SUBMISSIONS OF THE SCHOOL ENERGY COALITION

with respect to

FUNDING OF STAKEHOLDER PARTICIPATION IN POLICY PROCESSES

and

THE STRUCTURE OF THE ELECTRICITY DISTRIBUTION RATE PROCESS

July 15, 2004

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EXECUTIVE SUMMARY

These submissions respond to the OEB's requests for input on Electricity Distribution Regulation, and on Funding of Stakeholder Participation. The two areas are inextricably linked, and we have provided our submissions on that basis.

Principles of Stakeholder Participation

These issues require a clear understanding of the principles driving who, how and to what extent stakeholders should participate in the Board's processes. The principles can be divided into three areas:

Regulatory Models. There are two basic models for regulatory bodies:

- The top-down model, typified by the Ontario Securities Commission, is one in which the regulator is the protector of the public. Those protected are rarely represented before the regulator, which in that case acts as a referee for a fundamentally voluntary marketplace.

- The collaborative model, typified in the past by the Ontario Energy Board, is one in which the regulator balances the diverse interests of a number of stakeholders, often in monopoly situations where market participation is involuntary. Those whose interests are being balanced are typically represented in those decision-making processes.

The Ontario Energy Board should ensure that it remains clearly focussed in the second model.

Benefits of Stakeholder Participation. Three key benefits arise when stakeholders are allowed to participate fully in the regulator's processes:

- The regulator makes better decisions. Stakeholders come with diverse perspectives and thus allow the regulator to see issues in more dimensions and therefore more clearly. Historically the involvement of intervenors in Ontario's natural gas regulation, for example, has been an exceptionally good investment, with a return equal to many multiples of the annual cost.

- The regulator's decisions gain better public acceptance, either because they represent stakeholder groups making conscious tradeoffs of their interests with each other and with the utilities, or because stakeholders feel that their interests have been heard in the process.

- It is simply wrong to limit those whose interests are affected by decisions from being involved, and that is particularly clear when, as with energy, the costs of everyone else involved – utilities, Board staff, etc. – are borne solely by those ratepayer groups who want to be at the table themselves.

Making Stakeholder Participation Effective. In order to ensure that stakeholders can participate fully, the Board should keep three "effectiveness" principles in mind:

- Stakeholders can only participate usefully if they have the resources to do so. Stakeholders bring a "perspective" – domain knowledge – which can only be applied properly to energy issues if the stakeholders have access to sufficient expertise to do so. The Board staff cannot be expected to understand how the perspectives of each of many stakeholder groups apply to each energy issue unless those perspectives include a context of energy knowledge. That requires allocation of resources to the stakeholder groups – funding.

- The benefits of stakeholder participation are driven by diversity. While it is sometimes necessary to place limits on the number and identity of participants, those limits cannot be allowed to throw out the diversity benefits for the sake of pragmatism.

- The design and scheduling of processes can also limit stakeholder involvement. Very important is that the Board should not initiate its own policies, and then be the adjudicator between interests commenting on those policies. At a more mundane level, it is also important that the Board ensure scheduling does not stretch the resources of stakeholders unduly.

Decisions by the Board on how processes are structured, who is funded and for how much, and other similar pre-process determinations, will – consciously or unconsciously - have a fundamental impact on the Board's effectiveness. Stakeholder participation cannot be infinite, but whatever limits the Board may place on it should be done consciously, understanding precisely what is gained, and what benefits are being lost to achieve that gain.

Electricity Regulation Process

The Board's mandate to establish electricity distribution rates may be a difficult one to achieve, because of the inherent problems in LDC regulation. In addition to the fact that, with 97 utilities, there is no possibility of just having individual annual rate cases, there are other, more entrenched problems: the LDCs inexperience with, and suspicion of, regulation and the public review that entails; lack of standardization across the LDCs; application of general solutions to individual LDCs with widely differing rates; and the parallel regulation of the commodity and transmission components of electricity costs.

Horizontal vs. Vertical Ratemaking. One solution, and the direction the Board is considering, is to replace the old vertical method of ratemaking (decide each utility in turn, dealing with all issues) with a horizontal method (decide each common issue in turn, applying them to all utilities). This is an attractive option, but it has its own costs and benefits:

- Cost and Time. Horizontal ratemaking can reduce the costs of regulation, and the time to reach conclusions, but not as much as first appears. There is a danger that the horizontal process will become cumbersome and unwieldy, and therefore more costly and time-consuming.

- Comparability**.** Dealing with issues across the LDCs can become effectively a "best practices" review, with the potential that those best practices can be applied to all LDCs.

- Forest vs. Trees. Energy rates issues are interrelated. In a rate case, they are dealt with together, so connections are made. If they are dealt with in isolation, integration of solutions must be dealt with expressly.

- Deadline**.** Even using horizontal ratemaking to save time, meeting the goal of May 1, 2006 will be a challenge, and innovative approaches will be necessary.

Decisions based on factual inquiry. The main benefit of the classical adversarial approach to ratemaking is that there is a strong emphasis on getting all the facts on the table, and testing them to make sure they are reliable. That way the decisions of the Board panels arise mainly out of the truth as revealed, and have a strong foundation. It is critical that, if it moves in the direction of horizontal ratemaking, the Board maintain as much as possible of the fact-driven nature of its ratemaking processes. This does not mean that all processes have to be adversarial, but it does mean that there have to be appropriate

opportunities to add, modify, and challenge facts so that in the end the Board's decision is based on a full and reliable factual foundation.

Rate Cases. Horizontal ratemaking is still ratemaking, even if it is called a "policy process". At the end of the day, rates arise out of this process, and this entails adhering to whatever principles the Board believes are appropriate in the establishment of rates, including the principle of natural justice.

Revenue Requirement vs. Ratemaking. Cost of service regulation is really a two-stage inquiry: how much does it cost to operate the public franchise, and who (which ratepayers) should bear that cost? Revenue requirement can be established on its own, and is not dependent on the cost allocation and rate design principles used in the subsequent component. Dealing with cost allocation and rate design requires the revenue requirement and its components before rates are finalized. The ratemaking component can overlap the revenue requirement component, but ratemaking cannot be completed until after the revenue requirement is decided. Further, setting rates requires both components. It is not enough to identify the right total to be decided in rates, if the wrong people are paying it. Those rates would not be just and reasonable.

Proposal for Parallel Processes. We propose in this paper a schedule in which the revenue requirement and ratemaking processes run separately and in parallel, converging during the actual rate applications for the individual LDCs in 2005.

Ongoing Horizontal Review Processes. We also propose in this paper establishment of an ongoing annual horizontal review process to deal with: issues that are not addressed in the first one; policies that are not proving to work well in practice; and a periodic updating of all policies on a rotating basis.

Funding Process and Eligibility

The Board has recently been given the power to order costs for policy processes that do not qualify as "proceedings", as rate cases do. Stakeholders have been asked for input on the issue of how the Board should fund stakeholder participation in those processes. While the Board has specifically asked for input on the question of eligibility, we have chosen to propose answers to all three questions in this area. In the end, we conclude that the existing rules, with some additions and modifications, properly balance the interests of efficiency and costs containment against the benefits achieved from active stakeholder involvement.

What processes should be funded? We propose that all policy processes of the Board be funded through the power to order costs to participants, just as the Board currently does in proceedings. Policy processes are still in essence about rates and similar real-world decisions, and it is incorrect to try to distinguish the two categories as if their results are not the same. The process for deciding electricity distribution rates horizontally rather than vertically is a prime example.

This should apply not just to ratepayers and public interest groups, but also to utilities. While in the past the small number of well-staffed gas utilities made it less important to supervise their activities before the Board, the large number of regulated electricity market players creates a significant risk of duplication and waste – far in excess of anything that would come from ratepayer or public interest group participation – if the utilities are not subject to any discipline.

In our view, the Board should control the cost of each policy process in two ways:

- The process itself should be allocated the amount of time, and the process should be designed, to reflect the complexity and importance of the issues addressed. Participants will naturally have to

prioritize their use of resources, particularly in the next few years when the Board will be very active.

- Intervenors and utilities should advise the extent of their participation at the outset, and the Board member(s) responsible for the process should comment on those plans in light of the value the parties propose to add to the process.

The use of this less arbitrary approach to deciding what to fund will, it is submitted, result in tight budget controls without rejecting valuable contributions by specific participants.

What parties should be funded? The existing rules for costs include controls over funded participation by those without an interest in the result (the "officious intermeddler"), and by those whose involvement is wasteful, duplicative or inefficient. Those rules should be continued, and applied much as they are today, because they have proved in the past that they work. Duplication and inefficiencies are controlled by the intervenors themselves, through mutual co-operation and through individual restraint. In the few cases where intervenors have been excessive, the Board has reeled them in with costs disallowances.

We propose two changes to the rules:

- The rules should apply to utilities planning to participate, in exactly the same way as they apply to ratepayers (whose money everyone is spending) and public interest groups. Utilities that do not comply should have costs disallowed for rate recovery purposes.

- Parties should be required, in their initial eligibility letter, to estimate their budget, much like some of us do today. The Board should comment where budgets are unusual in their size or emphasis, but should not specifically approve them. Rather, parties in their costs claim at the end of the day should have to justify any variation from budget, and that variation and the justification should be factors the Board considers in assessing reasonableness.

How much funding should be granted? In keeping with the current rules, the Board should not impose arbitrary limits on each process. The structure of each process will impose practical limits, and the eligibility and claims rules will ensure that intervenors and utilities do not abuse the availability of costs.

INTRODUCTION

The Board, in its public consultation document entitled "Funding for Stakeholder Participation in Regulatory Policy Initiatives" dated June 23, 2004 has asked stakeholders for input into the proposed funding guidelines for policy development processes. The Board has also commenced, by notice to all stakeholders dated June 16, 2004, a consultation to determine the appropriate process for establishing 2006 electricity distribution rates and, after two days of informal discussions at the Ontario Science Centre on July 6th and 7th, sought written comments by July 16th.

Those two consultations are inextricably linked. If the electricity distribution process is fully funded and all legitimate stakeholders are entitled to participate, it is likely to be more thorough and deal in more detail with the issues, but because the intervenors would have more resources there are scheduling and procedural options available that would not be available in a more truncated process. Conversely, to the extent that the "policy process" for electricity distribution rates has the effect of determining in advance all or any component of those rates – for example through decisions on allowable expenditure classes, comparators, or the terms of a standard rate handbook – the participation of stakeholders is more necessary and critical to the process' success, so a broader eligibility rule and greater access to funding are more important.

These submissions will deal first with some principles of stakeholder participation, then look at the broad process issues for electricity distribution rates, then consider funding issues.

PRINCIPLES OF STAKEHOLDER PARTICIPATION

The School Energy Coalition has been vocal in the past about stakeholder participation in OEB processes. We believe that stakeholder participation is important as a matter of principle, but in addition it has practical benefits that are too important to give up.

Regulatory Models

There appear to be two basic models of regulation used throughout North America (with, obviously, many variations in between):

- ***Top-Down or Directive Model.*** In this model, the regulator sees itself as the primary protector of the consumer against abuses by a regulated entity or sector. This regulator sees its role as being to make rules and decisions that prevent the regulated persons from harming the consumers of their goods or services. Often there is a single basic principle of protection at work.

  The Ontario Securities Commission is a good example of this type of regulator. It's role is to ensure that those regulated – the private companies and individuals that participate in the investment business – behave within certain specific bounds so that investors are not taken advantage of. The regulator's role is thus prophylactic rather than policy-making. It regulates the market using a simple (here stated in an oversimplified way, of course) principle – "require those regulated to disclose all information fully, then let the market participants protect themselves". Further, that regulatory activity is carried on within the context of *regulated* participants who are allowed to make as much money as they can achieve, and *protected* consumers who participate in that market voluntarily. There is no monopoly, and no consumer is forced to participate.

  The other attribute typically seen in such a regulatory environment is that those being protected are rarely represented before the regulator in any type of decision-making process. In the case of the OSC, for example, representatives of investor groups – either as a whole or in specific subsets – are not active in the OSC's processes. As a result, the OSC has to build and maintain a considerable in-house expertise, because it cannot rely on intervenors to provide that expertise (and vigilance).

- ***Collaborative or Balancing of Interests Model.*** In this quite different model, the regulator sees its primary function as balancing the disparate interests of a number of market participants.

  The Ontario Energy Board has traditionally been this type of regulator. It does not see its primary role as protecting ratepayers against abuses by the utilities. Rather, it sees its primary role as balancing the interests of the utilities, and the interests of ratepayers and other stakeholders, both against each other and internally within groups of ratepayers or stakeholders. This approach by the OEB has been driven in part by the fact that the interests

of the various stakeholders are quite different (ie. not binary), all stakeholders participate in the regulated sector involuntarily (because it is a monopoly business), and many stakeholder groups participate actively in the decision-making processes. In this situation, the regulator does not need the same level of in-house expertise, because it is more an adjudicator balancing the interests of those before it.

The approach that the Ontario Energy Board should take today, it is submitted, is much closer to the second one than the first one, for the same reason in principle that it has adopted that model in the past. Where as here the legal role of a Board is to balance the interests of the participants in a monopoly market, it is imperative that those interests be before the Board to be balanced. It is inappropriate if those who are regulated have a significantly greater level of participation than those who are paying the bills for all participants.

Benefits of Stakeholder Participation

In our view, there are three practical benefits to having stakeholders participate fully and effectively in Board decision-making activities:

- ***Quality of Decisions.*** A much-used phrase (and one attributed to many possible sources) is "None of us is as smart as all of us". The processes of the Ontario Energy Board have year after year provided stark proof of that concept. In gas distribution rate cases, for example, where ratepayer and other stakeholder participation has been most active in recent years, many important improvements in the regulation of gas utilities have been initiated and/or most effectively promoted by stakeholder groups. Some examples include:

  - *The aggressive DSM programs of the two gas utilities.* Many components of those programs came about because environmental and ratepayer groups, working with each other and with the utilities, developed new ways of looking at DSM, and innovative solutions that allowed DSM programs to expand and become more successful. In DSM, the stakeholder groups have become an important resource for the utilities, and the levels of DSM achieved in Ontario have been much higher as a result.

  - *Limits on the deduction of customer care payments by Enbridge.* In the 2003 rate case, intervenors led the charge to challenge payments of more than $100 million a year by Enbridge for customer care services. As a result of the thorough inquiry and debate, the Board was able to order a reduction of $7 million a year in rates, which through 2005 will already have accumulated more than $21 million of savings to ratepayers.

  - *Limits on the deduction of corporate cost allocations to parent companies.* Both Enbridge and Union have proposed substantial charges from their parents to the Ontario distribution utility, and in both cases intervenors have challenged the level of those charges. In the 2004 Union rate case, about $9 million was disallowed, which given the planned continuation of those rates through 2005, means $18 million of ratepayer savings so far. In the 2005 Enbridge rate case, through a settlement agreement corporate cost allocations have been reduced by a substantial amount, and it is probably fair to say that

in the 2003 and 2004 cases they were also effectively reduced through a global O&M settlement.

- *Affiliate Transactions Generally.* In the past several rate cases the intervenor groups have actively explored the limits of affiliate transactions. While the Board has now announced a review of affiliate transactions rules, prompted largely by intervenor efforts, even the Board's proposals fall short of the range of affiliate issues that properly funded intervenors have raised. It is, in fact, somewhat ironic that intervenors have taken the lead on this issue, and raised the key issues, but the Board in the rate cases has shifted the issues to a separate generic process, in which those same intervenor groups are essentially not invited to participate.

- *Challenges to new weather methodologies.* Both Union and Enbridge have proposed weather assumptions that would have had the effect of increasing rates. In the case of Union, intervenor opposition has resulted in partial denial of the change, and in the case of Enbridge a settlement agreement with intervenors has resulted in a compromise without an amendment to the methodology itself.

- *Deferred taxes.* In 1999, when Enbridge spun off its non-utility businesses (as a result of intervenor initiatives over several years), Enbridge sought $168 million to compensate it for a deferred tax liability that it was taking on in the process. Intervenor groups have resisted that charge in a series of proceedings. No amount has been charged to date, and the current claim by the utility has been reduced to under $24 million. Stakeholders are resisting that claim as well, largely by exposing the facts to the light of day. In the final analysis the savings to ratepayers resulting from the actions of intervenors will be between $222 million and $314 million in terms of lower rates.

- *Rate design issues.* In numerous cases the utilities, at the initiative of intervenor groups, have reviewed the design of particular rate classes and concluded that those rates had to be adjusted. A good example is the amendments to Rate 6 for Enbridge, initiated by the School Energy Coalition and, when Enbridge agreed that they were appropriate, implemented in 2003 and 2004 without dispute. A similar but less collaborative situation occurred with Union Rate M2, and the Board has ordered a review of the class to identify and remove intra-class subsidies. Even where utilities have themselves identified rate changes, they have benefited significantly from the participation of ratepayer groups in working out the details, then settling implementation approaches that balance the disparate interests of ratepayers. A good example of that is the phase-in of upstream transportation cost re-allocations by Enbridge starting in October, 2004. Without the active participation and co-operation of a number of ratepayer groups, this could have been a highly contentious (and potentially politically charged) dispute. As it was, the ratepayer groups, after obtaining expert advice, found a fair balance and, with the utility, proposed that such balance be implemented.

These are but a few of many examples in which intervenor groups have delivered high value to the regulatory process in natural gas. The $3 million ($1.5 million times two rate cases) annual cost of their participation has a high "earnings multiple", in that the reductions in rates

that come out of that participation are consistently, year after year, many times the cost of that participation.

- ***Accountability and Consensus.*** As noted above, decisions that balance the various ratepayer, public interest, and utility interests can often be politically charged, and that is especially true given the last few years of electricity policy. Decisions imposed by a regulatory body in that context, without effective stakeholder participation, run the risk of being discounted precisely because they did not have the right people at the table. Or, put another way, when those affected by OEB decisions are at the table when the decisions are being made, there is a much greater likelihood that the decisions will end up being a consensus of the affected parties, or a transparent balancing of the positions of those affected parties. In the former case, such as an ADR settlement, parties are directly involved in trading off costs and benefits on particular issues, and are by definition likely to accept the result. In the latter case, even if there is no settlement, an open debate fosters acceptance of the result, as we saw in the customer care issue in the Enbridge 2003 rate case. In both cases, the public perception of the Board's decision is better, because the Board is seen to be more accountable to the various interests before it.

- ***Right vs. Wrong.*** The third reason why strong stakeholder participation is required at the OEB is that the Board's decisions are, ultimately, about rates. Those required to pay those rates feel they are entitled to be there to protect their interests, and they are correct in that feeling. It is generally not appropriate, nor sensible rate-making, to impose rates for a monopoly service on ratepayers without allowing them to protect their interests. To do otherwise would amount to expropriation without representation, and that is just wrong. As noted earlier, this is doubly wrong when the utilities, who are given relatively free rein to participate, and the Board itself, which is an active participant in many processes (as opposed to an impartial adjudicator), are both fully funded by the ratepayers to carry out those activities. It would be truly ironic if the only persons who don't get to participate are those who are paying for the participation of everyone else.

Making Stakeholder Participation Effective

The third category of principles appropriate to this issue is the distinction between different levels of stakeholder participation. There are three basic principles of importance:

- ***Availability of Resources Drives Stakeholder Participation Benefits.*** In order to participate effectively, stakeholders need access to resources. The energy sector has a range of complex and challenging issues, and stakeholders cannot be expected to participate effectively unless they have the appropriate level of expertise available to them. Contrast two ratepayer participation processes. In the first, ratepayer groups are given a proposed detailed policy document, and asked to provide "their perspective" on it. Ratepayer groups do not by their very nature have energy experts in-house. They have to seek out that expertise. If the policy process is not funded, they will have no budget to seek that expertise, and therefore (if they participate at all) they will have to comment without it. Since they will not understand the technical issues, the historical background, or the subtleties of the balancing of interests

required to produce the policy, they will be limited to platitudes that will provide little or no value to the Board. The consultation is really just for show, since it is unlikely to produce a better policy.

Contrast that with a funded process. In those circumstances, the ratepayer group acquires the knowledge and expertise necessary to analyze the policy document in detail, with the context of that ratepayer group front and centre. The expert analysts can then present issues and discussion points relevant to the ratepayer group to the group itself for discussion. The input the Board will receive from that group will thus marry the domain knowledge and issues of the group with a detailed understanding of the policy and technical constraints inherent in the energy issues. That input will be useful to the Board.

The term "domain knowledge" is a critical point here. There are a broad range of interests before the Board. It is unreasonable to expect Board staff or policy advisors to properly understand the context of each stakeholder group. They cannot acquire domain knowledge at any level of subtlety for all stakeholders, which means they have a choice. Absent thoughtful and expert input from the stakeholder groups, the Board must either a) make policy decisions without understanding how they impact on the ratepayers, or b) hire domain knowledge experts working for the Board who will specialize in each stakeholder sector within the energy field. Neither is an acceptable solution for the Board, and the most cost-effective yet thorough approach in keeping with the Board's mandate is to ensure that the stakeholders themselves have sufficient funding to supply the necessary knowledgeable input.

- ***Diversity of Stakeholder Interests is Central to the Benefits of Participation.*** Even if all stakeholders involved in the process are properly funded, there remains the question of which stakeholder groups or organizations will be at the table at all. This has two components: which sectors of the energy stakeholders will be allowed to participate, and within each sector which group or groups will represent them.

  The first point is one of materiality. Is there a level of market participation or importance required for one's views to be valued? What of those who are not representing ratepayers, per se, but public interest groups with a policy related mandate, like environmental groups? The second point is one of representation. Which groups have the mandate to represent the particular stakeholders they purport to represent? If more than one has a mandate of some sort, but the groups have diverse views on issues, in what circumstances in that acceptable? It is true that for some sectors – schools for example – the interest is sufficiently well-defined and focussed that a reasonable person would expect one entity to represent the interest. In other sectors – residential ratepayers may be one example – there may be a sufficient diversity of views within the group itself that representation by more than one responsible organization may be essential if all material voices are to be heard.

  We will comment in more detail on this below, but it is clear that there must be some practical limits on how many participants can be at the table before the process gets so unwieldy that it is unmanageable. On the other hand, it is important to be clear that it is the diversity of interests itself that provides the greatest benefits to the Board's processes. Whether that diversity is geographic (north vs. south, for example), socio-economic

(vulnerable vs. middle income ratepayers, for example), or philosophic (market-driven vs. imposed prices, for example), the Board has historically benefited from that diversity of views, and would be harmed if that diversity was lost in the future.

- ***Process Design and Scheduling Decisions can Limit the Value of Stakeholder Participation.*** The third area of pre-process decisions that can affect stakeholder participation is process design and scheduling. At the most basic level, a process that starts with what the Board thinks is the right answer already prejudges the outcome. There is an inherent conflict of interest between the Board as adjudicator balancing interests before it, and the Board as initiator and promoter of policy options. It is not fair to say that the two activities cannot both be pursued by the Board. It has done so in the past quite successfully. What is true, though, is that the Board must constantly be aware of the inherent conflict, and rigorously oppose any internal activities that run afoul of it. For example, in order to ensure that stakeholders are full participants, it is important that initial papers or discussion documents not represent Board policies or proposals. They can be either options papers (the "menu" approach), or they can be proposals by individual staff members or groups of staff without prior vetting by Board members (the "think piece" approach). Both methods add value to the process of developing policy, but without engaging that inherent conflict or undermining the public perception of the Board's impartiality.

  At a more prosaic level, if policy processes are scheduled so that they conflict with other Board proceedings, for example, stakeholder groups will not be able to deploy the resources they do have to participate effectively, because those resources will be otherwise committed. For example, the Ontario Science Centre consultation in early July was limited in its value because it conflicted with intervenors preparing final argument in the Enbridge rate case. The result was that most of the participants were utilities. This is obviously a delicate balancing act, and there will always in the end be some scheduling issues. The Board's record in that area has in fact been pretty good, but it would be a mistake to forget that scheduling can have a real impact on the quality of the Board's decisions by limiting stakeholder participation.

Stakeholder Participation Policy

The Board is going through a period of rapid and far-reaching changes. During the course of those changes, it will be making decisions – as to funding, as to process design, and others – that will either consciously or unconsciously decide who, how, and to what extent stakeholders play a role in the Board's work. It is submitted that the Board must, to properly fulfill its mandate, make its decisions about stakeholder involvement consciously and in keeping with the principles outlined above.

That doesn't mean there won't be tradeoffs. A counsel of perfection often means the job doesn't get done. But what it does mean is that where those tradeoffs have to be made, they should be made with eyes wide open, knowing what is being gained and what is being lost as a result. The Board will not, in our view, be fairly criticized if, in order to meet pressing needs and achieve short-term goals, it transparently identifies and implements limits on stakeholder participation

only to the extent necessary to get the job done, and without sacrificing the benefits unnecessarily. But the Board will be criticized – and will permanently injure its public reputation and value – if it places inappropriate or heavy-handed limits on intervenor participation, and thus loses too many benefits with insufficient gains.

ELECTRICITY REGULATION PROCESS

Introduction

The Board has been given the responsibility by the Minister of Energy to establish regulated rates effective May 1, 2006 for the 97 electricity distribution utilities in the province of Ontario. There is some question as to the extent to which the existing ratemaking methodology used in natural gas distribution can be applied to electricity distribution. Among the concerns are the following:

- ***Electricity Distributors Have No History of Rate Regulation.*** Because of the historical development of the municipal and other local distribution utilities in Ontario, the LDCs have not been regulated by the Ontario Energy Board. They were for a long time regulated in practice by Ontario Hydro, but that did not amount to "regulation" in the manner of the OEB or similar rigorous regulatory bodies. Even when the market was altered several years ago, it was not thought practical to institute immediately a full regulatory framework for the electricity LDCs, particularly given the consolidation and industry retrenchement that went on in the early days of deregulation.

  This has created two important results. First, from a practical point of view many of the remaining LDCs do not have the resources or expertise to manage a full regulatory process effectively. Regulation is itself an area of expertise, and with a few notable exceptions the LDCs have been forced to have existing staff "learn" just enough about regulation to get by, because they cannot afford to hire regulatory staff.

  Second, most LDCs have a negative, cautious or suspicious view of the involvement of stakeholders in the setting of their revenue requirement and rates. Since for the most part they looked in the past to the municipalities that owned them to provide political control over rates, they see regulation as an unnecessary formalization of something that worked without it in the past. They have not reached the stage of the gas utilities – acceptance that their customers have a right to participate in their rate-setting to protect their interests. While the gas utilities may not always like the time and expense necessary to deal with regulation, they do not believe that setting rates in the absence of those who must pay them could be an idea taken seriously at all. By contrast, many LDCs see nothing wrong with that, as long as in their view the rates end up being fair.

- ***The Cost and Time Involved in 97 Rate Cases Could be Unreasonably High.*** Where we have essentially three gas distributors in the province, we have 97 electricity distributors. Carrying out 97 annual rate cases using the gas regulation model is not even conceivable, let alone sensible. The OEB would need to quadruple in size, or more, and the multiplicity of proceedings would effectively prevent most stakeholders from participating in any case. As well, the individual LDCs would have to acquire the expertise to manage rate cases, and would each have to incur the substantial costs of that process. The necessary impact of such a future would be significantly higher electricity distribution costs, something no amount of benefits from ratepayer involvement could justify, even if those benefits were available in

those circumstances. This practical result means that the Board must necessarily find a different solution for LDC regulation, because the classical method is just not feasible.

- ***Electricity LDCs Lack Standardization of Costs, Allocations, and Rates.*** Gas regulation has evolved over a number of years, and as a result there are many aspects of the process that have been standardized – the chart of accounts, the affiliate relationships code, system expansion rules, etc. While there are probably many more areas in which standardization should be sought – cost allocation methods, rate classes and design, weather assumptions, etc. – the gas utilities are still well ahead of the electricity LDCs. Electricity distributors have almost no standardization, and the range of approaches, rules, and procedures in the various LDCs reflects the range of geographic and philosophical diversity within the province. A process to identify areas where standardization is possible, select standardized methods, and implement them, is urgently needed. It cannot be implemented over night, of course, but to the extent that rules for different LDCs can be standardized, a significant part of the unmanageability of the process can be overcome.

- ***Changes to the Rates for Individual LDCs Could Constitute Rate Shock.*** The process of getting to just and reasonable rates for LDCs will necessarily involve some form of cost of service baseline, and some standardization of rates and cost allocations. Given the diverse status quo, this will inevitably mean that some ratepayers will have significant rate shock as the system is modernized and regularized. Aside from the basic principle that rate shock should be avoided, there is the secondary issue that the OEB's first foray into LDC rate regulation should not be one in which ratepayers are seriously injured. This is not only poor regulation, but would have the effect of undermining the Board's effectiveness in dealing with this area.

- ***Commodity and Transmission Costs Also Have to be Regulated in Parallel.*** In gas regulation, most of the delivered costs of gas to the consumer are regulated in a single process. While the commodity itself is largely unregulated, to the extent that it is regulated (system gas) that is done in the annual rate case. Only upstream transportation (out of province) is regulated separately. By contrast, local distribution rates are only 10-12% of the delivered cost of electricity in the province. And, at the same time as the OEB is regulating the LDCs, the commodity will be partially regulated and transmission will be fully regulated. These processes are connected, but will operate separately and in parallel. The conventional approach to utility ratemaking breaks down when faced with that structure.

Horizontal vs. Vertical Ratemaking

One method of dealing with the above-mentioned practical issues is to move away from the vertical "silo" approach in which all issues are decided with respect to a single utility, then the decision maker moves on to the next utility and decides all issues with respect to that utility, and so on. Over time, such an approach (Enbridge and Union, for example) develops a body of accepted policy that tends to be applicable to both utilities, but differences remain and there is the disadvantage that common policies evolve only slowly.

The Board appears to be considering a more horizontal ratemaking approach, in which issues that are common to most or all LDCs can be dealt with one at a time, then made applicable to all LDCs across the board. Examples of issues that can be dealt with in this manner include many of those on the draft issues list circulated by the Board, and perhaps others as well. Obvious candidates for common treatment (and therefore standardization) include:

- Conditions of service, including issues such as late payment charges, termination of service, contributions in aid, etc.

- Categories of recoverable expenses and non-recoverable expenses.

- Methods of calculating recoverable amounts, such as depreciation and amortization schedules, bad debt allowances, etc.

- Policies for specific expenditure categories, such as salaries, wages and other remuneration, marketing and promotional expenses, etc.

- Affiliate relationships, including both recoverability of amounts invoiced from affiliates and provision of goods and services to affiliates.

- System expansion principles and tests.

- Rate classes and design.

- Cost allocation rules and methodology.

Fundamentally, there is nothing different about setting rates horizontally rather than vertically. Whether you split up the steps to be decided in determining rates by utility (vertically), or by subject matter (horizontally), in both cases the goal is to make sure all issues are dealt with for all utilities so that rates fall out of the process at the end. Just as there is no reason why it is not possible (although it may be sub-optimal) to set all rates on a vertical basis, with even the most basic common policies established on a utility by utility basis, there is also no reason why it is not possible (again with the caution that it may not be best) to set rates entirely on a horizontal basis, so that individual rate applications are entirely mechanical calculations of pre-determined rules.

There are both advantages and disadvantages to a common subject-based (horizontal) approach:

- ***Cost and Time.*** Certainly the horizontal approach has the potential to reduce the costs associated with ratemaking, and to allow it to be accomplished within a more reasonable time frame. This benefit obviously increases as the number of LDCs to be regulated increases. In part, this is itself a tradeoff. While 97 vertical processes in which there is one utility and several intervenor groups appears ridiculously cumbersome, a single omnibus process or multiple issue-driven processes are also encumbered – by the number of issues in one place, and by the need for all 97 LDCs to participate on those processes. So, if 97 processes with, for example, eight parties are unacceptable, how much more acceptable is a single but much

larger process in which there are 100 or more parties? Ontario Hydro's much maligned Demand/Supply Plan environmental assessment, while it undoubtedly delivered many benefits (we would have 60,000 MW or more of expensive capacity today, and electricity would be at least three times as expensive, were it not for that process), nevertheless it cost $100 million and took four plus years without even being completed. The Board can't afford to get into that same situation with electricity regulation.

- ***Comparability and Standardization Between LDCs.*** Horizontal processes allow thoughtful consideration of policy areas within the context of comparing different LDCs and striving for standardized answers. This is not just a question of making regulation more manageable by requiring all LDCs to operate in a similar manner. That is a benefit when done thoughtfully, but there is a further advantage. In the perfect situation, a horizontal process would amount to a "best practices" review in which all LDC practices in the area are analyzed, and the best (or best practices from other jurisdictions, if no local practices are good enough) are made the standard for everyone. Better still, if certain best practices are identified, that also makes it easier for LDCs to collaborate on acquisition and implementation of processes, technologies, and methods, increasing the quality of what they are doing and at the same time obtaining economies of scale.

- ***Forest vs. Trees Problem.*** Anyone who has spent time in the energy regulation sector understands that every issue is connected to virtually every other issue. There are two reasons for this. First, decisions in any given area will necessarily have an impact on other areas, and the first decisions are not thorough if they do not consider those impacts. For example, rules for the capitalization of overheads will affect whether individual system expansion projects meet economic criteria. System expansion rules will affect the success of DSM programs. DSM programs will affect load shape and therefore system peak sizing. Second, and often overlooked, decisions on policy areas constitute regulatory signals to LDCs that certain behaviours are promoted or discouraged. So, where the Board increases the ability of LDCs to outsource activities, this reduces inhouse resources at the LDCs. One result is likely to be reduced expertise available when planning and other decisions have to be made.

  The "forest vs. trees" problem arises whenever an inquiry is split up. To a limited extent, it arises when the vertical approach to regulation is used, as seen recently when an Enbridge panel had to consider the impact of storage pricing rules in a Union case. Splitting electricity regulation up horizontally has the potential to make connectedness of policies a much bigger issue. This can be managed by some form of omnibus process, but at a price of time and complexity (meaning stakeholders need more rather than less resources to participate). Alternatively, it can be managed by ensuring that each policy process includes express consideration of integration issues, but that adds duplication and potential lack of co-ordination between policy areas.

- ***Deadline for New Rates.*** One benefit of horizontal ratemaking is that it could take less time to get rates than 97 individual rate cases, given current Board and utility resources. If the Board needs rates for LDCs in place by May 1, 2006, there would simply not appear to enough time – 22 months – for those individual rate cases. However, as we saw with the

DSP, it is not clear that there is enough time for an omnibus policy process either, unless the Board adopts innovative approaches to make the process more efficient.

Decisions Driven by Factual Inquiry

That last point leads to the next area: the value of the adversarial process.

It is easy to reject the adversarial process as being archaic and largely benefiting lawyers and consultants rather than the ratepayer. There is no question that the process is relatively time-consuming and expensive, but it is also true that many of the successes of current energy regulation are the direct result of the strengths of the adversarial approach to regulation. If the Board is designing a new approach, it is worthwhile to identify which strengths led to the benefits achieved, so that the new approach as much as possible maintains those strengths and benefits.

It is often thought that the primary benefit of the adversarial process is the "debate" that goes on between opposing points of view. That debate, it is said, defines and tests the issues with precision and intensity, with the result that only results that withstand that debate are sustainable.

There is no doubt that the "debate" component of the adversarial process is important, but it pales by comparison to the real benefit of the process: the intellectual discipline of deciding issues based on the facts, not just ideas. Most components of the adversarial process are designed to ensure that all of the facts are before the decision-maker, and those facts are tested rigorously to ensure that they are really facts, rather than conjecture, positions, or wishful thinking. The theory – which is borne out in practice – is that once the truth is exposed to the light, the conclusions that should be drawn will be both easier to reach and more justifiable and robust.

Look at the typical gas rate case. The process commences with an extensive filing of evidence by the applicant, followed usually by a technical conference to fill in additional factual information. An issues list – often driven by the facts – is established and, if debated, is debated largely on factual grounds. A major component of the process is interrogatories, where the stakeholders elicit further facts, particularly from original source documents or data, to put the prefiled facts in context, to get what they really mean, or to test general statements against contemporaneous documentation. In some cases, this is followed by expert evidence from intervenors, who bring in new resources that identify and testify to additional facts. The next step, ADR, is in practice largely a discussion about facts, and issues are settled based often on compromise positions on the facts. The oral hearing, to the extent it is required, takes those facts that have not been mutually agreed, and are still the subject of differing positions, and subjects them to intense testing through cross-examination. This very often exposes some of those facts as untrue or misleading. The Board, in making its decision, is driven largely by the factual record, and while much judgment and common sense is of course involved, on most issues the Board's decision is the logical result of the revealed truth arising out of the process.

Contrast that with an informal policy review. In the worst case, one party (whether utility, Board

staff, or intervenor) does the research on the factual underpinnings of the policy under review, and the results of that research have to be accepted by all. No matter how good that researcher, it is unlikely that the factual basis created will be complete or rigorous. Then, the next step is the gathering of "input" from stakeholders. Those stakeholders may disagree with some of the facts on the table, expressly or implicitly, and that will inform their views. More often, there will be ambiguity about the truth, and the diversity of views that results will not be able to be resolved through factual analysis. In the end, the policy thus created is built on sand, and so only good luck will make that policy a good one.

In order to preserve the "factual inquiry" success of conventional regulation, it is submitted that the electrical regulation process – and other policy processes initiated by the Board – should ensure that the following components are included:

- ***Base Set of Data.*** Someone in the process, whether a utility, Board staff, or consultants, should have the responsibility to gather together and file as complete as possible a factual basis relating to the policies being reviewed as they possibly can. This should include the direct facts, such as the costs being incurred for particular functions, or the benefits achieved from particular operating approaches. It should also include indirect but relevant facts, such as the approaches to the particular problem in other jurisdictions, and the results from those different approaches. Whoever puts this filing together, it would have the same role as the pre-file in a conventional rate case, but with perhaps more reliability if the author is independent.

- ***Data from Different Perspectives.*** The process should include the ability for all parties to file data on the issue, either to augment what is included in the pre-file, or to challenge it. This will often, in the case of stakeholders, take the form of expert reports, but it could just as easily include compilations of other jurisdiction information or source documents relating to the pre-filed data. This would be equivalent to the expert witness component of conventional ratemaking, but would also cover some of the interrogatories process as well. If there is a diversity of interests at the table, it might cover almost all of the interrogatories process.

- ***Testing of the Facts Presented.*** There is no magic to the formal oral hearing approach to testing evidence, although it has withstood the test of time with a good record of success. However, alternative methods of testing the facts can be explored, such as technical conferences or direct debates between experts. In each case, though, two critical elements of the testing process should be preserved as much as possible: the ability to challenge the fact presenter directly through questioning, and the in-person presence during the fact testing of the adjudicator. On the latter point, most Board members will say that they have had numerous occasions in which the ability to watch witnesses was a critical element in getting to the truth.

As soon as the factual component of a "policy" process is limited by removing data sources or testing of that data, the process shifts away from the real world and becomes more of a discussions of ideas with no basis in reality. Calling something a "policy" process sounds like a discussion of ideas, rather than something more real. That is an erroneous conclusion, and assuming that policy requires less factual analysis than a conventional rate case is incorrect.

While there may undoubtedly be situations in which ideas need to be discussed for their own sake, in the case of ratemaking (and most other Board processes) it is the real world that should inform the discussion, because it is in the real world that ratepayers pay rates. That means that the quantity and quality of the factual basis before the decision-maker is the single most important aspect of the process.

Rate Cases

The last point really raises the next one: to what extent are the horizontal policy reviews contemplated for electricity distribution different from rate cases?

The answer is that they are not. Whether you deal with all of the issues to set just and reasonable rates for LDC X in a single vertical rate case, or you deal with them in twenty separate proceedings on an issue by issue basis, in the end the decisions on those issues will result in rates, and those rates must be just and reasonable.

This has two important implications. First, there is a natural tendency to think of discussions of policy as somehow having less riding on them than discussions of rates. This could lead, for example, to establishing processes, and making decisions about stakeholder participation within those processes, that are less rigorous than they should be because "policy discussions have less at stake". This is patently incorrect. Each policy review or discussion in this electricity distribution process is about rates, and the same rigour that would apply to a rate case must necessarily apply to these horizontally divided components of rate cases.

Second, these "policy" processes must have some form of formal adjudication that meets the tests of natural justice. While it is undoubtedly possible to think of policies that do not set rates, the policies being considered in the electricity distribution process will set rates, and so the same adjudication is necessary as would be necessary in a vertical rate case.

This is not just a legal and moral principle. In this case, it also contains within it a practical reality. If the policy processes do not have reasonable rigour on the adjudicative side, the likely result is that those affected will come back during the rate cases of the individual utilities and insist on dealing with those issues afresh. Without a strong adjudicative basis in place, the Board members deciding those rate cases may be constrained to accede to those requests, adding much time and duplication to the process, and wasting some of the potential benefits of the horizontal approach. Alternatively, the Board members may forge ahead in the rate cases, in which case one might expect that some parties who have been disadvantaged by the individual decisions will pursue their remedies. It is not in the Board's (or the public's) interests if the first electricity distribution rate process it undertakes devolves into a morass of legal and political disputes that could have been avoided at the outset.

It is therefore important, we submit, that the Board consider this initial set of policy discussions in electricity distribution to be no different from a rate case, and apply to that process the same discipline as would be applied if the vertical approach were used.

Revenue Requirement vs. Ratemaking Processes

Traditional cost of service regulation to establish rates for energy distributors involves investigating and answering two specific and distinct questions:

- ***Revenue Requirement.*** How much money does the applicant utility need to recover from ratepayers to operate the public franchise and earn its allowed rate of return?

- ***Ratemaking.*** Who should pay that cost (ie. what rate classes, in what proportions, and on what terms)?

These two questions are intrinsically related, of course, but not symmetrically. The ratemaking component is completely dependent on the results of the revenue requirement inquiry, not just in terms of the total dollars to be collected, but also the makeup of that revenue requirement (for cost allocation purposes).

On the other side, the revenue requirement inquiry is not in any way dependent on the ratemaking exercise. How much is needed, and what costs are included, should generally not be influenced by who is going to end up paying for it.

It is important to recognize that both components of the process are required before just and reasonable rates can be established. It is not enough that the utility is collecting the right total amount, but from the wrong people (because the cost allocation and rate design issues have not been addressed). Just and reasonable is not a general concept applying to the total amount of the rates (ie. the revenue requirement). "Rates" are the individual charges to ratepayers or classes of ratepayers, and the basis of those charges. It is rates - the rates actually charged - which must be just and reasonable, and getting a revenue requirement that is just and reasonable does not meet the Board's obligations under its governing legislation. It must ensure that the right people pay it, on the right basis. Failure to do so, as we note below, is a decline of the Board's jurisdiction.

Proposal for Parallel Processes

We understand that the Board is considering dividing up that revenue requirement and ratemaking components of regulating electricity LDCs. We agree with this conceptually, as long as two principles are recognized:

- ***The revenue requirement issues must be dealt with first***, since until that process has been completed cost allocation and rate design cannot be dealt with. As noted above, cost allocation and rate design start with a specific revenue requirement, and with specific cost components having specific attributes. While it is possible to create a cost allocation methodology, and design resulting rates, all using the principle of cost causality, but without knowing the underlying data that will create the actual rates, that design process cannot be completed until that data is known. Issues such as rate shock, the proper balancing of fixed

and variable costs and charges, and the implications of rate design on other issues (such as DSM and demand response), all of which are necessarily considered in the course of designing the actual rates, can only be considered in the context of the actual amounts being charged to individual rate classes.

- ***Both Revenue Requirement and Ratemaking must be completed before rates can be set.*** As noted earlier, it is not enough to collect the right amount from ratepayers. The utility must also collect it from the right ratepayers, and on the right basis, or the principle of cost causality that underlies the Board's (correct and well-accepted) view of just and reasonable rates would effectively be rejected. For example, we understand the Board is proposing that it will not consider any cost allocation or rate design issues in the process leading up to the May 1, 2006 rates. It will just deal with revenue requirement issues, and leave current rate structures (which have themselves not been subjected to proper public review) in place for 2006. It is submitted that this is not appropriate, because it fails to carry out the Board's mandate to establish just and reasonable rates.

We believe that it is possible to establish just and reasonable rates for May 1, 2006 in a proper manner, considering both components of the inquiry in a timely manner. The key, in our view, is to recognize that the two processes can overlap, since they are not symmetrically interdependent, and since the expertise in each area, while similar, is not the same. Therefore, parties can apply different resources to two processes going on at the same time.

Specifically, we suggest that the Board consider commencing its review of the most important revenue requirement issues now, with a view to completing that process by March of 2005. This, while a very short time, can if all parties co-operate result in the issues relating to the bulk of the revenue requirement being resolved on an issue by issue basis. At the same time, we suggest that the Board immediately put the Cost Allocation Working Group (adding proper funding) back on track, with a rate design group to follow the Cost Allocation Group's first comprehensive report (which should be by January) and a final decision on that report in March of 2005. The Rate Design Working Group could them develop a preliminary standardized rate handbook by June, 2005, with a decision on any contested issues in that handbook by September, 2005.

From the point of view of the individual utilities' rate cases, they would by February have everything they need to file for revenue requirement, so a filing deadline of the end of April, 2005 seems reasonable. At that point, they can commence running their cost allocation models, because the cost allocation decision should be out by then. By June, they should be ready to apply the rules in the standardized rate handbook to their allocated costs and the revenue requirement applied for, and at that point the report of the rate design working group should be available. When the decision on rate design is released in September, they can finalize and file for the rates component of their application, probably in October. Meanwhile, the inquiry into their revenue requirement will have been going on, and by November or December it should be possible in most cases to have a decision of the Board on the approved revenue requirement. This leaves January and February 2006 for any remaining issues on the applications of the standardized cost allocations and rates to the individual utilities, with a Board decision on the final rates themselves in March 2006. This leaves sufficient time to implement those rates by

May 1, 2006.

There is no question that the schedule – no matter how it is done – is tight, and there is some possibility that the final decisions will not take into account every possible issue. In subsequent rate cases or rate processes (see below) it will be necessary to deal with additional issues, and in some cases to review the initial decisions on the first sets of the issues. With that caveat, though, we believe that it is possible to get to May 1, 2006 electricity distribution rates without sacrificing consideration of important issues, and without sacrificing the stakeholder participation that is so critical to the Board's processes.

Ongoing Horizontal Review Processes

The difficulty of regulating 97 electricity LDCs does not go away just because a first set of rates is determined and implemented. On an ongoing basis, at least three categories of issues remain to be addressed by a continuing horizontal ratemaking process:

- ***Issues not addressed in the first process.*** It is not likely that all issues will be dealt with fully in the first process, because there is simply insufficient time. By way of example, if the Board implements a new Affiliate Relationships Code for gas utilities this year, it may determine as a temporary measure to have it apply to electricity LDCs for the first year, until the Board gets time to look at those issues in an electricity context. Once the first process has run its course, though, it will be time to go back to issues of that nature and have a proper review of each.

- ***Review of policies based on unacceptable results in practice.*** It is a given that the initial policies developed for the May 1, 2006 rates will include some that do not work well in practice. Where that is the case, utilities or stakeholders should be expected to bring those forward to the Board in a subsequent process, for review in light of the operating results.

- ***Periodic Updating and Review.*** Nothing stays constant, and policies can get old and outdated. The Board's processes should contemplate inclusion at the Board's initiation each year of some existing policies so that, on a regular cycle, all policies get reviewed periodically.

It is our suggestion that the Board consider an annual "generic rate case" for electricity LDCs, to deal with the three categories of policies described above. At the end of each such case, new or modified policies would be in place, and they would then apply to subsequent rate applications by individual distributors. This effectively preserves the horizontal approach to LDC ratemaking, by continuing to apply it annually after the first set of rates are set. It has the added advantage that, if timing results in some sort of triage of issues in the first go-round, those issues that are deferred (the "walking wounded", in triage parlance) will have a place to which they can be deferred, and the nature of that subsequent process will be known in advance.

FUNDING PROCESS AND ELIGIBILITY

Introduction and Background

The government has recently introduced legislation that will allow the Board to order parties such as utilities to pay the costs of stakeholder participation in processes other than formal proceedings such as rate cases. In addition, in the meantime it is understood that the Board's budget includes an amount of money for reimbursement of participation costs in policy processes. The Board has recently (in December) experimented with a funded policy development process, in that case the DSM Consultation.

The Board is not, of course, new to the granting of costs to stakeholders participating in the Board's decisions. In proceedings such as rate cases, there has developed over the years a comprehensive system for stakeholders wishing to be reimbursed for their costs, including application for eligibility in principle at the outset of a case, specific rules about the types and amounts of costs that can be reimbursed, and a process for applying at the end of a proceeding and the review of, and decision with respect to, that application.

In the existing system, any ratepayer or public interest group with an identifiable interest in the proceeding is eligible to seek funding, but must meet tests relating to avoidance of duplication, reasonableness of participation, and value to the Board, in order to actually receive funding. The Board has in the past been successful in using these rules to police the activities of intervenors, and make sure that costs are not wasted. A good example is the "two schools" situation in 2003, where there were two organizations representing the interests of schools as ratepayers, and the Board used its costs power judiciously to urge those two groups to form what ultimately became the School Energy Coalition, bringing in the existing parties, plus a number of others.

As noted earlier, the existing funding system for proceedings has been a very good investment, as funded intervenors have produced benefits having a value many times the cost of their involvement.

The Board's recent proposal expands formal funding to apply to policy processes – activities of the Board that are not part of a docketed adjudication of rates or other formal decision. The Board is expanding the number of policy processes in which it is involved, largely because of its increasingly broad mandate from the government, and has proposed to identify a small number of major policy processes for funding. It has also proposed to fund stakeholder participation of those processes in a limited way, with the limits being in the form of both amounts and identities of those parties who will be funded.

The Board has specifically asked for input on the eligibility criteria for funding of policy processes, and that is clearly an important consideration. These submissions will look at that question, but will do so in the context of the three basic questions that need to be asked in the design of any funding regime:

- Which processes or Board activities should be funded?

- Which stakeholders should receive funding to participate in those activities?

- What is the scope or amount of funding that should be available, whether measured individually or as a global amount for the entire process?

What is a Policy Process, and Which Ones Should be Funded?

The term "policy process" sounds like it is somehow divorced from the real-world activities of the Board in setting rates, granting franchises, overseeing system expansion, etc. What has to be recognized (and we have dealt with this in part earlier) is that everything the Board does is about whether Ontarians have access to natural gas or electricity, and how much they pay for it when they get it. A "policy process", for example, will always directly or indirectly decide either whether particular Ontarians get energy (e.g. system expansion policies, interconnect policies, etc.), or how much they pay for it (e.g. utility accounting policies, rate handbooks, affiliate transactions rules, etc.). Even procedural policies, such as the recent consultation on record-keeping, or the existing policy on ADR processes, are about how the Board determines rates, or what information it has before it to do so, and so are still fundamentally about rates.

The most extreme case, though, is the current case of electricity distribution rates, as discussed in depth earlier in these submissions. Although the Board is establishing a form of comprehensive policy process, and although the LDCs will technically have individual rate cases where their specific rates are determined, what is really happening is a rate case split up horizontally (by issue) rather than the traditional vertical division (by LDC). In this case, there is no fundamental difference between an Enbridge rate case (a funded proceeding) and the electricity distribution rates process (a policy process). Both are about rates charged to ratepayers. They merely take different routes to get to that result.

Another example of this is the Natural Gas Forum. This is clearly a "policy process", yet the Board's initial indication of its scope includes a review of performance-based ratemaking. As ratepayers have seen with great clarity in the recently completed PBR experiments for both Enbridge and Union, the design of the PBR system will have a significant impact on rates. As a result, on PBR alone (and this is true of other issues as well), the Natural Gas Forum can be expected to be in essence a rate case in terms of its practical results.

As will be discussed in more detail below, the fact that policy processes are still parts of the Board's basic rate making and system oversight mandates suggests that prima facie the rules for intervenor costs that are currently applied to rate cases should be applied to these policy processes as well.

But it is not enough to simply apply the current costs rules to all policy activities. It is of course necessary to make judgments about how much time and money should be spent on each activity, given the inherent complexity and/or importance of the activity and the other competing claims on the resources of the Board, the utilities, and the stakeholder groups. The question is: should those judgments be made without input by Board members or staff prior to commencing each

activity, or should they be made by the participants as part of the process itself?

One approach would be for the Board to make a conscious assessment of how much time and money should be allocated to each process. The Board could decide, for example, that the financial reporting rules for gas utilities constitute an area in which the Board already has considerable expertise, and the rate impact of one set of rules versus another is likely to be small. Therefore, the Board might arbitrarily decide that only a small budget – or even none at all – should be allocated to stakeholder participation in that process.

The other approach is to leave all processes open, but rely on the stakeholders to husband their own resources efficiently, and participate only where it is important for their interests that they do so. Thus, in the same example, it may be that all stakeholder groups decide to have zero or limited involvement in the financial reporting process, for the same reasons noted above that the Board might want to limit involvement.

The second approach has the advantage that stakeholders feel they have full access to the Board's policy making processes, so the Board still gets the benefit of stakeholder acceptance of policies, even if the stakeholders are not heavily involved. On the other hand, it has the disadvantage that a risk is created of empire-building within intervenor groups. If funding is unlimited, some stakeholders might take advantage of that blank cheque, despite the danger that Board panel members might limit their recovery if they are abusing the costs process.

In our view, the key to being careful with stakeholder funding lies in how the processes are designed, not the specific funding rules for those processes. The optimum approach, it appears to us, is for the Board to propose for each policy process a timetable and activity schedule appropriate to the complexity and importance of the issues in that process. Then, at the beginning of the process, all stakeholders should be invited to participate in a scoping meeting, during which one of the items for discussion would be the extent to which each intervenor plans to be involved. This should include a frank discussion between the parties and with Board staff of how each intervenor will be adding to the process, and how their expected costs of involvement are justified by that value added. This should also, in our view, include utilities that are planning to be involved, since they too are spending ratepayer money on the process.

If the Board adopts this approach, it does not need to place any specific limits on funding availability. The stakeholders will themselves police the process, and will ensure that not only intervenor costs, but also utility costs, are closely controlled. Further, because the Board would be involved at the outset, if it appears that some parties are planning to "make a meal" out of a process where it is not appropriate, the Board member or panel assigned to that process can make clear to the parties just how much their costs claim may be at risk if they do so. As has been obvious in past situations, where the panel at the outset warns specific parties about costs, the parties generally limit their activities so that they don't run afoul of the Board's warnings.

We therefore urge the Board to adopt this approach. In our view the benefits include:

- ***The Board avoids limits that could cut out valuable involvement by particular stakeholders.*** In the financial reporting example, above, there are stakeholders who, because

of expertise or interest, have specific input that could be valuable to the Board. A process such as what we are proposing – with a discussion of involvement up front - allows the Board to keep a lid on the overall total, while ensuring that the particular stakeholders that can help have appropriate funding to do so.

- ***The Board controls the costs of the utilities as well.*** We have not seen in the past a huge drain of ratepayer money due to utility involvement, because utility involvement has mainly arisen in the natural gas area, where there are only a few utilities, each with substantial in-house staff so that incremental costs of new activities are relatively low. The same is not true in electricity, where there are many more utilities, and with a few exceptions they have to hire outsiders or additional in-house staff to participate meaningfully in any new processes. An approach in which the utilities are strongly encouraged to husband their regulatory resources right at the beginning (for example, through shared participation or through no involvement at all) could save ratepayers as much or more as limiting funding for stakeholder participation.

- ***The Board avoids "circling back" on issues where intervenors were prevented from participating.*** If the Board simply closes the door on intervenors for any particular policy, the first time that policy comes up in a real-life situation like a rate case the intervenors are going to be considering it afresh, and will feel – correctly – that they are entitled to do so because they have been prevented from participating in the policy's development. Conversely, if stakeholders are invited to participate fully at the development stage, and make their own decisions about priorities between issues, they will be more willing to accept the policy when it is being applied in rate cases.

- ***The Board's funding of policy processes would be more flexible.*** The problem with many rule-based systems is that we cannot possibly contemplate all of the possibilities the real world will throw our way. A rule that ab initio each process has a budget, for example, fails to consider the possibility that the Board could benefit from one stakeholder being there on a more active basis. By letting intervenor participation in processes develop within each process, the funding and involvement are more likely to fit the complexity and importance of the issues and the value that each interested participant can supply.

Therefore, it is our conclusion that the Board should allow funding under the existing costs rules for all processes before it, but should design and schedule those processes with an eye to the time and resources that will be appropriate in the circumstances. The Board should encourage all potential stakeholder and utility parties to discuss their potential involvement in each process at the outset, and should be vigilant in sending the appropriate message to parties that are not exercising sufficient restraint.

Who Should Participate?

The Board has specifically asked for input on eligibility rules. School Energy Coalition is of the view that the existing costs rules and system, with some modifications, is the appropriate approach for the funding of policy processes. The Board has existing rules in place to control

who is eligible for costs, and what they have to demonstrate to maintain that eligibility. If the Board is to consider new rules, it should be in the context of some flaws or weaknesses in the old rules.

The current rules stem from two basic principles:

- ***Intervenors must have a real interest in the particular Board activity.*** This concept is delivered in the rules through allowing essentially ratepayer groups and public interest groups to apply for costs. The "officious intermeddler", while allowed to participate because processes are public, is limited through lack of access to funding or costs. Ratepayer groups by definition have an interest in proceedings dealing directly or indirectly with rates. Public interest groups have traditionally been required to demonstrate to the Board that they have a record of public interest involvement in the issues that the Board is considering.

- ***Intervenors must structure their involvement to be efficient and appropriate.*** This concept is delivered in the rules through prohibitions on duplication and similar constraints. Intervenors have in the past been penalized in costs when they failed to heed the efficiency requirement.

It does not appear to us to be necessary to impose additional rules that further limit eligibility. This stands to reason, of course. If a particular intervenor group is properly eligible for the Enbridge rate case, it is hard to see how that same group would not be eligible to receive costs in the Natural Gas Forum, unless the only issues on which the group participates are ones clearly excluded from the Forum. For example, an environmental group might participate in the Enbridge rate case, but might not need to participate in the Forum if it is focussing on the utility's role in providing system gas. On the other hand, once PBR is added to the agenda of the Forum, it is clear that DSM is a key issue in PBR, and an environmental group is an appropriate party in that context.

That does leave two matters for consideration in relation to eligibility.

First, how should the existing rules be changed to control spending of ratepayer money in regulatory processes by utilities as opposed to stakeholder groups? While we believe that the primary method of controlling this type of spending is in the rate cases of the utilities, it is also appropriate (for flexibility, if for nothing else), to consider utility involvement in each activity as it arises. In our view the same rules should apply to utilities wishing to participate as apply to stakeholder groups seeking costs.

In practice, this means that in most cases utilities would meet the first test – interest in the proceedings – by virtue of their simply being utilities. There may be some cases where that would not be true (consider whether Toronto Hydro has any real interest in a policy process on northern Ontario system expansion rules), but in general utilities would not be constrained because they don't have a legitimate interest in the outcome. In almost all cases, the main constraint would be on the efficiency of their involvement. We have already seen that the electric LDCs are feeling their way, and some of them want to be involved in everything just to be careful. Making the existing costs principles apply to them would require them – as it requires

the ratepayers themselves – to make sure they are not wasting the Board's time or the ratepayers' money in the process.

We note that, for the rules to apply to utilities, there must be consequences as well. In our view the sensible approach in policy processes (and in this respect they are somewhat unlike formal rate cases, in which the utility is an essential party) is that utilities wishing to participate should have to indicate their reasons for doing so up front, and should have to report their costs in detail at the end. The Board should rule on their costs, and any amount not approved should be non-recoverable in rates.

The second issue is the potential that the existing rules currently allow stakeholders some levels of duplication that may not be practical or even possible in the very active regulatory agenda of the next few years. It is our view that the current rules are largely self-policing on this point. Where there is some overlap already between intervenor groups – in the area of residential consumers, for example – the groups have been successful in making sure that they are not wasteful of resources. Issues are divided up, different groups naturally focus on different aspects of the case, and in general everyone is highly conscious that failure to deliver value added to the process can result in costs disallowance at the end of the day.

In the few cases where intervenor groups with similar interests have duplicative involvement in issues, it is often because the groups legitimately disagree on the appropriate outcome, just as the members of the public they are representing have a range of views on issues. A debate between residential ratepayer groups on whether approving or opposing a specific policy is in the interests of residential ratepayers is, in fact, useful to the Board in understanding the range of viewpoints. And, in any case, this happens only rarely.

We expect the current state of events – intervenors policing themselves to prevent duplication and inefficiency - to continue in the near term, if the current costs rules are made applicable to all of the Board's processes. The difference is likely to be that – even with funding available – groups will have limited internal resources and so will be rigorous in prioritizing the issues they address. And, as we have suggested earlier, the Board has ample powers at its disposal to send a clear message to those stakeholders who abuse the funding availability, for example by staffing up to allow involvement in everything without application of any judgment.

We therefore do not believe it is necessary to place further limits on who is eligible for costs, and urge the Board to use its existing rules fully to make the process efficient while still ensuring that all those with an interest in the Board's activities have full access.

Amount and Payment of Funding

As will be clear from our previous comments, the School Energy Coalition does not believe it is appropriate to set arbitrary limits on the amount of funding available for individual Board activities, or for specific parties to each process. If the Board adopts the approach we have earlier proposed for designing each policy process, the design itself will place practical limits on how much participants can spend, without making those limits arbitrary.

The approach has the flexibility that allows, for example, a single intervenor with a lot of value to add to the process to spend considerably more than an arbitrary budget would allow, while other parties with little to add will be constrained. If the system is properly overseen by Board members in each case, the amount spent on these processes will in total be the same as in the more arbitrary approach, but the spending will be more efficient and the value of stakeholder participation will be enhanced.

We note that the existing rules also require that intervenors show at the end of the process how they have been efficient. Intervenors run the risk of limited or no recovery if they do not pay sufficient attention to this requirement. This is by itself a strong incentive to control intervenor overspending.

But, we do suggest that a further step could enhance this impact. Right now, the fact that the only quantum-related decision on costs is at the end of the process makes it a bit of a "crap shoot" for the intervenors, and this is not really optimal. A better approach may be for the intervenors (and utilities) seeking recovery of costs in policy processes to estimate their general intervention budget for that process at the time they send their letter of intervention and request for costs eligibility. Many intervenors – including School Energy Coalition – do this already internally, and it is a useful discipline that would benefit most parties. It also gives the Board the opportunity to question at the outset significant deviations from what would be expected, and ask the intervenors to explain them.

We do not propose that the Board specifically approve parties' budgets at the outset. Rather, we suggest that the Board can and should comment on, or question, unusual budgets. Further, we do not propose that parties' budgets be considered a cap on their ultimate cost claims. Instead, we suggest that the Board should require a detailed explanation of material variations from budget (just as our clients do today). The amount of the variation, and the suitability of the explanation, would then be factors in the Board's determination of the reasonableness of the cost claim.

With that one change, we propose that the existing rules for costs be applied to policy processes. In our view, the natural result of the current rules is that the amounts spent by parties will be self-policed, and the Board has sufficient residual power to ensure that abuses do not occur.

CONCLUSION

The School Energy Coalition believes that the Ontario Energy Board benefits greatly from the active involvement of stakeholders in Board processes of all types. The design of those processes – such as the electricity distribution rates process – and the rules for funding of those processes should ensure that stakeholder participation is facilitated and the maximum value is achieved from that participation. In these submissions we have made a number of specific suggestions to accomplish that result.

All of which is respectfully submitted on this July 15, 2004.

Jay Shepherd
on behalf of the
School Energy Coalition