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BY EMAIL and RESS

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

Dear Ms. Walli:

Re: EB-2012-0397 – Encouraging Distributor Efficiency

We are counsel for the School Energy Coalition. We are writing with respect to an issue that arose at the February 27th Stakeholder Meeting, and which we believe may be of significant concern to many stakeholders.

At the Stakeholder Meeting, a number of participants expressed their preference for returning to the “PUC Model” of electrical distribution, as opposed to the “LDC Model”. Under the PUC Model, electrical distribution is delivered primarily as a public service, jointly with water, waste water, sewage, and in at least one case natural gas distribution. This contrasts with the LDC Model, in which electrical distribution is operated as a regulated monopoly business and as a standalone activity.

The Board will be aware that there has been widespread confusion as to the scope of the current consultation. The suggestion that moving back to the PUC Model is “on the table” in this consultation concerns the School Energy Coalition on both substantive and jurisdictional grounds. We are writing this letter to express those concerns.

Jurisdictional Issues

Prior to 1999, most Ontario distributors were operated within or in conjunction with public utilities commissions, as non-profit agencies of their local municipality. The PUC usually also provided other public utilities such as water and sewer services.



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The government of the day changed that, requiring all electricity distributors to become business corporations, which would be operated on business principles including return on equity and payment of taxes to the provincial government. As a result of this government policy change, the LDC Model was expressly selected as the structure for electrical distribution in the province.

There was much debate at the time, including substantial resistance from many electricity distributors and municipalities concerned with the potential impact on prices and service. The LDC Model prevailed, and despite changes in government since that time, remains the government-mandated structure of the electricity distribution sector.

It can legitimately be debated whether this change has been successful. Some would say that for every LDC that has flourished under the new regime, there is one that has struggled. In addition, some LDCs continue to try to implement a kind of hybrid, with mixed results.

However, whether or not the LDC Model was the best choice, it is clear that it remains government policy. The discussion at the Stakeholder Conference in effect invited the Board to consider whether it should regulate in a manner that helps distributors “get around” that government policy, i.e. implement the PUC Model indirectly.

In our view, the Board should communicate very clearly to the sector that it is not willing to subvert government policy in this manner. Distributors that want to implement the PUC Model should be advised to speak directly to the government, and seek changes in government policy that will allow the PUC Model option. The Ontario Distribution Sector Review Panel was a venue for expressing these views, and in fact heard such submissions from the EDA and others.

Unless the government makes changes of that nature, in our submission the Board must implement regulatory regimes that rigorously support both the letter and spirit of the current government policy.

Substantive Issues

Even if the government were to give the Board the green light to allow the PUC Model as part of its regulatory structure for the sector, in our view the substantive issues that need to be addressed are challenging. Delivering multiple monopoly infrastructure services through a single entity or operational group implies addressing certain key questions.

First and foremost, there are only really three options for melding the for-profit, business structure of electricity distribution with the non-profit, public service structure of things like water and sewage:

1. Shift electrical distribution back to the non-profit side, as before, so that the entire enterprise is operated on a non-profit public service basis.
2. Shift water and sewage to the business side, adding ROE and PILs, and a business-oriented approach, to the provision of those public monopoly services.
3. Try to operate an entity or group that has both for-profit business activities and non-profit public service activities.



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It appears to us that the first option is problematic in a number of ways. Obviously many municipalities will have a fiscal issue if their LDC dividends stop. Similarly, the provincial government is in effect defraying past costs of the electricity sector through PILs. More important than both, however, many LDCs operate at much better levels of efficiency, and have better distribution systems, than their non-profit predecessors. The twin disciplines of the profit margin, and more rigorous regulatory oversight, have in many cases produced favourable results.

The second option would seem on the face of it to be doable. Just as LDCs were formed in 1999 through government policy, so things like water and sewage could be converted to the business model. While it might be somewhat disruptive in the short term, it is at least arguable that there would be long term benefits.

Clearly, though, this would be a major change in government policy requiring thorough and thoughtful analysis and planning.

The third option is what some distributors are seeking today. It does not seem to be impossible. However, the defocusing that would result (e.g. bottom line vs. public good), and the potential for cross-subsidization of activities, could be considerable. At the very least, the non-profit side would have to be regulated by the same regulator, the Board, as the for-profit side, to avoid subsidy concerns.

What is more striking with this option, though, is that it would be a new, hybrid entity that has virtually never been implemented successfully. The only situations in which it has appeared to work are ones in which only lip-service is paid to either the for-profit or the non-profit motives.

Also of importance in this analysis is the question of gas distribution. The push to combine electricity, water and sewage, for example, begs the question whether gas distribution should also be included. The “poster boy” for this new PUC Model is in fact Utilities Kingston, in which gas distribution is a key part of the equation.

Gas distribution is delivered through public monopoly franchises, so there is no question the government could award those franchises to the local electrical distribution companies, but this is not a trivial step. Ontarians are generally well served by the two main gas distribution companies, and making such a change in the interests of economies of scope will not be obvious to everyone.

Finally, we note that going back to the way things were, the PUC Model, would be particularly difficult for the many Ontario municipalities who have sold their LDCs, mainly to Hydro One. Not only does the history of MAADs activity in the sector create practical difficulties, but by implication most Ontario municipalities have, by disposing of their distribution companies, “voted with their feet” against the old PUC Model.

Conclusion

SEC is sending this letter because we are concerned that some distributors, and perhaps their municipal owners, want to find a way around the government-mandated structure of the



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distribution sector. The choice of PUC Model vs. LDC Model is not a simple debate, and there are good arguments on both sides. The desire of some for change is not surprising.

However, in our view the role of the Board should be clear and uncompromising. Government policy has selected the LDC Model. Not only should the Board refuse to explore expansion of the PUC Model (under the guise of “economies of scope”), but in those situations in which municipalities are currently trying to avoid application of the policy, the Board should redouble its efforts to bring those LDCs within the government mandated structure.

All of which is respectfully submitted.

Yours very truly,

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Interested Parties