COMMENTS OF THE CONSUMERS COUNCIL OF CANADA

RE: CONSULTATION ON REVENUE DECOUPLING - EB-2010-0060

May 17, 2010

Introduction:

On March 22, 2010 the Ontario Energy Board ("Board") initiated a consultation process to examine the revenue adjustment and cost recovery mechanisms that are currently available to electricity and natural gas distributors to address revenue erosion resulting from unforecasted changes in the volume of energy sold. The Board retained Pacific Economics Group ("PEG") to analyse the mechanisms currently available to Ontario Energy distributors against selected alternative approaches used in different jurisdictions. PEG produced a Report entitled, "Review of Distribution Revenue Decoupling Mechanisms" (the "PEG Report") which compares Ontario's approaches to addressing distribution revenue erosion with various other approaches. PEG presented its findings to stakeholders in a presentation on April 19, 2010. The Board is seeking comments on the PEG Report. In addition, the Board set out a number of questions it considers relevant to the consultation.

These are the comments of the Consumers Council of Canada ("Council") on the PEG Report and the questions posed by the Board. Before addressing the issues set out by the Board the Council has some general observations about the consultation process.

General Comments:

Revenue decoupling mechanisms either fully or partially disconnect the link between the volume of energy consumed by customers and the recovery by energy distributors of their approved revenue requirement. In Ontario the electric and natural gas local distribution companies ("LDCs") are permitted to apply for lost revenue adjustment mechanisms ("LRAMs") which represent a form of partial decoupling. In addition, the natural gas LDCs have mechanisms within the context of their current incentive regulation mechanisms ("IRM") that adjust for declines in residential customer average uses. The Board is considering whether or not those mechanisms are sufficient, and if not, what further mechanisms might be required to address revenue erosion. From the Council's perspective, for the various reasons set out below it would be premature, at this time to introduce further decoupling in either the natural gas and electricity sector at this time. The Council accepts that changes may be appropriate in the future, but currently there is no compelling evidence that has been advanced to fundamentally change the existing regulatory frameworks in which Ontario energy rates are set.

The Board is currently engaged in a number of proceedings and/or consultation processes that are related to or could potentially impact the Board's consideration of revenue decoupling. This includes the Board's Review of Demand Side Management Guidelines for Natural Gas Distributors (EB-2008-0346) and its review of Rate Design for Recovery of Electricity Distribution Costs (EB-2007-0031). In addition, on March 31, 2010, the Minister of Energy and Infrastructure issued a Directive to the Board setting out the elements of a conservation and demand side management ("CDM") framework. The Board is in the process of developing a Code establishing that framework , one which will be enforced through the LDCs' licence conditions. The gas LDCs are currently operating under 5-year IRM plans that are in effect until the end of 2012. It is expected that when they are required to re-base in the next year the Board will undertake a review of the IRM models and determine what models should be the basis of rate-setting in the future. The electric LDC rates are set, primarily within the context of the Board's 3rd Generation IRM model established two years ago. That model will also likely be revisited in the next few years.

From the Council's perspective the Board must ensure that its consideration of revenue decoupling be considered in the context of those proceedings and consultations. For example, it may be determined through the Natural Gas DSM Guideline process that the current LRAM methodology is sufficient to eliminate the disincentive to promote DSM. In addition, in its review of the natural gas IRM models the Board may determine that the annual adjustments for average use are also still appropriate. In that context, there may not be a need for any further decoupling to be put in place.

In its Report PEG explores the Straight Fixed Variable ("SFV") pricing approach to decoupling. As PEG notes, in most applications this involves the elimination of volumetric charges (p. 10). This means that customers pay a substantial monthly charge regardless of usage and cannot reduce their bills with lower usage. The Board must consider whether a revenue decoupling approach such as this may be counter to its consideration of CDM and DSM for LDCs. In effect, a SFV approach may be inconsistent with the potential CDM framework that is to be based on the Minister's Directive. Additionally, within the consultation on rate design, there will likely be a consideration of rate designs meant to accomplish other objectives like basing rates on cost causality.

A fundamental aspect of revenue decoupling is to remove the risk associated with revenue variations due to CDM and DSM, but the factors considered could be much broader. As noted by PEG, some decoupling models consider revenue variation associated with high prices in energy commodity markets, increasingly stringent appliance efficiency standards , and policies encouraging distributed generation (p. 17). The Board recently completed its Cost of Capital Review (Eb-2009-0084). To the extent the Board adopts revenue decoupling mechanism and the risk for LDCs is reduced a reduction in return on equity ("ROE") and/or the LDC's deemed capital structure will be required. In effect, the introduction of further or full revenue decoupling will require a reconsideration by the Board of it ROE Guidelines.

Natural Gas LDCs:

Ontario's natural gas LDCs, Enbridge Gas Distribution Inc. ("EGD") and Union Gas Limited ("Union") are currently under five-year IRM plans. Those plans are in place until the December 31, 2012. Those plans were the subject of Settlement Agreements that are also in place until the end of 2012. Union and EGD are participating in the Board's Review of DSM Guidelines for Natural Gas Distributors. It is in that context that the Board will consider whether an LRAM is still necessary as well as other elements of the DSM framework. With respect to other decoupling options the Council submits that, given the five-year plans are still in place for another couple of years, it would be premature, and frankly inappropriate to consider those options prior to a consideration of the regulatory models that will be in place for Union and EGD beyond the current IRM plans.

Electric LDCS:

The Board has indicated that it is considering through this consultation whether the mechanisms currently available to LDCs are sufficient to address revenue erosion resulting from the unforcecasted changes in the volume of energy sold. From the Council's perspective there is no evidence, provided to date that they are not. There is no evidence that Ontario LDCs's financial integrity is being compromised through CDM initiatives. Ontario LDCs have the opportunity to apply for LRAMs and Shared Savings Mechanisms ("SSMs") when seeking rate approval from the Board. This ensures that the impact of their CDM programs are reflected in rates and that they are kept whole with respect to the impact of the programs. SSM also reward the LDCs on the basis of the savings that their programs have achieved. Of the 80 Ontario electric LDCs, most have not applied for LRAMs or SSMs. From the Council's perspective this is indicative of the fact that significant revenue erosion is not occurring.

Given the Ministerial Directive the Board is in the process of establishing and setting out in a Code the CDM Framework that will apply to Ontario LDCs. As a part of that framework LDCs will be required, as a condition of their distribution licences to undertake CDM programs, meet Board-established targets , and receive incentives to achieve those targets. LDCs will be required to evaluate, measure verify their results. In addition, there will be a requirement for the Board to annually review and publish the verified results (after an audit process) of each individual Distributor's CDM programs. The Minister has also indicated that the Board should have regard to the objective that lost revenues that result from CDM programs should not act as a disincentive to a distributor.

The Ontario electric LDCs are also (some, not all at this time) rolling out smart meter programs and TOU pricing. The smart meters will allow the LDCs to, among other things, collect data to determine the impacts of the CDM programs and facilitate better load forecasting and weather normalization. From the Council's perspective the smart meters will provide useful data around customer usage etc. It would be appropriate once we have several years of that data to consider whether revenue decoupling is required and if so, what model would be most appropriate. Until then, the Council continues to believe that revenue decoupling beyond what is in place now is not required.

Another concern of the Council is that the nature of the Ontario electricity sector creates a whole host of regulatory challenges for the Board, and for the LDCs it regulates. Given there are more than 80 LDCs the Board must continually be looking at ways to balance the interests of utility ratepayers and shareholders, while aiming towards some level of effective regulatory efficiency. Given the fact that Ontario LDCs have been given significant "tasks" by the Provincial Government (CDM targets, smart metering and facilitating renewable generation) to layer yet another change to the regulatory framework at this time may be onerous, inefficient, and not necessary.

Board Staff Questions:

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 Mechanism adequate in light of the contemplated introduction of CDM targets for all electricity distributors in the Province?**

From the Council's perspective there are other processes in place to consider the extent to which the current mechanisms are not adequate and alternatives are required. The Board is undertaking its review of the DSM Guidelines for natural gas LDCs. In addition, the Board is developing a CDM Code which will set out the parameters, rules and guidelines for electric CDM pursuant to the Ministerial Directive. As noted above, the Council is not of the view that revenue erosion is significant enough to go beyond adjustments to compensate LDCs for lost revenue associated with their CDM/DSM programs. At the time the Board reconsiders the IRM model(s) for the gas LDCs, and once useful customer data has been accumulated through smart meters, it may be appropriate to move to a more comprehensive revenue decoupling approach or some modifications to what is in place now.

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

As noted above, the Board must consider the extent to which there is evidence that a change is required. There are other proceedings/processes in place that are considering the impact of CDM/DSM and how to deal with those impacts. It would be premature to embark on a process in isolation of those processes. In addition, the Council submits that the Board should take into account the following considerations:

- Is there clear evidence that the current mechanisms are not working?
- In the context of revenue decoupling how does the Board best balance the interests of utility ratepayers and shareholders? How does regulatory efficiency fit into this balance?
- How does the Board put revenue decoupling in place while still maintaining its objective to protect consumers with respect to prices?
- How does the Board ensure that revenue decoupling does not compromise the principle of rate stability (how should potential rate true-ups be managed)?
- How does the Board ensure that any proposal for revenue decoupling is consistent with the rate-making principle of cost-causality?
- Will revenue decoupling really result in regulatory efficiency?
- Or, in the alternative will it create more regulatory costs and inefficiencies?
- How does the Board deal with intra and inter class fairness within the context of a revenue decoupling model? How can the Board be assured that appropriate cost allocation principles be maintained?

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

As noted above smart meters will be providing useful data regarding load characteristics, usage patterns, savings associated with CDM programs. In addition, smart meters will eventually make it easier for LDCs to develop load forecasts and weather normalization methodologies. The Council is of the view that after several years of data accumulation it may be appropriate to revisit the issue as to whether different approaches to revenue decoupling should be considered.

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 (ie. Distributor-provided CDM/DSM programs, other CDM/DSM programs, the economy, weather, customer growth, etc.)? Why or why not?**

The Council does not see a need to consider further decoupling at this time. If the Board is of the view that <u>all</u> variances from forecast in commodity demand regardless of the cause be eliminated, it will be imperative for the Board to consider the issue of risk and how the ROE and/or capital structure should be reduced. This is the only way to ensure that the interests of ratepayers are sufficiently protected. It would be completely inappropriate for the Board to move to full or modified decoupling without a consideration of reduced risk and the impacts on the ROE and capital structure.

5. **Are there 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 Council is of the view that if the Board is considering approaches to decoupling it should look beyond the approaches set out in the PEG paper. There may or may not be alternative approaches that might be better suited for Ontario, given the number of electric LDCs operating in the Province.

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?**

The Council is of the view that in the consideration of any approach the Board must look at the costs and benefits and ensure that the benefits of moving to a new or enhanced approach outweigh the costs. It would be inappropriate to move to a new model in the absence of a that analysis.

7. **Can or should the preferred approach need to be the same in both the gas sector and the electricity? 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)?**

From the Council's perspective there is no obvious reason as to why the same approach needs to be applied to the Ontario gas LDCs and the electric LDCs. In the gas sector the industry is primarily comprised of two large, privately owned LDCs. Even within that sector there are two different IRM models in place, and that has not proven to be unmanageable for the Board, intervernors or the LDCs themselves. The Ontario electricity sector is comprised of more than 80 LDCs, primarily publicly owned. In addition, the electricity sector has LDCs with many different characteristics (large, small, growth utilities, rural, urban etc.) Given the different characteristics inherent to both sectors a "one size fits all" approach would not, from the Council's perspective be prudent. In addition, there may well be very different DSM/CDM frameworks in place for each sector.