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Ontario Energy Board
27th Floor
2300 Yonge Street
Toronto, Ontario
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October 20, 2006

ATT: E. Kirsten Walli, Board Secretary

Dear Ms Walli,

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.

EB-2006-0087

In accordance with the Procedural Order No 1 dated October 6 2006 ECMI submits its comments with respect to the above noted matter.

In examining the topic of codification of processes, ECMI will attempt to discuss this activity on the basis of:-

- The current process
- The advantages of a Code
- The obligations under the creation of a code
- Contrast with a hearing
- The advantages of a hearing over a Code
- Apparent systemic bias
- Conclusions

ECMI considers it inappropriate to utilise a Code process to determine whether Code are an appropriate way for the Board to fulfil its regulatory functions.

Further it is inappropriate to determine whether a Code is an appropriate process when the Codes have not been developed. The current process is such a fundamental departure from generally accepted regulatory processes that it requires a more substantive process than the one currently offered by the Board. The expertise and the witnesses required to support or refute the process are so fundamentally different from those required to comment on the cost of capital proposal that the current process is not sufficient to permit a proper examination.

The submissions under the current process are not evidence. They are neither provided under oath nor subject to cross examination under oath. Such cross examination permits examination of not only real evidence but examination of the reasons for the stated evidence and the validity of those reasons.

What this process needs to determine is not whether or not the Board has the right to do something but whether the proposed process mitigates the ability of the Board through the process to fulfil its obligations under the law. If it does, then it is a flawed process and should not be pursued. Even if the Board has the legal right to use such a process, it should not do so.

It is ECMI's view that at the very least the current process requires a hearing to determine whether the proposed codification itself is outside the law. Such a hearing would permit the creation of evidence that is sufficiently transparent as to permit an evaluation which might permit a determination of the validity of the process.

It is important that the Board be permitted to establish Codes which govern the day to day activities of the regulated entities. The Distribution System Code, for example, outlines the principles that will be utilised by a regulated entity in fulfilling its statutory obligations. The orderly operation of the day to day activities of regulated entities was clearly the intent of providing a statutory basis for establishing Codes.

The establishment of a Code should not be so prescriptive as to preclude the proper and fulsome consideration of the merits of additional considerations which would produce a different answer.

The statutory creation of a right to establish Codes is not done in a void. This is particularly true in the case of administrative tribunals. Administrative tribunals under natural law have a duty to consider what is put before them and respond with reasons. Those duties are to ensure to the extent practicable, a transparent process to the benefit of those regulated as well as those being notionally

protected by such regulation. When one considers the statutory provision for the establishment of Codes, the obligation for the Board to publish draft Codes and consider the responses is not done in isolation of the transparency obligation and benefits. The Board has not demonstrated its compliance with the statutory consideration obligation unless it provides the reasons for its decisions with respect to the ultimate Code and publicly documents the consideration process that resulted in the ultimate Code.

During this current process, it was suggested that Board Staff recommendations to the Board are not public documents. This invokes a veil of secrecy over the process which mitigates against its transparency and credibility. Errors in any private submissions to the Board reduce the credibility of the Board itself. Failure to disclose the full process leaves such errors hidden from public scrutiny. This is a travesty against those regulated and an affront to those whom the regulation purports to defend.

Unlike Codes, hearings deal with LDC specific matters and matters which are not sufficiently universal to be codified. The outcomes of the hearing process, whether it be a PBR regime or a specific rate application have implications for individual customers or groups of customers as opposed to all of the customers within the Board's jurisdiction.

The apparent need for many "Z" factor considerations in the Cost of Capital process demonstrates that codification of this process is unwise. The absence of clear rules for Z-factor consideration may not be satisfactorily addressed. An ad hoc approach responding to individual cases differently mitigates any benefits flowing from a codified process. Further, the use of Z factors may result in more applications for specific consideration requiring more hearings to consider and establish appropriate action. It is possible to liken the excessive use of Z factors to the application of patches on a balloon. The more patches applied, the greater risk of leakage and greater difficulty in finding the leak.

The rules of evidence associated with a hearing are clear and permit not only examination of the evidence but the underpinning rationale for the evidence submitted during the hearing process. A hearing process on an item such as rates may permit full examination of the impact of a proposal on individuals affected by that rate which a Code process may preclude other than through an appeal to the Board as to the application of the Code. If the Code is in any way unclear, then the determination or interpretation under the Code may not be based on the common regulatory considerations applied to other regulated entities under that same Code. Such inconsistency does not provide good regulation.

In examining Board processes, it is apparent that a systemic bias on the part of the Board should not exist unless there is a robust statutory underpinning of that bias and in fact for a fundamental bias to exist, ECMI would submit that there needs to be a clear and irrefutable statutory duty for such a bias.

Regulatory experiments are risky for regulators, for those who are regulated by them and for the customers the regulator is charged with protecting. This proposed experiment seems to be part of a multi-pronged attack which includes; significant increase of regulatory burden in terms of filing requirements for information, and on another front reinterpreting, if not rewriting the Affiliate Relationships Code (ARC).

What is apparently lacking is the establishment of priorities by the Board which are clearly focussed on customers. The Chief Compliance Officer on a number of occasions has stated that enforcement of his unique interpretation of the ARC should be done without any consideration of the impact on customers. In their letters Board Staff appear to be putting themselves more and more in the role of the OEB itself. This “encroachment” is potentially dangerous for customers in that the opportunity for properly vetting decisions on items which some may consider minor changes may be lost.

The apparent embedding of another OEB Staff driven attack on Small and Medium sized Distributors using the cost of capital within this process is further cause for concern. The implications behind the Cost of Capital initiative is that the Small and Medium sized Distributors are being unduly enriched by the Cannon method. When this assumption is combined with the fact that the only LDCs that experienced an increase in deemed equity include Hydro One with an 11% rate increase as part of EDR 2006 process, it is hard to accept that this cost of capital process is customer focussed regulation.

It is easy to assume that a higher debt cost or higher equity level for smaller and medium sized LDCs in the Canon method automatically results in higher rates to customers than would be the case for a larger or consolidated LDC. However, local operating costs for a smaller or medium sized LDC may be lower than those of larger LDCs. Contributing factors that may lead to this situation could include employee expectations which may manifest themselves as lower local real estate costs, a less rich benefit package, a lower hourly rate, roots (family etc) within the community.

The automatic assumption that a higher debt cost for a LDC results in higher rates to customers assumes operating costs and quality of service remain the same. If however, the lower return offered the community shareholder precipitates a divestiture by that shareholder then the assumption of status quo operating costs and quality of service is probably not valid. New owners and management may be reasonably focussed on other priorities in the broader expanded service area.

If a small LDC is merged with a much larger LDC, there may be deterioration in service quality within the former small LDC's service area as a result of the merger, but this deterioration would probably not be apparent in any analysis of the enlarged entity's service quality performance. If a smaller LDC is merged with a much larger LDC then change in things like local Service Quality Indicators would generally be lost in the rounding.

This attack on the cost of capital may be supported by some participants. The apparent goal of the pursuit of a lower cost of capital appears to be driven by a desire to punish publicly owned OBCA Corporations explicitly without the recognition that the elimination of such entities may ultimately result in higher rates faced by those represented customers. A lower deemed cost of capital could precipitate the reduction of a fair market return for public shareholders.

Understating the cost of debt applicable to publicly held LDCs or in fact the cost of debt to their municipal corporation owners may result in a shareholder desire to liquidate the valuable community asset in pursuit of instant cash rather than accept a lower long term return based on an agenda driven statistical analysis of market forces on bond ratings (which may be accessible to larger LDCs and/or their equally larger municipal shareholders but are not generally accessible to smaller LDCs). This type of analysis clearly underpins any rationalisation for the conclusions reached in the Lazar Prisman report.

Both the Lazar Prisman report and the Lowry report recognised scale as an important factor in the cost of capital considerations. The Lazar Prisman report on Pages 21 and 22 makes reference to the notable "correlation" between Standard & Poor's bond ratings to the size of the entities being rated. That being that the larger entities should face a lower bond rating cost of debt while the smaller entities should face a higher bond rating cost of debt. As indicated in ECMI submission of July 4, 2006 in this process, there are two ways to capture this situation from a regulatory perspective. These include either a specifically higher deemed cost of debt for smaller LDCs or a higher equity component for smaller LDCs to reflect the higher risk recognised in the "correlation" of bond ratings for larger LDCs versus smaller LDCs. There is no indication that these comments were considered by Board Staff.

The MADD rush to a simple one shoe fits all cost of capital ignores the value of the LDC to the customer. Unit delivery costs are not of primary importance to most customers. The Service Quality Indices used by the OEB do not capture all of the items of importance to customers. MADD salesmen rely on a feeble Ontario energy process which purports to evaluate no harm to customers. This process fails to require any assessment of customer priorities and satisfaction before and after any proposed merger. Simplistic unit cost are often utilised as a substitute for real work which should add value to any MADD process. Board

staff eagerness to embrace the simple answer and the one shoe fits all answer fails to serve or protect customers.

The recent MADD application involving Gravenhurst identified no harm to customers as the criteria which the OEB should use in determining the acceptability of a MADD application. No harm to customers is an appropriate criteria provided that the customers potential harm is considered on the basis of each of the clusters of customers involved in the MADD application. Such considerations should include rates and quality of service. Other potential harm to customers can flow from items in the quality of service not currently considered or measured by the OEB in its service quality indices catchment net.

The Board Staff stated objective “to avoid imposing barriers to consolidation within the electricity distribution sector” should reflect a careful balance of permitting the status quo in terms of structure and permitting the rationalisation of the industry. It is easy to interpret the “avoid imposing barriers to consolidation within the electricity distribution sector” to mean establish an artificial set of rules which demand a consolidation of the industry through financial punishment of smaller and potentially more cost effective distributors which may well currently provide a higher standard of service for the communities they serve because of their locally based and in many cases lower cost skilled staff. The status quo may often produce a higher value to customers than forced mergers or divestitures.

The preceding comments on the current process, the potential advantages and need for a Code and needs which might support the development of a Code, the lack of fulfilment of the obligations which underpin the establishment of a Code, the deficiencies of a Code when compared to a hearing and the risk of systemic bias all demand that the proposed codification of the PBR process is inappropriate. Further, Codes should be pursued only when they are of a general nature governing day to activities of regulated entities.

It is not only a question of whether codification of rates can be done. It is more a question of whether it should be done, given the time line and the complexity of the issues.

Respectfully submitted.

Original signed by R. White

Roger White
President