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VIA MAIL AND EMAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
26th Floor
2300 Yonge Street
Toronto, ON
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Dear Ms. Walli:

Re: Review of Electricity Distribution Cost Allocation Policy
Board File Number: EB-2010-0219

Vulnerable Energy Consumers Coalition - Comments

As Counsel to the Vulnerable Energy Consumers Coalition (VECC) I am writing, per the Board's Letter of September 2nd, to provide VECC's comments regarding the options and recommendations set out in the Elenchus Report. The comments are organized according to the individual issues identified and dealt with in the Report. Following this are some more general comments on the future development and use of cost allocation studies.

New MicroFIT Rate Class

The Elenchus Report recommends (page 12) that:

- The Board continue to use the USoA accounts currently identified to establish the uniform provincial fixed rate for microFIT.
- Each distributor should be allowed to establish its own microFIT rate to better reflect cost causality for each distributor.

The Report does not recommend adding a separate class for microFIT to the cost allocation model.

In VECC's view the first two recommendations outlined above deal with the issue of rate design for microFIT as opposed to its cost allocation treatment. VECC notes that this mixing of cost allocation and rate design issues occurs a number of times throughout the Elenchus Report. However, given that the Report has raised a number of rate design issues, VECC will provide its comments.

VECC notes that the Board's recent EB-2009-0326 Report dealt with not only the costs elements that should be included in the microFIT rate but also the matter of whether there should be a single province-wide rate. If the issue of whether or not there should be a provincial-wide rate is open to reconsideration at this time as Elenchus recommends, then VECC submits the matter of which accounts/cost elements are to be included in determining the rate should not be excluded merely on the basis that the matter was recently reviewed. With respect to the cost elements to be included in the rate, currently the amortization and PILs related to General Plant assigned to Meters are both included but that interest expense and net income are not. In VECC's view this inconsistency is something that the Board should address at this time if it determines the scope of the current review is extends to matters of rate design for microFIT.

VECC notes that when asked about this issue during the November 18th stakeholder meeting, Elenchus indicated that the inclusion of these additional cost elements "seemed reasonable". Elenchus also observed that distributors applying for their own (unique) microFIT rate would be free to include whatever cost element they felt were appropriate. VECC submits that if a cost element is appropriate to include in these rates, then the change should be made to the generic rate and not limited to those distributors who make individual applications.

VECC also has concerns regarding the recommendation to allow distributors the flexibility of applying for their own microFIT rate. The argument is that such an approach would better reflect cost causality. However, if improved cost tracking/cost causality is the goal then the matter should not be left up to distributors to decide whether or not a unique LDC-specific rate is warranted. In VECC's view consideration should be given as to whether an LDC-specific rate would be materially different from the province-wide rate. In this regard, the Board could establish a range (e.g. 80%-120%) around the rate and direct that a LDC-specific rate is required if the calculation indicates it would be outside this range. VECC notes that Elenchus' recommendation (page 12) to include a separate sheet in the Cost Allocation model that would determine the microFIT charge would facilitate such an approach. For those distributors whose specific rate falls witnin the "range", the province-wide rate would be used.

Finally, with respect to the treatment of microFIT in the Cost Allocation model, VECC agrees with the Elenchus recommendation that it not be added as a separate customer class. The main reason for this is that the Cost Allocation model is used to determine if rate adjustments are required in order to better align rates with costs. The previous discussion addresses how this can be done within the context of a province-wide rate. Introducing a separate class is not warranted unless the objective is to have LDC-specific rates for all distributors. Also, in VECC's view, the distributors and the Board need to gain more experience with microFIT connections before creating a separate class in order to determine whether use of the Residential-related cost elements (e.g. the Residential weighting factors for Billing) is appropriate.

Unmetered Loads

The Elenchus Report recommends (page 17) that:

- A separate sheet should be added to the cost allocation model that will include the default values used for these types of customer and that would give the option to distributors of using their own values in place of the default values with descriptions of how the default values were developed.
- For distributors that do not have a separate USL class, the distributor should be required to demonstrate that the revenue to cost ratio for these types of customers would still be within the Board's recommended range.

In VECC's view there are two separate issues at play here. The first is whether or not there should be a separate customer class for USL or whether it is reasonable to include them as part of the GS<50 class. In this regard, VECC agrees with Elenchus' recommendation that, in cases where there is not a separate customer class, the distributor should be required to demonstrate that the revenue to cost ratio for these customers is within the Board's recommended range. As noted during the Stakeholder meeting, in order to do this the distributor will be required to "run" the cost allocation model with USL as a separate class.

The second issue relates to clarifying how USL is included in the cost allocation model. The specific issues are the establishment and use of default weighting factors for cost elements such as services and billing. A related issue is the need to distinguish between USL fixtures versus connections versus customers. VECC generally agrees with the Elenchus recommendation regarding the inclusion of a separate sheet that sets out the default value for USL.

However, in VECC's view, this default sheet should do more. It should also clearly explain the distinction between fixtures, connections and customers and how the relationship between the three that is assumed for purposes of setting the default values. This sheet should also outline the billing approach (see page 15 of the Elenchus Report) that is assumed for purposes of the default values. Then a distributor should be required to confirm that its circumstances are similar to those implicit in the default values. If the circumstances are not the same, then the distributor should be required to develop its own weighting factors. In the alternative, the cost allocation model could include different default values which reflect different circumstances.

During the Stakeholder meeting Elenchus suggested that LDCs should be able to use the default values without justification. VECC disagrees. The default values reflect a certain assumptions about how the billing is carried out and about the relationship between connections and accounts. If these assumptions do not match the LDCs circumstances then the default values are inappropriate and should not be used.

Finally VECC notes that in those circumstances where USL is not a separate class but included as part of the GS<50 and provided a credit to recognize the meter/meter reading savings, the treatment should be as follows:

- The cost allocation to the GS<50 class should recognize that only a subset of the customers/connections have meters and require meter reading.
- The "cost" of providing the USL credit should be allocated to the other customers in the class (similar to the treatment afforded the TOA).

Transformer Ownership Allowance (TOA)

The Elenchus Report recommends (page 22) that the Board modify the cost allocation model to ensure that only the customer classes that include customers that provide their own transformation are included in the determination of the determination of the TOA.

VECC finds the wording of this recommendation to be somewhat ambiguous. However, VECC notes that this recommendation is meant to reflect Option #1 which calls for the cost allocation model to be modified so that the cost of the TOA would be charged to the other customers in the same class and there would be no impact on the other customer classes. VECC agrees with the intent of the recommendation as described by Option #1.

VECC notes that the Filing Guidelines issued earlier this year already accomplish this objective as the "cost" of the TOA is excluded from the revenue requirement to be allocated and the distribution revenues by class used in the model are net of the TOA. VECC agrees that this is the appropriate way to address the TOA issue. The "costs" of the TOA are then included in the rate design for the affected customer classes.

During the Stakeholder meeting an alternative approach to the cost allocation treatment of the TOA was discussed whereby:

- The "cost" of the TOA is included in the Cost Allocation model but allocated directly to the affected customer classes, and

- The TOA allowance is not netted out of the distribution revenues for each class.

VECC notes that, unless the revenue to cost ratio is precisely 100%, this approach would result in different revenue to cost ratios for the affected classes than the approach currently set out in the Filing Guidelines. Furthermore, changing the level of the TOA would alter the revenue to cost ratios for these classes. As result, this alternate approach could impact the determination of the appropriate revenue to cost ratio adjustments for other customer classes.

In VECC's view such a result would be inappropriate and inconsistent with the objective that the TOA should have no impact on the other customer classes. As result, VECC submits that the Board should continue with the approach as set out in the current Filing Guidelines.

Allocation of Miscellaneous Revenues

The Elenchus Report recommends (page 26) that:

- The major components included in Miscellaneous Revenues should be identified and allocated to customer classes of these revenue categories, in a manner similar to the allocation of the corresponding costs. The remaining Miscellaneous Revenues should be allocated to customer classes in the same proportion as composite OM&A.
- Miscellaneous revenues and related costs should be included in the determination revenue/cost ratios in the cost allocation model.

VECC agrees that the cost allocation model can be refined to better deal with the major sources of miscellaneous revenues. However, such an approach requires that both the cost and the revenues associated with the major sources be properly attributed to customer classes. For those major sources of Miscellaneous Revenues that are derived from customers (e.g. Late Payment Charges, Account Set Up and Collection Charges) the revenues by customer class should be readily available and, ideally, the costs of providing the associated services would similarly be allocated to each customer class. However, the current cost allocation model generally uses "weighted number of bills" to allocate the costs associated with billing and collecting to customer classes. The only exception is bad debt expense which is allocated on the basis of bad debt history by class. Implementation of the Elenchus recommendation would require that the "costs" associated with these activities be more precisely identified and then allocated in a manner that reflected the activity by customer class. In the alternative, if one assumes that the current cost allocation properly assigns the "costs" to customer classes then the revenues should be assigned to customer classes based on the history/forecast of these revenues by customer class.

For sources of Miscellaneous Revenues that are not derived from customers (e.g., Service Charges for Access to Power Poles) the revenues should be assigned to classes in a manner similar to how the costs associated with the assets involved were allocated to classes. Following this principle, the revenue from pole access fees would be allocated to classes in accordance with how the cost of poles (Account #1830) is allocated to classes. Furthermore, this allocation could be refined to reflect LDC specific information as to whether the poles involved were associated with the distributor's bulk, primary and/or secondary delivery systems.

Overall, while the Elenchus recommendation set out the appropriate principles for allocating miscellaneous revenues VECC submits that further work is required before such these principles can be properly reflected in the Board's current Cost Allocation Model. If the Board wishes to move in the direction recommended by Elenchus at this time VECC suggests that either a) Board Staff prepare a proposal that could be commented on by interested parties or b) the Board establish a small working group of interested parties to develop detailed recommendations as to how the model could be changed in the near term.

Finally, VECC agrees that Miscellaneous Revenues and related costs should be allocated to customer classes and included in the determination of the customer classes' revenue to cost ratios.

Weighting Factors for Services and Billing Costs

Elenchus recommends (page 28) that a separate input sheet should be developed that would include the default factors, explain the reasons behind the different weighting factors and include the option for distributors to substitute their own values for the default values where appropriate.

VECC agrees with this recommendation. During the course of the Stakeholder meeting a question was raised regarding treatment of customers (such school boards) that have many connections which are separately metered but who are sent only one "aggregated bill". VECC acknowledges that such arrangements could impact on the weighting factors used for billing and could be considered if/when distributors develop their own values. However, the development of alternative factors would need to consider not only the reduced costs due to having to issue only one bill for a number of connections but also any increased costs with preparing a single aggregated bill.

Also, VECC notes that the introduction of such weighting factors gives rise to the question as to whether such differences should be reflected in the rate design for the affected classes so that the costs allocated to the class are properly attributed to the individual customers within the class, similar to the credit provided to USL customers and the TOA provided to customers with their own transformers.

Allocation of Host Distributors' Costs to Embedded Distributors

The Elenchus Report recommends that Schedule 10.7 of the 2006 EDR Handbook should continue to be the approach followed by host distributors and this schedule should be incorporated into the cost allocation model. The Board should establish a threshold above which host distributors would be required to establish separate charges for embedded distributors. The Report then recommends the following thresholds:

- If the embedded distributor represents more than 10% of the host distributor's total volume sales, or
- If the embedded distributor is larger than 500 kW average demand per month.

During the course of the Stakeholder meeting Elenchus clarified that the proposed thresholds were to apply by delivery point.

VECC notes that similar to the recommendations on microFIT this section of the Elenchus Report also mixes issues of cost allocation and rate design. The purpose of Schedule 10.7 is to determine the cost of serving embedded distributors for purposes of designing an appropriate rate for these customers. If Embedded Distributors are not to be treated as a separate class then they will be included in the appropriated GS class(es) and there is no need for Schedule 10.7 for purposes of cost allocation. If they are to be considered a separate rate class then either:

a) They are included in the cost allocation model as such and the relevant allocation factors are applied to determine the costs that need to be recovered from the class, or
b) They are included in the cost allocation model and the relevant costs are determined through a separate process (e.g. direct allocation).

The Elenchus Report sets out thresholds that should used to determine when a separate class should be required and then proposes approach (b) be used to determine the associated costs and rates. Finally, it should be noted that there are currently instances where distributors do not follow any of the preceding approaches but rather determined a separate rate for embedded distributors and treated the revenues as miscellaneous revenues. For purposes of this discussion these instances can be viewed as a variation of alternative (b) as they required a separate determination of the costs and rates for embedded distributors.

The Report's preference for this approach appears to be based on the view (see pages 30-31) that embedded distributors are generally served only by "bulk facilities" as opposed to through the use of primary and/or secondary assets and that, since most distributors' cost allocation models do not separate out "bulk assets", the cost allocation models themselves are not sufficiently refined to determine the appropriate costs. However, this may not be the case and the types of assets used to serve the embedded distributor may be no different from those used to service other similar sized customers. As result, VECC submits that before adopting approach (b), the distributor should be required to explain what is unique about the embedded utility customer relative to other similar sized customers. If a satisfactory explanation can be provided then the distributor should be permitted to adopt approach (b). Otherwise, the embedded distributor should simply be treated as a separate customer class within the standard cost allocation model (i.e., no direct cost assignment).

VECC's other main concern with this recommendation is that Schedule 10.7 from the 2006 EDR Handbook was developed prior the OEB's Cost Allocation model. As a result, there are inconsistencies between the two in terms of both the cost elements allocated to embedded distributors and the allocation methodologies used for the individual cost elements. If distributors are to directly assign costs to their embedded distributor(s) then, VECC submits, the approach as set out in Schedule 10.7 needs to be updated. It should be noted that, during the course of the Stakeholder meeting, Elenchus agreed with this view. Again, such an update could be accomplished by either a) Board Staff preparing a proposal that could be commented on by interested parties or b) the Board establish a small working group of interested parties to develop detailed recommendations as to how the schedule could be revised in the near term.

Allocation of Costs to Load Displacement Generation

The Elenchus Report recommends (page 39) that:

- Standby charges should be established for new load displacement generation above certain size, for example 500 kW. In lieu of a specific customer analysis, default avoided costs values could be used as a simplified approach. A simplified approach could also be followed to establish the benefits that load displacement generation may provide. The Board, following its own judgement, could choose a 5% reduction to allocated costs.
- Unless the distributor chooses to follow the above recommendation for existing standby charges, they should continue to be allowed to maintain on an interim basis their standby charges until more research has been evaluated on this issue, including rate design approaches.

It is this area of the Elenchus Report where VECC has the most concerns. First, the recommendations appear to deal primarily with how the rates for standby service should be established and not how the service should be treated in the cost allocation. The relevant cost allocation issues are matters such as:

- Should Standby service be included as a separate customer class in the cost allocation model,
- If yes, how should this should be done? Here options would include: a) Separating out standby service as a separate service class from the services provided to service load net of the customer owned generation but using the standard allocation factors as per the cost allocation model or b) establishing a separate service as per alternative (a) but directly assigning the costs.

- If no, how should the revenue from standby service be allocated to customer classes?

However, the options put forward by Elenchus do not address these issues.

Rather what the Elenchus Report deals with are the same issues that were the subject of EB-2007-0630 (i.e., determination of the rates and benefit for DG). Furthermore, the Report does not do a very comprehensive job:

- It does not build on or reference any of the work undertaken by Board Staff or EES Consulting during this earlier proceeding.
- The Elenchus Report does not acknowledge the difficulties these earlier works had in determining the appropriate benefits to be attributed to DG but rather opts for a benefit allocation based on “judgement”. Furthermore, during the course of the Stakeholder meeting it became clear that there was no basis to the suggested 5% value and that it was simply “pulled out of the air”. VECC notes that once a factor is adopted by the regulator it is viewed as having credibility and justification is frequently required for any change. As result, in VECC’s view, it is important that such factors have at least some basis in reality before they are adopted. In VECC’s view, there is no basis for Elenchus’ proposed 5% value.
- The Elenchus Report recommends the use of an avoided cost estimate for purposes of “costing” Standby Service. During the course of the Stakeholder meeting, Elenchus indicated that by avoided costs it meant it meant the OEB’s approved avoided costs. Elenchus has not undertaken any analysis to determine the appropriateness using such costs. However, VECC notes that these avoided costs are based on estimates developed by Hydro One Networks in 2005 for customers supplied from its system and were characterized as “preliminary in nature”. VECC has been long concerned about the continuing use of these estimates as representative avoided costs for all LDCs and urges the Board not to expand the use of what are clearly questionable and dated estimates.

Overall, VECC submits that it is inappropriate for the Board to effectively adopt a new approach to setting Standby rates within the context of what is purportedly a “cost allocation view”. Indeed, it is VECC’s understanding that such determinations are to be part of the Board’s rate design initiative which will be undertaken at a future date.

With respect to the relevant cost allocation issues noted above, VECC recommends that the Board has three options. It can task either Elenchus or Board Staff with properly evaluating the relevant options and recommending an approach for comment by interested parties. Alternatively, it could establish a small working group of interested parties to address the cost allocation issues associated with Standby customers. Furthermore, as discussed in the previous paragraph, this exercise should be focus strictly on the incorporation of the Standby class within the current cost allocation model. If included in the model, the resulting revenue to cost ratios should <u>not</u> be used to adjust existing or new

Standby Rates. Rather the methodology used to establish the interim rates would continue until the appropriate basis for setting Standby rates was established.

Revenue to Cost Ratio Range Recommendations

The Elenchus Report recommends (page 44) that:

- For the GS 50-4,999 kW class the top range should be reduced to 1.40 (from 1.80). The bottom range should be left unchanged at 0.80.
- For Street Light and Sentinel Light customer classes the bottom range should be increased gradually (from 0.70) over 3 to 4 years to match the bottom range of the GS<50 class of 0.80. The top range should be left unchanged at 1.20.

During the course of the Stakeholder meeting Elenchus was asked to explain the asymmetric range recommended for the GS 50-4,999 class. Elenchus' rationale relied solely on the fact that the current range for this class was asymmetric, with a higher top end range relative to the bottom end range. Also, when asked about the phase-in of the bottom end of ranges for the Sentinel Light and Street Light classes, Elenchus explained this was to ameliorate rate impacts.

In VECC's view, revenue to cost ratio ranges should reflect the confidence parties (i.e., the Board, the LDCs and customers) have in the cost allocation model's results. This confidence is influenced by the quality of the load research data used in the
models, the level of cost data disaggregation used in the models and acceptability of the allocation factors used. Issues regarding the number of customers that will be outside the established range and the bill impacts if they moved to the boundaries of the established ranges should not influence the selection an appropriate range. Such issues should be addressed and taken into account when establishing the year over year adjustments that will be required in order that the revenue to cost ratios for a distributor's individual customer classes move towards (and eventually to) the accepted revenue to cost ratio range.

Discussions during the Stakeholder meeting indicated that utilities with well established cost allocation models that are supported by long standing statistically valid load research programs typically used revenue to cost ratio ranges of either 90-110% or 95-105%. The reason for the continued use of a range is to recognize that cost allocation is not a perfect science and that, even in these circumstances, there is some margin of error in both the load data and frequently the allocation factors used only approximate cost causality. Given these inherent margins of error, rates that yield a revenue to cost ratio within the prescribed range are considered to be fairly based on costs.

Given the limited load research data supporting most Ontario LDCs cost allocation models and the acknowledged need for improved cost data (per the

Board's EB-2007-0667 Report, page 5), VECC submits that ranges applicable to Ontario electricity distributors should be in the order of 80-120% or 85-115% at best. For purposes of the current policy review, VECC suggests that for those customer classes where the range is currently wider than 80-120%, this value should be adopted. For all other classes the current ranges should be maintained.

VECC does not agree with the asymmetric range proposed by Elenchus for the GS 50-4,999 class. The range should be 80-120%. However, at the same time, it should be recognized that the timeframe over which customer class ratios above 120% can be reduced to this value will be determined primarily by the need to limit year over year bill impacts for those customer classes whose current ratios must be increased as an offset.

Similarly, VECC does not agree with the Elenchus proposal to increase the bottom end of the Sentinel Light and Street Light ranges to 80% over 3 to 4 years, in the interest of managing the rate impacts. Rather the lower end of the range should be set at 80% and the speed at which the Sentinel and/or Street Light classes of a particular distributor are increased to this limit should be determined so as to manage year over year bill impacts for the classes' customers.

Finally, VECC wishes to raise an issue not addressed in the Elenchus Report and that is whether or not the revenue to cost ratios should be adjusted once if they are within the recommended "range". Clearly adjustments may be required in order to offset the revenue gains or losses from adjusting the ratios for other classes that are still outside the range. However, in a number of the cost of service-based Applications filed over the past two years distributors have proposed further adjustments to revenue to cost ratios that are already within the Board's recommended range simply on the basis that the values should move closer to 100%. In contrast, other distributors have chosen to only adjusted their revenue to cost ratios so as to achieve values that simply meet the minimum/maximum values set by the Board.

To-date, Board decisions have generally approved which ever approach the distributor has chosen to take. In VECC's view, this issue should not be left to the whim of the distributor and a more standard and principled approach is required. Given that revenue to cost ratios falling within the prescribed range are considered to be based on rates that reasonably recover costs, it is VECC's view that additional bill impacts should not be imposed on customers simply to move the ratio closer to 100%.

Accounting Changes and Transition to IFRS

The Elenchus Report recommends (page 47) that there is no need to modify the cost allocation model to address the accounting reporting changes. It also recommends that various accounts (see Appendix A of the Report) should be added to the cost allocation model.

VECC agrees that IFRS (in itself) should not necessitate changes to the cost allocation model, unless it triggers a need for the Board to make changes (e.g. definition) to the USOA accounts currently used.

The various accounts identified in Appendix A are either regulatory asset accounts or pass-through accounts for LV charges. None of the accounts represent costs that form part of a Distributor's Service Revenue Requirement and, as a result, none of them are actually allocated to customer classes by the cost allocation model. Elenchus confirmed this point during the Stakeholder meeting and indicated that the purpose for including them was for "completeness" in that some LDCs questioned why these accounts were not required by the model while other regulatory asset accounts (e.g. RSVAPower) were. VECC has no objection to the inclusion of these accounts in the model if doing so makes it easier for LDCs to accept and use the model.

Other Issues

Next Steps

In many cases, even if the Board were to accept Elenchus' recommendations, additional work needs to undertaken and/or details worked out before the cost allocation model can be revised. Furthermore, after the cost allocation model has been revised it will need to be test to ensure the changes have been properly implemented. Also, in certain instances (e.g., Issues #4, #6 and #7 above), VECC believes (as reflected in its comments) that there is a need to clarify the scope of the current review and that significant work is still required to determine the appropriate approach.

In VECC's view these activities should involve more than just Board Staff. To this end, VECC suggests that ether a) Board Staff (or its consultants) be tasked with working through the details and interested stakeholders then asked to provide comment or b) as small working group of interested stakeholders be formed to work through the implementation with Board Staff.

Future Availability of Smart Meter Data

The Board's September 2nd letter states that "with the installation of smart meters and the availability of smart meter data better cost allocators for the cost allocation model would become available". The letter goes on to state that a more comprehensive review should be feasible in two to three years.

VECC would point out that availability of several years of smart meter data is only one of the requirements for developing better cost allocators. The data available from the smart meters must also be “weather normalized” before it can be used to develop allocators for purposes of cost allocators. As the Board is aware, Ontario electricity distributors currently use a variety of methods to develop weather normal load forecasts and there have been disagreements in various rate application proceedings as to how historical weather normal use values should be determined. As result, VECC submits that two to three years may be an optimistic timeframe. Furthermore, to facilitate the development of improved cost allocators the Board should either encourage distributors to investigate how they should go about weather normalizing their smart meter data or undertake such an investigation on its own initiative.

If you have any questions regarding the preceding comments please contact either Bill Harper (416-348-0193) or myself (416-767-1666).

Yours truly,

Michael Buonaguro
Counsel for VECC