

July 7, 2009

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

Via RESS and by courier

Dear Board Secretary:

**Re: Board File No. EB-2009-0152
The Regulatory Treatment of Infrastructure Investment for Ontario's Electricity
Transmitters and Distributors**

The Electricity Distributors Association (EDA) is the voice of Ontario's local distribution companies (LDCs). The EDA represents the interests of over 80 publicly and privately owned LDCs in Ontario.

The EDA greatly appreciates the Board's initiative to consider innovative approaches for the regulatory treatment of infrastructure investments. The attached submission has been prepared in consultation with EDA members at a joint meeting of the Regulatory and Finance Councils. The EDA generally supports the innovative approaches suggested in the Board staff discussion paper as helpful tools that will facilitate distributors' fulfilment of the extended obligations assigned to them by the Green Energy and Green Economy Act (GEGEA), specifically related to smart grid development and renewable generation connection activities.

A central theme in the EDA's comments is that the capital investments for connecting renewable generation and for development of smart grid will simultaneously require investments for replacing the aging infrastructure and for replacing essential system elements in order to maintain distribution system reliability and operability. When such overlapping initiatives are combined into a single project initiative, it would be exceedingly difficult and, in our view, impractical to break down a complex project into 'routine' and 'non-routine' activities for any purpose including recovering the costs incurred using different mechanisms. The separation of activities becomes particularly difficult where 'non-routine' investment drivers are responsible for causing the so-called 'routine' investments. Therefore, the EDA strongly endorses and recommends that the alternative mechanisms identified in the staff discussion paper should be made applicable to all elements (i.e., Routine, Non-routine and GEGEA related activities) of

infrastructure projects that are driven by the need to accommodate the GEGEA objectives, thereby the development of renewable generation and the smart grid.

Further, the EDA agrees with the Board's Chair that more innovative approaches to regulating infrastructure investment are required. To this end, we request that, going forward, the Board continue to take steps to re-orient its regulatory framework and approaches to reflect the fact that the clear intent of provincial policy is to enable electricity distributors to provide truly integrated energy solutions to consumers within their local communities. The EDA looks forward to working with Board members and staff in this regard.

The EDA would like thank the Board for giving the opportunity to provide comments on this important initiative.

Yours truly,

“Original Signed”

William Hawkins
Vice President, Policy and Regulatory Affairs

Attached: EDA submission

dp:

**The Regulatory Treatment of Infrastructure Investment for Ontario's
Electricity Transmitters and Distributors**

Comments on specific questions raised in the staff discussion paper

- 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?**

When it is necessary to foster investment in projects that are beneficial to customers and the investors are wary about investing in such projects because of high regulatory risk, the Board could permit the framework and mechanisms identified in the paper to apply to other rate regulated entities as well.

- 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?**

The EDA members agree with the Board staff’s view that it is neither necessary nor practical to pigeonhole the investments into categories such as “routine”, “non-routine incremental”, and/or “GEGEA-related”. What is important for the regulatory treatment (cost recovery) is to determine the primary driver for any investment initiative but not the “category” of individual sub components of the infrastructure investment.

- 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?**

It would be feasible for the electricity distributors to accommodate an increasing renewable generation in their grid only in an integrated conjunction with the development of smart grid, the replacement of aging infrastructure, and the improvement to system reliability. Therefore, the alternate mechanisms identified in the staff discussion paper should indeed be applicable to all elements (i.e., Routine, Non-routine and GEGEA related activities) of infrastructure projects that are required in fulfilling the extended obligations imposed on distributors by the GEGEA.

- 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?**

The alternative mechanisms identified in the staff paper are expected to strike a balance between the risks faced by a distributor in constructing the infrastructure and the benefits offered by the mechanisms. In this context, the crux of the matter is to identify which of the alternative mechanisms can be applied to the infrastructure investment being made by a distributor given the risks of the investment, not given the source of recovery of such costs. The alternative mechanisms are necessary to provide the much needed regulatory assurance on cost recovery which in turn facilitates timely infrastructure investments for

accommodating renewable generation and development of smart grid. Therefore, irrespective of the path followed for cost recovery, alternative mechanisms should be applied to infrastructure investments.

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?

The Green Energy Act requires distributors to develop a smart grid in order to be able to accommodate anticipated increased levels of renewable generation. To fulfill this mandate, distributors will need to make investments in smart grid technology although it is at an early stage of development. Since new technology is at an early stage of development, an approach of “learning by doing” is crucial in this context.

Further, a key consideration for a distributor’s decision to invest in new technologies is whether or not there is an assurance of cost recovery for the investment being made. As development of smart grid technology is at an early stage of development, it is crucial for distributors to have regulatory assurance in order to be able to make investments in smart grid development. Accomplishing the government’s investment objectives in this area will require it.

Unless and until investments are made proactively, smart grid development will remain stunted and distributors will not be able to fulfill their mandate to accommodate increased levels of renewable generation. Therefore alternative mechanisms should be made applicable to investments in smart grid technology although it is at an early stage of development.

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?

As stated earlier, it is not necessary or in many circumstances ever possible to definitively classify the investments as “routine” or “non-routine”. Instead, what is important is to see what the driver is for infrastructure investment initiatives.

Under the Green Energy and Green Economy Act (GEGEA), distributors will be required to accommodate an increasing level of renewable generation in their grid. Distributors will have to make simultaneous and substantial capital investments to replace aging infrastructure; and to maintain system reliability and operability in conjunction with other investments for connecting renewable generation and for development of smart grid. Further, they will also be required to make investments to deploy smart meters and connect new load as required. In all, potentially, there will be a large capital expenditure plan for most distributors.

The cumulative effect of the capital plan will require distributors to raise a significantly greater amount of capital than they had previously planned (i.e. pre GEA). In the circumstance of most distributors in Ontario, which are government (municipal and provincial) owned, the source of equity capital is ‘Retained earnings’, and thus subject to

limitations that need to be acknowledged. Further, the OEB will recognize that any material amendments to the retained-earnings policies of government-owned utilities has the potential to generate material impacts on the fiscal position of municipalities and the province, with possible tax policy implications.

Given the inherent constraints faced by most distributors in raising equity capital, if faced with capital expenditure obligations that lack flexibility, going forward distributors may be compelled to satisfy these obligations by increasing their leverage beyond their present deemed capitalization as reflected in their rates. This escalation in risk level would in turn decline the credit quality of distributors and increase their cost of capital, an obviously unattractive outcome. Under these circumstances, to avoid increasing leverage and risk to an unacceptable level within their capital structure, distributors may be compelled to inappropriately rationalize their capital expenditures to accommodate certain government-mandated investments while being forced to delay certain other essential reliability-oriented projects because of lack of capital. The alternative mechanisms proposed in the discussion paper, and their permitted application, will be critical to avoid this type of negative scenario in future.

However, if alternative treatment is allowed for all elements (i.e., Routine, Non-routine and GEGEA related activities) of infrastructure projects, it will ensure that all projects get the same priority treatment. On the other hand, if some projects are made ineligible for alternative mechanisms (potential exclusion of “routine” investments), those projects are likely to get the least priority as distributors prioritize their capital expenditure requirements.

Further, it will be highly difficult and impractical for distributors to breakdown multilateral complex projects into routine and non-routine investments for the purpose of applying for the cost recovery of those investments separately through conventional and alternative mechanisms respectively.

Therefore, the EDA recommends that the investments driven by the need to accommodate renewable generation or developing smart grid should be made eligible for the use of alternative mechanisms.

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?

As mentioned above, the alternate mechanisms identified in the staff discussion paper should be applicable to all elements (i.e., Routine, Non-routine and GEGEA related activities) of infrastructure projects that are required to be launched to fulfill the extended obligations imposed on distributors by the GEGEA.

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?

The EDA agrees with the Board staff's view that the Board should not be prescriptive in establishing criteria at this time as it would limit the flexibility of any new policies that may be adopted by the Board in future. Since the Board would review applications on a case by case basis in order to ensure that a balance exists between the risks of a project and the benefits being sought, the Board can make the determination at that time whether the infrastructure investment being made would qualify for the alternative mechanism being sought or not.

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?

Prior to executing high risk projects, distributors should be allowed to request confirmation from the Board that prudently-incurred costs would be included in rates should such a project be abandoned if such abandonment is outside the control of management. In fact, if a project risk is perceived to be high, distributors may not take the risk of starting the project unless there is a regulatory assurance that prudently incurred costs associated with the project will be recoverable should such a project be abandoned for reasons outside the control of distributor's management.

However, if projects which are not initially perceived to be of high risk but later get abandoned for reasons beyond the control of distributor's management, it is unfair to expect the distributor to bear the costs of such a project. The stipulation that distributors, prior to starting a project, have to request confirmation from the Board that prudently incurred costs will be recoverable is unfair because distributors may not have initially perceived the project to be of high risk but due to reasons beyond the control of distributors, a project might get abandoned. This stipulation erects an unnecessary barrier that compels distributors to seek prior confirmation from the Board in respect of all projects.

In order to remove barriers for investing in infrastructure, the uncertainty associated with recovery of costs for high risk projects should be removed to facilitate investments by distributors in such projects.

The EDA therefore recommends providing regulatory certainty that prudently incurred costs associated with any abandoned projects will be recoverable in rates as long as the abandonment is outside the control of management, irrespective of whether distributors have sought prior confirmation from the Board for such recoverability or not.

In addition, and simultaneously, there may be projects that get stranded after being put in to service without completing the expected life of the project. In such an event, distributors should not be expected to bear the unrecovered portion of project costs as long as the reasons for stranding of assets are demonstrably beyond distributor's control.

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?

The EDA believes that this treatment would be appropriate not only for electricity transmitters but also for distributors. The magnitude of investments required by a transmitter and a small distributor would be very different but it could be significant for both of them because of the difference in their sizes. For example, an investment of \$10 million may be considered insignificant by a big company but for a small company the same amount would be very significant. Similarly, an infrastructure project that is considered a major project by a small company is actually treated as a minor project by a big company. Measuring all companies by the same yard stick would mean ignoring the difference in their sizes which in this case would be damaging to certain companies based on size.

Therefore, the EDA recommends that eligibility of this regulatory treatment (including CWIP in rate base during the construction of facilities) for an infrastructure investment be considered based on the proportion of the investment with respect to the company's revenue and with respect to the particular circumstances of the company but not by the simplistic issues like type of utility (i.e., transmitter vs. distributor).

In view of the above, the EDA suggests that the regulatory treatment of including CWIP in rate base during the construction of facilities is appropriate for distributors as well.

Further, the regulatory treatment of including full CWIP in rate base during the construction of facilities would allow distributors to phase in the cost of large, multi-year projects. In addition, this treatment provides smoothing effect on rates as large investments are placed into the rate base over a few years. This regulatory treatment also increases distributors' cash flow thereby mitigating the potential for decline in a distributor's credit quality during a major construction program. Due to the benefits offered by this treatment, distributors would be confident to raise the much needed capital for large infrastructure investments. Therefore, the EDA recommends that distributors be allowed to include full CWIP in rate base during the construction of transmission facilities for large infrastructure investments.

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?

Adjusting the depreciation to match a contract term of the connecting renewable generation facility would ensure that distributors completely recover the costs incurred, especially if the contract term is consistent with the useful life of the generation facility. For example, if connection facilities for a renewable generation are expected to last for 30 years but the useful life of the lone generation facility that is being connected to the system is only 20 years, matching the period of depreciation with the contract term of the generation facility would ensure that all costs incurred in providing the connection facilities are recovered. This treatment ensures fairness among all stakeholders by providing intergenerational equity by allowing distributors to recover costs of the project from the rate payers who have used the facility. In addition, project specific depreciation would improve utility's cash flow situation. Therefore, utilities should be permitted to propose project-specific depreciation.

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

Legislation may mandate infrastructure investments but it does not provide the capital required for projects. If the required capital is to be raised by distributors for investing upfront in infrastructure projects, new mechanisms and incentives will be necessary to permit distributors to raise necessary capital for building the needed facilities.

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?

The Board should permit utilities to propose a project specific ROE in order to make the projects more attractive. This will enable distributors to raise the required capital.

The ROE should be based on the risk of a particular project and it is highly difficult to propose either a range or a generic ROE adder without a complete understanding of the project risk. Therefore, the Board should determine an appropriate ROE on a case by case basis based on the project risk.

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

As mentioned in the answer to question 6 above, distributors face potential limitations in sourcing the equity capital necessary for infrastructure investments. Therefore, it would be beneficial for distributors to have the flexibility to refinance or employ different capitalizations as necessary to source the capital for new projects. The EDA agrees with the Board staff that project specific capital structures have the potential to be effective in raising capital for large infrastructure projects in a variety of ways.

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

The alternative mechanisms suggested in the staff discussion paper attempt to remove barriers to long term investments. In addition, the Board is requested to consider providing regulatory certainty in respect of Technology Investment by allowing recovery of stranded costs for replacing legacy systems with new technology. Legacy systems, although functional with remaining useful life, may become obsolete in time because of rapidly changing technologies. The obsolete equipment requires replacement with new technology for the purpose of improving efficiency and effectiveness of the overall distribution system. Therefore it is imperative that the Board consider allowing recovery of stranded costs for replacing legacy systems with new technology.

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?

Potential considerations identified in the staff discussion paper cover a number of key aspects that the Board should consider when reviewing applications for the alternative treatments. However, the dialogue should remain open to incorporate lessons learnt along the way as we proceed with the implementation of new mechanisms.

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

Performance conditions should not be prescribed unilaterally but should be tailored to the nature of the project (risk) and the specific mechanism requested while minimizing administrative burden on distributors. Generally, performance conditions should only be required if an early recovery mechanism is in place.

18. Are the reporting requirements suggested appropriate and adequate?

The new reporting requirements should be such that only essential information is collected for monitoring various projects. The new reporting requirements should not become an onerous administrative burden to distributors.

In addition, the new reporting requirements should be conjoined with the existing reporting requirements so that all necessary information is filed by distributors at the same time and through the same existing process rather than at different times of the year.

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?

It is important to note that the new infrastructure investments are mandated by the Province. In addition, most distribution utilities are owned and governed by governments who have direct interest in ensuring the interests of their constituents (i.e., rate payers) are protected. The OEB and stakeholders should recognize and take comfort in this fact and take steps to avoid prescribing unnecessarily restrictive conditions that would prevent or delay the infrastructure investments that distributors are mandated to make.

The conditions to be imposed by the Board at the time of approval should be based on the nature of project risk and the type of alternative mechanism approved for the project. There should be no additional conditions required to be established at this time.

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?

As mentioned above, electric utilities in Ontario are for the most part, publicly owned institutions and the rate payers interests are protected by their shareholders. Therefore, it is not necessary to restrict the utilities by prescribing overabundance of tests and conditions.

The test for applicants to meet should be based on the nature of the investments for which an alternative mechanism is required. No new or additional tests need to be prescribed at this time.

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?

The existing filing guidelines such as Filing requirements for distribution rate applications; for rate adjustments based on 2nd and 3rd generation IR plans; and the initial filing guidelines for filing distribution system plans, are extensive and adequately support the case-by-case approach that the Board would consider.

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?

The process of applying for the regulatory treatment of infrastructure investment should not be any more prescriptive than what it already is. Being more prescriptive in nature has the potential to stifle innovation and delays initiation of projects. The application process and the timing of application identified in the staff discussion paper are appropriate for now.

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?

Prior to executing projects, distributors should be allowed to request confirmation from the Board to find out whether the facilities qualify for the requested alternative treatment. This process would provide the necessary regulatory certainty for the recovery of costs that would be incurred on those projects. Upfront regulatory assurance encourages distributors to raise the capital for investments in infrastructure projects.

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

Using the single issue rate review process would be beneficial in encouraging infrastructure investments. The Board should consider project-specific applications dealing with rate making implications of a new project without re-opening the entire base rates for review. This would enable clearing of project specific applications expeditiously.

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?

Use of rate riders during an IR year (Incentive Regulation Period) is an appropriate approach for implementing rate adjustments associated with the alternative treatments. This approach

smoothes out rate impact and also provides utilities with the required cash flow for investments in infrastructure. In addition, it provides regulatory certainty that is so essential for starting new infrastructure projects.

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?

The EDA agrees with the Board staff that distributors should be permitted to seek multi-year rate riders, for multi-year projects, designed to increase over time through automatic step increases according to a pre-determined schedule. This approach would increase cash inflows to utilities as their project costs increase. In addition, this would provide regulatory certainty of cost recovery in time and encourages distributors to facilitate infrastructure investments.