**Aiken & Associates**
578 McNaughton Ave. West
Chatham, Ontario, N7L 4J6
Phone: (519) 351-8624
E-mail: randy.aiken@sympatico.ca

April 20, 2012

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

Dear Ms. Walli:

**Re: EB-2010-0378 – Approaches to Mitigation for Electricity Transmitters & Distributors - Comments on Staff Discussion Paper of the London Property Management Association**

These are the comments of the London Property Management Association ("LPMA") with respect to the above noted Staff Discussion Paper. Comments have organized around the questions for stakeholder written comment.

**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?**

LPMA submits that 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. This is because the customer only sees the total bill impact. They do not look at the components of the bill. They are paying for a service that provides for the delivery of electricity to their residence or place of business. The delivered price of electricity is what is important the same was as is the price of a product purchased on eBay. The customer is indifferent if the cost of the product they purchase on eBay is $90 with a shipping and handling (delivery) charge of $10 for a total of $100 or whether the product cost is $70 with a shipping and handling charge of $30. The cost is the same to the consumer.

On the other hand, customers can purchase their electricity commodity from retailers. In this case, they have some control over the price they pay for the commodity in that they can switch retailers or return to the Regulated Price Plan. They do not, however, have any choice associated with distribution rates, transmission rates or any of the costs associated with the amount of electricity delivered to their properties.

LPMA submits that is also appropriate for the Board to consider the bill impact associated with only the regulated portion of the total cost that is regulated by the Board. Distributors and/or transmitters should not automatically be allowed to increase their rates at a higher pace simply because the commodity portion rises by less than 10%. Similarly, they should not be forced to raise rates by a small amount, simply because the commodity costs rise by more than 10%.

LPMA believes that the Board should a rate mitigation mechanism that is based on the regulated components of the total bill. LPMA also suggests that instead of an arbitrary level of 10%, the Board should consider the need for mitigation measures based on a measure of the Consumer Price Index ("CPI"). This is the best known inflation index to consumers. Since the CPI changes significantly over the course of a number of years, the 10% limit, while appropriate when inflation is at one level, may not be appropriate when inflation is at lower or higher levels on a consistent basis. LPMA submits that in the current low inflation environment in which the Bank of Canada continues to support a target of 1% to 3%, LPMA submits that mitigation measures should be used to ensure that the bill impacts associated with regulated rates should be used if the impacts on the regulated portion of the bills exceeds 2 to 3 times the rate of inflation.

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

LPMA believes that these guiding concepts are appropriate, but incomplete.

In particular, LPMA supports the need for price signals to be apparent to customers. The current government policy in Ontario sends mixed signals to customers. Time of Use rates provide an incentive for customers to reduce or shift consumption but them many customers receive a 10% reduction in their costs associated with the Ontario Clean Energy Benefit. The Board should not fall into the same trap as the Ontario government. The policy should be clear and mired in smoke and mirrors.

Rate mitigation of legitimate costs is a short term gain that may well mask long term pain. The problem is that sooner or later, the long term arrives with a lot of pain. This often results in severe intervention by government.

LPMA believes that an addition guiding concept, related to the framework ensuring that regulated utilities continue to have the opportunity to earn a fair return on capital is a guiding concept that ratepayers should be allowed to share in returns in excess of a fair return on capital, similar to the earnings sharing available to ratepayers of natural gas utilities.

Utilities are entitled to the opportunity to earn a fair return on capital; they are not entitled to keep all profits in excess of this amount. They are allowed to earn a reasonable return in return for the privilege of being allowed to provide a monopoly service. Ratepayers are equally entitled to a portion of the excess earnings above a reasonable return to ensure that they are paying just and reasonable rates.

An additional guiding concept that LPMA believes is appropriate is the inclusion of the right of ratepayers to be heard and participate in the process(es) used to set rates. Ratepayers have been well served by the current regulatory process, whether it is related to participating in cost of service applications, assisting the Board in the design and implementation of incentive regulation mechanisms and participating in numerous consultatives that have helped Board policy.

The participation of ratepayer representatives has provided the Board with a balanced view of issues raised by the industry over the years and has resulted in balanced and independent responses to issues. This balance and independence, of course, is essential if the Board hopes to maintain the confidence of the industry and the customers serviced by the industry and keep the government from having to intervene in the industry in order to protect consumer interests.

LPMA looks forward to continuing to assist the Board in providing the balanced view that the Board requires to do its job

**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?**

LPMA believes that an implication of the proposed definition is that the Board will need to see the forecast of rate changes for a multiple year period. Mitigating rates based on the proposed definition means shifting the recovery of some level of costs to a future period. Unless it can be demonstrated that rate changes in this future period will be less and allow for the deferred recovery of the costs this ends up like borrowing money to pay the interest on previously borrowed money. As seen in Europe these days, this approach to long term planning often ends up in disaster.

LPMA submits that if there is a need to push the recovery of current costs off into a future period it should consider the following:

* What is the future period for the recovery of current costs?

* How can the Board and stakeholders be satisfied that the future period will allow for the deferred recovery of costs without creating the need for even more rate mitigation?
* What is the impact on intergenerational equity?
* How will the tax/PILS impacts of the deferred revenue and current costs be dealt with? What impact could changes in tax rates have on ratepayers?

**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?**

Yes, the Board's mitigation framework should continue to have a threshold. LPMA submits that a threshold is required to provide certainty to both utilities and ratepayers. Businesses need some longer term certainty as to the maximum level of cost increases for electricity consumption they will be facing for long term planning purposes. Residential customers would also benefit from knowing the maximum increases that could occur over a long term period.

Both business and residential customers would be able to plan for reduced electricity consumption, through conservation and demand management, through fuel switching, self generation or by other means. These types of decisions need long term planning horizons and the provision of an upper level of increases over a long term would benefit all parties enhancing their ability to make informed and economically efficient decisions.

As noted above, LPMA submits that the Board should the threshold from 10% to a multiple of the CPI, as this index is well known to customers of all types.

A multi-year cost of service application is a tool that could be used by utilities, the Board and intervenors to identify circumstances under which rate mitigation should be considered. For example, in a multi-year cost of service application, there may be an unacceptable rate increase resulting in the first test year, but more moderate increases proposed for the second and subsequent test years. In this circumstance, the deferral of revenue from the first year to the second and/or subsequent years would allow for rate mitigation in the first year while still recovering the costs over a relatively short time horizon.

This approach has the benefit of minimizing intergenerational inequity, allowing the utilities to recover their costs in a timely manner, minimizing the additional costs on ratepayers associated with long time horizons and carrying costs, while at the same time sending appropriate price signals to customers.

**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?**

LPMA believes that the noted criteria for establishing a threshold are appropriate. In particular, LPMA believes that the criteria need to be transparent to, and easily understood by, customers. This is any LPMA recommends that the threshold be set in relation to the CPI.

The Board may want to include a criteria related to the willingness to pay by consumers. This willingness to pay would be related to the level of reliability of service received by those consumers. LPMA notes that with the advancements made and reduction in costs associated with small portable gasoline generators, natural gas powered backup generators and small storage technologies to name but a few, customers may be willing to accept lower reliability if the costs associated with the grid are more affordable.

The Board may wish to consult with intervenor representatives on how to measure the willingness to pay by various customer groups, along with the related issue of the level of reliability trade off with costs.

**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?**

LPMA does not see any merit whatsoever in the industry unit cost-based threshold. This is because it will quickly become a viscous circle. Utilities will give employees higher wages or build gold plated systems, know that others are doing the same. This drives up the industry unit costs, which in turn allows utilities to justify similar increases in the future.

Utilities will still have an incentive to keep costs down, but only in relation to others in the province. LPMA submits that this will rob ratepayers of strong incentives for all utilities to increase productivity wherever possible and to the maximum extent possible, resulting in ratepayers paying for a lack of productivity in the industry as a whole.

LPMA continues to believe that the current regulatory system of checks and balances on a utility by utility basis provides the best value to both ratepayers and utilities. As the Board continues to hear from the utilities, most of them considers themselves to be unique in some way. LPMA tends to agree with this, although there may be some disagreement on the extent of the differences.

The different circumstances faced by utilities and their customers may well result in thresholds that are different for different utilities. This is often the outcome of current regulatory proceedings. Through the rate setting process, the Board arrives at a decision based on the evidence of the applicant and the submissions of ratepayer groups following a sort of "forensic audit" of the applicant's evidence by the ratepayer groups and Board Staff. This is a very thorough process that lends credibility to the regulatory system, including the Board and to the rates that emerge from the process.

The Board often approves different increases for the various components of the revenue requirement based on the evidence before it in specific applications. If a utility can demonstrate that it needs to hire additional staff because of customer growth or that it can do the work more economically internally than by continuing to contract out, the Board is more likely to approve the increases requested than if the utility fails to demonstrate the need for additional staff. In these circumstances, LPMA submits that the threshold is also likely, and appropriately, different between the two utilities.

The result of the current regulatory process is often agreement on most, if not all, of the issues that go into the calculation of the revenue requirement in a cost of service application. The Alternate Dispute Resolution ("ADR") process allows utilities and ratepayers the opportunity to reach an agreement that is satisfactory to both parties. This often results in a significant reduction in the regulatory burden of the Board. The threshold that many intervenors base their analysis on during a rates proceeding is not a fixed number. It almost always varies between utilities and is based, in part, on how high existing rates are relative to others and what the utility may **need** to do and what they may **want** to do. This is reflective of the fact that consumers **need** electricity and they **want** to pay affordable rates.

**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?**

LPMA does not believe that any of the alternative mechanisms identified in the Staff Paper should be considered by the Board. Each of these alternatives suffers from a major lack of transparency and ease of explanation to customers. The only alternative mechanism that may have any merit is the inclusion of construction work in progress in rate base.  However, LPMA believes there should be some changes made to the way the Board currently uses this option.

Much is made of the potential to lesson rate shock experienced by consumers.  This is effectively done by phasing in higher costs in the early years before the investment would normally go into service and be placed into rate base.  LPMA submits that this approach, while lessoning rate shock, can also end up costing customers more over the life the asset.  This is because customers pay the return on capital while the asset is in CWIP.  LPMA notes that the Navigant report states that the longer the construction lead-time in constructing an asset the greater the rate mitigation benefit provided by CWIP and that CWIP is a mechanism best suited for a single large investment which requires several years to construct.  The Navigant report goes on to indicate that very few distribution projects require a multi-year construction cycle and therefore the application of CWIP would probably have few applications in Ontario.

LPMA submits that the use of CWIP as a rate mitigation measure should only be considered in those few instances when the investment is large and long.

LPMA does not support the use of the conventional deferred recovery of the revenue requirement.  This simply pushes the problem to the future.  This could result is more severe issues in the future if other cost pressures (such as those arising from more government directives) materialize.  As was expressed by numerous parties throughout this consultative, the electricity industry in Ontario is not in a steady state.  It is changing due to government edicts, the replacement of aging infrastructure, new technology and new requirements being imposed on the system (such as renewable and distributed generation).  In this environment, the Board cannot be expected to foresee changes that may take place in the short or medium term.  This means that the Board cannot know with any level of certainty that the recovery of amounts in a deferred recovery account will not create bigger problems in the future than those created at the current time.

LPMA believes that the funding adder approach has worked well for smart meters and renewable generation expenditures.  Funding adders can be used even if the level of proposed expenditures, or their timing, is uncertain.  LPMA submits that this is most likely scenario facing utilities as they deal with new expenditures required by the government and replacing aging assets.  There are no reasons to expect that the use of funding adder would not work well as a rate mitigation measure.  It has the added value that if need be, it can be changed from time to time to take into account unforeseen rate impacts in future years.

LPMA supports an option for utilities to chose their method and timing of rebasing rates under a cost of service application. However, once a utility picks the method and timing, it would be held to that methodology and time table. For example, a utility may have an option to choose from an IRM methodology similar to that currently in place, but could choose to rebase after 3, 4 or 5 years under the incentive mechanism. If they chose 4 years, for example, they could not rebase until year 6 (first year is the original cost of service application, years 2, 3, 4 and 5 are the four years under the incentive mechanism). The only exception to this would be the triggering of an offramp provision. The other choice that the utility may have is to file a cost of service application that covers multiple years, perhaps 3 to 6. If the utility chose a four year cost of service application, then it could not rebase until the fifth year. There may or may not be offramps associated with this cost of service option.

As noted above, LPMA believes that the use of any mitigation mechanism should be transparent and easy to understand from the perspective of an average customer. Another criteria would include the impact on customers over the length of time that the mitigation measure would be in place. From a customer perspective, it does not make sense to delay a cost this year if the cost is going to be higher next year and the years after. This could be case, especially if short and/or long term interest rise from their current historical low levels. A rise in the short term interest rates will increase the carrying costs ultimately paid by customers on the deferred revenue. Increases in long term costs results in a higher cost of debt and equity that is, again, recovered from ratepayers. In other words, it may be in the customers interest to pay now rather than pay more later. Customers who carry credit card balances are becoming painfully aware of the true cost of delaying payment.

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

LPMA believes that from the customers perspective, the conditions that need to be in place in order to ensure the appropriate and effective use of the mechanisms identified are likely to vary from utility to utility. It is also likely that the conditions that need to be in place may vary from customer group to customer group and from customer to customer. Some will want to delay as long as possible from paying. Others will want to pay up front in order to save in the longer term. For example, individuals that expect to be on fixed incomes in the near future may prefer to pay now rather than later when their ability to pay may be more constrained.

Finally, LPMA submits that the issue of revenue to cost ratios for the various customer classes needs to be taken into account before any mitigation measures are introduced. It may be that mitigation measures are only required from some rate classes.

As an example, moving the revenue to cost ratio from 103% to 100% may remove the need for mitigation measures for the residential class, but at the same time this could increase the revenue to cost ratio for the GS < 50 kW class from 90% to 97%, which may result, in combination with the approved revenue requirement, in the need for mitigation measures that would not be required in the absence of a change in the revenue to cost ratio.

As illustrated in this example, rate mitigation measures will be needed for one class in either scenario. With no changes to revenue to cost ratios (both of which are within the Board approved ranges), the residential customer would need mitigation. In moving the ratios closer to unity for both classes, the GS < 50 class would need mitigation. The last scenario, however, has the added benefit of reducing the cross subsidy from residential to GS < 50 customers.

Sincerely,

*Randy Aiken*

Randy Aiken
Aiken & Associates