Shepherd Rubenstein

By EMAIL and RESS

Jay Shepherd
jay@shepherdrubenstein.com
Dir. 416-804-2767

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Our File: EB20240092

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Nancy Marconi, Registrar

Dear Ms. Marconi:

Re: EB-2024-0092 – Electricity Connections Consultation - Submission

We are counsel for the School Energy Coalition ("SEC"). Pursuant to the OEB's letter of March 13, 2024, and in response to the Stakeholder meeting on April 3, 2024, this letter constitutes SEC's submissions on the issues being addressed in this consultation.

Issues Raised

This consultation arises out of a request from the Minister of Energy on November 29, 2023, as follows:

> *"I encourage the OEB to review electricity infrastructure unit costs in the electricity sector and potential models for cost recovery that could help to ensure infrastructure costs are kept low and are not a barrier to growth in our province. I also ask that the OEB review its electricity distribution system expansion connection horizon and revenue horizon direction to ensure that the balance of growth and ratepayer costs remain appropriate. Please report back on this review in June 2024." [emphasis added]*

While some parties may focus on the latter part of this request, SEC views this as all part of the broader government goal of removing barriers to growth arising from electricity infrastructure costs, and in particular the costs incurred in connecting new customers. Revenue and connection horizons are only a part of that analysis (see below).

Who Should Pay, and When?

We are aware that some parties may look at the issue of electricity connections as a determination of whether utilities, or developers, should pay the cost of connecting new customers to the electricity grid. This is often how it is portrayed in the media.

This is incorrect. Neither developers nor utilities ever pay the costs of new connections. Those costs are either borne by new customers connecting to the grid (through the price of their new homes or other facilities), or by existing customers (through additions to rate base and therefore to rates).

Related to this is the question of the financing of new connection costs, and therefore the assumption of the risk that the connections will end up being economic.

Connection costs that are allocated to the new customers (whether through contributions in aid of construction by developers/new customers, or through development charges and similar capital amounts) are typically financed through the new homeowner's mortgage financing. The risk that they will be economic (i.e. generate sufficient revenue over the long term) is on the new customer.

Conversely, for connection costs that are socialized to existing customers, for example through reduction of the CIAC or through rate basing of growth investments, those existing customers – who are financing the connections through rate base - bear the risk that the new connection will be economic.

SEC believes it is imperative that the OEB's Report to the Minister stress that customers pay for all costs associated with growth investments, and take all the risks that those investments will be economic.

The issue is always: which customers?

What Amounts Should be Treated as Connection Costs?

The Distribution System Code (DSC) is currently based on the paradigm "beneficiary pays". It therefore contains two definitions - "enhancement" and "expansion" - which reflect the distinction between capital spending caused by new customers, and capital spending that is part of the normal optimization by the distributor of the system. The theory is that this distinction is binary in nature.

Like all causation questions, this distinction is fraught with difficulty. Philosophers (and lawyers) spend whole careers debating these issues.

In reality, causation in this kind of situation is a continuum, and there is no clear distinction between capital spending caused by new customers, and all other capital spending. In SEC's view, there are three general categories of utility capital, with grey areas in between:

- Capital spending that is only required because a specific, identifiable customer or group of customerst is going to be connected to the system.

- Capital spending that is required because of population/utility growth, but when incurred is not attributable to specific customers or groups of customers.

- Capital spending that is required regardless of whether growth is occurring.

The problem with the current DSC approach is that it incents (perhaps even requires) distributors to treat all spending in the second category as part of the first category, and thus recoverable from new customers. Historically, there has in effect been almost no second category at all. The first two categories are all treated as expansions.

When the concepts of connection and revenue horizon are factored in, this results in the first customers in a high growth area being saddled with disproportionate costs for the generalized growth of the community. From a public policy point of view, this means that it is more difficult to open up new geographic areas to residential or commercial development, because the first movers pay a high price to do so. This is an obvious barrier to provision of new housing in Ontario.

SEC therefore believes that the first step in responding to the Minister's concern over barriers to growth is to make clear which categories of growth-related spending are the responsibility of the utility and existing customers.

Further, SEC believes that at least some growth-related spending is driven, not by the needs of the local community, but also growth pressures across the province. If the province is experiencing high growth, there is no reason why the customers of a smaller utility should experience a significantly higher impact than the customers of a larger utility, just because the most developable area is in the smaller utility's service territory.

To this end, SEC recommends that the OEB in its Report propose/consider two changes to the current DSC:

1. ***Growth Category.*** Create a new category of distributor capital spending that is driven by growth, and involves bringing power to a new geographic area identified as a growth area in an Official Plan or similar document, but is not attributable to a specific customer. This could include residential, commercial, or industrial growth areas.

2. ***Broader Socialization of Growth Capital.*** Explore mechanisms that would allow the annual carrying cost of distributors' growth capital spending, other than that attributable to specific customers, to be socialized in whole or in part across the province, rather than to individual distributors' customers. This would ensure that, for example, GTA-wide growth that arises in a smaller territory, like Newmarket or Orangeville or Milton, does not unfairly burden the existing customers of that smaller utility.

<u>Recovery from Homebuyers</u>

Currently, recovery of expansion costs is a delicate dance between the local distribution company, which seeks to maximize the contributions in aid of capital, and the developers/builders, who will pass on their costs to the homebuyers.

For the LDC, every dollar they get from developers is a dollar of capital spending they don't have to justify in a rebasing or ICM application. They know their existing ratepayers will resist rate increases. Forcing developers to pay for as much capital spending as possible reduces the risk that rate increases will be too small to cover their costs.

While the developer may be seen as passing through connection costs, in fact there is an external market for the homes they sell. Upward cost pressures such as contributions in aid of construction cause their homes to be more expensive, and buyers may elect to look at other areas in which similar homes are less costly. Developers will not simply eat the costs of electrical connections. However, they may build and sell fewer homes if their homes are too pricey.

The cost to developers is made more problematic because the developer has to front the cost of the connection, either with cash payments or with letters of credit, and takes all the risk that – whatever the connection and revenue horizons used - the economics of the connection will be as expected by the LDC. This risk is also priced into the cost of homes.

Nothing is free.

This context is the reason why a "development charges" approach is attractive. A development charge, in its purest form, is a predetermined amount that the buyer of a home pays when their new home is connected to the electricity grid. It is – at least in theory - not based on an economic model of the profitability over time of that connection, or that group of connections in a subdivision.

Instead, if done properly a fixed charge is an assessment of the long-term incremental cost to the electricity distributor of adding a customer (or perhaps a customer with specific characteristics).This means that the cost is for a "typical" residential connection, not this particular one. It also means that the credit for future revenue is for a "typical" residential customer, and can be determined using empirical sources. (In this scenario, it is not necessary to have a revenue horizon. It is only necessary to determine, from historical data, how much revenue a new connection of a given type actually produces during the life of the new equipment serving it.)

The payment also only arises when the connection is made. This is important for the developers. If they do not have to take the risk that their developments will proceed as planned, the cost of their homes will be lower.

It is important to note that development charges shift part of the risk (the connections risk) from the developers to the LDC, i.e. from new to existing customers. Until a home is built, it is the existing customers that bear the risk. Once the home is built, the buyer assumes all risk. This should mean that the connections risk is accepted by the LDC and its existing customers.

Of course, if the standard development charge is calculated in a thoughtful way, it will factor in the likelihood that some developments will not proceed, or will be delayed. In that way, the existing customers of the LDC are better protected. As noted, it will also factor in the predictable future revenues from new customers, so that the homebuyers are also better protected. In both cases, it requires less reliance on forecasting because past data can be used as a reliable predictor of future costs.

In the best case, the OEB can establish standard amounts that are based on province-wide data.

SEC's conclusion (as existing customers of most LDCs) is that development charges are a good idea that should be developed. If done right, they will assign the immediate cost of new connections to those who benefit from the connections, but with a much simpler approach based on empirical data rather than forecasting. They will also reduce the cost of new homes, benefitting all in the community.

The use of development charges would likely, depending on how they are designed, end the use of contributions in aid of construction. Growth capital would be added to rate base as incurred, and be recovered in rates. As subdivision approvals are issued, standardized development-type charges would be levied and used to reduce rate base.

There is an obvious risk that some utilities would overbuild, because recovery in rate base is relatively easier than recovery from developers. This would have to be policed, but the OEB is experienced in approving and monitoring the capital spending of utilities.

<u>Recovery from Ratepayers</u>

The use of development charges implies that the local costs of serving new subdivisions are ultimately borne by the purchasers of new homes, either in the charge itself, or in their rates after occupancy. The ratepayers front the cost through rate base, but are made whole through the charges. Because developers do not have to pay development charges until they are actually in the building process (when many of the homes will already have been sold and development charges collected), the cost and risk are much lower.

The OEB has seen a number of examples, including recently, of growth capital in which the cost (sometimes substantial) is to bring power to an undeveloped area, rather than to serve a subdivision or other development within an established community. The Whitby case (North Brooklin) was a perfect example of this. Land that is mostly being farmed will be developed over perhaps twenty years, with tens of thousands of new residents. To do that, capacity has to be brought in, at considerable cost, from the nearest Tx station. This is all part of the Official Plan and regional planning for the area.

Under the current rules, examples like this are obviously expansions, but because of the cost they present a barrier to any developer being in the first group to build.

On the other hand, if areas of land like North Brooklin are not opened up to new development, the government's housing objectives will not be met. Whether it is in

Halton Hills, or Milton, or Whitby, or Shelbourne, areas around the GTA are going to need expansions of high capacity lines.

Clearly some part of the responsibility to pay for the costs of growth lies on the residents of the local area, who presumably will benefit from increased population in local revenues, services, etc.

However, SEC believes that some parts of that growth are typically more regional in nature. The new residents of Whitby are a function of the demand for new housing in the GTA.

SEC therefore proposes that LDCs faced with substantial regional growth spending be afforded the opportunity to seek approval to categorize that spending as regional in nature. If the OEB agrees, the LDC would be allowed to recover the cost through a levy across the province, rather than solely from their local customers. This could be through a new fund, through the Global Adjustment, or through some other mechanism.

<u>Overall Recommendations</u>

Based on this analysis, SEC recommends that, for the purpose of improving the affordability of new homes in Ontario, the DRC be revised to achieve the following:

1. ***Categorization of Costs.*** Establish a new category of expansion-type costs that are driven by regional or community growth rather than requirements for connection of identifiable groups of new customers.

2. ***Socialization of the Costs of Regional Growth.*** Develop a process for socializing a portion of the costs of growth-related expansions across the province, rather than saddling individual LDCs and their customers with all of the costs of regional growth.

3. ***Standardized Connection Charges that Function as Development Charges.*** Replace contributions in aid of construction with a type of development charge that is levied at the time the subdivision plan is approved. Development charges should reflect the average cost of local facilities to connect customers (or categories of customers), net of the typical revenues customers contribute. In the best case, the development charge should be a standard, province-wide amount that all LDCs use.

All of which is respectfully submitted.

Yours very truly,
Shepherd Rubenstein Professional Corporation

Jay Shepherd

cc: Brian McKay, SEC (by email)