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VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
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Dear Ms. Walli:

Re: EB-2014-0138 – Comments of the Vulnerable Energy Consumers Coalition (VECC) Review of the Board's Policies and Processes to Facilitate Electricity Distributor Efficiency: Service Area Amendments and Rate-Making Associated with Distributor Consolidation

Please find enclosed the comments of VECC in the above noted proceeding.

Yours truly,

Michael Janigan
Counsel for VECC

cc: OEB - Ashely Hayle - AshleyDawn.Hayle@ontarioenergyboard.ca

EB-2014-0138

ONTARIO ENERGY BOARD

Review of the Board's Polices and Processes to Facilitate Electricity Distributor Efficiency: Service Area Amendments and Rate-Making Associated with Distributor Consolidation

General Comments

1. The Vulnerable Energy Consumers Coalition (VECC) welcomes the opportunity to provide its views on the development of OEB policies with respect to service area amendments. The issue is clearly of interest to the Ontario Government's as shown by the establishment of the Ontario Distribution Sector Review Panel. Changes in ownership of utilities and the associated costs and potential savings of these transactions have a direct impact on customers and are especially important to ratepayers of limited means.
2. Our submissions are organized in accordance with Board Staff's questions and by the separation of the issues of Service Area Amendments and MAADS related rate issues.

Service Area Amendment Issues

What are the benefits of an "open for competition" approach to un-serviced areas? How would the Board implement such an approach in light of section 28 of the Electricity Act, 1998 and existing licence conditions? Under an "open for competition" approach: (i) how will the Board ensure that all prospective new customers will receive an offer to

connect on fair and reasonable terms; and (ii) how should the interests of Incumbent Distributors and their ratepayers be taken into consideration?

1. It is unclear what provisions of s.28 of the *OEB Act* Board staff are implying might preclude the Board from choosing a particular utility to service an unserved area. Hydro One Inc.'s (Hydro One) licence establishes that it serve all areas which are not already within another utility's licence service territory. However, this is a matter of practicality not government or Board policy. There is no legislative or regulatory restriction which prohibits the Board from granting a licence to a new or existing distributor. All utilities have an obligation to connect unserved customers. No customer has an obligation to accept this offer. They may seek out alternatives.

2. While the Board has a policy which discourages overlapping licence territory we are unaware of any similar legislative prohibition. In our view it would be perfectly reasonable for the Board to grant a licence to a non-incumbent utility where it believed the incumbent's construction of plant or expansion of service was not safe, efficient or in the interest of a Regional Electricity Plan. Such conditions might easily arise in new suburban developments which abut the distribution plant of an urban utility. The incumbent (usually, but not always Hydro One) does not have a "right" to new customers but must make them an offer to connect. The customers (developers) are within their rights to ask whether the offer is reasonable in light of any alternatives. When this leads to a dispute as to who is best suited to serve the Board has the obligation to hear and arbitrate the matter. It may determine that the least cost solution is in the public interest or it may decide that there are other

factors, such as the impact on the incumbents existing customers that need to be considered. Deciding such matters should be done on the basis of facts. The Board cannot, we would respectfully argue, preclude the possibility of competing offers for service on some generic policy basis.

3. The Board should also be wary of arguments that postulate some form of "death spiral" where the incumbent speculates that by denying it new customers what is left are only those customers who are costly to serve. This is incorrect. Not serving a new customer doesn't make a utility worse, or better off – it simply maintains the status quo.

Should the Board's SAA policy facilitate SAAs that have the effect of aligning a distributor's service area with municipal planning boundaries and, if so, in what way?

4. No. One of the fundamental changes that occurred in the electricity sector in the late 1990's was the corporatization of the electricity utilities. This remains the legislative policy of Ontario. Inherent in that policy is the separation of the municipal and utility construct. Clearly municipal planning can have an impact on the need for electricity distribution. However, the most efficient electricity distribution service is usually based on the physical location of existing plant and service centres regardless of which municipality they are located in.

5. If not for the historical origins of electricity distribution as a function of municipal departments the organization of Ontario's electricity distributors might be considerably different today. Such is the case with natural gas. Even in the short span of 15 years many would find it difficult to imagine

an urban center like Toronto being served by the multiple of utilities that once existed. There is no alignment of municipal interests with electricity distribution and no need, nor policy directive, to make one. Arguably the purpose of the change in electricity distribution corporate structure was to eliminate electricity distribution from the toolbox of municipal politics. We don't think the Board should consider steps which move back in this direction.

What role should municipal planning, community energy plans and regional planning have in the SAA process?

6. It is important not to confuse issue of regional electricity planning with those of municipal planning. The purpose of the former is, in part, to meet the needs of the latter. Municipal planning focuses on the criteria, rules and regulations that will guide development. This is not the same as the actually building of industries and homes. Clearly distributors must keep themselves aware of municipal planning and actual developments in order to anticipate new investments.
7. The Regional Energy and other energy related plans are clearly matters for utilities to keep abreast of.
8. While both are important aspect of a utility's planning process we do not think they impact the issue of SAAs or MAADs. The question itself causes pause. It appears to imply that some utilities (small ones presumably) are less able to meet external planning requirements. Some smaller utilities might be challenged to meet the obligation of regional electricity plans or

new customer developments. The same might be said for the vast number of other regulatory obligations Ontario utilities have needed to respond to over the past 15 years. However, so long as the distributor is meeting its licence obligations these matters should not be of concern.

9. We believe that good public policy is that which accommodates well-functioning utilities who offer good service at reasonable rates to their customers. Notwithstanding the provisos expressed (in different ways) by both distributors and intervenors, the diversity of electric distribution utilities serves the Board by allowing it to compare efficiencies within Ontario. Some of Ontario's mid-size and small utilities offer compelling examples of good service at reasonable prices. The public interest in general would not be well served if the diversity of distributors shrinks simply because a utility collapses under the weight of ancillary regulations.

How can the Board be satisfied that the process will ensure that the connection of new customers proceeds in a timely manner?

10. An important principle to be considered in a service area amendment application is the <u>actual</u> need for service. Utilities should not be allowed to "capture" service areas in advance of a real and clear requirement of customers.

11. The Board might also consider whether an offer to connect should include communicate to those involved a process for resolving connection disputes and competing offers. Of course, this recommendation is

premised on the Board developing a standardized SAA process. Such a process need not be overly complicated.

MAADS Related Rate Issues

What are the merits and risks of allowing a consolidated entity to set its own rebasing deferral period? Should the Board establish a "default" minimum deferral period and, if so, what should the length of that deferral period be?

12. Board Staff have raised a number of questions regarding the application of rate to proposed or recently merged or acquired utilities. As we have noted in past proceedings VECC has a number of concerns with these transactions.

13. The costs of mergers and acquisitions are usually well articulated and easily accounted for. As such they are readily available to be recovered from ratepayers. Savings are much more ephemeral. Savings are acquired over time, if at all. They are intertwined with other changes at the utility. In the end it may be difficult to determine whether there are any net savings to ratepayers. Utilities themselves recognize this problem. In a recent application PowerStream Inc. had has this to say:

> Each year it becomes increasing difficult to precisely analyze the merger savings due to organic growth and the impact of government, regulatory and other changes to the business. In order to complete our analysis of the merger savings we reviewed the savings we projected to achieve in 2011 and beyond that were considered "ongoing". (Exhibit D1/T1/S3/pg.3 – EB-2012-0161).

14. We are also concerned by what appears to be a prevailing notion that large utilities are by the very fact of their size more efficient than small ones. Notwithstanding the suggestion raised in Report Renewing Ontario's Electricity Distribution Sector ("The Report"), there is little hard evidence of long-term savings when large utilities take over small ones.

15. The Report's support for mergers is in our view based on a flawed analysis. It erroneously suggests smaller utilities are less efficient than larger ones using non-adjusted OM&A comparisons to support this thesis. In fact, as the Board has heard from many utilities, differences in accounting and most notably in capitalization policies can skew utility-to-utility OM&A comparison. The size of a utility's capital program can have a similar effect.

16. The Report misunderstands how utilities pay for transformation services and it generally ignores the ability of small utilities to capture economies of scale through outsourcing and utility-to-utility cooperation. It suggests that small utilities pay higher interest costs while making no allowance for the fact that many (if not most) of these utilities have capital structures characterized by large unfunded long-term debt (i.e. there long-term debt is notional). The result is that it implicitly compares the short-term debt costs of small utilities with the long-term debt costs of large ones.

17. Among its other shortcomings the Report confuses the issues of resource indivisibility (plant/per maintenance crew) with economies of scale. Finally, it does not even consider whether there are diseconomies of scale

in consolidations. Clearly there are. Ontario's largest LDCS have larger bureaucracies and higher compensation rates due, in part, to their highly unionized labour force.

18. The Board, which examines these issues in detail in its proceedings has an obligation to the public interest to consider only the facts. It should not rely on rhetoric which presumes economies of scale without actually demonstrating them.

19. The facts are that many small to mid-size utilities earn comparable rates of return and have lower customer rates than many large utilities. They provide just as good service and arguably offer a closer and better customer experience.

No Harm Test (VECC)

20. Utility Regulation expert Scott Hempling describes "utility harm" in the following manner: "[I]n *the public utility context, "harm" means "failure to act cost-effectively." Having received protection from competition, a utility must perform as if subject to competition. It must make all feasible, cost-effective efforts to reduce costs and increase quality. Diverting resources from more productive use—incurring what economists call "opportunity cost"—fails this test. This opportunity cost principle applies to mergers in two distinct situations. What if a merger precluded some other utility action, including some other merger, that would have yielded more customer benefits? Further, what if a commission approved the merger subject to conditions allowing the applicants to keep gains they'd have*

given customers willingly? By approving these transactions, the regulator denies customers benefits they'd have received had the utility been subject to competition. That denial—keeping prices above or quality below competitive levels—is harm. (http://www.scotthemplinglaw.com/essays/no-harm-vs-positive-benefits)

21. In VECC's view there is merit in considering this perspective. It argues for finding positive benefits in a transaction.

22. As VECC has argued previously (see Norfolk Power Inc.-Hydro One Inc. EB-2013-187/196/198) that the No Harm test must be considered from the perspective of both the acquiring and acquired customer's basis. As noted above the Test should include a long-term perspective. As we noted in the Norfolk proceeding, if the Board does not take a long-term perspective it sets up the conditions for utilities to game customers by offering short–term discounts to mask long-term negative impacts.

23. Labour is a large cost to utilities. The Board's no harm test should consider the impact on customers if the acquiring utility has a higher compensation per FTE ratio than the target utility. If so then it is legitimate to ask whether this cost structure will ultimately be visited upon the newly acquired ratepayers. That would be harm.

24. VECC is also concerned with promises of short term rate freezes which tempt both the regulator and ratepayers. In our view these are often inducements with short term benefits made in exchange for long-term higher costs.

Is rate harmonization in the public interest (VECC Question)

25. In VECC's view, before the Board considers what rate making or rebasing scheme might apply to the transacting parties it should consider whether the harmonization of rates is itself in the public interest. In fact, the question of harmonization is seldom raised at the time of a MAAD's transaction and if raised seldom answered definitely.

26. In its work on benchmarking the Board has heard from utilities that there are unique characteristics which make comparing costs difficult. Experts have described a number of these differences including geographical terrain ("rocks and trees"), age of system, customer density, and underground or overhead circuit design. When utilities merge and seek uniform rates these distinctions, once held near and dear as a way to avoid comparison, appear to become irrelevant to the discussion of whether once distinct groups of ratepayers should now share service costs.

27. There is a clear logical inconsistency in respect to rate harmonization arising out of MAADs transactions. If a utility is sufficiently different as to have rates accepted by the board based on different "unique" costs why would one then assume these factors disappear when utilities are consolidated? If for example (and in the abstract) one accepts that the rates approved for Gravenhurst Hydro include an inherent higher costs due difficult terrain and lower customer density, then it is not clear why the customers of Ajax should be forced through a rate harmonization scheme

to subsidize Gravenhurst customers simply because Veridian Connections chose to acquire that Utility. To not consider this question is to implicitly assume a singular provincial wide distribution rate is a just and reasonable rate and in the public interest.

28. Often rate harmonization appears to be taken on faith as being clearly in the interest consumers. In other MAAD applications the question of harmonization is avoided under the guise that the decision has not yet been made. Almost always the utility will return to ask the Board to harmonize the rates with an explanation that the cost allocation and billing requirements are too cumbersome and expensive to maintain. We think this issue should be addressed directly in a MAADs application and its potential for harm to some ratepayers considered.

29. As we argue below a MAADs proceeding is not a rate application. However, in the context of an acquisition the issue of rate harmonization is about the future intention of how a utility intends to operate. As such it is clearly within the scope of the proceeding. In VECC's view the issue of rate harmonization should be given greater scrutiny at the time of utility acquisition.

What are the merits and risks of allowing a consolidated entity to set its own rebasing deferral period? Should the Board establish a "default" minimum deferral period and, if so, what should the length of that deferral period be?

30. We are somewhat confused by this question and the remainder of the questions on rate setting. Change in ownership is subject to s.86 of the

OEB Act. That proceeding does not set rates. The question of whether rates are just and reasonable must be made on its own merits.

31. The Board has used the "grace period" policy in MAADS transaction to allow the utility to make extra-ordinary rates of return (over earn) – something that would not normally be allowed under the just and reasonable rate standard. This is done in recognition of the upfront cost of the transaction (a period during which it may under earn) and to provide an incentive for utilities to make efficient cost savings transactions. A utility cannot make the decision as to how long it will be allowed to over earn because it is not allowed to regulate itself. A utility may propose to the Board a period other than a default established by the Board. In our view this is a legitimate option. Different transactions will have different costs and benefits. The Board should consider alternative proposals on their merit.

32. The second part of this question is whether the Board can reasonably establish "grace periods" which makes an *a priori* promise not to scrutinize the rates (rates of return) of a utility. While this may be possible in law, it would be in our submission unwise as a matter of good regulation. A ratepayer has the right to expect rates based on the opportunity of a utility to make a <u>reasonable</u> rate of return. When that standard is being put aside to further long-term benefits for consumers there still remains the expectation that regulators are knowledgeable in having weighed the public interest – in this case how long the ratepayer must pay more than

costs would dictate. To meet that expectation the Board must satisfy itself that the potential long-term savings outweigh any short-term higher rates (overearnings). We are unable to see how this can be done by "default" and in the absence of information about the potential savings, actual costs and the timing of both.

Once a consolidated entity has proposed a rebasing deferral period, should it be required to wait for the entire period before applying for a rebasing of its rates, or should it be allowed to apply for rebasing at any time within the proposed period? What are the merits and risks of each approach?

33. As a matter of law we do not think the Board can preclude a utility from making an application for rate relief. The Board's policies are non-binding on the adjudicative panels of the Board. This is as it should be since general policies cannot anticipate all events and extenuating circumstances. Presumably a utility proposing to change (raise) rates sooner than it implied, or promised as part of a MAADs proceeding would suffer great scrutiny.

34. We note that in the similar circumstance when a competitive company fails to meet the expected benefits of an acquisition or amalgamation earnings fall, the market returns are discounted, and senior management often let go. In our view, in a case of a "failed" transaction the Board, as a proxy for market discipline, might consider applying a lower rate of return than the default used for ratemaking. The same might be said for a utility found

not have met the efficiency objectives it proposed to the Board as part of an ownership change transaction.

35. We also note (as we have stated in previous s.80 applications) that the rebasing options in the existing Board policy are with respect to consolidated utilities. As we have discussed above we are concerned that the Board's current policies are premised on the assumption that all changes in ownership must result in a consolidated utility with a uniform rate class. This is not correct. The Board is under no obligation to approve a single corporate structure. Nor does it have an obligation to accept a single rate class system even if a singular corporate structure or licence is approved.

Concluding Comments

36. In our view there is a public policy enthusiasm for consolidation that is not matched by the facts as to what is in the interest of ratepayers. Certainly there will be cases in which consolidation brings benefits to consumers. Some applications will be based on other motivations. The Board has the responsibility to distinguish between the two.

DATED AT TORONTO, MAY 7, 2014