



McCarthy Tétrault LLP  
Suite 5300, 66 Wellington St. W  
Toronto, ON M5K 1E6  
Canada  
Tel: 416-362-1812  
Fax: 416-886-0673

**George Vegh**  
Direct Line: 416-601-7709  
Email: gvegh@mccarthy.ca

March 21, 2012

**Via Courier**

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street, Suite 2700  
Toronto ON  
M4P 1E4

Dear Madame:

**Re: Renewed Regulatory Framework  
Board File No.: EB-2010-0377; EB-2010-0378; EB 2010-0379; EB-2011-0043  
and EB-2011-0004  
Stakeholder Conference – March 28-30, 2012**

Enclosed please find two hard copies of a presentation filed by the Intervenor DRRTF in the above-noted matters which we intend to make at the Stakeholder Conference March 28-30, 2012. A copy of this cover letter and attached submission has also been filed through RESS.

Sincerely,

*signed in the original*

George Vegh  
Chair, Distribution Regulation Review Task-Force

GAV:mt  
att.



# Presentation by Distribution Regulation Review Task Force to OEB on Renewed Regulatory Framework Review

March, 2012



# Overview

- Task Force supports Framework Review as a way to address need for infrastructure investment in a manner that addresses customer expectations and rewards higher performing utilities.
- There are many issues raised in various Board materials; the key now is to prioritize them both by reference to their importance and their sequence.
- It is also important to clarify process for framework review both in terms of timing and participation.

# Prioritization by Importance

- DRRTF's agrees with Chair that “one of the major challenges facing the sector today and the most significant driver of costs is the scale of capital spending expected over the next few years.”
- The rate treatment of capital investment is the most significant issue facing the sector and should be the first issue addressed in the Framework Review.

# Infrastructure Investment: Fundamental Review

- The Framework Review should be driven by the need to fundamentally reconsider the rate treatment of infrastructure investment in light of how different types of investment are treated.
- It will take time to coordinate with the other elements of the framework review and to produce an enduring approach to capital treatment that will be in place until the next framework review.

## Capital Treatment During IR

- The concept that there is an “allowed capital envelope” in base rates is inaccurate.
- Capex spending results in incremental depreciation and carrying costs which creates a challenge, over & above other challenges
- All else equal, to hold earnings constant, the rate of capex spending must decline to limit the growth in depreciation and carrying charges
- In the extreme, this would likely (or inevitably) result in deferred project spending, and very large COS requests at rebasing time
- This, in turn, will result in both higher rates, and greater rate volatility for customers at rebasing time
- The mix of capital spending also matters
- All else equal, higher levels of capital investment not associated with higher off-setting incremental revenues create a greater challenge

# Different Capital Has Different Rate Impacts

***All Utility Capital isn't the same – it's made up of different types:***

- **Customer Attachment and System Expansion Capital**
  - Long term; 'revenue producing' in that new load and customers are attached - may lead to scale economies over time
  - Low (or lower) depreciation rates ; sometimes partially funded through capital contributions
  - Short term deficiencies and longer term sufficiency
- **System Integrity, Reinforcement and Enhancement Capital**
  - Long term; needed to meet load growth, customer service levels and safety requirements – may have some revenue producing elements
  - Low depreciation rates ; sometimes partially funded through capital contributions
- **Infrastructure Renewal Capital**
  - Long term; replaces existing infrastructure that is fully depreciated
  - NO new load or customers – non-revenue producing
  - Not funded through capital contributions
- **General Plant – Shorter term capital**
  - E.g., vehicles, IT; high depreciation rates in the range of 6% to 20% annually
  - Not revenue producing and not funded through capital contributions
  - High depreciation rates so some, most, or even all of depreciation and return not in rates within the IRM-PCI period
- **Mandated Investment – May fall into categories described above**
  - Distributed Generation Connection Costs
  - Compliance with Regulations and Government Initiatives – e.g. Smart Meters/Smart Grid, Customer service rules

# Rate Impacts of Different Capital Types

Long Term Capital Type	Funding Mechanisms	Effect on Revenue Requirement	Effect on Rates
Customer Attachment and System Expansion	Distribution Rates Additional Billing Units Capital Contributions	++	+/-
System Enhancement Capital	Distribution Rates Additional Billing Units	+++	++
Infrastructure Renewal Capital	Distribution Rates	+++	+++++

# Capital Treatment During IR

## Capital Constraint Challenges

- Most utilities are experiencing an increased (and perhaps lumpy) need for capital to fulfill obligations related to safety and reliability
- In addition, many utilities have increasing replacement obligations as ageing assets reach their end of life
- These requirements are driving both a need for higher capital, and changing the mix of capital toward non-revenue generating capital
- Further, the input prices underpinning capital projects (labour & materials) may be growing faster than the rate of macroeconomic inflation (GDPIPI)
- Other challenges include:
  - Containing O&M and Capital costs within the bounds of macroeconomic inflation
  - Achieving productivity equal to the X-Factor or greater
  - Volumetric profile

# Interim Solution

- In addition to fundamental review, there is a need for an interim solution.
- Current framework addresses infrastructure investment through Cost of Service rebasing and Incremental Capital Module (“ICM”) between rebasings.
- ICM approved in 2008 and has evolved over time through case by case approach. Case by case approach has permitted experimentation.
- This experimentation has provided experience for the Board and participants to draw upon. It is now helpful to learn from that experience and provide a consistent and predictable approach to ICM on an interim basis, pending the framework review.

# ICM Criteria

ICM Criteria	OEB Decision/Report
“Materiality, Need and Prudence”	Report of the Board on 3rd Generation Incentive Regulation for Ontario’s Electricity Distributors, July 14, 2008, s. 2.5; see also, Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario’s Electricity Distributors, September 17, 2008, Appendix B.
“Materiality, Need and Prudence”, <b>plus</b> “extraordinary and unanticipated”	Hydro One Networks Inc. Decision, May 13, 2009 (EB-2008)-0187).
Materiality, Need and Prudence”, <b>plus</b> “extraordinary”	Oshawa PUC Decision, June 10, 2009 (EB-2008-0205).
“Applicants must demonstrate that the amounts exceed the Board’s materiality threshold and clearly have a significant influence on the operation of the distributor, must be clearly non-discretionary and the amounts must be outside the base upon which rates were derived. In addition, the decision to incur the amounts must represent the most cost-effective option for ratepayers.”	Guelph Hydro Electric System Inc., Decision, May 13, 2009 (EB-2008-0205 (corrected)) June 10, 2009; and Oakville Hydro Electricity Distribution Inc., Decision (EB-2010-0104), June 10, 2009.
“Discrete, Material and non-discretionary” and, apparently, facility specific. <sup>[1]</sup>	Toronto Hydro-Electric System Limited (EB-2011-0144), Decision, January 5, 2012

<sup>[1]</sup> The decision referred to the fact that municipal transformer stations have been funded through ICM and suggested that an IRM application that requested funding for similar facilities would be “directly analogous to projects that the Board has previously approved under ICM for other distributors.” (at p. 22).

# Clarity on ICM

- There is a need to bring clarity to this issue. A number of processes available to provide clarity.
- Simplest could be test case in an LDC's 2012 ICM filing (like PILs proceeding (EB-2008-0381)).

# Prioritization and Sequencing

- The other framework components that can be addressed on a prioritized basis are:
  - Total bill mitigation;
  - performance measures; and
  - regional planning.

# Bill Mitigation

- Part of bill mitigation is the treatment of capital (avoiding step change increases upon rebasing).
- Important point is to maintain clarity and proper governance so that OEB maintains its focus on distribution issues, and not seek to regulate impact on total bill, which is beyond distributors' and the OEB's control (in the absence of legislative change).

# Performance Measures

- An outcomes' based approach to regulation requires focus on how performance is effectively measured and evaluated.
- The Board current performance measures are flawed and incapable of meeting these new requirements.
- Major flaws are peer grouping methods and current productivity measures.
- Replacing measures will require considerable time and access to information, thus requiring an early start.

# Regional Planning

- If regional planning is confined to cost responsibility issues under TSC, then it can be addressed with a straight forward code amendment, without the need for a full review of regulatory framework.