essential that educating, informing and assuring customers in an accurate and timely manner becomes a priority to ensure that they understand the ever changing electricity sector environment and have a true appreciation for the value of electricity.

The PWU stresses the need for the Board to determine the value customers place on reliability and the amount they are willing to pay for service improvement based on WTP surveys. Utilities and regulators in North America have undertaken WTP studies for many years. Regulators in Great Britain, Norway, Italy and Sweden among others have conducted WTP studies to determine the value that customers place on reliability and the amount they are willing to pay for service improvement. Some of the

[6] Ontario's Long-Term Energy Plan, Building Our Clean Energy Future, November 23, 2010, Page 59
[7] Ontario's Long-Term Energy Plan, Building Our Clean Energy Future, November 23, 2010, Page 59
[8] See for example: OEB. EB-2010-0139. Decision and Order on the preliminary issue of early re-basing, in the matter of an application by Norfolk Power Distribution Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2011. February 11, 2011.
[9] See for example: OEB. EB-2010-0002. Decision with Reasons, in the matter of an application by Hydro One Networks Inc., 2011 and 2012 transmission revenue requirement and rates. December 23, 2010.

regulators have taken the WTP information and incorporated the values into their distribution rate regulation.[10]

The PWU believes that generating acceptance of rate increases can be addressed to a large degree by educating customers and helping them understand the value of electricity. The Board and the utilities must communicate with customers to understand what is important to customers and how customers perceive the value of electricity. In communicating with customers on the value of electricity it is essential to provide them with an understanding of the ongoing need to finance electricity system infrastructure improvements, operations and maintenance.

4.1 Value of Water

The American Water Works Association ("AWWA") has conducted a study to gain such understanding with regard to water. The AWWA's study results are presented in a publication entitled *Avoiding Rate Shock: Making the Case for Water Rates.*[11] The objective of the AWWA study was to provide a better understanding of how water utilities might make a good case to their decision-making bodies, customers, and other stakeholders about the need for sustaining local financing of water infrastructure improvements, operations, and maintenance.

The AWWA's key findings include the following:

> **Finding #1. People undervalue water, which compounds the challenge of getting rate increases accepted.**
>
> **Finding #2. A consistent, structured communications outreach program builds the credibility necessary to support the customer-utility relationship and, therefore, rate increases.**
>
> **Finding #3. It's never too late to start doing the right thing – think long-term, and plan beyond the current crisis.**
>
> **Finding #4. Billing practices and rate structure options can affect customer reactions and acceptance of rate increases.**

[10] Cronin, Francis J. Service Reliability and Regulation in Ontario. October 29, 2010. Page 35. http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/221949/view/PWU_WritteComment_20101029.PDF

[11] American Water Works Association. Avoiding Rate Shock: Making the Case for Water Rates. April 2004.

The AWWA notes that regardless of the methods employed to gain customer feedback, building a baseline of information that provides a window into the public attitudes can and will be critical to any utility's communications outreach efforts.[12]

In a report issued by the Smart Grid Consumer Collaborative, research confirms only a small percentage of consumers have knowledge or awareness of how power is generated and distributed.[13] In the absence of such awareness consumers can be expected to undervalue electricity.

According to the AWWA customer surveys can provide insight into existing perceptions in individual communities, but the following insight can be applied across the board:

- **Benefits of increased investment in drinking water infrastructure often are not clearly communicated or understood.**
- **Regional variations in the perceived value of water must be considered in communications planning.**
- **Clearly explain the benefits of increased spending on water infrastructure.**

It is reasonable to assume that the above insight is applicable to the Ontario electricity environment. Utilities and the electricity sector as a whole should put continuous effort into communicating with customers on:

- The benefits of investing in system needs;
- What the utility/industry is doing to enhance performance and control costs;
- Consequences of under investment; and,
- Progress reports on capital projects as well as updates on budgets and timelines.

Communication should be on going, transparent and consistent to enhance credibility of electricity sector investment needs and build community support for future needs.

[12] American Water Works Association. Avoiding Rate Shock: Making the Case for Water Rates. April 2004. Page 17.
[13] Smart Grid Consumer Collaborative. 2011 State of the Consumer Report. Page 6.

The AWWA notes that regional variations in the perceived value must be considered in communications planning.[14] The perceived value of electricity could be considerably different in a northern community as opposed to the greater Toronto area. As well differences in customer value within individual communities is likely. These differences need to be understood and incorporated into the communication strategy to optimize its effectiveness.

The AWWA notes that rate increases are easier to accept when the public is aware of the value the utility is providing.[15] In a recent AWWA Journal article, AWWA Executive Director Jack Hoffbuhr noted that, "if water is not valued, it will be wasted without a second thought."[16]

The PWU submits that the benefit of customer communication on the value of electricity is that it can act as a "shock absorber" in an environment where rate increases are unavoidable. The Board's RRFE should therefore include an objective on raising customer awareness on the value of electricity services and the need to and benefits of investing in the system. As noted earlier, educating customers on the value of electricity will minimize the need for bill mitigation that results in intergenerational inequity and higher total costs. In addition, customer valuation of service determined through properly constructed and implemented WTP surveys will ensure that utility performance is aligned with consumer expectations.

Customer education should also address initiatives mandated by Government policy and the resulting increases in utility costs.

[14] American Water Works Association. Avoiding Rate Shock: Making the Case for Water Rates. April 2004. Page 11.
[15] American Water Works Association. Avoiding Rate Shock: Making the Case for Water Rates. April 2004. Page 62.
[16] Hoffbuhr, Jack, Was Malthus Right? Journal AWWA, August 2003. Page 6.

5 GUIDING CONCEPTS FOR A MITIGATION FRAME WORK

The Mitigation Discussion Paper provides five guiding concepts to consider in the context of a mitigation framework:

- Intergenerational inequity should be minimized;
- Framework should be sustainable and adapt to changing and varied circumstances;
- Framework should strike a reasonable balance between gradualism in rates/bills and economic efficiency (e.g. price signal should not be lost);
- Framework should ensure the opportunity for utilities to earn a fair return on capital; and,
- Framework should promote regulatory predictability.

The PWU supports the guiding concepts set out in the Mitigation Discussion Paper with the addition of two additional guiding concepts:

- The mitigation framework should ensure that bill mitigation will not have a negative financial impact on the utility; and,
- The mitigation framework should ensure that the utility's ability to sustain adequacy, reliability and quality of service at levels valued by the customers is not compromised.

The PWU supports the development of rate mitigation that holds the utility financially harmless, including its financial risk profile. The PWU submits that for consistency with the Board's legislated objectives, any rate mitigation that the Board might consider:

a. Should not result in a shortfall of the revenue required by a utility to cover costs for expenditures and programs that the Board deems just and reasonable; and,
b. Should not result in the deferral of such expenditures and programs to future years, nor the cancellation of such expenditures and programs.

The two additional guiding concepts that the PWU recommends address these objectives.

Any shortfall in revenue or deferral/cancellation of programs related to costs deemed by the Board as just and reasonable for the adequacy, reliability and quality of electricity services would reduce the economic efficiency of a utility's network investment plan.

5.1 Intergenerational Inequity Should be Minimized

Minimizing intergenerational inequity is a fundamental regulatory principle which the Mitigation Discussion Paper notes the Board has identified as a sound regulatory principle.[17] As discussed in the Mitigation Discussion Paper:

> - **Intergenerational inequity should be minimized. The question for consideration in the context of mitigation is the extent to which policy options separate incurred costs from the period in which related services are provided. While financial accounting principles usually match costs to benefits, doing so may conflict with other regulatory objectives such as rate stability and predictability, and earnings stability. To the extent that mitigation alters the timing of cost recovery, this may be an important consideration.**

There is abundant evidence in Ontario's Long-Term Energy Plan: Building Our Clean Energy Future ("LTEP")[18] released on November 23, 2010 that the combination of the costs of refurbishing current infrastructure, the elimination of coal fired generation and its replacement with higher cost solar, wind and gas generation and the associated infrastructure will result in significant ongoing electricity cost pressures. As a result, the effect of deferring costs into the future will burden future ratepayers with these additional costs on top of ongoing cost increases. Rather than "smoothing" rate impacts, deferral will unfairly compound future rate impacts and exacerbate the impact of intergenerational inequity. This will be the case regardless of whether the mitigation is a result of postponing maintenance and investments or a result of smoothing the collection of approved costs over time.

[17] OEB. EB-2008-0408. Report of the Board: Transitional Financial Reporting Standards. July 28, 2009. Page 7.
[18] Ontario Ministry of Energy. Ontario's Long-Term Energy Plan, Building Our Clean Energy Future, November 23, 2010.

The PWU submits that there is absolutely no reason to believe that customers will be more able to accommodate the impact of rate increases in the future than they are today. Any deferral of costs to future periods will only result in future ratepayers facing even higher rates and being unfairly burdened with costs that should be shared by current ratepayers. Therefore, mitigation of approved rate increases related to a utility's economically efficient network investment plan should be required on an exceptional basis to accommodate rate shock rather than routinely based on a threshold (e.g. OEB's 10 per cent guideline).

5.2 Framework should be sustainable and adapt to changing and varied circumstances.

Utility circumstances can vary considerably and the Board should accommodate these differences to ensure reasonableness and fairness in regulatory treatment amongst the utilities. The Board's strategy of dealing with mitigation proposals on a case-by-case basis as well as providing various mitigation mechanisms recognizes the varied circumstances of the utilities and provides for viable options to address unique utility circumstances and needs.

To enhance the sustainability of the mitigation framework the Board should include policy on utility communications with customers on the need for the rate increases as a part of ongoing communications that educates customers and helps them understand the value of electricity and investment in infrastructure sustainment and development. Doing so will enhance the sustainability of a RRFE framework. In comparison requiring utility's to routinely consider rate/bill impact mitigation is unlikely to be a sustainable regulatory approach especially when significant and ongoing increases in bill amounts are foreseen in the long term.

5.3 Framework should strike a reasonable balance between gradualism in rates/bills and economic efficiency

A utility's network investment plan should ensure economic efficiency and service standards that the customers are willing to pay for based on the WTP surveys. The balance in gradualism in rates/bills and economic efficiency therefore would be built into the utility's network investment plan and should avoid future catch up at higher cost. However, incremental costs related to Government energy policy (e.g. Smart Grid Plan) do not weigh into this balance and gradualism in rate impact and cost efficiency related to these costs would need to be addressed separately. Since these incremental investments do not require catch up to maintain on going service levels, gradualism of rates/bill impact related to these investments can be according to the timeline dictated by government policy, or in the absence of such a timeline, by a mitigation threshold set by the Board.

With the large increases (46 per cent in the next five years and 100 per cent in the long term) in electricity pricing expected it is essential that utmost effort is put into customers' ability to mitigate their electricity bill amount through the time-of-use ("TOU") rate design (i.e., Critical Peak Pricing).

The Mitigation Discussion Paper states that:

> **Minimizing the magnitude of increases or volatility in the rates paid by consumers must be balanced with price signals that reflect the true cost of the services that are being provided to them. While mitigation can be a useful regulatory instrument, it ought not to be overused to the extent that consumers fail to appreciate the direct and unavoidable consequences of utility activities.**

In the absence of empirical data on the impact of TOU pricing on customer consumption, the current TOU rates were designed to provide distribution revenue neutrality on a provincial basis. The TOU rate design therefore minimizes the pricing signal. According to Paul Joskow and Catherine Wolfram, "if end-use consumers face retail prices that do not reflect variations in marginal generation costs, they will consume too much during peak periods and too little during off-peak periods. Distortions in consumption lead to distorted investment in and utilization of generating

capacity."[19] If a proposed rate design is intended to result in lower costs, those lower costs should be reflected in the rate design. Doing so provides the incentive to react to the new rates, which results in lower costs.

Maximum price differential and pricing signal for peak load reduction can be attained through Critical Peak Pricing ("CPP"). In a report prepared for the Board, the Brattle Group describes the outcome of a review of experimental evidence on the effectiveness of residential dynamic pricing programs:

> **We find that demand responses vary from modest to substantial, largely depending on the data used in the experiments and the availability of enabling technologies. Across the range of experiments studied, time-of-use rates induce a drop in peak demand that ranges between three to six percent and critical-peak pricing tariffs lead to a drop in peak demand of 13 to 20 percent. When accompanied with enabling technologies, the latter set of tariffs lead to a drop in peak demand in the 27 to 44 percent range.**
>
> **…**
>
> **These results have important implications for the reliability and least cost operation of an electric power system facing ever increasing demand for power and surging capacity costs. Demand response programs that blend together customer education initiatives, enabling technology investments, and carefully designed time-varying rates can achieve demand impacts that can alleviate the pressure on the power system. Uncertainties involving the fuel prices and the form of a carbon pricing regime that is in the horizon emphasize the importance of the demand-side resources. Dynamic pricing regimes also incorporate some uncertainties such as the responsiveness of customers, cost of implementation and revenue impacts. However, these uncertainties can be addressed to a large extent by implementing pilot programs that can help guide the full-scale deployment of dynamic pricing rates.**

Pilot studies conducted in other jurisdictions have indicated that a surprising number of customers that are given a choice between TOU and CPP choose CPP over TOU despite the higher CPP peak prices.[20]

The PWU recommends that the OEB develop CPP as it will provide a stronger pricing signal than TOU pricing while contributing to the economic efficiency of Ontario's power system. The off-peak period is significantly longer with CPP than with TOU providing customers with more flexibility. To ensure utility revenue neutrality and

[19] Paul Joskow & Catherine Wolfram. Dynamic Pricing of Electricity. December 2011.
[20] The Brattle Group. Dynamic Pricing: Past, Present, and Future. 06/14/2011

strengthen the pricing signal, it is essential to understand how customers would react to CPP. Therefore, the Board should conduct research on the impact of CPP on electricity consumption through CPP pilot studies. Access to technology that would enable customers to react to CPP could be incorporated in a Smart Grid Implementation Plan to allow customers to mitigate their own rate/bill impacts.

6 OEB'S CURRENT APPROACH TO MITIGATION

The Board currently uses various conventional[21] mechanisms for mitigating rate and/or bill increases, including deferral or phase-in of approved costs in rates, customer rebates, and funding adders.

With regard to ex-post mitigation the Mitigation Discussion Paper notes:

> **A deferral or phase-in of approved costs has generally been the approach approved by the Board to address overall distribution rate increases, with the deferred revenues tracked in deferral accounts for future recovery. Generally, the recovery period has not exceeded four years in order to minimize intergenerational inequity. Utilities were permitted to earn interest on the deferred amount, at the Board's prescribed rate.**

The Mitigation Discussion Paper references Edison Electric Institute's observation that "[t]he basic intent of a deferral or phase-in of a rate increase over a multiyear period is to spread the "pain" associated with the rate increase over a longer period. A rate deferral is simply deferred recovery of a utility's prudently incurred costs".[22]

In the Navigant Report, it is noted that in order to ensure the utility is kept financially whole, a deferral or phase-in requires that the deferred amount be recognized as a credible regulatory asset and that the utility be provided the opportunity to earn a reasonable carrying charge. This is consistent with the Board's practice, as noted in section 2.2.2 of the Mitigation Discussion Paper, whereby utilities have generally been permitted to earn interest on a deferred amount, at the Board's prescribed rate.

[21] Staff has defined conventional mechanisms as those that have been traditionally used by utilities in Ontario.
[22] Prepared for Edison Electric Institute by The Brattle Group. *Rate Shock Mitigation*. June 2007. Page 11.

Mitigation plans are considered by the Board on a case-by-case basis. According to the 2006 EDR Report:

> **Mitigation proposals will need to be considered on a case-by-case basis. There is no compelling single methodology that can equitably address all of the situations that may arise.**

As noted earlier in this submission, utility circumstances can vary considerably and the Board's approach of dealing with mitigation proposals on a case-by-case basis recognizes the various circumstances experienced by utilities.

According to the Mitigation Discussion Paper the Board's existing mitigation policy focuses on the "typical" customer within each rate class and whether the total bill impact experienced by that customer exceeds 10 per cent.

The Mitigation Discussion Paper also suggests that granting flexibility over the timing of a rate adjustment to offset large increases may be a powerful tool and viable opportunity for mitigation.

What the Board's current approach to mitigation fails to consider is customer valuation of electricity service. Consideration of customer value determined through WTP surveys in the rate setting process will facilitate the assessment of the need for mitigation.

6.1 Mitigation Framework Threshold

In the Mitigation Discussion Paper Board staff recognizes that controlling costs *ex-ante* through the rationalization of investment may be insufficient to lessen the impact on consumers of rising electricity rates and/or bills. As such, the Mitigation Discussion Paper states that *ex-post* mitigation to alter the timing and manner of cost recovery may also be necessary.

The Board needs to weigh the pros and cons of the alternative mitigation mechanisms in terms of not only today's customers, but also future customers recognizing that there is no reason to believe that customers (or the economy as a whole) will be more

able to accommodate the impact of rate increases in the future than today. This is especially so given the price increases foreseen in the LTEP.

As indicated earlier the PWU does not support *ex-ante* bill mitigation as it puts at risk long term system sustainability and the provision of service at levels valued and expected by customers. It would impede the efforts required to address the significant issue of aging assets and frustrate the catch up efforts. To ensure the continued sustainability of electricity services the Board must recognize the urgent need to replace the large proportion of aging assets as well as aging workforce and in doing so recognize the potentially catastrophic outcome of postponing the required investments until service reliability deteriorates. *Ex-ante* bill mitigation would result in postponement of investments. The impact is worse where the mitigation must address increases in bill items that are not the utility's line items (i.e. electricity price) in addition to its own line items. The utility should not be responsible for mitigating bill line items that it has no control over through the mitigation of its rates. Further *ex-ante* bill mitigation exacerbates the impact of revenue disallowances that are the outcome of cost of service reviews, on a utility's ability to sustain and develop the system. In addition, if an IRM is not based on indices that apply to the utilities, any catch up required as a result of the inappropriate IRM will be impeded by *ex-ante* mitigation.

Network investment planning should be based on customer valuation established through WTP surveys to ensure that utility performance is aligned with consumer expectations. Any mitigation of bill increases required should take place *after* (i.e. *ex-post*) such a network investment planning process and the regulatory approval of just and reasonable costs in order to ensure sustainability of the system at levels valued by customers. Mitigating bill increases *as a part of* the planning process (i.e. *ex-ante*) will jeopardize service performance at levels that customers expect, if not in the near term, in the future.

The PWU supports *ex-post* rate mitigation that holds the utility financially harmless, on an exceptional basis rather than a routine basis, to ensure that mitigation does not result in inordinate intergenerational inequity and exacerbate the impact of rate increases expected in future years.

According to the 2006 EDR Handbook, distributors are required to provide a mitigation plan when total bill increases for the typical customer in any customer class or group exceeds 10 per cent. This threshold serves as a screen for a more detailed review and consideration of requested rate increases, and whether action is needed to reduce the impact on customers. The 10 per cent threshold is indifferent to the underlying cause of the bill impact and is based on the Board's judgement as to an appropriate threshold rate increase level above which a utility is required to propose a mitigation plan. While this approach provides predictability it lacks transparency because the consideration underpinning the threshold is absent.

The idea of incorporating customer perspective has been raised in previous consultations. In its submission[23] on the development of the 2006 EDR Handbook, the Vulnerable Energy Consumers Coalition noted that at the time, there was no readily available empirical data regarding customer attitudes as to "acceptable" levels of bill increases.

In its Written Argument filed in EB-2009-0096,[24] the Canadian Manufacturers & Exporters ("CME") suggested that the Board should commission, or require utilities to commission, empirical studies on the sensitivity of the Ontario economy to increases in the "all in"[25] electricity price to determine the limits of tolerance and affordability, and, in particular, to test the appropriateness of the existing 10 per cent threshold. These empirically-determined limits of affordability and tolerance could then serve as the limits for utility spending.

Consistent with comments provided earlier in this submission, the PWU does not agree with CME's premise of the consideration of the "all in" electricity price (i.e. total bill) in determining the sensitivity to increases and the appropriateness of a threshold that is to apply to distribution rate increases (see Section 3). With regard to CME's

[23] Evidence of William Harper and Joyce Poon on behalf of Vulnerable Energy Consumers Coalition, in the matter of the 2006 Electricity Distribution Rate Handbook. December 13, 2004.
[24] An application by Hydro One Networks Inc. for 2010 and 2011 Distribution Rates.
[25] CME defines the "all in" price to include (a) regulated transmission charges; (b) regulated distribution charges; (c) Global Adjustment/Provincial Benefit; (d) regulated charge relating to province-wide recovery of shared benefits from GEA related investments; and (e) charge to recover costs of Ministry of Energy conservation programs.

suggestion of determining affordability and tolerance, the PWU's preferred approach is for the determination of customer valuation of electricity services.

The WTP approach described above would apply to utilities' fundamental network system services. Any incremental services related to government policy that are beyond the utilities' fundamental services such as those related to a utility's Smart Grid Plan would fall outside of the WTP survey. Postponement of investments in a utility' Smart Grid Plan is unlikely to compromise on going service reliability at levels determined through WTP surveys. Therefore, for these investments ex-ante mitigation is an option and CME's approach of determining the limits of affordability and tolerance through empirical studies on the sensitivity of the Ontario economy to increases in electricity price, and in particular, to test the appropriateness of the existing 10 per cent threshold would be appropriate to identify limits for utility spending on its Smart Grid Plan. Since the smart grid initiative is largely intended to address system-wide supply issues system-wide allocation of utility smart grid costs is appropriate and would be consistent with the system-wide allocation of new infrastructure costs related to new renewable energy generation. The PWU forwards the concept of system-wide allocation of costs related to utilities' smart grid plans in its submission on the RRFE Smart Grid Initiative.

6.2 Alternative Mechanisms

As set out earlier, the PWU supports rate mitigation approaches that holds the utility financially harmless including their financial risk profile, that does not compromise the utility's ability to recover its just and reasonable costs and maintain service levels customers expect and value, and that does not create intergenerational inequity that burdens future rate customers with a disproportionate share of the cost.

Alternative mitigation mechanisms[26] identified by the Navigant Report include: Lease of Assets; Securitization; Trended Original Cost Ratemaking; rate basing of Construction Work in Progress; and Voluntary Customer Payment Plans. Navigant points out that these mechanisms "systematically change the pattern of capital recovery and the calculation of the utility's revenue requirement, and they aren't used necessarily just to mitigate rate shock".[27] [28]

In the PWU's view, it behooves the Board to consider the near term as well as the long-term electricity bill outlook in considering a cost recovery methodology with a clear recognition of the consequences of each alternative.

7 APRIL 5, 2012 LETTER FROM THE BOARD - ATTACHMENT A: ISSUES FOR COMMENT

In this section the PWU provides comment on issues listed in Attachment A to the Board's April 5, 2012 correspondence related to an RRFE vision and context as well as on the issues listed under "Rate-setting & Mitigation", and "Other". The PWU's comments on the: "Planning" and "Performance & Incentives" issues are provided in the PWU's submissions on those respective topics.

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

The PWU's vision for a sustainable and long-term regulatory regime for the electricity utilities is one that focuses on customer value and establishes appropriate and

[26] Mechanisms that generally do not have mitigation as their primary purpose (in the case of mechanisms that are used primarily for financing) or that have not been traditionally used by utilities in Ontario in the regulatory context have been classified as alternative mechanisms. Page 41.
[27] Prepared for Edison Electric Institute by The Brattle Group. *Rate Shock Mitigation*. June 2007. Page 11.
[28] The role of many of these alternative mechanisms in cost recovery is also discussed in an essay by Scott Hempling, Esq. and Scott H. Strauss, Esq., published by the National Regulatory Research Institute (NRRI) entitled *Pre-Approval Commitments: When and Under What Conditions Should Regulators Commit Ratepayer Dollars to Utility-Proposed Capital Projects?*. November 2008.

transparent incentives based on Ontario utility data to achieve performance levels that align with customer expectations.

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

To achieve this vision it is necessary to recognize customer value as the key input to the regulatory framework. This key input would be obtained through robust customer WTP surveys that will establish the utilities' service quality (i.e. customer service and system reliability) standards and provide the context for utilities' network investment planning and the regulatory framework.

The OEB and utilities will need to educate customers to build an understanding of the value and costs of electricity services and the impact of Government energy policy on them. Customer WTP surveys will then form the basis for utilities' asset management and investment planning thus incorporating customer value into the utilities' determination of service quality standards and cost. Regulatory incentives and benchmarking based on empirical analysis of Ontario utilities' data will be used to achieve service quality and total cost performance. Standards for asset management best practices will ensure system sustainability while mitigating time and cost of regulatory review processes. To enhance the sustainability of the regulatory framework, issues that utilities are or will face (e.g. aging assets, aging workforce) should be addressed expeditiously. The framework recognizes that customers are unlikely more able to accommodate rate increases in the future than they are today and that postponing maintenance and capital investments to mitigate rate increases today compromises future service quality and results in higher future rate increases. Therefore bill impact mitigation will be limited to *ex-post* mitigation.

7.3 As a means of representing the Board's vision for the regulatory framework, Board staff prepared a strawman that summarized the key elements of the regulatory framework. In providing comments on the issues the Board would be assisted if stakeholders also provided comments in relation to this vision.

The PWU opposes the following three aspects of the strawman table.

1) **Feature: Performance Standards and Incentives**

   Model Framework: Experts retained to assess utility plans and audit utility planning processes to assess the utility's effectiveness in prioritizing and pacing network investment with regard to bill increases to consumers.

   Change: Potential for expedited review based on utility's effectiveness in prioritizing and pacing network investment with regard to bill increases to consumers.

Utilities should prioritize and pace network investment according to their asset management plan based on asset condition assessment: not based on bill increases. While utilities do consider bill impact in investment planning, prioritization and pace of network investment should be based on the value customers place on service reliability determined through WTP surveys. Any mitigation of bill increases required should take place after (i.e. *ex-post*) such a network investment planning process and the regulatory approval process in order to ensure sustainability of the system at levels that provide for service quality performance valued by customers. Mitigating bill increases as a part of (i.e. *ex-ante*) the planning process will result in service performance at levels below customers' expectations and that they are willing to pay for.

2) **Feature: Approach to Rate Setting**

   Model Framework: Partial PBR - OM&A is indexed to performance outcomes and a productivity measure; capital based on approved plan is a pass-through.

   Change: Sever treatment of OM&A and capital to increase pursuit of operating efficiencies and recognize significant need for capital investment.

The RRFE should provide for regulatory certainty that will provide the incentive for long term structural change and increased efficiency. Efficiencies should be driven through Incentive Regulation ("IR") on total cost. Applying IR to O&M only creates an

incentive to transfer costs from O&M to Capital that incentivizes cost allocation inefficiency that results in higher costs for customers over the long term. It also creates intergenerational inequity with a disproportionate amount of costs imposed on future customers. Further, there are similar issues related to O&M related to the replacement of aging assets as there are with the need for incremental capital investments. In addition there is the significant issue of replacing an aging workforce and the need to attract additional skilled workers for the incremental work that will have significant impact on O&M.

IR on total cost plus an improved incremental capital module would be appropriate.

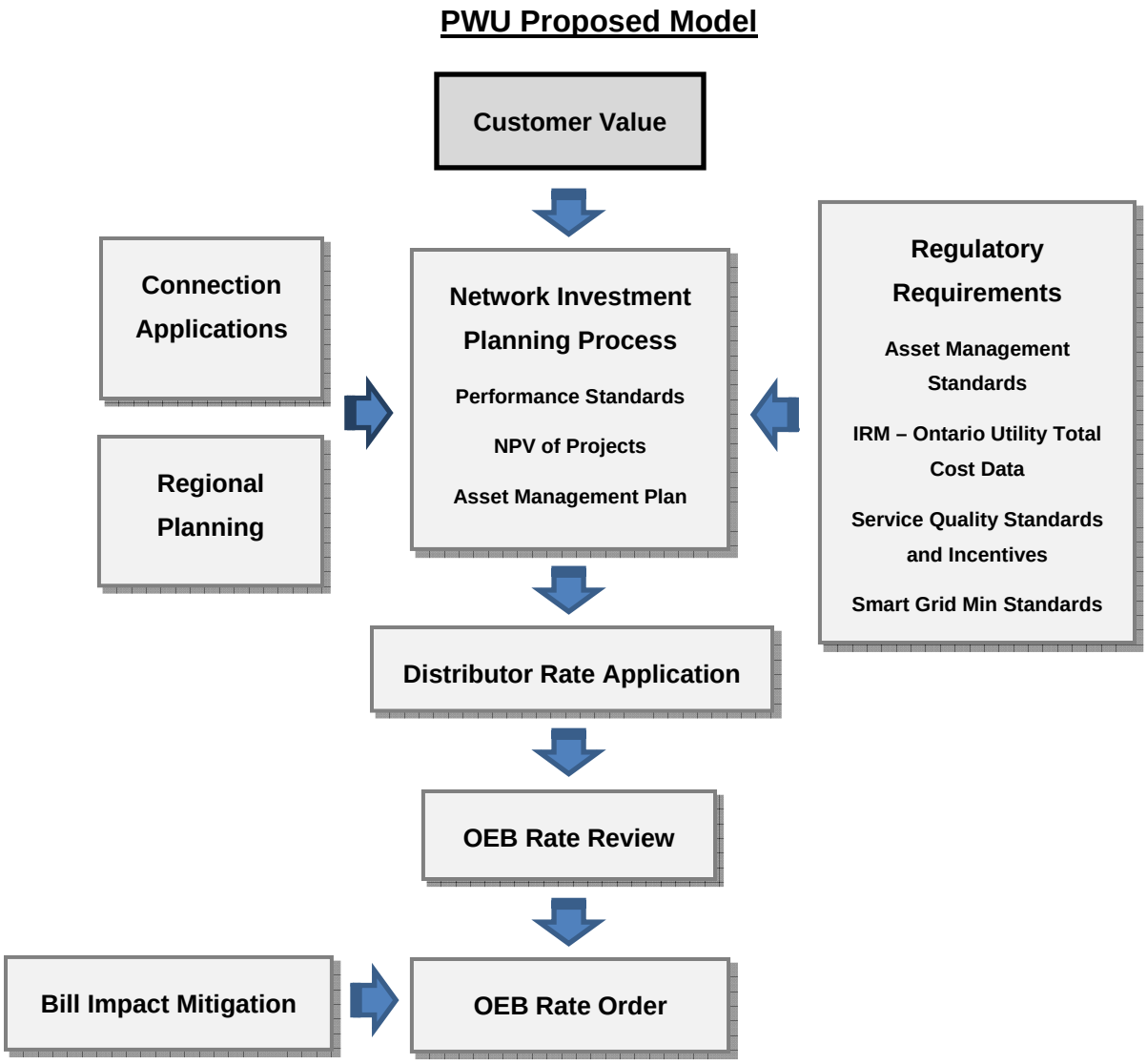
3) **Feature: Total Bill Mitigation**
   Model Framework: Ex-ante and ex-post; total bill considered.
   Change: Ex-ante added. Changes in all charges considered.

The PWU does not support *ex ante* bill mitigation as it impacts the utility's business planning (e.g., investment plan, asset management) and puts at risk long term system sustainability and service at levels expected/valued by customers. It would impede the efforts required to address the significant issue of replacing aging assets and an aging workforce. To ensure a viable electricity industry the Board needs to address this urgent issue and in doing so recognize the potentially catastrophic outcome of postponing the required capital investments until such time when service reliability deterioration is evident. *Ex ante* bill mitigation would result in the postponement of investments. The impact is exacerbated where the utility's mitigation must also address increases in bill items that are not the utility's bill items (i.e. electricity price). Utilities do consider the total bill impact of their investment plans, which they have control over. The utility should not be responsible for mitigating bill line items that it has no control over through the mitigation of its rates. Further *ex-ante* bill mitigation exacerbates the impact of revenue disallowances that are the outcome of cost of service reviews on a utility's ability to sustain and develop the system.

The PWU position on the strawman flow chart is as follows:

- The customer expectations/value determined through WTP surveys is the start point;
- The regulatory framework would include asset management standards; total cost performance incentives (IRM) based on Ontario utility data; service quality standards and incentives; and smart grid minimum standards; and,
- *Ex-post* mitigation.

The PWU's RRFE model flow chart is illustrated below.



7.4 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?

In aligning rate-setting with the approved multi-year investment plan the utility's rate base could be adjusted for the incremental capital investments at the time of its annual IR rate adjustment. In-line with this approach, the utility's application for the revenue requirements related to the multi-year capital investment plan would need to reflect the timing of the annual IR rate adjustments. The multi-year capital investment plan will mitigate regulatory risk which in turn will enhance the network investment planning process.

The PWU would point out that if the Board adopts the GDP-IPI for the RRFE as it has in 3rd Generation IRM, should the distribution Industry Price Index ("IPI") significantly exceed the GDP-IPI, the revenue shortfall that results from this discrepancy will impact the extent to which the multi-year plan will alleviate the utilities' plight.

7.5 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?

When the Board implemented 3rd Generation IRM the Board intended and the distributors expected there to be the option of the use of an Incremental Capital Module over the course of the IR term. That is, there was a regulatory pact on the regulatory treatment of incremental capital investments required over the course of the IR term that could not be accommodated through the rates in place in the IR plan, not-withstanding utility efficiency gains consistent with the IRM. Given the issues faced in the implementation of the existing ICM provision it is essential that the Board initiate a consultation and amend and implement the amended ICM expeditiously in order to mitigate regulatory risk and restore regulatory confidence. The consultation should review the Board's policy and guidelines on the ICM, and the ICM model and

determine how the ICM needs to be amended to effectively address the issues raised by the utilities on the urgent need to replace aging assets. Since there are O&M costs involved in addition to the capital investments, the amended ICM should address both cost factors.

Assuming that there will be rate re-basing between 3rd Generation IRM and the implementation of the IR component of an RRFE, the amendment to the ICM as an interim measure would not impact the longer-term RRFE approach of incorporating multi-year capital plans in rates just as the on-going use of the current un-amended ICM would have no impact. In the PWU's view, the RRFE should provide both options: multi-year capital plan and an ICM. For utilities that have less certainty in their planning process as a result of outside factors/influences, the ICM would be the better option. However, some utilities that have enough certainty at the time they apply for a multi-year capital plan may require the ICM should unanticipated demands materialize over the course of the IR term.

7.6 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?

Total cost benchmarking should provide the appropriate incentives that will (a) help determine appropriate cost levels; (b) achieve further efficiencies; and/or (c) assist in managing cost increases. Using partial cost benchmarking (i.e. O&M only) results in inappropriate incentives that will result in higher costs in the long run (e.g. increased capitalization). In addition any further cost benchmarking should incorporate service quality performance given the link between utility cost and service quality performance. Benchmarking based solely on cost, may rank utilities with good service quality performance as poor performers based on cost providing an incentive for utilities to sacrifice service quality to reduce costs. For further details on the impact of partial benchmarking based on O&M please see section 6 of the PWU's submission in the RRFE's initiative on *Defining and Measuring Performance of Distributors* (EB-2010- 0379).

7.7 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?

If a utility's application results in a rate change that is equal to or less than a rate adjustment that would result from the IRM and the utility's service quality performance is at the level that customers value as determined though customer WTP surveys, the rate application could be reviewed using the same process used for IR rate adjustments with the added review of service quality performance and evidence on the alignment of its performance with customer expectations.

Assuming that the Board sets standards for asset management, then for utilities that require rate changes in excess of that which would result from the IRM, self-certification of the utility's compliance with the standards, and verification of the correct application of the self-certification process can be the basis for an expedited review of the utility' network investment plan. For further discussions on this approach please see the PWU's submission in the RRFE's Distribution Network Investment Planning initiative (EB-2010-0377).

7.8 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?

It is essential that educating, informing and assuring customers in an accurate and timely manner becomes a priority to ensure that they understand the ever changing electricity sector environment and have a true appreciation for the value of electricity.

The PWU submits that the benefit of customer communication on the value of electricity is that it can act as a "shock absorber" in an environment where rate increases are unavoidable. The Board's RRFE should therefore include an objective on educating and raising customer awareness on the value of electricity services and the need to, and benefits of investing in the system. Helping customers understand the value of electricity will minimize the need for bill mitigation that results in intergenerational inequity and higher total costs. In addition the PWU submits that

customer valuation of service determined through properly constructed and implemented WTP surveys will establish the level of service reliability that customers are willing to pay for that would form the basis for the distributor's investment planning process to ensure that utility performance is aligned with consumer expectations, leading to a viable electricity industry.

For further details on this approach see section 4 of this submission.

Other

7.9 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?

Priority needs to be given to the replacement of aging assets and an aging workforce within the 3rd Generation IR term. Consistent with the PWU's vision and context, for the transition to the RRFE the Board will need to:

- Work with the utilities on educating customers to build an understanding of the value and cost of electricity and the impact of Government energy policy on them;
- Conduct customer WTP surveys;
- Develop standards for utility asset management and a self-certification process for utility compliance with the standards;
- Develop service quality standards and incentives;
- Develop line loss standards, performance metrics and incentives; and,
- Develop a total cost IRM based on Ontario utility data.

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

In developing the RRFE the Board should address the issue of what the impact of its regulation of the electricity utilities has been to date on their cost and service quality

performance. This issue should be addressed through research and analysis of all the utility data that the Board has in its possession including the data the Board collected for First Generation PBR. Doing so will help the Board understand the start point for the RRFE and allow it to assess the impact of the RRFE going forward.

8 ISSUES FOR COMMENT AND APPROACHES TO MITIGATION

The following are the PWU's input to the issues for comment set out in the Mitigation Discussion Paper.

8.1 Is it appropriate for the Board to consider the total bill impact even if the applicant does not control or have the ability to influence all elements of the bill?

The PWU's views on the whether it is appropriate for the Board to consider the total bill impact even if the applicant does not control or have the ability to influence all elements of the bill are provided in section 3 of this submission. In summary, the PWU is sympathetic and sensitive to the total bill increases resulting from the Ontario Government's energy policy that consumers have and will continue to experience. The PWU does not believe that it is appropriate for the Board to consider the total bill impact when the applicant does not have control of all elements of the bill.

The PWU agrees that the Board should be informed of total electricity bill impacts that emanate from all sources; but in the PWU's view it would be improper for the Board to seek to address total bill impact through a short-term rate objective that places undue burden on future rates and future rate payers. The OEB's objective of protecting the interests of consumers includes the prices paid by consumers as well as the adequacy, reliability and quality of electricity services. A utility is entitled to the recovery of its prudently incurred costs of providing regulated services. To deny a utility the recovery of its prudently incurred costs would compromise its ability to achieve adequacy, reliability and quality of electricity services.

8.2 Are these guiding concepts appropriate? If not, how might these concepts be changed? Are there additional concepts that should be considered?

The PWU supports the guiding concepts set out in the Mitigation Discussion Paper with the addition of two additional guiding concepts:

- The mitigation framework should ensure that bill mitigation will not have a negative financial impact on the utility; and,
- The mitigation framework should ensure that the utility's ability to sustain adequacy, reliability and quality of service at levels valued by the customers is not compromised.

These additional guiding concepts are discussed in section 5 of this submission.

8.3 What are the implications, if any, of defining mitigation as considerations that are brought to bear only after a cost has been determined by the Board to be reasonable, prudent and/or eligible for recovery?

There is abundant evidence in Ontario's Long-Term Energy Plan that the combination of the costs of refurbishing current infrastructure, the elimination of coal fired generation, and its replacement with higher cost solar, wind and gas generation and associated infrastructure will result in significant ongoing electricity cost pressures. Rather than "smoothing" rate impacts, mitigation that results in deferral will unfairly compound future rate impacts and intergenerational inequity. This will be the case regardless of whether the mitigation is a result of postponing maintenance and investments or a result of spreading out the collection of approved costs over time.

In considering ex-post mitigation the Board needs to assess the extra cost of doing so (e.g. costs associated with the deferral account) and the impact on the price signal and how it might affect economic efficiency.

8.4 Should the Board's mitigation framework continue to have a threshold? If so, why? If not, what other tool(s) might utilities and the Board use to identify the circumstances under which mitigation should be considered?

Mitigation should not be used routinely, but on an exceptional basis. Routine mitigation dampens the price signal to the customer that would result in the inefficient use of electricity services from a system perspective. In the PWU's view, there is the need for the Board and utilities to help customers understand the value of electricity services and through on going communications help them understand the need for rate increases. Customer valuation of services should be determined through WTP surveys that will determine the level of service that customers are willing to pay for. Where rate increases reflect just and reasonable costs for the provision of services at levels that meet customers' valuation of electricity services mitigation should not be required. However, where the rate increase is tantamount to rate shock mitigation, through the phasing-in of the approved rate increase should be considered.

The PWU notes that the threshold of 10% was introduced in the 2000 Electricity Distribution Rate Handbook to mitigate the impact of rate restructuring that was designed to be revenue neutral. (see Section 8.5)

8.5 Are the above noted criteria for establishing a threshold appropriate? Why or why not? What other criteria might be appropriate, why, and what are the implications for the setting of a threshold of these criteria?

Customer valuation of service determined through transparent and properly constructed and implemented WTP surveys should form the basis for network planning and cost of service. In the PWU's view, the threshold should be determined based on the results of WTP surveys and should only apply to the costs over which the utility has direct control (i.e. the utility's rate increase). Any mitigation threshold should be kept above the range of what customers are willing to pay. Deriving a threshold based on customer value would achieve transparency and a threshold that is aligned with customer valuation. This approach precludes ex-ante mitigation of costs related to a utility's network investment plan that would in any case require future catch-up at higher future costs and jeopardizes system sustainability. However,

thresholds can be set for mitigation of cost increases related to Government policy mandates as phasing in such requirements would not compromise a utility's ability to sustain service at levels that their customers expect.

8.6 Staff invites comments from stakeholders as to the merits of, and considerations for, the approaches identified in section 3.3.2 above. Are there other approaches that the Board could consider for deriving a threshold?

Please see the comments in 7.5, above.

The approaches set out in section 3.3.2 of the Mitigation Discussion Paper only have merit to the extent that they might be applicable to ex-post mitigation of costs related to utility's network investment planning or to the mitigation, ex-ante and/or ex-post, of costs related to government mandated initiatives.

The PWU notes that as described, the approaches do not appear to consider the significant requirement to replace aging assets.

8.7 In light of the cost pressures facing electricity utilities, the Board's approach to rate-setting, and the considerations noted in the Navigant Report, what is the appropriate role, if any, of the conventional and alternative mechanisms identified in this chapter for the purposes of mitigation? What criteria might utilities and the Board use to guide consideration of the use of these mechanisms?

As discussed in this submission, the PWU does not support ex-ante mitigation and the comments below are provided in the context of ex-post mitigation considerations.

With regard to the appropriate role of mitigation mechanisms please see the comments in 7.5 above.

The criteria that the Board and utilities need to consider in applying mitigation mechanisms include:

- The impact on intergenerational inequity related to the compounding effect of mitigation (e.g. deferral account) at a time when significant cost pressures are expected in the near to long-term.

- Customer valuation of services to determine when mitigation may be dispensed with to avoid unnecessary routine mitigation.
- The impact of mitigation on pricing signal and economic efficiency.

8.8 What conditions need to be in place in order to ensure the appropriate and effective use of the mechanisms identified in this chapter?

The conditions that need to be in place to ensure appropriate and effective use of ex-post mitigation mechanisms in general include:

- Energy policy stability;
- Economic stability; and,
- Regulatory predictability.

All of which is respectfully submitted