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Kirsten Walli
Board Secretary
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Dear Ms Walli,

Consultation on Distribution Revenue Decoupling
Board File No.: EB-2010-0060
Our File No.: 339583-000065

Introduction

The comments in this letter are submitted on behalf of our client, Canadian Manufacturers & Exporters ("CME"). They relate to the Report of the Pacific Economics Group Research ("PEG") entitled "*Review of Distribution Revenue Decoupling Mechanisms*" dated March 19, 2010 (the "PEG Report") and the seven (7) Board Staff questions contained in the Board's letter to interested parties dated March 22, 2010 (the "Board's Letter").

Current Conditions and Purpose of this Consultative

The Board's Letter indicates that the purpose of this consultative is to confirm whether the Revenue Decoupling mechanisms currently in use are adequate and sufficient under "current conditions".

The "current conditions" prompting the consultative include amendments to the *Ontario Energy Board Act, 1998* (the "*OEB Act*") made by the *Green Energy and Green Economy Act, 2009* (the "*GEA*") contemplating that electricity distributors will be required to achieve Conservation and Demand Management ("CDM") targets as part of an overall policy promoting and expanding energy conservation by consumers. The Board's Letter also refers to "developments in metering" which we assume refers to smart meters pertaining to the use of electricity. As far as we are aware, there have been no developments in metering pertaining to gas usage.

In our view, before customer-specific historical time-of-day consumption data from smart meters can be used in the design of any Revenue Decoupling mechanisms, the period over which the historical data has been gathered needs to be long enough to establish that the data is reasonably stable. We suspect that averages over a period of at least three (3) years and perhaps as many as five (5) years will be necessary to achieve that stability objective. Accordingly, while the recent developments in smart metering can prompt a

conceptual discussion of the possible use of customer-specific time-of-day consumption data in the design of regulatory decoupling mechanisms for electricity utilities, it is premature, at this time, to consider the possible implementation of any such mechanisms on a utility-specific basis. The existence of stable customer use data is a precursor to implementation.

Whether or not the *GEA*'s emphasis on CDM programs warrants any chance in the Board's current regulatory approach to Revenue Decoupling should begin with a consideration of the existing Revenue Decoupling situation pertaining to the gas and electricity utilities the Board regulates.

The Existing Situation

1. Gas Utilities

The major gas utilities, Union Gas Limited ("Union") and Enbridge Gas Distribution Inc. ("EGD"), have Revenue Decoupling mechanisms in place pertaining to:

(i) Revenue erosion attributable to distributor provided CDM/DSM programs, and

(ii) Declines in normalized average use in the smaller fixed rate classes caused by other CDM/DSM programs and factors other than weather.

For the gas utilities, these mechanisms are based on the provisions of long term Incentive Regulation Mechanism ("IRM") Settlement Agreements. These Agreements do not expire until December 31, 2012. The combined effect of the Return on Equity ("ROE") and earnings sharing provisions of these Agreements allocates the risks and rewards associated with load losses and gains, caused by factors not covered by these Revenue Decoupling mechanisms, between ratepayers and the utility owners.

In order to respect the provisions of these Agreements, any modifications to the Revenue Decoupling mechanisms currently used by Union and EGD could not be introduced before the year commencing January 1, 2013.

2. Electricity Utilities

Generally speaking, the electricity distribution utilities the Board regulates have no Revenue Decoupling mechanisms.

Hydro One Networks Inc. ("Hydro One") has operated its distribution system for years under the auspices of load forecasts that take into account their test period estimates of conservation. Neither its distribution deliveries, nor distribution earnings have been materially eroded by factors attributable to conservation and Hydro One has resisted the submissions by the Green Energy Coalition and Pollution Probe that an LRAM is necessary. In the Board's recent EB-2009-0096 Decision with Reasons, Hydro One was directed to adopt an LRAM.

As far as we are aware, there is no evidence from the small electricity utilities that shows that they have experienced any material revenue erosion and related under-earnings due to conservation measures adopted by its customers. Any historic under-earnings experienced by smaller utilities is most likely primarily attributable to the fact that, until

recently, they have been operating under the auspices of base rates for 2006 established on the basis of their 2004 actual results. For those utilities that have just recently been re-based, it is too early to tell whether the volume forecast embedded in their new base rates is too high because it inadequately reflects the impacts of conservation. The volume forecasts upon which base rates have recently been set may well turn out to be too low rather than too high. Any utility that turns out to have under-forecast its base year volumes is unlikely to support the imposition of Revenue Decoupling mechanisms because those mechanisms will require it to pay monies back to their utility customers.

On the electricity front, there is little, if any, evidence of which we are aware to support the premise that the Government's increased estimates emphasis on CDM/DSM is exposing all gas, electricity distributors to material revenue erosion risk.

In these circumstances, we question whether there is a sufficient evidentiary base to justify imposing any generic decoupling mechanisms on all electricity distribution utilities.

At this stage, we suggest that the discussion of Revenue Decoupling mechanisms be confined to discussions at a conceptual level. The need for and the appropriateness of any specific Revenue Decoupling mechanisms for a particular electricity utility should be determined in a utility-specific context and on the basis of evidence that addresses all of the ratemaking implications for that particular utility that are inextricably intertwined with Revenue Decoupling.

Revenue Decoupling Concepts to Consider

1. Possible Causes of Revenue Erosion Attributable to Unforeseen Changes in the Volume of Energy Sold

Many factors can cause revenue erosion. As indicated in the Board's Letter, these causes include:

(i) Distributor provided CDM/DSM programs;

(ii) Other CDM/DSM programs;

(iii) Declines in average use attributable to factors other than weather or the economy;

(iv) Load changes due to weather;

(v) Load changes due to customer loss; and

(vi) Load changes due to other economic factors.

Risks faced by a particular utility will decline materially if the design of a particular Revenue Decoupling mechanism is broadened to cover all of the possible causes of revenue erosion.

2. Risk/Reward Implications of Broadening Revenue Decoupling Coverage

From the perspective of gas and electricity consumers, the adoption of Revenue Decoupling mechanisms that shield utilities from all risks associated with revenue variations attributable to unforecasted changes in energy sold must be accompanied by appropriate reductions in ROE and in the opportunity of utility owners to earn more than the Board approved ROE.

A determination of the appropriate ROE and the share of earnings above the Board approved ROE to be allocated to ratepayers is inextricably intertwined with the introduction of or the enhancement of a Revenue Decoupling mechanism. The allocation of risks between utility owners and ratepayers associated with load losses and gains not covered by a Revenue Decoupling mechanism are provided by the combined effect of the ROE the Board allows and the parameters of any earnings sharing mechanism that prevails in the rate-making regime the Board has approved for a particular utility it regulates. If the coverage of Revenue Decoupling mechanisms is broadened, then the utility risk/reward profile materially changes. Proposals to implement Revenue Decoupling mechanisms necessarily trigger a concurrent determination of matters pertaining to ROE and earnings sharing.

3. Compatibility with Cost-Related Rate Design Principles

Over the past 36 years, the Board has consistently expressed its adherence to the concept that rates should be designed to be "cost-related". In applying this well-established principle, the Board has gradually increased the level of customer-related costs being recovered in fixed monthly charges and the level of demand-related costs being recovered in capacity or demand-related charges linked to peak period usage. These well established rate design principles should be adhered to and not disregarded when considering the design of any Revenue Decoupling mechanism.

At a conceptual level, the adoption of Full Fixed and Variable ("FFV") cost based rates can materially reduce a distributor's exposure to revenue erosion. For example, if all customer costs allocated to ratepayer classes are recovered in a customer charge, all demand-related or capacity-related costs are recovered in a demand charge, and all variable costs are recovered in a commodity charge, then the risk of revenue erosion would be materially reduced.

4. Need for Reliable Historical Usage Data

Information that will eventually be available from smart meters could be used in the design of fully or partially cost-based Revenue Decoupling mechanisms where demand-related or capacity-related costs are recovered in a capacity charge linked to peak period usage. However, as already noted, what is needed before developments in smart metering can affect the design of Revenue Decoupling mechanisms is data that will be available from these smart meters for an historical period that is sufficiently long to support an inference that the data is reasonably stable. At the moment, it is premature to consider modifying the design of revenue recovery mechanisms to reflect developments in smart metering.

5. Need for Accurate Volume Forecasts

Regardless of the scope of coverage they provide, Revenue Decoupling mechanisms do not relieve the Board from being satisfied that the annual volumes a distributor forecasts that it will sell are reliable and reasonably accurate. Encompassed in these annual volume forecasts are forecasts of customer numbers, as well as forecasts of peak period demands. Accurate forecasts of these items are required to facilitate the design of just and reasonable rates and to minimize the risk of rate instability by providing a realistic fulcrum around which Revenue Decoupling variance accounts and other variance accounts operate. Despite its frustration with having to consider issues pertaining to the reasonableness of load forecasts[1], the Board cannot fix just and reasonable rates without being satisfied that the forecasts presented by the utilities it regulates are reasonably accurate and reliable.

6. Differences in the Administrative and Regulatory Burdens

The administrative and regulatory burdens associated with different Revenue Decoupling mechanisms varies. For example, the year-to-year administrative and regulatory burdens associated with a Revenue Decoupling mechanism based on a FFV rate design would likely be lighter than the burdens associated with a Revenue Decoupling mechanism confined in scope to revenue erosion caused by distributor provided CDM and DSM measures. At a conceptual level, the differences in administrative and regulatory burdens associated with different Revenue Decoupling mechanisms should be considered when determining the Revenue Decoupling mechanism, if any, that should be adopted by any particular utility the Board regulates.

Comments on the PEG Report

Our comments on the PEG Report are based on the Revenue Decoupling concepts we have outlined.

In our view, the PEG Report describes some, but not all, of the concepts that we believe are relevant to a consideration of the adoption of Revenue Decoupling mechanisms by particular utilities. For example, the Report does not refer to the inextricable interconnection between Revenue Decoupling and the reduction in risks faced by utility owners. In our view, extending Revenue Decoupling coverage for a particular utility must be accompanied by a material reduction in equity return and an increase in the ratepayers share of earnings in excess of the Board-approved equity return. The risk reduction features of Revenue Decoupling mechanisms should not be disregarded.

The Report appears to envisage that "one size fits all" Revenue Decoupling mechanisms can be imposed generically on all of the utilities the Board regulates. For reasons already outlined in this letter, we regard matters pertaining to the need for and, if needed, the design of an appropriate Revenue Decoupling mechanism to be issues of evidence to be adduced on a utility-specific basis.

[1] Vice Chair Mr. Kaiser expressed this frustration in a recent Decision dated April 20, 2010, pertaining to the Cambridge and North Dumfries Hydro Inc. electricity distribution utility.

The suggestions contained in the Report that distributors should reduce existing fixed charges to residential customers appear to us to be incompatible with the Board's long standing adherence to cost-related rates. In our view, the cost-relatedness of rates should not be diluted to achieve conservation objectives.

Response to Board Staff Questions

Our responses to Board Staff Questions are based on the Revenue Decoupling concepts we have described in this letter.

1. In light of developments in metering, CDM and demand side management ("DSM"), among possible others, is the implementation of further or modified revenue decoupling mechanisms for electricity and/or gas distributors warranted at this time and if so, why? For example, is the Board's current Lost Revenue Adjustment Mechanism adequate in light of the contemplated introduction of CDM targets for all electricity distributors in the Province?

We suggest that the need for further or modified Revenue Decoupling mechanisms for electricity and/or gas distributors should be assessed on a utility-specific basis.

Generally speaking, extending the coverage of a Lost Revenue Adjustment Mechanism ("LRAM") to cover all conservation-related declines in weather normalized revenue and not limiting it in scope to distributor provided CDM measures seems sensible. The normalized average use variance accounts used by Union and EGD could be modified to achieve this objective. Such measures should only be introduced upon the expiry of existing Settlement Agreements and should be conditional upon concurrent adjustments being made to reduce ROE and increase the ratepayers' share of earnings above the Board-approved ROE.

For reasons already outlined, it is premature to consider implementing any Revenue Decoupling mechanisms dependent upon customer-specific time-of-day consumption data recorded by smart meters.

2. What factors should be considered when assessing the suitability of Ontario's current mechanisms and of alternative approaches? Are any of these factors more or less important than others? If so, why?

The factors that should be considered include:

(a) The extent to which the utility-specific test period forecasts reflect forecasts of conservation;

(b) The extent to which current mechanisms and alternative approaches provide Revenue Decoupling coverage for the various factors that can cause revenue variances;

(c) The risk/reward implications of extending Revenue Decoupling coverage, including the need for a concurrent reduction in ROE, as well as an increase in the ratepayers' share of earnings above the Board approved ROE;

(d) The rate design implications of current mechanisms and alternative approaches, including adherence to cost-related rate design principles;

(e) Stability of customer-specific usage data for use in current mechanisms and alternative approaches;

(f) Comparative administrative and regulatory burdens associated with current mechanisms and alternative approaches; and

(g) Respect for the provisions of unexpired long-term IRM Agreements.

3. What, if any, are the implications of the wide-spread deployment of smart meters for the Board's approach to revenue decoupling?

The eventual availability of usage data provided by smart meters will provide opportunities to design Revenue Decoupling mechanisms that reflect differences in costs caused during peak periods and non-peak periods. These possible approaches cannot be considered until there is sufficient data for an historical period that is long enough to support an inference that the data is reasonably stable.

4. What scope for further or modified revenue decoupling might be appropriate? For example, should the impact of all variances from forecast in commodity demand be eliminated regardless of the cause (i.e., distributor-provided CDM/DSM programs, other CDM/DSM programs, the economy, weather, customer growth, etc.)? Why or why not?

Broadening the scope of existing Revenue Decoupling mechanisms cannot be considered without concurrently considering the risk/reward implications of such measures, as well as their DSM rate-making consequences and other related rate design implications, including adherence to the well established principle that the customer charges, demand or capacity charges and commodity charges recovered in rates should be cost-related.

5. Are there any alternative approaches, beyond those identified in the PEG Report, which better address revenue erosion due to changes in consumption? What are the costs, benefits and implications of implementing the alternative approach?

The range of possible approaches is broad. For example, a Revenue Decoupling mechanism is arguably unnecessary in a situation where the year-to-year impacts of conservation can reasonably be forecast. In this scenario, there would be no revenue erosion coverage other than that reflected in the forecast. At the other end of the spectrum is a Revenue Decoupling mechanism which provides full coverage for any and all causes of revenue erosion or revenue gain attributable to unforecasted changes in the volume of energy sold. The costs, benefits and implications of one approach within the range of alternatives versus another will vary by utility. Each utility should provide evidence pertaining to these costs, benefits and implications if and when it is proposed that an alternative approach be approved and implemented.

6. Is there a preferred approach (or elements of an approach) and if so, what are the important implementation matters that must be considered? What are the costs, benefits and implications of implementing the preferred approach or of refraining from doing so?

As already noted, the LRAM type of approach of providing Revenue Decoupling coverage for unforecasted changes in the normalized volume of gas sold attributable to conservation measures seems sensible, provided the risk reduction features of the mechanism are concurrently reflected in a reduction to the Board-approved ROE and in any applicable earnings sharing mechanism. This approach could be extended to variances in actual volumes of gas sold attributable to conservation, if normalized data is unavailable.

The extent to which the LRAM objective is achieved through the combination of modifications to the design of the cost-related charges in existing rates and the operation of deferral or variance accounts should be determined in utility-specific rate cases. It is in these utility-specific rate cases that the costs, benefits and implications of implementing an LRAM approach covering all conservation-related unforecasted changes in the volume of energy sold compared to the existing situation can be determined.

7. Can or should the preferred approach need to be the same in both the gas sector and the electricity sector? Why or why not? Would any other form of differentiation based, for example, on a specific distributor characteristic(s) be appropriate? If so, what might be the defining characteristic(s)?

The Revenue Decoupling guiding principles applied to the gas and electricity sectors should be the same. However, the specifics of the particular approach taken to extend the scope of the LRAM type of coverage to all conservation-related unforecasted changes in the volume of energy sold need not be the same in both sectors.

A consideration of Revenue Decoupling mechanisms also has DSM overtones. For example, the adoption of FFV cost-based demand or capacity charges based on peak period use could stimulate both conservation and off-peak usage. The adoption of this type of approach, as well as other Revenue Decoupling options, could lead to a conclusion that a Shared Saving Mechanism ("SSM") is no longer required to promote conservation.

Refining the parameters of an LRAM type of coverage in the gas sector should be finalized upon expiry of the existing IRM Agreements and in conjunction with issues currently before the Board in the DSM proceedings pertaining to the major gas utilities.

Similarly, each electricity distributor should be required to apply the same guiding principles, such as the need to adhere to cost-related rate design guidelines and to make concurrent adjustments to ROE and earnings sharing ratios when proposing a LRAM type of mechanism. However, each utility should be permitted to propose specifics that reflect its utility particular circumstances.

It should also be recognized that there is another consultative process currently underway pertaining to electricity distributor rate design, including matters pertaining to the classification of customers of electricity distributors. Completion of the consultative process pertaining to rate design for electricity distributors appears to us to be a precursor to the selection of a Revenue Decoupling mechanism that best suits the particular needs of the different electricity distributors the Board regulates.

We hope these comments will be of some assistance to the Board. We appreciate being provided with an opportunity to comment on these matters.

Please contact me if there are any questions arising from the contents of this letter.

Yours very truly,

Peter C.P. Thompson, Q.C.

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