

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

IN THE MATTER OF a generic hearing 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 provisions for methods and techniques to be applied by the Board in determining distribution rates for licensed electricity distributors.

WRITTEN SUBMISSIONS OF LONDON HYDRO

Introduction

1. Following the *Notice of Proceeding and Notice of Hearing* (the “Notice”) issued by the Ontario Energy Board (the “Board”) London Hydro applied for, and was granted, intervenor status in this Proceeding. London Hydro is also participating in the parallel Code Development Process¹ being conducted by Board staff concurrently with this Proceeding.
2. The Board has attempted to treat this Proceeding and the Code Development Process as separate and distinct proceedings, but it has become clear that these two proceedings are inextricably linked by the subject matter. Implementation of a scheme does not occur in a vacuum, the objective and details of the scheme must be known to understand whether the implementation plan is appropriate. Based upon comments from Board Staff at the Code Development Process - Technical Conference², it is understood there is a third process pertaining to “deferral and variance accounts” which will impact short term debt rates and is therefore also related to this Proceeding.
3. London Hydro would like to acknowledge that a significant amount of information has been provided and valuable discussion has taken place as part of the Code Development

¹ Board File Nos. EB-2006-0088 and EB-2006-0089.

² Transcript – October 17, 2006, pages 17, 18.

Process. However, the separation of the processes has not created an efficient, effective process.³

4. Procedural Order No. 1 in this Proceeding provided that participants were not to use this Proceeding to address the following issues:
 - (a) Whether incentive regulation, in whatever form it may ultimately take, is an appropriate methodology for setting distribution rates.
 - (b) The details of the incentive regulation and cost of capital methodology to be used in setting electricity distribution rates.
 - (c) Whether any particular individual distributor should be exempt from the application of incentive regulation or cost of capital methodology that is being developed through the Code Development Process.

Therefore, London Hydro will address those issues in its submissions to the Board in the Code Development Process on October 27, 2006.

5. As part of the Code Development Process, Board Staff, in response to Question 4 posed by the Coalition of Large Distributors, stated that the implementation of the cost of capital and incentive regulation methodologies were part of this Proceeding. This blurs the line of what should be dealt with in each forum.
6. London Hydro is concerned that the separation of the processes has the potential to diminish the good work that has been completed through a rush to implement changes prior to the impact of the changes being known to the licensees, ratepayers or the Board.
7. Simply put, the proposed license amendments contemplated in this Proceeding seek to incorporate two codes, the Cost of Capital Code and the Incentive Regulation Mechanism Code (the "Codes") into every distributor license. The Codes are currently in the early stages of development and are the subject of considerable debate in the Code Development Process.
8. London Hydro's position that it is premature to make a definitive statement regarding the appropriateness of such amendments given the early stage of the codes and the lack of clarity regarding exemptions.

Board's Jurisdiction to Incorporate a Code into a License

9. The Board's jurisdiction to incorporate codes into a license is granted by the *Ontario Energy Board Act, 1998* S.O. 1998, c.15 Sched. B (the "OEB Act") section 70.1 which provides:

³ Transcript - Sept. 20, 2006, pages 134-176. Several participants expressed concern regarding the procedure in the Code Development process and its relationship to this Proceeding.

70.1(1) The Board may issue codes that, with such modifications or exemptions as may be specified by the Board under section 70, may be incorporated by reference as conditions of a licence under that section.

10. London Hydro agrees that a properly developed code (i.e. in accordance with all of the requirements of the OEB Act) may be incorporated into a license in certain circumstances.⁴ The incorporation of an as yet to be developed code cannot be included as a condition of a license. Prior to the finalization of a code there is nothing to incorporate. Therefore, it is premature to make comments on the appropriateness of the proposed language of the amendment.
11. London Hydro submits that section 70.1 cannot be read in isolation but must be read in conjunction with sections 70(13) and 78 of the OEB Act. In addition, the Board must determine that the amendment of the license complies with the requirements of section 74. Any attempt to incorporate a Code or condition that violates these other statutory requirements simply cannot stand.

Section 70.(13) – Prohibited License Amendments

12. Section 70.(13) of the OEB Act provides:

70.(13) A licence under this Part shall not require a person to dispose of assets or to undertake a significant corporate reorganization.

13. If either of the Codes would require the licensee to dispose of an asset or to undergo a significant corporate reorganization the statute prohibits its inclusion as a condition of a license. Because the Codes are not complete, it is not possible to understand the impact of the proposed codes on licensees and whether the Codes would require any particular licensee such concern. Therefore, it is not possible to state whether the inclusion of both named Codes will comply or run afoul of the statutory requirements.

Section 78 – Just and Reasonable Rates

14. Section 78 requires the distributors to charge rates pursuant to an order of the Board.

78. (1) No transmitter shall charge for the transmission of electricity except in accordance with an order of the Board, which is not bound by the terms of any contract.

(3) The Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity and for the retailing of electricity in order to meet a distributor's obligations under section 29 of the Electricity Act, 1998.

15. Just and reasonable rates require an examination of the evidence and a determination that the resulting rates are just and reasonable. The mechanistic application of a formulaic

⁴ London Hydro will make submissions as to whether the Board has satisfied all of the statutory requirements necessary to legitimize the two proposed codes in the Code Development Process.

approach may not result in just and reasonable rates. To date, there has been no evidentiary basis established that could underpin a decision or order that the Codes will always result in just and reasonable rates as required by statute.

Section 74 – Preconditions to License Amendments

16. In addition, the Board has commenced this proceeding under section 74 of the OEB Act and therefore there must be a determination for each licensee that the requirements of (1) or (2) are satisfied.

74. (1) The Board may, on the application of any person, amend a licence if it considers the amendment to be,

(a) necessary to implement a directive issued under this Act; or

(b) in the public interest, having regard to the objectives of the Board and the purposes of the Electricity Act, 1998.

17. Therefore, prior to the Board amending a license either (a) or (b) must be satisfied.

(a) With respect to paragraph (a) there needs to be a directive issued under the OEB Act (not any other act) and the amendment must be “necessary”. This would require that the objective of the directive could not be achieved without imposing a condition in the license. If the Board has an option of achieving the goal of the directive in another manner then the Board cannot rely on paragraph (a).

(b) With respect to paragraph (b), the need for a finding that the amendment is “in the public interest” having regard to the objectives of the Board and the purposes of the *Electricity Act, 1998*. London Hydro submits that the Board must have evidence that the impact of the amendment will be in the public interest prior to being able to amend the license. The current proposed Codes will have an unknown impact on rates, returns for shareholders and the financial health of the utility. It is known that over 40% of ratepayers would see a distribution rate increase (when looking at the proposed changes to capital structure in isolation) and to date, Board Staff have not submitted evidence that either provides an analysis on this topic or how this is in the public interest.

18. At this time, there is no basis upon which anyone can state that the as yet to be developed Codes will comply with the statutory requirements of the OEB Act. As the proposed wording intends to incorporate proposed codes that could potentially run afoul of other provisions in the OEB Act, it is simply not possible to state whether the proposed license amendment would be acceptable to any particular licensee let alone all licensees. Therefore the proposed amendments are premature.

Will the Proposed Amendment Incorporate the Codes into a distributor's License?

19. If it is assumed, and London Hydro is not conceding that such is the case, that the Codes are developed properly, in accordance with all procedural and substantive requirements and do not offend any of the other statutory provisions of the OEB Act, then the proposed language will incorporate the Codes into a license. However, it is simply impossible to determine if such amendments should in fact take place and therefore, the issue is premature.
20. London Hydro would like to caution the Board that the language chosen may have other, unintended consequences. The proposed language obligates the Board to apply the Codes. Therefore, it is unclear how the Board would deviate from the application of the Codes where circumstances warrant.

Fundamental Philosophical Shift

21. The proposed amendments embody a fundamental philosophical shift in the rate making process. Codifying rates in a mechanistic approach, which are the subject of the enforcement provisions of the OEB Act, is a dramatic change from the current practice.
22. The current proposed wording would appear to prohibit a utility from making an interim application to the Board without an exemption or other relief.
23. Traditional ratemaking practice in the gas industry provides that the applicant uses their actual debt:equity ratio, rather than a deemed capital structure, provided it is within a reasonable range. As the actual and deemed capital structures depart from each other, it becomes more difficult to make the link to just and reasonable rates. In the most recent rate decision for Natural Resource Gas Ltd. ("NRG") had applied for rates on a deemed structure of 65:35.⁵ The Board denied NRG's request and the Board required NRG to use a debt:equity ratio that approximated the actual ratio. This approach is not consistent with the proposed approach for the electric utilities.
24. In the brief history with the Board establishing rates for LDCs, a deemed capital structure, based upon LDC size, has been used. London Hydro understands that most LDCs organized their affairs to closely resemble the appropriate deemed structure. Establishing a single deemed capital structure for all utilities that may not reflect the actual capital structure is a departure from the current practice and the practice in the gas industry. London Hydro will comment on this further in the Code Development Process.
25. It should be remembered that when Dr. Cannon prepared his report and utilities were transformed from parts of public utility commissions to stand alone entities the Board provided guidance to the utilities to structure themselves. This guidance helped utilities organize their affairs in a manner that the Board considered reasonable. In the 2006 EDR process, the Board recognized that there may be deviations from the original structure but

⁵ RP-2005-0544, page 25.

only required utilities with a significant deviation to provide an explanation. This was recognition that utilities may have consciously made choices to structure their affairs in a particular manner and provided that was reasonable, it was acceptable.

26. Those conscious decisions in arriving at the current debt:equity level are jeopardized by the overly intrusive nature of the proposed Cost of Capital. The Codes may indirectly require utilities to alter their debt:equity structure to preserve their financial well-being and such decisions are the responsibility of management not the Board. The Board has recognized that it should not unnecessarily intrude on management's role in running the business and where management has made a reasonable decision, it should not be second guessed.

The Board considers that utility management should be in a position where it can conduct the business confidently and conventionally, without fear that the regulator will intrude to second guess decisions which are reasonable at the time they are made.⁶

27. It is management that carries the burden of organizing the affairs of the utility, not the Board. As the Code extends its influence, it restricts management's ability to organize its affairs and such influence may infringe upon management's responsibilities.
28. The Board has effectively embarked on a ratemaking exercise without the evidence or other procedural protections afforded to utilities and ratepayers.

Summary

29. The Board cannot forget the unique nature of the proposed codes in comparison to other codes which have previously been incorporated into licenses. Previously, codes have been intended to mandate a certain standard of conduct or behaviour. Distributors' in undertaking the obligations of compliance with such codes could look to the Board for the recovery of reasonable expenditures related to compliance with such conditions. These codes will establish rates that will determine the revenue a distributor will receive and that ratepayers will be required to pay. The OEB Act requires that rates must be just and reasonable and the mechanistic application of the proposed codes may not adhere to the statutory requirement.
30. It is London Hydro's submission that it is premature of the Board to propose such amendments as it is not possible to comment on speculative codes. Therefore London Hydro reserves its rights to object to the inclusion of the codes in its license or to seek exemptions from such codes, either in whole or in part.
31. In summary, London Hydro requests that the Board discontinue this Proceeding until such time as the Code Development Process has been completed. During this time, the Board should work with stakeholders to go to a more permanent rate making process.

⁶ RP-2003-0063, Decision with Reasons, p. 112.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

LONDON HYDRO

By Its Counsel



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