Urban Development Institute / Ontario

February 16, 2004

Delivered Via Regular Mail & Facsimile

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 26th Floor
Toronto, Ontario
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Attention: Board Secretary

Gentlemen:

RE: CONSULTATION TO REVIEW EFFICIENCIES IN THE ELECTRICITY DISTRIBUTION

The Urban Development Institute/Ontario ("UDI") is pleased to provide comments to the Ontario Energy Board respecting improving efficiencies in the Electricity Distribution Sector.

By way of background, UDI has acted as the voice of the land development and building industry in Ontario for over forty years. With over 300 members, UDI is actively involved in all facets of public policy research and advocacy, working with private and public stakeholders and all levels of government across Ontario.

UDI's membership is engaged in all aspects of the planning and development of communities and the construction of residential, industrial and commercial projects throughout Canada and around the world. UDI’s members include land developers, builders, land use and environmental planners, financial institutions, engineers, lawyers, environmental scientists, surveyors, economists, market research firms and architects. UDI serves as a forum for knowledge and research on all facets of land use planning, land development and urban affairs. Together they constitute the collective forces guiding the creation and improvement of Ontario’s built environment and are vital contributors to the provincial economy.

UDI's members are directly concerned with the subject matter of this proceeding because they pay a very large portion of the cost of electricity distribution facilities in Ontario. In 2001, land developers in Ontario paid approximately $175 million with respect to the cost of such facilities. Therefore, inefficiencies in the electricity distribution sector are of vital interest to UDI and its members.

THE PROMOTION OF THE EFFICIENCY OF CAPITAL ACTIVITIES

1. UDI makes only one core submission in the context of this consultation process: The Board should promote efficient growth of capital distribution facilities.

2. The efficient growth of capital distribution facilities would be good economic policy, as well as potentially reducing the capital contributions made by developers to distributors. Regulatory measures should be implemented to lower the overall cost of new distribution facilities, while maintaining appropriate electricity distribution reliability, safety and service.

EFFICIENT GROWTH OF DISTRIBUTION CAPITAL FACILITIES IS A LEGISLATIVE OBJECTIVE OF THE OEB

3. The promotion of the efficient growth of capital distribution facilities falls within the objectives set out at section 1 of the *Ontario Energy Board Act*, including:

   (a) "To promote economic efficiency in the generation, transmission and distribution of electricity".

   The phrase "economic efficiency" is very broad and encompasses more than the day-to-day operation of existing facilities. It includes the promotion of the efficient growth of Ontario's electricity infrastructure. This is clear from the various provisions included in the *Ontario Energy Board Act* dealing with new facilities, such as the requirements for Board approval of the construction of transmission facilities (section 92) and provisions facilitating the construction of facilities (sections 101 and 103).

   (b) "To protect the interests of consumers with respect to prices and the reliability and quality of electricity service".

   Developers act in the stead of consumers, developing for them buildings the price of which may reflect the price paid by the developer for electricity distribution facilities. Therefore, one of the Board's legislative objectives is to protect the interests of developers with respect to the prices they are charged by distributors.

   (c) "To promote communication within the electricity industry and the education of consumers".

   To the extent developers directly pay for, and often construct, distribution facilities they form part of the "electricity industry". As a result, the Board should promote communication and transparency between distributors and developers.

4. The Board has, to a certain extent, applied these statutory objectives to promoting the efficient growth of capital distribution facilities. As noted in the Board Staff's consultation paper dated February 10, 2004 (the "Consultation Paper"), the Board has, in part, addressed the efficiency of capital activities by allowing for developers to obtain alternative bids for the construction of certain distribution facilities. The Consultation Paper also noted that:

   "To operate on a commercial basis, distributors had to create new strategic and business plans, recapitalize their assets and create commercial capital structures. The OEB mandated the commercial capital structure and rate of return on assets for distributors".

5. Moreover, as defined by the Consultation Paper (although perhaps not in everyday electricity industry usage), the efficiency of capital activities falls within the concept of operational efficiency:

   "Operational efficiency relates to the level of costs incurred by a distributor in providing service to its customers. Operational efficiency can be said to improve if a distributor reduces its costs while providing the same level of service to its customers. Distributors can achieve these improvements in many ways, including:
   - working "smarter" so that the same work can be done with fewer resources; and
   - contracting out selected activities that can be performed by an external specialist at lower cost than internal resources (which may lack the scale or specialization to perform the same activity as efficiently)".

6. Thus, not only should distributors be required/incented to operate and maintain their existing facilities in an efficient manner, but capital projects (new facilities) should also be realized in an efficient manner, using the same criteria as the Board Staff has listed for "operational efficiency". The regulatory tools proposed by UDI to increase the efficient use of capital by distributors are consistent with improving operation efficiency, as defined in the Consultation Paper.

7. With the benefit of experience garnered over the three years since the *Distribution System Code* came into force, UDI submits that now is an appropriate time for the Board to take further measures to increase the efficient use of capital by distributors.

PROPOSED REGULATORY TOOLS

8. UDI proposes two regulatory tools to make more efficient the growth of capital distribution facilities:

(a) OEB regulation of the construction and cost recovery of upstream distribution facilities; and
(b) Mandated transparency with respect to offers made under section 3.2.2 of the *Distribution System Code* ("Expansion Offers").

9. These two regulatory tools reflect the two types of capital distribution facilities: (i) facilities for use by more than one specific development project – usually outside the geographic boundaries of a development project ("Upstream Facilities") and (ii) facilities dedicated for use by only one development project – usually inside the geographical boundaries of a development project ("Project Facilities"). Upstream Facilities include substations and major distribution lines serving multiple developments. Project Facilities include local transformers and distribution lines serving only the development project buildings.

10. UDI seeks increased efficiency with respect to the construction of both types of distribution facilities.

UPSTREAM COSTS

11. UDI submits that the OEB should regulate the construction and cost recovery of upstream distribution facilities and the calculation/imposition of Upstream Costs.

Developers Pay For Upstream Costs

12. The charges to developers for Upstream Facilities ("Upstream Costs") are typically calculated by distributors based on the overall cost of the growth of the distributor's network, multiplied by a factor that reduces the total cost to the developer's share of the total growth cost. Occasionally, developers are charged only for new Upstream Facilities attributable directly to their projects.

13. UDI's experience has primarily been with communities in the Greater Toronto Area that experience significant growth. Almost all distributors in such communities require developers to pay for Upstream Facilities, although different distributors have used different nomenclature for those facilities.

14. Almost all distributors require developers to pay 100% of the Upstream Costs. No distributor has allowed the construction of Upstream Facilities to fall within the scope of work of an alternative bid within the meaning of section 3.3 of the *Distribution System Code.* Distributors unilaterally decide what facilities to construct and reckon the Upstream Costs.

15. UDI notes that the higher the Upstream Cost charged by the distributor, the higher the capital contribution required of the developer under chapter 3 of the *Distribution System Code.*

The Dissonance between Planning for Growth and Paying for Growth

16. Typically, developers pay for the growth of distribution networks. This is despite the fact that:

    "Electricity distributors are currently responsible for planning the development of their distribution systems over time, taking into account anticipated growth in customers and the demand for power." (Consultation Paper and section 3.4 of the *Distribution System Code*)

17. This dissonance between who plans for growth (e.g. exactly what facilities to construct, when and where) and who pays for growth has acted as a barrier to enhanced efficiency of the growth of capital distribution facilities.

Long Term Measure

18. Long term, distributors should pay for the growth they plan and, if necessary, distribution rates should be allowed to rise to permit payment for growth. Incorporating capital costs as a driver of distribution rates will bring Upstream Costs within the core electricity regulatory system and allow for traditional incentive regulation (such as PBR) to drive efficiencies for capital activities. At the moment, there is no incentive for distributors to act efficiently when planning for growth and designing Upstream Facilities. After all, developers pay the cost of those facilities – not distributors.

Short Term Measures

19. Short term, the Board should mandate and expressly incent distributors to increase efficiency with respect to the growth of capital distribution facilities.

20. UDI accepts that most distributors currently design Upstream Facilities to reasonable standards in order to reach appropriate levels of reliability, safety and service. However, the cost of Upstream Facilities is entirely another matter.

21. Currently, distributors are not incented to reduce the capital costs of Upstream Facilities paid for by developers. A number of distributors have taken the position with UDI that they have no choice but to charge to developers the cost of Upstream Facilities because (with the possible exception of some industrial/commercial projects) distribution rates are too low to recover the cost of such facilities. UDI submits that the Board should investigate this allegation, and if it is correct, in the long term the Board should raise distribution rates so that the full cost of electricity distribution is covered by rates (i.e. the operational, maintenance and capital costs). Adding customers to a distribution network should not be a burden on distributors to be passed on to developers.

22. As long as distribution rates are insufficient to allow for the recovery of Upstream Costs, and even assuming that the construction and design standards applied by distributors are appropriate, the Board should carefully regulate the cost of Upstream Facilities. In particular, UDI submits that until rates rise sufficiently to cover Upstream Costs the Board should:

(a) ensure that developers are responsible only for development-related growth, not natural growth (e.g. growth due to increased demand from existing customers, such as consumers adding a larger refrigerator, second dishwasher, etc.);
(b) mandate or incent the adoption of province-wide equipment standards and equipment buying pools, in order to aggregate the buying power of Ontario distributors and obtain volume-discount cost savings from equipment vendors;
(c) mandate or incent the adoption of province-wide electricity contractor qualification standards so that contractors can increase in size and sophistication, allowing them to work in multiple distribution territories;
(d) prohibit distributors from favouring their own labour forces over independent qualified contractors (the work should be done by the party able to do it most effectively and efficiently);
(e) monitor and approve the methodology and assumptions used by distributors to calculate Upstream Costs (e.g. the demand associated with a single family dwelling and the calculation of the total expected cost of development growth of facilities); and
(f) ensure that funds collected in the form of Upstream Costs are used only to pay for Upstream Facilities (i.e. restricted to only capital facilities related to the distribution of electricity) and that if the fund of Upstream Costs collected in a particular year is not used as planned, the amount over collected is used to reduce the anticipated capital requirements of the distributor in the following year.

23. UDI recognizes that barriers exists to the efficiency of capital distribution activities, including those identified by the Consultation Paper:

- “absence of discipline applied to under-performing distributors and managers”; and,
- “poor access to information on methods of enhancing distributor efficiency”.

24. Because capital efficiency is a matter that is not, to UDI’s knowledge, measured by distributors or the Board, UDI submits that mere incentive regulation is insufficient in the short term to overcome these barriers. Developers carry the capital cost of Upstream Facilities. Distributors and their managers appear to be unconcerned with the cost of such facilities. Therefore, direct regulatory intervention is warranted by the Board to increase the information available to it and developers about capital costs and related information, and to mandate efficient behavior.

TRANSPARENCY

25. Transparency in the form of greater information exchange between distributors and developers would promote the efficient growth of capital distribution facilities. The current pressing problem is that many distributors do not reveal sufficient information to developers at the time the expansion offer is made to allow the developer to evaluate the reasonableness of the capital contribution sought from it and the efficiency of the distributor's capital activities.

26. As noted by the Consultation Paper, "The Distribution System Code sets out a procedure that allows distribution customers to obtain alternate bids for connections and expansions (section 3.3)". Distributors are required by the *Distribution System Code* (section 3.2.2) to provide to developers an offer outlining what expansion work is required by the distributor and the capital contribution to be paid by the developer.

27. Most distributors now provide an offer with the terms associated with the developer choosing to proceed by alternative bid, a second option with the terms associated with proceeding without an alternative bid, and variations of the latter two options. Thus, at least in theory, when deciding how to proceed a developer can compare the total costs and other factors associated with each option.

28. Unfortunately, most distributors provide only the most basic information concerning their application of the economic model set out at Appendix B to the *Distribution System Code*. It is this model that determines the amount of the capital contribution required from developers. Because they usually receive little information, developers have no way to determine if many of the inputs and assumptions applied by the distributor to the economic model are reasonable.

29. In particular, the figures for Upstream Costs, operating and maintenance expense, and expected future revenues significantly impact the calculation of the capital contribution required of a developer. How these items are calculated is a matter of keen interest to developers. This information may also indicate distributors' operational efficiency. For example, a distributor with an operating and maintenance expense figure significantly higher than the average may not be operating and maintaining its facilities in the most efficient manner. Similarly, a distributor with high capital costs but low expected revenues may not be designing its capital facilities in an efficient manner in light of customer and load densities. While not determinative, these figures are useful indicators of potential inefficiencies.

30. UDI submits that the Board should mandate increased transparency with respect to such matters, which would improve the capital and operational efficiency of distributors by facilitating the accountability of distributors.

31. UDI is not seeking any more information than is already in the hands of developers and in a format already available to distributors. For example, every distributor contacted by UDI has admitted to using an electronic spreadsheet developed by the Electricity Distributors Association to calculate developers' capital contribution (the "EDA Spreadsheet"). The spreadsheet reveals much of the information required by developers, in a useful form. None of the information contained in the EDA Spreadsheet is confidential.

32. UDI submits that distributors should be required by the Board to provide to developers with each expansion offer a completed EDA Spreadsheet for each option provided for by the expansion offer. At the moment, each developer is in the position of a *de facto* monopoly with respect to a particular development project. In the circumstances, transparency is a precondition for both efficiency and fairness.

<u>Summary</u>

33. UDI submits that the Board should adopt the following measures to promote the efficient growth of capital distribution facilities:

   (a) *OEB regulation of the construction and cost recovery of upstream distribution facilities;*

      (i) *Long term, distributors should pay for the growth they plan and, if necessary, distribution rates should be allowed to rise to permit payment for growth;*
      (ii) *Short term, the Board should mandate and expressly incent distributors to increase efficiency with respect to the growth of capital distribution facilities, including the Board taking measures to:*

         (1) *ensure that developers are responsible only for development-related growth, not natural growth (e.g. growth due to increased demand from existing customers, such as consumers adding a larger refrigerator, second dishwasher, etc.);*
         (2) *mandate or incent the adoption of province-wide equipment standards and equipment buying pools, in order to aggregate the buying power of Ontario distributors and obtain volume-discount cost savings from equipment vendors;*
         (3) *mandate or incent the adoption of province-wide electricity contractor qualification standards so that contractors can increase in size and sophistication, allowing them to work in multiple distribution territories;*
         (4) *prohibit distributors from favouring their own labour forces over independent qualified contractors (the work should be done by the person able to do it most efficiently);*
         (5) *monitor and approve the methodology and assumptions used by distributors to calculate Upstream Costs (e.g. the demand*

associated with a single family dwelling and the calculation of the total expected cost of development growth of facilities); and

(6) ensure that funds collected in the form of Upstream Costs are used only to pay for Upstream Facilities (i.e. restricted to only capital facilities related to the distribution of electricity) and that if the fund of Upstream Costs collected in a particular year is not used as planned, the amount over collected is used to reduce the anticipated capital requirements of the distributor in the following year.

(b) Mandated transparency with respect to Expansion Offers, including requiring distributors to provide to developers with each expansion offer a completed EDA Spreadsheet for each option provided for by the expansion offer.

UDI appreciates the opportunity to participate in this consultation and welcomes any questions the Board may have.

Yours truly,

Neil Rodgers

Neil Rodgers
President