

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15, Schedule B;

IN THE MATTER OF a generic proceeding initiated by the Ontario Energy Board pursuant to section 74 of the *Ontario Energy Board Act, 1998* to amend the licenses of electricity distributors to make provision for methods and techniques to be applied by the Board in determining distribution rates for licensed electricity distributors.

SUBMISSIONS OF BOARD STAFF

Position Summary

Board Staff submits that:

1. **Regulatory Efficacy.** The Board's approach of promulgating codes to establish methods and techniques for the calculation of distribution rates enhances regulatory consistency, predictability, rigour and efficiency.
2. **Jurisdiction.** The Board does have the jurisdiction to proceed in promulgation of codes to apply to the setting of distribution rates through amendment to distributor licences.
3. **Recommendations for Proceeding.** The issue of the authority for, and appropriateness of, the proposed method for setting distribution rates through codes and licence amendments is unlikely to be resolved in the short term. At the same time there is a need to get on with establishing distribution rates for 87 distributors to be effective May 1, 2007. In these circumstances, Board Staff recommends that the Board discontinue the code-based approach and therefore discontinue this hearing. The work underway in the two related code proceedings should continue in the form of promulgation of filing guidelines for 2007 distribution rates. Time is of the essence and the Board should take these steps quickly.

With discontinuation of this proceeding, further determinations herein, including determination of jurisdiction, would not be required. Board Staff

submits that the Board should nonetheless, in some other manner and in due course, proceed to final determination of the issues raised by the parties regarding jurisdiction. Board Staff does not recommend that the Board abandon the code-based approach in the longer term.

Background

For the 2006 rate year, distribution rates were set in accord with the 2006 Electricity Distribution Rate Handbook (the “2006 EDR Handbook”). This handbook effectively constitutes guidelines under which electricity distributors were expected to file applications to set distribution rates for 2006.

The Board is currently engaged in a number of initiatives aimed at achieving greater consistency, rigour and regulatory certainty in the filing for, and approval of, distribution rates.

Thus the Board is undertaking a number of studies, the outcomes of which will inform a 3rd generation incentive mechanism for setting and adjusting electricity distribution rates. These studies include:

- Cost allocation
- Comparators and cohorts (Phase 2)
- Distribution rate design (including smart meter rate design)
- Asset management, depreciation and working capital
- Line losses and distributed generation

It is currently anticipated that these studies, and the 3rd generation incentive mechanism to set distribution rates that will be informed by these studies, will be completed during the 2008 to 2009 period.

In addition, the Board has embarked on a plan for setting distribution rates for the period 2007 through 2010 (the “Plan”), of which this proceeding forms a part. On April 27, 2006 the Board issued a letter to all licensed electricity distributors regarding the Plan. The objectives of the Plan were stated as including the objective *“to provide greater regulatory certainty to distributors during 2007 to*

2010 as several rate-related studies are carried out". In its April 27th letter the Board determined that to achieve its objectives, the Board needs to, among other things:

1. confirm the cost of capital to be used in adjusting annual revenue requirements for 2007 and beyond; and
2. establish a simple, practical and mechanistic incentive rate adjustment mechanism for the Plan period.

The Board stated that important design criteria for this project would include "*consistency of approach across distributors*" and "*ease of implementation by distributors*".

The Board's Plan is described in the April 27th letter as a process under which:

- mechanisms and principles for an incentive regulation mechanism and for establishing cost of capital for the Plan period would be developed, and codified; and
- the resulting codes would be applied to set distribution rates during the Plan period through the mechanism of distribution licence amendment.

In EB-2006-0088 (cost of capital) and EB-2006-0089 (2nd generation IRM) the Board is reviewing the aforementioned mechanisms and principles for codification.

By Notice of Proceeding and Notice of Hearing dated July 7, 2006 the Board, of its own motion, commenced this generic hearing to amend the licences of electricity distributors to incorporate the mechanisms and principles for determination of cost of capital and 2nd generation IRM. The Board invited submissions on the proposed amendments.

The Board received a number of submissions which address a broad range of issues regarding the Plan. Many of the submissions address the jurisdiction of the Board to proceed with the Plan. In particular, many of the submissions

contend that the Board does not have jurisdiction to proceed with the Plan, and/or that proceeding with the Plan would be bad regulatory policy.

By Procedural Order No. 2 dated November 8, 2006 the Board has invited Board Staff and any party that did not address the jurisdiction issue to do so.

Regulatory Efficacy of the Board's Approach

Application of the codes would enhance consistency, predictability and regulatory certainty in determination of distribution rates, both across distributors and as between different decision makers within the Board. Policy issues would be generically determined and consistently applied.

Consistent application of the codes, including of generically determined policy issues, would enhance the timeliness of rate determinations. Filings would be more focussed and consistent. A standard set of filing requirements could be developed on a relatively detailed basis, which should facilitate preparation by distributors of filings in support of rate applications. Review of consistent materials would be faster, providing for timely rate determinations. Consistency among distributors would provide certainty to distributors and other interested parties.

A relevant question is whether codes and licence amendments are required to achieve consistency and certainty, or whether the Board can and should continue to rely on guidelines in pursuit of these objectives.

In many respects, the code development process has been similar to the process used for development of the 2006 EDR Handbook. Both processes involved open consultation. Both processes pursued the objectives of standard form rate filings and determination of rates on a consistent basis across distributors and as between different Board decision makers. The main distinction between the Plan process currently proposed and the 2006 process is that the codes proposed to be used under the Plan process set out methods and techniques for distribution rate calculation that would bind the Board, whereas the guidelines were not binding. It is Board Staff's view that the use of binding instruments would provide

greater clarity, consistency, rigour, definition and expediency to the distribution rate setting process, and would thus produce rates that were just and reasonable, and that were derived from a sound and consistent application of relevant policy.

A number of the interested parties, in their previous submissions herein, asserted that codification of methods or techniques for setting distribution rates makes bad regulatory policy. The point seems to resolve to a concern that such formulaic determinations could result in rates that were not just and reasonable in the case of any particular distributor.

To the extent that a party considered that the application of the methodology set out in the codes would not yield just and reasonable rates, recourse would be available. Under section 74 of the *Ontario Energy Board Act, 1998* (the "Act") any person may apply to amend a licence. The Board may amend the licence if it determines that it is in the public interest to do so, having regard to the objectives of the Board and the purposes of the *Electricity Act, 1998*. In such instance, the applicant would have to make clear and focussed argument as to what departures from the codes were justifiable. This would impose a measure of rigour and discipline.

Board Staff is of the view that the Board's Plan constitutes good and sound regulatory policy and includes appropriate procedural safeguards. Implementation of the Plan would enhance consistency and regulatory predictability and certainty in determination of distribution rates, both across distributors and as between different decision makers within the Board. Consistency in particular, including consistency in the application of policy, would enhance the timeliness of rate determinations, and regulatory certainty for distributors, ratepayers and other stakeholders.

Jurisdiction

The jurisdictional basis for the Board's Plan is sections 70 and 70.1 of the Act. The operative provisions state that:

- The conditions of an electricity distributor's licence may specify methods or techniques to be applied in determining the licensee's rates.
- The Board may issue codes that may be incorporated by reference as conditions of a licence.

Pursuant to these authorities, the Board has proposed to specify the methods and techniques for determining cost of capital, and adjusting distribution rates from year to year, in two codes. The codes would be issued and incorporated by reference as conditions of distributor licences. The Act (section 70.2) provides that prior to issuing the codes, the Board must provide notice of its intention to issue the codes, provide interested parties with reasonable opportunity to make written submissions on the proposed codes, and issue the codes only after consideration of submissions received.

A number of parties have argued that binding codes (presumably as distinct from the 2006 guidelines) improperly "fetter the discretion" of the Board in a manner that exceeds the Board's jurisdiction.

Board Staff notes the recent decision of the Supreme Court of Canada in *Bell Canada v. Canadian Telephone Employees Association*¹, in which the court made the following observations respecting "fettering of discretion" through the use of binding statutory guidelines:

In oral argument, counsel for Bell stated repeatedly that the guideline power "fetters" the Tribunal in its application of the Act. This assumes that the sole mandate of the Tribunal is to apply the Act, and not also to apply any other forms of law that the legislature deemed relevant – such as guidelines. This assumption is mistaken. If the guidelines issued by the Commission are a form of law, then the Tribunal is bound to apply them, and it is no more accurate to say that they 'fetter' the Tribunal than it is to suggest that the common law 'fetters' ordinary courts because it prevents them from deciding the cases before them in any way they please.
[Paragraph 35]

¹ [2003] 1 S.C.R. 884

In light of this recent ruling, it is submitted that the issue of “fettering” only arises when the legislature did not intend to authorize the instrument in question to be binding on the decision maker. In this case, the legislature has expressly provided the Board with the power to promulgate codes and associated licence conditions specifying methods or techniques to be applied in determining distribution rates.

Recommendations for Proceeding

The Plan for determining distribution rates constitutes good and sound regulatory policy. The Board’s jurisdiction to proceed with its Plan is clear. However, Board Staff is concerned that the process is currently stalled in debate about jurisdiction. Board Staff is concerned that debate about the authority of the Board to proceed using a code-based approach is apt to delay, to an undesirable extent, the setting of rates for electricity distributors. This state of affairs presents real concern in respect of establishing distribution rates in a timely manner to be effective May 1, 2007. In the result, the objectives of providing predictability, consistency, ease of implementation and timeliness in the setting of distribution rates during the Plan period are no longer being served by the current process.

In the current circumstances, it is the view of Board Staff that the Board would be better advised at this particular time to proceed with a process that is more familiar to the industry and other parties, and thus capable of expedited implementation. Board Staff thus recommends that the Board discontinue the code-based approach, and therefore this hearing, and proceed by way of guidelines rather than codes.

The code development process has already provided interested parties with opportunity to ask questions, to provide and explore the merits of various expert opinions and to make submissions. The Board can easily leverage the extensive work already done in that process and proceed directly to finalize a set of guidelines for establishment of 2007 distribution rates.

Time is of the essence and the Board should take these steps quickly.

With discontinuation of this proceeding, further determinations herein, including determination of jurisdiction, would not be required. For the reasons articulated above, Board Staff believes that the code-based approach has considerable merit. Board Staff therefore recommends that the Board should, in some other manner and in due course, proceed to final determination of the issues raised by the parties regarding jurisdiction, so that all of the regulatory tools available to the Board can be fully and efficiently utilized in the future. Board Staff does not recommend that the Board abandon the code-based approach in the long term.

All of which is respectfully submitted.

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