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**VIA EMAIL and COURIER
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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: Regulatory Treatment of Infrastructure Investment
OEB File No. (EB-2009-0152)
Comments of Power Workers' Union on Board Staff Discussion
Paper**

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 Regulatory Treatment of Infrastructure Investment (EB-2009-0152).

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: John Sprackett
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Doc 727443v1

List of PWU Employers

Atomic Energy of Canada Limited (Chalk River Laboratories)
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power – Lake Superior Power
Brookfield Power – Mississagi Power Trust
Bruce Power Inc.
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)
Electrical Safety Authority
EPCOR Calstock Power Plant
EPCOR Kapuskasing Power Plant
EPCOR Nipigon Power Plant
EPCOR Tunis Power Plant
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.
London Hydro Corporation
Middlesex Power Distribution Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Safety Solutions
Nuclear Waste Management Organization
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Sioux Lookout Hydro Inc.
Sodexo Canada Ltd.
TransAlta Energy Corporation - O.H.S.C. Ottawa
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

**Board Staff Discussion Paper on
The Regulatory Treatment of Infrastructure Investment for Ontario's
Electricity Transmitters and Distributors**

Comments of the Power Workers' Union

July 7, 2009

1. INTRODUCTION

1. On April 3, 2009, the Chair of the Ontario Energy Board (the "OEB" or "Board") issued a Statement confirming the Board's commitment to creating conditions that will foster timely and appropriate investment in electricity distribution and transmission infrastructure while ensuring that the interests of ratepayers continue to be protected.

2. Key elements of this Statement include:

- Ontario's electricity utilities are currently investing substantial amounts of capital to replace aging infrastructure, deploy smart meters, connect new load, and maintain system operability and reliability.
- The *Green Energy and Green Economy Act, 2009* (the "GEGEA") will further increase utility infrastructure investment. In this regard, Ontario's electricity utilities will:
 - be charged with planning for and connecting renewable distributed electricity generation;
 - be given responsibility to implement the smart grid; and

- assume a lead role creating a conservation culture through the implementation of conservation and demand management programs.
- Given the magnitude of current and expected future utility infrastructure investment, the Board intends to examine whether alternatives to the traditional approach to cost recovery from ratepayers for capital investment are required with a view to better facilitating such investment.
- Consideration of these issues will be made in the context of the Board's objectives as set out in the *Ontario Energy Board Act, 1998* (the "Act"), including the requirement to set just and reasonable rates and to balance the interests of ratepayers and utilities, and furthering the new objectives in the GEGEA, which will require significant investment in new infrastructure, by ensuring that the proper cost recovery approach is in place to encourage needed investment while protecting the interests of ratepayers..

On June 1, 2009, in a second Statement the Chair advised of the development of three initiatives, one of which is to consider more innovative approaches to cost recovery, primarily in relation to infrastructure investments relating to the accommodation of renewable generation and smart grid development.¹

3. On June 10, 2009 the OEB initiated a consultation on more innovative approaches to cost recovery for electricity infrastructure projects and released a Board staff discussion paper *The Regulatory Treatment of Infrastructure Investment for Ontario's Electricity Transmitters and Distributors* (the "Discussion Paper") for comment from all interested parties.

4. The Discussion Paper sets out a range of mechanisms for the regulatory treatment of infrastructure investment that could be used to support the setting of rates.

¹ The other two separate yet related initiatives address the following issues: (i) distribution infrastructure planning and funding related to renewable generation connection and smart grid development activities; and (ii) cost responsibility associated with the connection of renewable generation facilities to distribution systems. The three initiatives together will lay the foundation for an integrated framework for electricity infrastructure development in the Province.

5. The following are the Power Workers' Union's ("PWU") comments on the Discussion Paper.

2. GENERAL COMMENTS

6. The GEGEA received Royal Assent on May 14, 2009, and proclamation of the amendments to the *Ontario Energy Board Act, 1998* and enactment of the GEGEA, are expected in the near future.

7. The PWU notes that the GEGEA will, when proclaimed, make a number of amendments to the Act including those relevant to the issue of cost recovery associated with the connection of renewable generation facilities to electricity delivery systems and the development of the smart grid. The amendments that impact cost recovery of infrastructure investment include, among others, the following:

- the GEGEA gives renewable generation a right to connect to the system;
- the GEGEA requires distributors and transmitters to expand their systems to accommodate renewable power. This means that, if a renewable generation proponent is prepared to connect to the system, then a transmitter or distributor² must pay for the costs of reinforcing its networks to accommodate that generator;
- the GEGEA directs the OEB, the economic regulator, to require transmitters and distributors to file plans that will lead to the expansion of their systems to facilitate renewable and distributed generation.³ This puts the OEB in the position of encouraging system expansions. This is a reversal of its conventional role of providing a financial check on any system expansions which are not economically self-sustaining;
- The GEGEA commits Ontario to the comprehensive development of a smart grid. The implementation of smart grid technology across Ontario will have a profound effect on the province's transmission and distribution systems. The commitment to go ahead with the implementation of the smart grid is embodied in amendments to both the *Electricity Act, 1998* and the Act;

² s. 79.1 of the *Ontario Energy Board Act*.

³ ss. 70 (2.1) of the *Ontario Energy Board Act*

- The job of developing the smart grid concept across the province will be vested in transmitters and distributors. Every transmitter or distributor will be required to submit to the Board plans for the development and implementation of the smart grid in their system. Each transmitter and distributor will then have as a condition of licence from the Board "to make investments from the development and implementation of the smart grid in relation to the licensee's transmission system or distribution system";
- A new objective for the Board of promoting the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities⁴;
- New deemed conditions of licence that will require distributors and transmitters to: (a) file for Board approval plans for the expansion or reinforcement of their respective systems to accommodate the connection of renewable energy generation facilities, and the development and implementation of the smart grid; and (b) expand or reinforce their respective systems in accordance with those respective Board-approved plans or as otherwise mandated by the Board or prescribed by regulation.

8. Having regard to the legislative context in Ontario, the PWU recognizes that the GEGEA requires a fundamental rethinking of the way in which energy supply resources and network expansions are measured and valued. It also imposes a dramatic change in how the economic regulator, the OEB, is to carry out its mandate.

9. To appreciate the fundamental shift brought about by these changes, it is helpful to contrast the GEGEA's approach to these issues with the way that these issues are currently addressed.

⁴ paragraph 5 of subsection 1(1) of the Act

System Expansion

10. One of the challenges faced by renewable and distributed generation is that it requires the expansion of transmission and distribution networks. Sources of renewable power tend to be distant from areas of load (i.e., where the power is consumed, largely in growing urban and suburban areas). It is therefore necessary to build long transmission connections to bring the power from the source to the user.

11. Similarly, on the distribution side, the traditional model is that distribution is served by upstream sources of centralized generation. The model of distributed generation has a number of small generators embedded within a distribution system. Accommodating new sources of local distribution imposes costs on distributors.

12. There is thus considerable cost in expanding transmission and distribution systems. The challenge for energy regulation has been to determine when networks should be expanded and who should pay the expansion costs.

13. For example, with respect to approving the expansion transmission and distribution networks, the conventional approach is based on low cost planning. A key element of these considerations is that all types of generation are treated the same. Each generator has equal, non-discriminatory access to transmission and distribution systems. Thus, the regulator's goal was to ensure proper cost allocation among users of the system; the goal is to keep the economic playing field level.

14. The GEGEA takes a fundamentally different approach to approving system expansions. Transmitters and distributors are required to expand their systems to accommodate renewable and distributed generation regardless of their economic merit relative to other forms of available generation. A generator that requests a connection and complies with "the applicable technical, economic and other requirements" is entitled, as a matter of right, to a connection and the transmitter or distributor must make the necessary expansions to its system to accommodate the facilities.⁵

⁵ See proposed s. 25.36 of Electricity Act.

15. As well, the GEGEA explicitly departs from the requirements of non-discriminatory access to transmission and distribution systems. It provides that renewable energy facilities are to be provided “priority connection access” to transmission and distribution systems.⁶

The Changing Role of the Ontario Energy Board

16. Underlying the Board’s analysis of cost effectiveness in the areas of system portfolios and network expansions (as well as virtually every other area of OEB regulation) is a fundamental premise of the role of the OEB as a traditional economic regulator.

17. Essentially, the theory of economic regulation under which the OEB (and most other utility regulators) operate is that its key role is to ensure that investment in electricity networks is restricted to what is prudent. In other words, the OEB is the economic watchdog whose main job is to ensure that utilities only carry out cost effective expansions.

18. Under the traditional approach, regulators like the OEB commonly make cost recovery decisions concerning new capital projects when construction is completed and the facility has entered commercial operation. Under this traditional approach, commonly referred to as the “prudent investment rule”, cost recovery is available only on satisfaction of two conditions: costs are prudently incurred, and the project is “used and useful”.

19. The change to this view and its replacement of the Board’s mandate from economic efficiency to green economics is one of the most fundamental and challenging change brought about by the GEGEA.

20. Under the GEGEA the OEB is to require transmitters and distributors to expand their systems to connect renewable generators. The Act requires distributors and transmitters to file plans with the OEB for expansion and reinforcement of their systems and, in accordance with OEB approved plans, or at such other times directed by the

⁶ See proposed s. 26 (1.1) to the Electricity Act.

Board or by regulation, “to expand or reinforce its transmission system or distribution system to accommodate the connection of renewable energy generation facilities.”⁷

21. The OEB, which prior to the GEGEA, was the check on expansions, is now assuming the role of agent or facilitator for expansions.

22. This change in role provides some fundamental challenges for the OEB in the context of the OEB’s traditional regulatory tools, that have been relied upon to make cost recovery decisions on utility infrastructure investments (i.e., to limit expansions to economically efficient expansions), require reconsideration with this new mandate.⁸

23. Given that the connection of renewable energy generation facilities and the development of a smart grid are policy matters of priority for the Government this new mandate makes it necessary to reconsider many of the regulatory tools that the OEB now uses to determine their continuing applicability within this new paradigm. In the PWU’s view, this is an opportune time for the Board to ensure that the proper cost recovery approach is in place and fully supports the Board’s consideration of this issue under this initiative.

24. The Discussion Paper contemplates certain modifications to the traditional approach, many of which are short-term and project-specific. The PWU observes the incentive mechanisms identified in the Discussions Paper are not mutually exclusive. Further, the PWU observes the cost recovery mechanisms focus on considerations of how and when to approve the recovery of the costs associated with large capital projects.

25. As noted in the Discussion Paper⁹, portions of the Discussion Paper draw heavily on the Federal Energy Regulatory Commission’s (“FERC”) July 20, 2006 Final Rule, Promoting Transmission Investment through Pricing Reform (Order No. 679; 116 FERC ¶ 61,057) and some of the incentive mechanisms identified in the Discussion Paper are

⁷ s. 70 (2.1) of the *Ontario Energy Board Act*.

⁸ That is, a range of practices and conventions that are drawn upon in deciding cases. For example, the premise that only used and useful assets are brought into rate base, that prudence reviews are retrospective, not prospective, and that there should be non-discriminatory access to transmission and distribution systems.

⁹ Discussion Paper, page 3

the same as those adopted by the FERC. Portions of this Discussion Paper also draw heavily on a National Regulatory Research Institute (“NRRRI”) paper written by Scott Hempling and Scott H. Strauss, *Pre-Approval Commitments: When and Under What Conditions Should Regulators Commit Ratepayer Dollars to Utility-Proposed Capital Projects?* issued in November, 2008.

26. The Discussion Paper recognizes the need to ensure that solutions adapted from other jurisdictions are suited to the Ontario context. In fact, there are marked differences between the Ontario U.S. federal/state regulatory and electricity markets.

27. OEB staff believes that these documents provide a sound basis for developing a similar approach in this Province.

28. The PWU notes that the purpose of FERC Order 679 is to:

- Promote investment in transmission infrastructure
- Promote electric power reliability
- Lower costs for consumers
- Reduce transmission congestion

Key provisions of FERC Order 679 include:

- Incentive rates of return on equity for new investment by public utilities;
- Full recovery of prudently incurred construction work in progress, pre-operations; and/or abandoned plant costs;
- Accelerated depreciation; and,
- Increases in rates of return for entities that join or continue to participate in a Regional Transmission Organization (“RTO”) or Independent System Operator (“ISO”).

29. The incentive mechanisms adopted by the FERC arose because Congress directed the FERC through the *Energy Policy Act of 2005* to develop incentive transmission investment rules in order to encourage transmission investment and address impediments to transmission development in the U.S. In this regard, generation

investment and demand for power have grown steadily over the past decade, but transmission investment has lagged because of:

- lack of single set of rules governing transmission, such as for siting, rate recovery and usage rights
- the dichotomy of state versus federal regulation (e.g., lack of regulatory certainty, reliability rules, protection from expensive regional markets)

30. Overall the Discussion Paper appears to focus on reducing generators' barriers to entry through economic devices.

31. In the PWU's view, the following are the transmission and distribution investment risk factors faced by regulated utilities in Ontario that need to be considered by the Board in its deliberations on this issue:

- Time delays
 - Time is money and costs escalate
- Negative public opinion
 - Not in my backyard concerns
- Siting uncertainties
 - Approvals
- Cancellation by project developers
- Recovery of project costs
 - After the fact prudence reviews
 - Delayed cost recovery

32. The PWU's specific comments on the Discussion Paper are organized in the order of the 26 questions presented in the Discussion Paper. In providing comment the PWU is guided by the following key principles/objectives within the context of the legislative framework:

- a. The Board should, to the extent possible, refrain from encouraging policies that amount to a departure from the principle of cost causality.
- b. Changes in cost recovery policies should not result in unfair discrimination between and among generators and loads

- c. Changes in the regulatory treatment of infrastructure investment should “first, do no harm” (e.g., core requirement that appropriate safety, reliability and customer service levels should be maintained and not compromised).

3. PWU SPECIFIC COMMENTS

Reference: 1. Should the framework and mechanisms identified in this Discussion Paper apply to other rate-regulated entities? If so, why and for what types of projects?

33. The framework and mechanisms identified in this Discussion paper could apply to the regulated assets of Ontario Power Generation (“OPG”). Given the planned need for significant investment in base load capacity, particularly nuclear power, in coming years, delaying rate recovery for these new regulated assets until they are placed in service may, in the case of such large, capital-intensive assets, have rate implications that may need to be mitigated. OPG’s Niagara Tunnel Project is another example of a large, multi-year construction project that could be eligible for the incentive mechanisms and regulatory treatment contemplated.

Reference: 2. Are there other broad classifications for investment, beyond “routine”, “non-routine incremental”, and/or “GEGEA-related” that should be considered? If so, what are they and what are the specific underlying drivers for such investment?

34. The PWU believes “GEGEA-related” is too broad a classification and recommends that this proposed grouping be subdivided into two sub-classifications: “Renewable Generation” and “Smart Grid or “System Redesign”. Both are Government high priority policy initiatives arising from the GEGEA but have different drivers: the former involves investment in new transmission and distribution facilities to enable the connection of new power supply; the latter involves the deployment of advanced or innovative technologies that increase the capacity, efficiency, or reliability of existing or new transmission and distribution facilities. Transmitters and LDCs are charged with developing and implementing “Smart Grids” in Ontario which involve converting radial systems to networks with state of the art safety, control, protection systems that achieve appropriate reliability. Transitioning transmitters and LDCs to own and operate Smart

Grids is essential to being able to take delivery of power and redeliver it within the service area on an as needed basis in a safe, reliable manner.

Reference: 3. Should the mechanisms identified in this Discussion Paper apply to the recovery of costs incurred by electricity transmitters or distributors for investments to accommodate renewable generation or to develop the smart grid, or both? Why or why not?

35. The mechanisms identified in the Discussion Paper should apply to the recovery of costs incurred by electricity transmitters or distributors for both initiatives. In fact, the PWU believes the mechanisms should apply to all infrastructure investments made by electricity transmitters and distributors. In support of extending the incentive mechanisms to all infrastructure investments , the PWU suggests this approach:

- Will ensure that utility management consistently evaluates all risks.
- Avoids preferential incentives toward one application of capital which will skew decision-making and may have unintended consequences e.g., over-investment in generation connection and (in relation to all other projects that are disadvantaged) under-investment in other areas of utility operations.
- Is consistent with the fairness principle and dictates that, to the maximum extent possible, symmetric treatment should be afforded all market participants (e.g., loads and generators).

The PWU suggests failure to extend the incentive mechanisms to all infrastructure investments could:

- Lead to negative effects, including: delays in needed utility investments thereby compromising reliability, safety and customer service levels, and increasing the risk of shortages, blackouts, brownouts and other service concerns; and deferring projects until crisis conditions prevail, leaving insufficient time for OEB examination of potential alternatives.
- Result in rationalization/rationing of capital due to concerns about the ability of the utility to access capital on reasonable terms and conditions.

36. In sum, the mechanisms must be applied consistently so as not to skew the regulated utilities' decisions or their customers' decisions.

Reference: 4. Should the mechanisms set out in this Discussion Paper be applied to infrastructure investment if the cost of the investment is potentially recoverable through a Province-wide cost recovery mechanism? Why, or why not?

37. Despite the fact that the policies of the alternative funding stream are unknown at this time, the PWU agrees with Board staff that the mechanisms should be able to be applied to infrastructure investment even if the cost of the investment is potentially recoverable through the Province-wide cost recovery mechanism referred to in section 2.3.1 of the Discussion Paper. To the extent that, in whole or in part, monies are recoverable through the Province-wide fund they can be treated in the books of account like a customer capital contribution.

Reference: 5. Should the mechanisms set out in this Discussion Paper be applied to infrastructure investment in smart grid technology while it is at an early stage of development and where governing standards are yet to be developed? Why or why not?

38. The PWU recommends that the Board deal with early movers on a case-by-case basis so as not to impede or impair innovation or the realization of opportunities.

Reference: 6. Should "routine" investment made by a transmitter or distributor be eligible for one or more of the alternative treatments identified in this Discussion Paper? Why or why not?

39. Yes. Please see the PWU's comments with respect to issue 3.

Reference: 7. Should the mechanisms identified in this Discussion Paper be presumed to apply to certain types of investments (for example, to accommodate renewable generation)? Why or why not? If so, to which investments?

40. As noted in the PWU's comments with respect to issue 3, all transmission and distribution infrastructure investments should be eligible for the mechanisms.

Reference: 8. Should the Board be more prescriptive as to which type of investment may qualify and which will not? If so, what criteria might the Board use to make a determination on which type of investment would qualify?

41. While it would generally be inappropriate for the Board to favour or prefer an investment opportunity, the PWU recognizes that the Board has a responsibility to further the Government's policy objectives as set out in the GEGEA. However, the Board's objectivity and impartiality are vital to the industry. Balancing of interests in the public interest (i.e., there are winners and losers) is an integral consideration in the Board's decision-making process; the Board is also an instrument of public policy through directives and legislation.¹⁰ Having noted this context, the PWU proposes that any investments required to maintain ongoing service quality, reliability and safety ought to qualify.

Reference: 9. Should the Board permit applicants to request confirmation from the Board that prudently-incurred costs associated with any abandoned projects will be recoverable in rates if such abandonment is outside the control of management? Why or why not?

42. In the PWU's view, the Board should permit applicants to request confirmation from the Board that prudently-incurred costs associated with any abandoned projects will be recoverable in rates if such abandonment is outside the control of management, as a way to reduce the up-front risk associated with important infrastructure projects. In the PWU's view, this incentive will be an effective means to encourage transmission and distribution development by reducing the risk of non-recovery of costs.

43. This incentive should be evaluated on a case-by-case basis to ensure that the decision to abandon the facility was truly beyond the utility's control. The PWU submits that a case-by-case approach and the limitation to prudently-incurred costs should adequately discipline investment decisions.

44. Examples of circumstances where recovery of up to 100% of prudently incurred costs of facilities that are cancelled or abandoned would be appropriate are as follows:

- A utility may have investment in a project abandoned due to a change in circumstances from those originally planned.
- A generation developer may decide to terminate a project.

¹⁰ Applies as well to other regulators (e.g., FERC Order 679 arose because Congress directed the FERC to fix the transmission problem in the U.S.)

- A developer may have difficulty in obtaining siting approvals.
- The project was cancelled or abandoned due to problems in obtaining regulatory or other approvals.

45. As well, recovery of the costs of projects abandoned or cancelled in favour of technologically superior investments should be allowed provided that the initial investment decision can be found to be prudent.

46. Adoption of this incentive would enhance the ability of transmitters and distributors to remain financially whole which is of paramount importance to the maintenance of ongoing service quality, reliability and safety. Absent this mechanism, external factors beyond management's control could cause (irreparable) financial harm to the regulated entities with unintended consequences, which would not be in the public interest (i.e. system and service deterioration).

Reference: 10. Should the Board allow for full or partial CWIP to be placed in rate base during the construction of transmission facilities to accommodate the connection of renewable generation and/or develop the smart grid? Why or why not? Should the Board allow this particular treatment for distribution investment? If so, on what basis?

47. The PWU submits that the Board should allow for prudently incurred full or partial CWIP to be placed in rate base for electricity transmitters with significant expenditures to accommodate connection of renewable generation and/or develop the smart grid and on major new infrastructure projects unrelated to renewable generation or the smart grid with long construction periods spanning several years.

48. In the PWU's view, the ability for a utility to recover up to 100% of prudently incurred CWIP on a case-by-case basis has the following major benefits:

- Reduces cash flow difficulties associated with the long lead time to construct new transmission.
- This will balance short-term and long-term rates by increasing the rates during construction and lowering the rates during operation of a facility (i.e., smoothing of rates).

49. While it is less likely this particular regulatory treatment is appropriate for most distribution infrastructure investments, in the context of the Discussion Paper there may be instances where distributors may make investments in large, capital-intensive assets where it might be appropriate to phase in the cost of any large, multi-year projects, to provide a smoothing effect on rates and thereby mitigate the rate impact that would otherwise take place when the large new plant is placed into service.

Reference: 11. Should the Board allow depreciation to be adjusted to match a contract term or the useful life of the connecting renewable generation facility? Why or why not?

50. The PWU supports the introduction of an incentive whereby depreciation is matched to contract term. In the PWU's view, the use of accelerated depreciation over shorter time periods, rather than the useful life of the facilities, provides improved cash flow and better positions public utilities for longer term distribution and transmission investments. In the PWU's view, accelerated depreciation could be relevant to a specific facility that may have a useful life less than its physical life due to obsolescence (e.g., accelerated obsolescence of transmission facilities due to changing transmission technology). Determinations with respect to the allowability of accelerated depreciation should be made on a case-by-case basis. In addition, accounting and tax issues must be carefully considered.

Reference: 12. In light of a legislative context in which the Board may mandate infrastructure investments, are incentives necessary or appropriate in Ontario?

51. The PWU submits that, absent any information or analysis on barriers to infrastructure investment in Ontario, it is problematic to comment on this issue. Nonetheless, the PWU is of the view that incentives are necessary or appropriate if certain conditions apply, examples include:

- Utility financial capabilities and the availability of capital in today's markets constrain capital investment projects.
- Do small utilities have the technical resources sufficient to undertake a major capital project?
- Does the utility have ready access to capital on reasonable terms?
- There is evidence that, absent pre-approvals, the project cannot be financed.

- There is evidence that the undertaking of major capital projects will result in unfavorable changes in the utility’s risk profile.
- The utility has no access to the level of financing required to complete the project, and that it cannot proceed absent assurance of contemporaneous cost recovery.

52. Incentives are appropriate in the context of providing accurate, verifiable and actionable price signals to proponents, regulated utilities and other market participants.

In this regard, the PWU endorses the following incentive guidelines:

- Is the “end result” just and reasonable, balancing the needs of consumers and investors?
- Incentives recognize construction risks; they are not a “bonus” for good behavior.
- Not every incentive will be available for every investment.
- Applicants may request incentives that are not in the Board’s final rules.
- New investment in existing facilities will be eligible for incentive treatment.

Reference: 13. *If the Board were to provide for incentives, should it allow project-specific ROE? If so, should the Board consider adopting a range rather than a specific adder? Further, how might the Board determine an appropriate range or ROE adder?*

53. While incentive rates of return on equity (“ROE”) for new investment by public utilities represents the most direct and effective means of attracting capital, the PWU has several concerns about applying this incentive on a project-specific basis through ROE adders.

54. In this regard, the PWU has the following concerns:

- The added regulatory burden (imposed upon both the Board and applicants) associated with the need for case-by-case determinations (e.g., development of evidentiary record/showings, additional costs for cost of capital experts).
- Will the Board have two sets of economic analysis: one that applies to conventional facilities and one for renewable facilities; if so, how can this distinction be coherently maintained (i.e., harmonized) in an integrated electricity system?

- Project-specific ROE conflicts and are not reconcilable with postage stamp rate design.
- If the LDC's assets are pooled then so is its risk and the overall level of risk should be compensated through an appropriately parameterized allowed rate of return.
- Project-specific rate making through ROE adders (and project-specific capital structures) remove the utility from managing all the risks of its business and creates accountability for the regulator (i.e., will unduly engage the regulator in risk management activities that are properly utility management responsibilities).
- Will skew investment and utilization decisions.

55. The PWU suggests an alternative to a project-specific ROE adder is the use of a range rate to a connected entity (e.g. rates differentiated by customer class) determined using sound rate making with due regard for the context of the market, its evolution, the long term impacts and fairness and equity. If a range rate is made available to generators it ought to be made available to loads also. Based on the foregoing, the PWU recommends that further consideration of this issue be deferred to another process.

56. The PWU notes the Board is proceeding with a review of its policy regarding the cost of capital ("COC") in September 2009, Board File No. EB-2009-0084. In its Notice of Consultation Process, the Board indicated that further examination of its policy regarding the cost of capital is warranted to ensure that, on a going forward basis, changing economic and financial conditions are accommodated if required.

57. The PWU suggests that this process would provide an appropriate forum for further consideration of the alternative mechanisms related to project-specific ROE (and project-specific capital structures) referred to in this Discussion Paper. The Board's issues list for the upcoming COC consultation process, that will form the basis of its review, can be expanded to incorporate these two issues.

Reference: 14. *If the Board were to provide for incentives, should it allow project-specific capital structures?*

58. Despite the fact a rigid approach to acceptable capital structures could threaten the viability of some projects and despite the fact this incentive has the following positive attributes:

- Gives applicants the flexibility to refinance or employ different capitalizations as needed.
- Proposals for this incentive evaluated on a case-by-case basis.
- These structures may be effective for development of consortium projects.

The PWU has the same concerns as expressed in relation to ROE adders. (Please see PWU comments with respect to issue 13).

Reference: 15. What other alternative mechanisms, if any, might the Board consider be made available to applicants? Why?

59. The Board could consider allowing full recovery of prudently incurred pre-operations costs. The PWU notes that the FERC has adopted this incentive mechanism in FERC Order 679. Under this incentive mechanism, the FERC gives public utilities, where appropriate, the ability to include 100 percent of prudently incurred transmission-related CWIP in rate base and to expense prudently incurred “pre-commercial” costs¹¹. In the FERC’s view, “These rate treatments will further the goals of section 219 by providing up-front regulatory certainty, rate stability and improved cash flow for applicants thereby easing the pressures on their finances caused by transmission development programs.”¹²

60. The PWU submits this mechanism offers the following advantages:

- A utility may make a large investment in pre-operation costs.
- Reduces cash flow difficulties associated with the long lead time to construct new facilities (e.g., transmission).

¹¹ Includes costs associated with pre-construction activities, such as: planning, related studies, and siting costs, including costs of routing studies, costs of certification associated with regulatory approvals (including legal and consulting costs), costs of public hearings and informational hearings, costs for design, planning, drafting, surveying services, etc.

¹² Determinations are made by the FERC on a case-by-case basis. The FERC allows public utilities the opportunity, in appropriate situations, to include 100 percent of CWIP in the calculation of transmission rates and to expense pre-commercial operations costs for new transmission investment (instead of capitalizing these costs and earning a return)

- Provides upfront regulatory certainty.
- This will balance short-term and long-term rates by increasing the rates during construction and lowering the rates during operation of a facility (i.e., rate smoothing).

61. Generally, the PWU notes appropriate alternative mechanisms include measures that do not artificially or inappropriately raise or lower efficient barriers to entry, that are equitable for generators and loads, that do not give rise to unacceptable long run implications, that facilitate distributors' transition from radial service to network service, that do not impair safety or reliability and ideally increase both.

62. An example of such an alternative mechanism is a range rate (e.g. rates differentiated by customer class). In the PWU's view, an examination of transmission congestion management may yield other alternative mechanisms. However, good information on congestion in Ontario is needed. The PWU submits the current congestion payments scheme frustrates investments in transmission because it results in generators making sub-optimal dispatch choices that obscure the need for investment in transmission - the mis-match of loads and generation creates congestion - efficient decisions need to be made by all if the systems are to be optimized.

Reference: 16. *In addition to the potential considerations identified, are there any other matters that the Board might consider in making decisions on requests for alternative treatment?*

63. The Board may wish to consider whether the transition to a Smart Grid is facilitated, whether the public interest is protected.

Reference: 17. *What performance conditions, if any, should be established?*

64. Performance conditions should be identified and analyzed on a case by case basis.

65. For multi-year projects, the Board could require that a specified percentage of the costs of a project be incurred, or specific milestones of the project be completed, before any early recovery mechanism takes effect. This would incent project sponsors to maintain project schedules and complete project schedules on time. But the PWU cautions that the Board should exercise caution in this regard, recognizing that project

delays may be due to events beyond the project sponsor's control (e.g., labour or equipment supply shortage).

66. At a minimum, consistent with the "first, do not harm" criteria the Board should require that service reliability, quality and safety be maintained.

Reference: 18. Are the reporting requirements suggested appropriate and adequate?

67. The PWU notes the information proposed to be sought is not readily available in existing reporting requirements and would be required only from companies that have been granted alternative treatment for specific projects.

68. The reporting requirements as set out in the template in Appendix A to the Discussion Paper are appropriate and adequate for the purpose of helping the Board to monitor the success of the alternative treatments in facilitating timely and appropriate investment. As well, where early cost recovery is authorized, such information will enable the Board to monitor the progress of construction of pre-approved facilities.

69. The PWU suggests an annual filing requirement (i.e., affected companies to report annually on approved projects no later than April 30th of the following year) is an appropriate reporting frequency for the stated purpose of the reporting requirements. This will assist the Board to evaluate anticipated utility performance, to monitor performance throughout the course of the project (including a review of utility rationales for schedule slips and cost overruns), and to take actions in response to unanticipated events.

Reference: 19. Are there any other conditions that the Board might need to establish in relation to an approved alternative mechanism referred to in this Discussion Paper to protect ratepayer interests?

70. The Board could provide penalties for inappropriate performance for discretionary actions/events within the regulated entity's control (i.e., poor market behavior), but only through clearly articulated and understood rules. If, for example, a regulated entity frustrates a load or generator from connecting according to the negotiated schedule then the regulated entity could be subject to an economic penalty. This penalty could take the form of a disallowance of costs in rates based on a

prudency review. Penalties will contribute to fairness in regulatory treatment between those entities that strive to meet the connection schedule and those that choose not to make it a priority.

Reference: 20. *Beyond those already reflected in the Board's existing filing guidelines (e.g., the Z-factor test of causation, materiality, and prudence) and in the Board's jurisprudence, is there a specific test that successful applicants should be required to meet in order to be granted an alternative treatment?*

71. The PWU has no comment.

Reference: 21. *Are the Board's existing filing guidelines for electricity transmitters and distributors sufficient to support the case-by-case approach discussed in this Discussion Paper? If not, what additional information should an applicant provide?*

72. The Board's existing filing guidelines for electricity transmitters and distributors are not sufficient to support the case-by-case approach discussed in the Discussion Paper. They were developed under the traditional regulatory approach.

73. The case by case approach is implicitly geared to discerning the omnibus administration of these applications. Filing guidelines have no purpose in novel or first of their kind applications. The Board may articulate preliminary tests that the application will be evaluated against, but these tests will undoubtedly be incomplete and may only be completed through the adjudicative process.

Reference: 22. *Should the process for applying for the regulatory treatment of infrastructure investment discussed in this Discussion Paper be more prescriptive (e.g., the timing, sequencing, and/or combining of applications)? Should it be combined with the process for approving infrastructure investment plans? If so, why and in what way?*

74. In the PWU's view, greater regulatory certainty and procedural flexibility are important considerations to encourage infrastructure investment.

75. While the desired end-state is for the Board to be more prescriptive in providing regulatory certainty, the PWU anticipates that the Board's approach to processing applications for the regulatory treatment of infrastructure investment will evolve over time with the benefit of practical experience. Accordingly, the PWU submits that, after the Board has gained a reasonable level and amount of experience it may be able to be

more prescriptive. Until that time, the PWU is of the view that the Board would be better served by providing an adaptive process.

76. The PWU notes that one of the two objectives the electricity distribution infrastructure planning initiative is designed to accomplish is to address regulatory risk by implementing accounting and funding mechanisms which should enable electricity distributors to move forward with appropriate investments relating to the accommodation of renewable generation and smart grid development. While not absolute, the two processes can be combined to take advantage of obvious synergies - the data inputs are the same - and it would be administratively convenient, expedient and cost-effective to proceed on this basis. The PWU is of the view that consideration of the regulatory treatment of the portfolio of infrastructure investments on a blanket basis, to the maximum extent possible, at the time of the approving distributor and transmitter infrastructure investment planning approval stage is a viable option to general rate cases (involving consideration of all of a utility's costs, whether increased or decreased since the last general rate case) and single-issue rate reviews involving consideration of only a capital improvement at a time. However, the option for proceeding with single-issue rate reviews involving consideration of only a capital improvement at a time should be available to the regulated utilities to permit maximum flexibility.

77. For small utilities, the transaction costs of a full rate case (as well as a single-issue rate view) could compare unfavourably or be disproportionate to the size of the revenue increase associated with the likely outcome.

Reference: 23. Should the Board permit applicants to seek approval prior to construction of the facilities to determine whether the facilities qualify for the requested alternative treatment(s)? Why or why not?

78. Yes. In short, there is merit in providing clarity and predictability in the early stage of the proposed project. This type of assurance would greatly assist the project sponsor in securing the needed funding for the project. Such assurance at the early stage would facilitate infrastructure investments that promote particular policy objectives, particularly for major projects whose size, scope and complexity are such that many companies would be unwilling and unable to commit to spend money on the project absent such

assurance. There is significant policy objective in creating a framework that encourages companies to make infrastructure investments to further Government policy objectives.

79. The PWU notes this type of pre-approval does not commit the regulator to cost recovery specifically. In determining whether the project qualifies for infrastructure incentives, the applicant would have to satisfy the Board that its request for specific infrastructure incentives under the Board's rules meets the OEB's standards for infrastructure incentives. Any decision stemming from the review of such an application should only rule on whether the applicant's proposal qualifies for alternative treatment and which treatment will be granted. Board staff does not envision that the decision will generally result in an immediate change in the applicant's rates. The PWU shares this view.

80. Even where the issue before the regulator does not involve cost recovery, a pre-approval process can create a useful template for future consideration of cost recovery issues. As well, considerations of pre-approval actions that do not directly involve cost recovery give the regulator the opportunity to balance multiple factors besides cost.

Reference: 24. What are the implications, if any, of using the single-issue rate review process?

81. The GEGEA provides for Board approval of infrastructure plans. For a project that is not explicitly identified in a Board-approved plan, the single-issue rate review process would provide a utility the flexibility to apply to the regulator outside of the normal rate application cycle for a rate increase as a result of a single capital project. This would provide applicants seeking alternative treatment the opportunity to demonstrate that the project is consistent with the terms of the Board-approved plan. In the PWU's view, given the regulatory cost and burden associated with the use of the single-issue rate review process, its use should be reserved for unusual or exceptional circumstances that are not captured elsewhere in the Board's integrated regulatory framework for electricity infrastructure development and where the utility has no other options for meeting its capital requirements within the context of its financial capacities underpinned by existing rates. The Board would need to establish eligibility criteria for

processing applications under the single-issue rate-review process (e.g., materiality, need, drivers).

Reference: 25. Is the use of rate riders an appropriate approach for implementing rate adjustments associated with the alternate treatments identified in this Discussion Paper? Alternatively, should the adjustments be made directly to base rates?

82. A rate rider is typically a temporary credit or charge approved by the regulator. Delivery rate riders often occur when the actual costs incurred by a distribution and transmission utility to provide electricity service to their customers differ from their approved rates. The possibility of delivery rate riders still remains because distribution and transmission rates are often based on forecasted costs that may differ from actual costs. The imposition of rate riders or surcharges has the benefit of allowing for the recovery of certain specific cost increases without the need for a general rate case.

83. Under the Board's current practice, all or a portion of the rate rider can be converted to base rates in a subsequent rate rebasing application subject to the Board carrying out a prudence review. This practice may introduce a financing risk (e.g., if revenue streams are considered doubtful). Given the long-term nature of the infrastructure assets under consideration, in the PWU's view, it is more appropriate that the adjustments are made directly to base rates.

Reference: 26. Should the Board allow applicants to seek approval of multi-year rate riders or should the applicant be required to apply every year to adjust its rate riders to reflect any changes in project costs?

84. To the extent rate riders are used, the option should exist for applicants to adopt either approach. This issue should be addressed as part of the case by case consideration of infrastructure projects.

4. CONCLUDING COMMENTS

85. The PWU appreciates the opportunity provided by the Board to participate in this consultation process that examines whether alternatives to the current approach to cost recovery from ratepayers for capital investment are required.

86. As indicated in these comments, while the PWU is generally supportive of the incentives identified in the Discussion Paper, the PWU is of the view that, in determining its policy on these issues, consideration of cost recovery policy changes intended to foster timely and appropriate investment in electricity distribution and transmission infrastructure, primarily in relation to infrastructure investments relating to the accommodation of renewable generation and smart grid development, should not ignore the basic principle of cost causality as a means of achieving both economic efficiency and fairness. The PWU believes the incentives should apply to all distribution and transmission infrastructure investments to ensure a level playing field and to mitigate/avoid potential for capital rationalization (e.g., that might impair service reliability, quality and safety).

87. The PWU is cognizant of the newly added objective of the Board relating to renewable generation as contemplated in the GEGEA; however, the Board should exercise caution so that this newly added objective does not undermine the Board's existing objectives of protecting the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service and promoting economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity, as well as facilitating the maintenance of a financially viable electricity industry.

88. In summary, the PWU is of the view the following key factors are crucial to attract investment and commends them for the Board's consideration;

- Have clear rules for cost recovery, and honour them – changing rules creates uncertainty and deters investment.
- Have processes that provide for quick review of new infrastructure proposals and predictable outcomes.
- Have incentives for innovative or riskier proposals, or penalties for missing targets.
- Monitor for and punish “bad” market behaviour, but only through clearly understood rules.

89. The PWU cannot stress more the importance of having clearly and correctly articulated working guidelines and eligibility criteria in relation to the processing of applications for alternative regulatory treatment for specific projects. In this regard, the PWU recommends that the Board issue for comment to interested stakeholders any draft rules, criteria, guidelines, etc. that it develops arising from this initiative prior to finalization and adoption. This added step would minimize the chance for misinterpretation and/or ambiguity of the rules by applicants and contribute to a common understanding by all participants in the regulatory forum

These are the comments of the PWU all of which are respectfully submitted.