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May 8, 2008

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

Dear Ms. Walli:

Re: AMPCO Submission on Motion, Oshawa PUC Decision (EB-2007-0710)
Board File No. EB-2008-0099

Pursuant to Pocedural Order No. 1 issued May 2, 2008, attached please find AMPCO's submission regarding the above proceeding.

Please contact me if you require additional information.

Sincerely yours,

Adam White
President

Copies to:
George Vegh, McCarthy Tetrault
Oshawa PUC and Intervenors in EB-2007-0710
Consumers Council of Canada
All parties to the Cost Allocation Review proceeding EB-2007-0667

Association of Major Power Consumers in Ontario
www.ampco.org

372 Bay Street, Suite 1702
Toronto, Ontario M5H 2W9

P. 416-260-0280
F. 416-260-0442

EB-2008-0099

IN THE MATTER OF the Ontario Energy Board Act, 1998 (the "*OEB Act*");

AND IN THE MATTER OF an Order by the Ontario Energy Board dated March 19, 2008 which approved rates and other charges to be charged by Oshawa PUC for electricity distribution (Board File No. EB-2007-0710);

AND IN THE MATTER OF Rules 42, 44.01 and 45.01 of the Board's *Rules of Practice and Procedure*;

Submissions of the Moving Party, the Association of Major Power Consumers in Ontario ("AMPCO")

George Vegh

McCarthy Tétrault LLP
Toronto Dominion Bank Tower
Suite 5300, Box 48
Toronto, ON M5K 1E6

gvegh@mccarthy.ca

Tel: (416) 601-7709
Fax: (416) 868-0673
Counsel for Association of Major Power Consumers in Ontario

Introduction and Summary of Submissions

1. The decision being reviewed approved revenue to cost ratios that allow Oshawa PUC, at its discretion, to require large volume customers to provide material and ongoing subsidies to other customers. Specifically, the rates authorized Oshawa PUC to require large volume customers pay the following percentage of the costs of serving them:

Customer Class	**2008**	**2009**	**2010 and beyond**
GS < 50 kW	125%	123%	120%
GS > 1000 kW to 5000 kW	257%	221%	180%
Large Use	186%	150%	115%

2. AMPCO submits that the rates based on this level of compensation are not just and reasonable because they unduly discriminate against large volume customers by requiring them to subsidize other customers. This subsidy is inconsistent with what Bonbright identifies as an attribute of a sound rate structure: "Avoidance of undue discrimination in rate relationships so as to be, if possible, compensatory (i.e., subsidy free with no intercustomer burdens)."[1]

3. The OEB has also applied the rule against undue discrimination in several decisions. Most recently, in its analysis of the Board's jurisdiction to establish rate affordability programs (the "*Rate Affordability Program Decision*"), the Board unanimously endorsed the primacy of cost causality as an inherent component of a just and reasonable rate.

4. The majority opinion expressed the principle as follows:[2]

"Economic regulation is rooted in the achievement of economic efficiencies, the establishment of fair returns for natural monopolies <u>and the development of</u>

[1]Bonbright, Danielsen and Kamerschen, *Principles of Public Utility Rates* (2d) (PUR, Inc. 1988), p. 384.
[2] Emphasis Added, EB-2006-0034, (2006) pp. 4-6.

> appropriate cost allocation methodologies…The Board's rate setting activities that currently have the effect of transferring benefits do so to accommodate either regulatory efficiency, the removal of financial barriers in support of government policy initiatives or to support a mitigation policy to overcome cost differential such as in rural rate subsidies…The Board also notes that to the extent that any of the current benefit transfers are material, such as in the rural rate subsidy and conservation initiatives, they are supported by the objectives of the Act, specific sections of the Act or by Ministerial Directives under section 27 of the Act."

5. The minority opinion did not disagree with this basic proposition. It agreed that cost causality is key in the normal course. However, it made room for a departure from cost causality in exceptional circumstances, such as considering a rate affordability program for low income customers:[3]

> "A finding that the Board has jurisdiction to consider ability to pay in setting rates, does not mean, as the majority suggests, that there will be a "fundamental change" in rate-making principles across the board. I accept that cost causality is the basic principle. I also accept the Federal Court's view [in *Allstream Corp. v. Bell Canada*] that there should be exceptional circumstances. But I also believe that in the appropriate circumstances the Board has the authority to enact those programs."

6. As a result, both the majority and minority opinions in the *Rate Affordability Program Decision* endorsed the proposition that cost causality is an inherent component of a just and reasonable rate. They only differed on whether the Board could depart from that principle in exceptional circumstances. There is no suggestion in this case that there are exceptional circumstances justifying a departure from cost causality for Oshawa PUC. As a result, the issue that divided the majority and minority in the *Rate Affordability Program Decision* is not raised here and neither the majority nor the minority opinion supports the ongoing and discretionary departure from cost causality contemplated in the Decision.

7. In the submissions set out below, AMPCO will address the legal constraints respecting cross-subsidies and how these constraints have been recognized by the Board. These submissions will seek to demonstrate that a policy of material and ongoing cross-

[3] Emphasis Added, EB-2006-0034, (2006) p. 20.

subsidies is inconsistent with the requirements of a just and reasonable rate. It will also be argued that the *Cost Allocation Report* does not purport to endorse such a policy.

8. Having said this, AMPCO acknowledges that not every departure from unity, no matter how immaterial or short lived, is always unlawful. Instead, the point is that all material departures from unity must be demonstrably justified. Specifically, AMPCO submits that the following principles should apply to cost allocation in setting electricity distribution rates generally and to the rates approved for Oshawa PUC in particular:

- revenue to cost ratios must be as close to unity as practical;
- any departure from unity must be demonstrably justified;
- departures from unity cannot exceed the range of approved outcomes in the *Cost Allocation Report*;
- departures must be temporary and accompanied by a mitigation plan; and
- the cost of rate mitigation should be borne by the rate classes that benefit from the mitigation.

9. The grounds in support of these principles are set out below.

OEB Decisions and Representations on Cost Causality

10. The consensus view in the *Rate Affordability Program Decision* reflects a long line of OEB decisions that endorse the proposition that cost causality is an inherent component of a just and reasonable rate.

11. For example:[4]

"Over the years, the Board has had many requests for special status for a customer group or a customer. The Board has been consistent in its response to such requests by adhering to its established principles in dealing with cost allocation and rate setting. <u>Principled ratemaking involves the creation of a unified and theoretically consistent set of rates for all participants within the system. It begins with the establishment of a revenue requirement for the regulated utility and proceeds to design rates for the respective classes according to well-recognized and consistent theory respecting such elements as cost allocation.</u> This is an objective and

[4] RP-2003-0063 (2005), p. 5.

dispassionate process, which is driven by system integrity and consistent treatment between consumers on the system. Principled ratemaking typically does not involve a ranking of interests according to a subjective view of the societal value of any given participant or group of participants. This approach is not unique to Ontario. A departure from these principles should only be undertaken where the evidence and all other circumstances outweigh the inherent virtue of an objective process.

12. Another example:[5]

"The Board is required by its legislation to "fix just and reasonable rates", and in doing so attempts to ensure that no undue discrimination occurs between rate classes, and that the principles of cost causality are followed in allocating the underlying rates."

13. Finally, the Board's commitment to cost causality as a component of just and reasonable rates is so firm that it would not allow a departure from that principle through incentive regulation. The Board dismissed a request by Union Gas to set rates based on a range of revenue to cost ratios between rates classes in its performance based regulation proposal:[6]

"The Board is also not prepared to accept the argument that there is no need to provide revenue and cost information on a rate class basis. The Board has generally relied on the revenue-to-cost ratio in determining that there is no unfair assignment of cost responsibility among rate classes. Evidence in this proceeding established no other basis upon which to check for cross-subsidization other than to use cost information.

"The Board does not accept Union's arguments that 'using a cost based measure, such as cross-subsidy is not meaningful in PBR because rates are judged just and reasonable by not being escalated beyond the restrictions approved by the Board' nor that 'the approval by the Board of a level of pricing flexibility means that if Union makes rate changes anywhere within the boundaries of the flexibility constraints approved by the Board, then the result will be just and reasonable rates'. The Board can not automatically assume that the resulting rates will remain just and reasonable among classes."

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[5]Emphasis Added, EBRO 493 (1997), p. 316-7.

[6]Emphasis Added, RP- 1999-0017, paragraphs 2.458-2.459 (2001).

14. This principle has informed the OEB's representations to the Courts as well. These representations are not made lightly. When tribunals appear before Courts to make submissions with respect to jurisdiction, they do so, not as an interested party with the goal of winning the case, but rather as a friend of the Court, to provide the Court with information that it requires to make a decision.[7] As a result, when the OEB makes a submission to the Courts on its jurisdiction, it should be treated as a solemn representation of its jurisdiction.

15. The Board advised the Divisional Court of its rate setting authority as follows:[8]

> "It has always been the Board's practice to allocate the revenue requirement to the different rate classes <u>on the basis of how much of that cost the rate class actually causes.</u> <u>Put simply, rates are designed such that each rate class pays for the actual costs it imposes on the utility. To the greatest extent possible, the Board strives to avoid inter class subsidies</u>."

16. This representation to the Court was specifically based on limitations to the Board's jurisdiction to depart from principles of cost causality. The Board stated:[9]

> "<u>The Courts have specifically noted that treating customers equally includes charging consumers with similar cost profiles the same rate.</u> Although the legislature is entitled to override the common law through statute if it chooses to do so, it must do so through clear and unambiguous language."

17. The Board also stated that cross-subsidies between customer classes would be inconsistent with its statutory objective to "protect the interests of consumers with respect to prices and the reliability and quality of …service". According to the Board, that

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[7] See: *Northwest Utilities Ltd. v. Edmonton (City)* , [1979] 1 S.C.R. 684 and *Children's Lawyer for Ontario v. Goodis* (April 18, 2005), Ont. C.A.

[8] (Emphasis Added, Factum of the Ontario Energy Board dated September 12, 2007 filed with Divisional Court in Court File No. 273/07 "OEB Factum").

[9] Emphasis Added, OEB Factum, paragraphs 23 and 24.

objective would be offended by a rate design that involved "conferring benefits on one set of consumers at the expense of another." [10]

18. Finally, the Board represented to the Divisional Court that, although it engages in balancing between consumer and utility shareholders, it cannot engage in "balancing of interests between groups of customers."[11]

19. As a result of the foregoing, there is one proposition upon which there is agreement among scholars, OEB panels (including both the majority and the minority opinions in the *Rate Affordability Program Decision*) and the OEB's representations to the courts: a just and reasonable rate does not include material and ongoing cross-subsidies between customer groups.

20. Given this, it is helpful to consider the consistency of the reasons offered by the panel in the decision at issue with this principle.

21. First, as noted by the Oshawa panel, the Board's *Cost Allocation Report* identified "observed limitations in data [that] affect the ability or desirability of moving immediately to revenue to cost framework around unity, which is considered ideal. The Board's ranges are a compromise until such time as data is refined and experience is gained." [12]

22. Second, the panel stated that even moving to the ranges identified in the *Cost Allocation Report* "would result in unacceptable impacts for customers in some of the remaining classes and some mitigation is warranted." (at p. 13)

23. AMPCO submits that neither of these rationales supports the justness and reasonableness of the rates that would arise from this decision.

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[10]Emphasis Added, OEB Factum, paragraph 40.

[11]OEB Factum, paragraph 44.

[12] Oshawa PUC Decision, at 13.

The *Cost Allocation Report*

24. The *Cost Allocation Report* does *not* say that moving towards unity is an unattainable ideal. It says that the ranges are "minimum requirements" that do not replace the need to achieve unity if practical in light of data quality:[13]

> "To the extent that distributors can address influencing factors that are within their control, (such as data quality), they should attempt to do so and to move revenue-to-cost ratios nearer to one."

25. Also:[14]

> "Distributors should endeavour to move their revenue-to-cost ratios closer to one if this is supported by improved cost allocations."

26. The Decision thus erred to the extent that it treated the minimum requirement allowed for in limited cases -- that is cases where data deficiencies prevent achievement of cost recovery unity -- as if it was some sort of distant ideal. The movement towards revenue to cost of unity -- which according to the *Cost Allocation Report*, is to be achieved if supported by data quality – is not even acknowledged. There was no suggestion in the Oshawa decision that data quality was lacking in this case.

27. Specifically, the data quality in Oshawa's cost allocation is not inherently less reliable than other data that generally must be relied upon in setting rates and was specifically relied upon in this case.

28. Further, if data quality were in issue, one would have expected the panel to direct that the data be improved. However, the panel did not identify any specific problems with the data and did not impose any requirement to improve data quality. In fact, the panel gave almost no recognition of the principle against undue discrimination other than stating that

[13] *Cost Allocation Report,* at p. 4, Emphasis Added.
[14] *Cost Allocation Report,* at p. 7, Emphasis Added.

the maximum ranges would continue to be in place "until such time as data is refined and experience is gained." The panel provided no further direction on:

- What data was to be refined;
- What steps Oshawa PUC is required to take to collect and refine this data;
- The level of refinement that was necessary;
- The schedule for this refinement;
- What experience was to be gained;
- What lessons would sought to be learned from this experience;
- When this experience would be completed; and
- Why the customer classes who benefitted from under-paying during this period should not ultimately have to pay for the under-collected costs.

29. The Oshawa panel ignored the elements of the *Cost Allocation Report* reflecting a Board policy of continuing to allow distributors to set rates in a manner that departs from cost causality only in limited circumstances. Instead, the Oshawa panel would replace that policy with a policy that such departure is at the discretion of LDCs and for an open-ended period regardless of the status of data quality and with no requirement to improve data quality. The Oshawa panel would create a policy of setting the goal of cost allocation, not at unity, but a transition to achieving a range. If a utility achieves the range, the LDC might decide whether or not to achieve unity, entirely at its own discretion and for whatever purpose it might choose.

30. The grant of discretionary authority to utilities is not just a theoretical problem. In this case, the OEB did not seek, and Oshawa PUC did not offer, a principled or practical reason why large customers should be expected to continue paying more than their costs.

31. As indicated, the decision under review does not identify any deficiency in evidence that would prevent the attainment of unity in this case. Further, there was no basis in evidence for the panel to conclude that even the maximum ranges could not be achieved in this case. All it said was that bringing rates to within the range would have an

"unacceptable impact for customers in the remaining classes." The decision offered no principled reason why it is unacceptable for some preferred customers to pay their *actual* cost of service but it was acceptable for larger customers to pay *more than* their cost of service.

32. This suggests a dangerous pattern where a utility can, at its discretion, determine who should be paying how much based, not on cost causality (or even the "exceptional circumstances" identified by the Board in the *Rate Affordability Program Decision*) but on an explicit or implicit set of non-economic preferences held by the utility.

33. Signs of this pattern are already emerging. For example, in Hydro One's distribution rates case, Hydro One is proposing to change cost allocation to pursue various political goals. According to Hydro One, the reason for moving the revenue-cost ratio to unity for distributed generation customers is that they should no longer provide any subsidies "in support of Government policy to promote Distributed Generation in Ontario."[15] However, it is proposing that large customers continue to over-contribute to the cost of serving them, because to do otherwise "would result in either unacceptable bill impacts or the need for an excessively long impact mitigation period."

34. In other words, under an approach which allows utilities to over and undercharge customers at their discretion, utilities are given the opportunity to allocate the cost of distribution services by reference to political objectives: they get to choose winners and losers. Although this approach has no basis in principled rate making, it is entirely consistent with the discretionary taxing policy approach allowed by the decision under review.

35. It is submitted that this is not the policy that the Board intended to achieve through the *Cost Allocation Report*.

[15] EB-2007-0681, G1, 3, 1, p.3.

36. AMPCO submits that the policy reflected in the *Cost Allocation Report* should be interpreted in light of the Board's legal obligations and the principles of sound rate making. This consists of the following principles:

- revenue to cost ratios must be as close to unity as practical;
- any departure from unity must be demonstrably justified;
- departures from unity cannot exceed the range of approved outcomes in the *Cost Allocation Report*;
- departures must be temporary and accompanied by a mitigation plan; and
- the cost of rate mitigation should be borne by the rate classes that benefit from the mitigation.

Mitigation

37. As indicated, the panel justified the three year transition to the maximum range (as opposed even to unity) on the grounds of mitigating impacts to customers. However, instead of allowing those customers to simply be transitioned to a more cost-reflective rate over time without harming third parties, the panel imposed a requirement that, during the transition, large customers should continue to overpay even beyond the overpayment implied by the maximum range set out in the *Cost Allocation Report*.

38. Two points should be made. First, there is a lack of symmetry between the Board's treatment of rate impacts when they are to the cost of large customers and when they are to the cost of other customers. When unbundling transmission rates, the Board observed that large customers that had contracts in place with Ontario Hydro would lose their "special rate treatment", but that this cost was appropriately borne by large customers. The Board put it as follows:[16]

> "Based on the evidence, these contracts, excluding back-up contracts, cover 1780 MW, equating to some $59 million annually of equivalent network charges. Such an amount would represent a significant cost shift to the rest of the transmission customers. While this may have been warranted by the circumstances that existed at the time of excess power capacity under a monopolistic, bundled electricity

[16] EB-1999-0040, p. 60, Emphasis Added.

regime, under an unbundled, open access regime the circumstances are entirely different. While the Board is sympathetic to the potential impact of the new regime on certain customers or customer groups, it is not uncommon for a major restructuring of the electricity industry to bring about certain unwelcome financial impacts on specific customers or customer groups in the short term."

39. It is not clear why large customers should bear the costs of regulatory restructuring when it adversely impacts them and, at the same time, be expected to continue to shelter other customers from the costs that are brought about through the application of appropriate principles of cost allocation.

40. The second concern with this approach to rate mitigation is that it fails to distinguish between the transition to higher rates over time (which may be justifiable) and the continuation of a subsidy (which is not justifiable).

41. In other words, it may be appropriate for the Board to smooth the impact of a rate increase. In this way, a transition from the lower rate to the higher rate is carried out over a period of time. However, the customers who benefit from that transition should be responsible for the costs of the transition – the goal is to mitigate rate shock, not to prolong the subsidy.

42. This smoothing effect is seen, for example, in the Board's treatment of commodity costs for gas and electricity which are recovered over annual and quarterly periods to avoid rate shock. However, there is a cost to this smoothing and this cost is ultimately paid for by commodity customers. It is not paid for by other customers.

43. Similarly, in this case, if the Board believes that moving to unity in one period is such a dramatic change as to constitute a rate shock for some customers, then it may transition those customers over a longer period. However, the customers who benefit from the transition should bear the costs of the transition.

Conclusion and Request for Costs

44. In light of the foregoing, it is respectfully requested that the Board set aside the decision of the panel and replace it with an order that includes the following requirements:

    i. That Oshawa PUC's revenue to cost ratio used for setting rates for 2008 be brought to unity;
    ii. That, if Oshawa PUC can demonstrate that, for some rate classes, it is not practically possible to achieve unity, then Oshawa PUC shall identify the data or other requirements necessary to achieve unity for these classes and collect and file this information with the Board so that the Board may rely upon it to set rates based on unity for 2009; and
    iii. If, for whatever reason and for whatever period, the Board determines that a revenue to cost ratio of unity should be transitioned for the benefit of customer classes that would otherwise experience "rate shock", then Oshawa PUC can phase in any rate adjustments provided that any under-recovery from a customer class is ultimately collected from that customer class over time, and not from other classes of customers.

45. AMPCO hopes that its submissions have been helpful to the Board and respectfully requests recovery of 100% of its costs with respect to this motion.

ALL OF WHICH IS RESPECTFULLY SUBMITTED, this 8th Day of May, 2008

George Vegh

McCarthy Tétrault LLP
Toronto Dominion Bank Tower
Suite 5300, Box 48
Toronto, ON M5K 1E6

gvegh@mccarthy.ca

Tel: (416) 601-7709
Fax: (416) 868-0673
Counsel for Association of Major Power Consumers in Ontario