Ontario Energy Board

EB-2010-0219

Report of the Board

Review of Electricity Distribution Cost Allocation Policy

March 31, 2011

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EXECUTIVE SUMMARY

Cost allocation policies reasonably allocate the costs of providing service to various classes of consumers and, as such, provide an important reference for establishing rates that are just and reasonable.

As indicated in the Board's September 2 letter, this consultation was intended to be limited in scope, with a more comprehensive review becoming more feasible in the next two to three years as smart meter data increases in volume and better cost allocators for the cost allocation model ("CA Model") becomes available. The focus of this consultation was therefore to determine the need for and nature of any update and refinement to the following elements of the Board's electricity distribution cost allocation policy as follows:

- To take into account the creation of the microFIT rate class;
- To refine the following specific components of the cost allocation methodology:
  - Cost allocation to unmetered loads (i.e., unmetered scattered loads, street lighting and sentinel lighting);
  - Treatment of the transformer ownership allowance;
  - Allocation of miscellaneous revenues;
  - Weighting factors for services and billing costs; and
  - Allocation of host distributor costs to embedded distributor(s).
- To review options for allocating costs to load displacement generation;
- To refine the three widest Target Ranges, which are associated with the following rate classes: General Service 50 to 4,999 kW, Street Lighting, and Sentinel Lighting; and
- To address accounting changes and the transition to International Financial Reporting Standards ("IFRS").

The Board retained the services of Elenchus Research Associates, Inc. ("Elenchus") to prepare a report that included background, options and recommendations on the above-listed matters (the "Elenchus Report"). A stakeholder meeting was held on November 18, 2010 during which participants had an opportunity to engage Elenchus in a discussion on the content of its report. On December 2, 2010, the Board received written comments on the Elenchus Report from 17 stakeholder groups.

Informed by the Elenchus Report and the stakeholder comments, and as further explained in this Report, the Board has made revisions to its policy and plans to undertake separate consultations in certain areas as follows:

MicroFIT Customers

The Board will provide an update to the default province-wide microFIT charge in November of each year. All distributors filing a cost of service application should provide information on the nine cost elements identified in the Board's EB-2009-0326

Decision and Order. This information, along with the most recent information on record for distributors that are not filing a cost of service application in that year, will be used to derive the annual microFIT charge update.

Distributors will be expected to request a change to their microFIT charge to the updated default province-wide microFIT charge as part of their annual incentive regulation application or cost of service application.

Distributors filing a cost of service application may request a distributor-specific microFIT charge but must demonstrate that the experience it has gained provides sufficient and adequate evidence for it. A microFIT administrative costs worksheet will be added to the CA Model for the purpose of collecting data from distributors for the Board's annual update to the default charge and to provide a tool for distributors wishing to apply for a distributor-specific microFIT charge.

Distributors wishing to seek approval for a distributor-specific microFIT charge may consider adjusting the weighting factors for the nine cost elements identified in the Board's EB-2009-0326 Decision and Order. Those distributors may also consider whether additional cost elements should be included in the determination of their proposed microFIT charge.

Load Displacement Generation

Additional research and further consultation on this topic will be required before a standard methodology is established. The Board believes that these issues warrant attention in the short term, and will to that end initiate a separate consultation in the near future. In the meantime, the Board will entertain applications by distributors requesting, as part of their next cost of service application, to have their existing interim standby rates declared final.

Miscellaneous Revenues

The Board expects distributors that have the relevant information to allocate the major components of miscellaneous revenues to customer classes in the same proportions as the corresponding cost drivers are allocated to customer classes. The remaining miscellaneous revenues should be allocated to the customer classes in the same proportion as composite operations, maintenance and administrative ("OM&A") expenses.

Treatment of Unmetered Load

As part of their next cost of service application, the Board expects each distributor to include a separate unmetered scattered load ("USL") class in their CA Model and on their proposed Tariff of Rates and Charges. A distributor that does not believe that it is necessary to create a separate USL rate class would have to demonstrate to the Board the benefits of not creating such a class.

There is a need to clarify some aspects of the terminology surrounding the USL and Street Lighting classes (e.g., definition of a customer, an account, a device) and the associated modeling methodology. This matter will be addressed as part of a separate consultation process that will be initiated by the Board.

Weighting Factors for Services and Billing Costs

The Board expects each distributor to assess the circumstances specific to their service area and ensure that the weighting factors they use appropriately reflect them. A new worksheet will be added to the CA Model to facilitate the customization of the weighting factors.

Transformer Ownership Allowance

The treatment of transformer ownership allowance in the CA Model will be streamlined to be consistent with the methodology outlined in Chapter 2 of the Filing Requirements for Transmission and Distribution Applications.

Allocation of Host Distributor Costs to Embedded Distributor(s)

The Board is of the view that the methodology outlined in Schedule 10.7 of the 2006 Electricity Distribution Rate ("EDR") Handbook, as updated in proceeding EB-2007-0900, provides an appropriate basis for estimating the costs to be allocated to an embedded distributor rate class.

The Board is also of the view that it is appropriate to use a threshold approach whereby any host distributor with embedded distributor(s) that exceed(s) the threshold(s) should treat its embedded distributor(s) as a separate customer class. Before determining what the threshold(s) should be, the Board will undertake further analysis. This analysis will require the collection of additional data on embedded loads from distributors and the Board will issue a letter shortly to all rate-regulated electricity distributors providing further details on this upcoming information request.

Changes to Revenue-to-Cost Ratio Ranges

The pace at which revenue-to-cost ratios should be adjusted to a Board-approved ratio should only be affected by concerns regarding its impact on any rate classes.

The Board's range for the General Service 50 to 4,999 kW and the Sentinel Lighting classes are revised to 0.8 to 1.2; all other Board ranges remain unchanged at this time. The Board's policy remains that distributors should endeavour to move their revenue-to-cost ratios closer to one if this is supported by improved cost allocations.

Accounting Changes and the Transition to IFRS

Until the changes have been finalized, it would be premature to attempt to implement IFRS-related changes to the CA Model. While no changes to the structure of the CA Model are anticipated to be required as a result of the transition to IFRS, the Board will ensure that the CA Model can accommodate an increased number of accounts in the event they are required.

Implementation

The Board's electricity distribution cost allocation policy is intended to continue to be evolutionary in nature, with the expectation that the degree of precision will continue to be enhanced as more experience is gained and additional information becomes available.

In order to implement the changes to the CA Model required from the policy changes set out in this Report, a cost allocation working group ("CA Working Group") will be established to identify and propose to Board staff the necessary revisions to the CA Model and provide input to Board staff on the development of the supporting documentation. Informed by Board staff and the CA Working Group's recommendations, the Board will issue a revised CA Model.

The revisions to the Board's cost allocation policy set out in this Report will be implemented through cost of service applications starting with the 2012 rate year. The Board's revised CA Model is not expected to be available before the April 29, 2011 filing deadline for those distributors requesting cost of service rates effective January 1, 2012. The Board notes, however, that it expects the current CA Model to be able to accommodate most of the policy changes set out in this Report. The Board anticipates that the CA Model changes will result in a more "user-friendly" platform with some additional flexibility. Accordingly, the Board expects that, in most cases, a distributor that is required to file its application before the issuance of the revised CA Model will be able to comply with the policy by applying it to the current CA Model. If necessary, a distributor in this situation may update its cost of service application with the revised CA Model once it becomes available.

1 INTRODUCTION

Cost allocation policies reasonably allocate the costs of providing service to various classes of consumers and, as such, provide an important reference for establishing rates that are just and reasonable.

On November 28, 2007, the Ontario Energy Board (the "Board") issued its *Report of the Board: Application of Cost Allocation for Electricity Distributors* (the "2007 Report"). The 2007 Report set out the Board's current policies in relation to specific cost allocation matters for electricity distributors, and represented the culmination of a consultation process that had begun several years earlier. It addressed a number of issues, most significantly the relationship between the class revenue and the class total allocated costs (the "revenue-to-cost ratio"). The 2007 Report also discussed the treatment of the monthly service charge, metering credits for the unmetered scattered load class, transformer credits for customer-owned transformers, and charges for the provision of standby power for customers with load displacement generation.

In its 2010-2013 Business Plan, the Board indicated that it would review its electricity distribution cost allocation policy and revise it as required (the "Review"). In September 2010, the Board initiated a consultation process for that purpose. All materials in relation to this consultation are available on the Board's web site.

Informed by a consultant's report and stakeholder comments, this Report sets out the Board's updated approach in relation to its electricity distribution cost allocation policy.

Implementation details relating to certain elements of the Board's approach as set out in this Report are being assigned to a Stakeholder Cost Allocation Working Group (the "CA Working Group") that will provide input to Board staff. Further detail is set out in Chapter 3 of this Report. Informed by Board staff and the CA Working Group's recommendations, a revised Cost Allocation Model (the "CA Model") will be released.

This Report sets out information on two further separate consultation processes to be initiated by the Board as well as information on the next step to establish threshold(s) above which a host distributor will be expected to establish a separate rate class for its embedded distributor(s). Except for these three matters, the revisions to the Board's cost allocation policy set out in this Report will be implemented through cost of service applications starting with the 2012 rate year. The Board's revised CA Model is not expected to be available before the April 29, 2011 filing timeline applicable to distributors requesting cost of service-based rates effective January 1, 2012. Changes to the CA Model to reflect the revised policies set out in this Report are expected to result in a more "user-friendly" platform with some additional flexibility. However, the Board anticipates that the current CA Model can accommodate most of those policy changes, and as a result most distributors should be able to comply with the revised policies by applying them to the current CA Model if their filings are due before the revised CA Model is issued. If necessary, a distributor that files its cost of service

application before the revised CA Model becomes available may update its application at that time.

1.1 SCOPE OF THE REVIEW

As explained in the letter issued by the Board on September 2, 2010 (the "September letter") initiating this consultation process, this Review is limited in scope, with the potential for a more comprehensive review to be undertaken in the future.

The focus of the Review was to determine the need for and nature of any update and refinement to specific elements of the Board's electricity distribution cost allocation policy as follows:

- To take into account the creation of the microFIT rate class;
- To refine the following specific components of the cost allocation methodology:
  - Cost allocation to unmetered loads (i.e., unmetered scattered loads, street lighting and sentinel lighting);
  - Treatment of the transformer ownership allowance;
  - Allocation of miscellaneous revenues;
  - Weighting factors for services and billing costs; and
  - Allocation of host distributor costs to embedded distributor(s).
- To review options for allocating costs to load displacement generation;
- To refine the three widest Target Ranges, which are associated with the following rate classes: General Service 50 to 4,999 kW, Street Lighting, and Sentinel Lighting; and
- To address accounting changes and the transition to International Financial Reporting Standards ("IFRS").

The revisions to the Board's policy set out in this Report strike what the Board believes to be a reasonable balance between administrative burden, implementation costs and incremental precision. They also take into account the current information limitations of distributors. The Board's electricity distribution cost allocation policy is intended to continue to be evolutionary in nature, with the expectation that the degree of precision will continue to be enhanced as more experience is gained and additional information becomes available.

On October 27, 2010, the Board issued a letter to all licensed electricity distributors, transmitters and generators announcing a Renewed Regulatory Framework for Electricity ("RRF") in Ontario. That letter identified that the Board's cost allocation project, among others, fits within the RRF and that work on cost allocation would continue in co-ordination with the RRF.

1.2 THE CONSULTATION PROCESS

As indicated in the September letter, the Board retained the services of Elenchus Research Associates, Inc. ("Elenchus") to prepare a report on the cost allocation issues

noted above. That report, entitled *"Cost Allocation Policy Review: Options and Preferred Alternatives"* (the "Elenchus Report"), provided background information and set out options and recommendations made by Elenchus on the matters in scope for the Review. The Elenchus Report was released for comment on October 20, 2010.

To facilitate the provision of written comments, a stakeholder meeting was held on November 18, 2010 in order to provide participants with an opportunity to engage Elenchus in a discussion on the content of the Elenchus Report. In advance of the stakeholder meeting, the Board posted participants' written questions on the Elenchus Report to ensure that the stakeholder meeting was as efficient and productive as possible.

The Board received written comments on the Elenchus Report from the 17 stakeholders listed in Appendix A to this Report. The Board has benefited from those written comments in determining the revisions to its electricity distribution cost allocation policy set out in this Report, and thanks all stakeholders for their thoughtful input.

Organization of this Report

The remainder of this Report is organized as follows: Chapter 2 addresses each of the issues in the order listed above. The discussion of each issue includes background information to provide context, Elenchus' recommendation(s) and a summary of the input received from stakeholders, and concludes with a statement of the Board's approach. Chapter 3 then discusses next steps.

2 STAKEHOLDER COMMENTS AND THE BOARD'S APPROACH

This Chapter is divided into sections that address individually each of the nine issues listed in the Board's September 2, 2010 letter initiating this consultation process. The initial "General Comments" section addresses comments of a general or over-arching nature that were made by stakeholders during the course of the consultation.

2.1 GENERAL COMMENTS

In addition to the detailed comments that stakeholders provided on each policy issue being reviewed in this consultation, several also warned in their comments that the benefits of achieving increased detail and precision in cost allocation studies do not always justify the additional cost. The Board acknowledges this note of caution, and has remained cognizant of the need to maintain some degree of flexibility in recognition of the different circumstances of individual distributors. Among other things, this consideration has prompted the Board to make provision for the use of default values rather than distributor-specific values refinements that may be costly to derive.

This flexibility, however, is not intended to encourage the use of default values by distributors that can reasonably be expected to undertake the incremental effort to more accurately allocate costs to their customer classes. As several stakeholders observed, default values should not be the preferred option in the CA Model and should only be used where they are appropriate to the distributor's actual circumstances or where the distributor can demonstrate that the anticipated benefits of increased precision would not be commensurate with the cost of producing distributor-specific values.

2.2 TREATMENT OF MICROFIT CUSTOMERS

2.2.1 BACKGROUND

The current rate treatment for microFIT generators resulted from the proceeding that the Board initiated on September 21, 2009 on its own motion in order to determine "a just and reasonable rate to be charged by an electricity distributor for the recovery of costs associated with an embedded generator account having a nameplate capacity of 10 kW or less … that meets the eligibility requirement of the OPA's microFIT program" (EB-2009-0326).

In a decision released February 23, 2010[1], the Board's approach was that the costs to be included in determining the microFIT charge should be strictly related to the administrative activities associated with the customer and would not include any costs related to system operation.

The Board determined that those costs should be recovered solely through a fixed monthly service charge and that a single province-wide charge should be established

[1] EB-2009-0326 Decision and Order, issued February 23, 2010.

for all distributors for the time being. The province-wide charge of $5.25 per month was established on the basis of the customer weighted average of nine specific cost elements using data from 62 distributors.[2]

2.2.2 RECOMMENDATION OF ELENCHUS

The Elenchus Report recommended that distributors should be allowed to establish and seek approval for their own individual microFIT charge to better reflect the specific cost causality for the individual distributors. To facilitate the determination of the distributor-specific microFIT charge, Elenchus recommended that a separate sheet identifying the nine cost elements used by the Board to establish the province-wide monthly microFIT charge be added to the CA Model. Elenchus was of the view, however, that the establishment of a separate customer class in the CA Model was not needed.

Elenchus also recommended that the nine cost elements used by the Board in establishing the province-wide charge as described above could continue to be used by distributors that did not have sufficient experience with microFIT customers to support a distributor-specific charge.

2.2.3 STAKEHOLDER COMMENTS

Continued use of the current nine cost elements

Most stakeholders that submitted written comments supported the Elenchus recommendation to continue to use the nine cost elements identified by the Board in proceeding EB-2009-0326 to determine the cost of serving microFIT customers. The stakeholders were of the view that not enough time has elapsed to enable distributors to gain sufficient experience or a better understanding of the costs incurred in serving microFIT customers to justify changing the cost elements used at this time.

The only participant proposing a change was the Vulnerable Energy Consumers Coalition ("VECC"). VECC suggested that the Board should reconsider the account elements that are included in the determination of the province-wide charge and specifically suggested that interest and net income expenses related to General Plant assigned to Meters should be added to the cost elements used to determine the microFIT charge.

Distributor-specific microFIT charge

Stakeholders were also generally supportive of the recommendation to allow distributors to establish and seek approval of their own microFIT charge since distributor-specific charges would be more reflective of the distributor's own costs and would better reflect cost causality principles. However, views were diverse concerning the timing of the move to distributor-specific charges.

[2] Rate Order dated March 17, 2010 (EB-2009-0326).

The Association of Major Power Consumers in Ontario ("AMPCO") and distributors supported allowing distributor-specific charges at this time. However, the Electricity Distributors Association ("EDA") and London Property Management Association ("LPMA") suggested that the province-wide approach be continued for now. In their view, the move to distributor-specific charges should be deferred until distributors have gained more experience in connecting microFIT generators and identifying associated costs. More experience is required to determine whether actual costs differ enough across distributors to warrant distributor-specific rates.

Two representatives of ratepayers, School Energy Coalition ("SEC") and VECC, did not support the Elenchus recommendation. SEC was of the view that distributors should not be allowed to establish their own rate because to do otherwise would limit the uptake of microFIT in specific geographic areas and may result in additional costs incurred by the distributor that would not be cost justified. VECC's view is that it should not be left up to the distributors to decide whether to use their own microFIT charge. VECC suggested that the Board establish a range around the rate and that the distributor only be allowed to establish and seek approval of their own rate if they fall outside the range. VECC noted that the consultant's recommendation about adding a separate sheet to the CA Model to determine the distributor's own microFIT charge would facilitate this approach.

Separate microFIT class for cost allocation purposes

The creation of a separate customer class for microFIT in the CA Model was supported by LPMA and Oakville Hydro as this would enable distributors to reflect their own microFIT charge and would provide for consistent treatment by distributors.

VECC did not support the creation of a separate customer class for microFIT unless the Board's objective is to have distributor specific microFIT charges. VECC is of the view that distributors and the Board need to gain more experience with microFIT connections before creating a separate customer class. VECC also stated that the CA Model is used to determine if rate adjustments are required to better align rates with costs and for the province-wide microFIT charge this can be accomplished by the addition of a separate sheet to the CA Model, as recommended by Elenchus.

Weighting factors for microFIT customers

Those stakeholders that commented on the weighting factors used to determine distributor-specific costs generally recognized that the weighting factors would be one of the factors that would cause microFIT cost to differ across distributors.

AMPCO indicated that allowing distributors to modify the billing weighting factor for microFIT would be necessary to allow distributors to properly allocate the costs imposed by microFIT customers including transitional costs to their customers. In AMPCO's view, the weighting factors used should reveal the extent to which cost differences are due to transitional technical issues versus basic differences between microFIT and

residential billing service. AMPCO was concerned that, if transitional costs are not allocated properly, the true cost of microFIT would not be known, customer cross-subsidization would result and these costs would not be addressed and reduced over time.

Updating province-wide average microFIT costs

The EDA and Hydro One Networks ("Hydro One") suggested that the Board undertake an annual update to the microFIT charge to reflect the experience gained by distributors with microFIT connections, while SEC was of the view that no change to the microFIT charge is required at this time. SEC stated that, with more experience with microFIT data and smart meter data in the next few years, the Board would then have the information it needs to decide if changes are required for the microFIT charge.

LPMA noted that the current microFIT charge is based on a weighted average of current cost experiences of distributors so, if a distributor with a relatively large percentage of microFIT customers establishes and seeks approval for their own rate, the provincial microFIT charge for the remaining customers could become more volatile, reflecting the removal of costs from this distributor. To avoid this volatility, it would be necessary to base the default province-wide charge on the cost of all distributors, including those that adopt their own distributor-specific rate.

MicroFIT charge as miscellaneous revenue

The Coalition of Large Distributors ("CLD") suggested that the revenue from microFIT charges should be treated as miscellaneous revenues and Hydro One asked the Board to confirm this treatment.

2.2.4 THE BOARD'S APPROACH

The Board's approach, as set out below, takes into account that the Board's view that the rate at which distributors are gaining experience with the administrative costs associated with microFIT customers varies considerably across distributors. Accordingly and as further explained below, the Board will maintain and update annually the default province-wide microFIT charge, but is also prepared to consider applications for distributor-specific microFIT charges.

Continued use of the current nine cost elements

The Board continues to consider the approach set out in its EB-2009-0326 Decision and Order to be an appropriate basis for establishing the administrative or service charge to be paid to distributors for microFIT connections. Specifically, the costs to be recovered through the microFIT charge should be strictly related to the administrative activities associated with this class of customer and should not include any system operation related costs. These microFIT administrative costs will continue to be based on the nine cost elements identified in the EB-2009-0326 Decision and Order and supported by

most stakeholders, but will now be refined to also include the interest and net income expenses related to General Plant assigned to Meters as suggested by VECC. Consistent with the EB-2009-0326 Decision and Order, administrative or service costs associated with microFIT customers should continue to be recovered solely through a fixed monthly charge.

A microFIT administrative costs worksheet will be added to the CA Model. This worksheet will serve to collect data used by the Board to calculate an annual update to the default province-wide microFIT charge. The worksheet will also inform the distributor of what its distributor-specific microFIT charge would be based on using the methodology and the nine cost elements noted above, which will help the distributor assess whether or not there would be a large difference from the default province-wide microFIT charge. Additional information on the requirements associated with applying for a distributor-specific microFIT charge is provided further below.

All distributors are expected to include the calculation of their microFIT administrative costs, as will be contained in the revised CA Model, even if they apply to use the default province-wide charge as the basis for charging any microFIT customers they might have. This information will facilitate the Board's update of the default province-wide charge, and also provide a basis on which the Board can assess whether variations would support distributor-specific charges. For distributors that need to file their cost of service applications prior to the issuance of the revised CA Model, a separate sheet should be provided showing their administrative costs for the nine cost elements identified in the EB-2009-0326 Decision and Order.

In calculating the annual update to the default province-wide microFIT charge, the Board will use the data collected on the microFIT worksheet from all distributors filing a cost of service application, along with the most recent information on record for distributors that are not filing a cost of service application in that year. The costs for distributors that have a Board-approved distributor-specific microFIT charge will also be included as part of these data.

The updated province-wide charge will be communicated by the Board in November of each year. Distributors that do not have a distributor-specific microFIT charge will be expected to request to change their microFIT charge to the updated default province-wide microFIT charge as part of their annual incentive regulation application or cost of service application. Accordingly, a Board-approved change to the default province-wide microFIT charge will come into effect either on January 1st or May 1st of the following calendar year, depending on whether the distributor's rate year starts on January 1st or May 1st.

Distributor-specific microFIT charge

The EB-2009-0326 Decision and Order indicated that the single province-wide charge was established as a foundation and that, over time and with empirical information regarding the costs associated with the microFIT class, the Board would be in a better

position to consider the effectiveness of the province-wide charge. The Board also stated that the Board may consider moving to utility-specific charges at some point in the future if it was determined that the actual costs for microFIT customers are significantly disparate across distributors.

The Board notes that two ratepayer representatives were opposed to allowing distributor-specific microFIT charges and, among those that were supportive of a distributor-specific approach, views were diverse in relation to when distributor-specific charges should commence to be allowed.

The Board believes that the rate at which distributors are gaining experience with the administrative costs associated with microFIT customers varies considerably across distributors. While the response to the microFIT program has been significant, experience to date remains limited for many distributors. As such, the Board will maintain a province-wide microFIT charge as noted in the previous section.

The Board does, however, anticipate that most distributors will gain further experience in serving microFIT customers over the coming years. The Board is therefore prepared to consider applications for distributor-specific microFIT charges. Any distributor that applies for a distributor-specific charge will be required to demonstrate that the experience it has gained provides sufficient and adequate evidence for it.

The Board recognizes that, as distributors gain experience with microFIT connections, distributors wishing to seek approval for a distributor-specific microFIT charge may identify additional cost elements that should be included in the determination of that charge. Proposed additions could be reflected in the microFIT administrative costs worksheet filed with the Board in a cost of service proceeding, and will be considered at that time.

Weighting factors for distributor-specific microFIT charge

The calculation of the current province-wide microFIT monthly charge resulting from the EB-2009-0326 proceeding is based on nine cost elements, all of which can be described as “customer-related” costs. The microFIT class mimics the Residential class in terms of weighting within the nine cost elements. Hence, the costs attributable to the nine cost elements for the Residential class were used as a proxy for the microFIT class. Going forward, if a distributor feels that the weighting factor applicable to the microFIT class should be different from the Residential class within any of the nine cost elements, the distributor may propose a different weighting in the microFIT administrative costs worksheet that is to be added to the CA Model.

Separate microFIT class for cost allocation purposes

The Board notes that it would be appropriate to establish a separate microFIT customer class in the CA Model if the intention were to allocate common costs to the microFIT class in the same manner as those costs are allocated to other customer classes.

However, the Board does not consider it necessary to establish a separate microFIT class within the CA Model given that the costs being allocated to microFIT customers are, for the time being, limited to administrative costs. The microFIT charge is limited in scope and, as mentioned above, the addition of a separate worksheet in the CA Model should provide the flexibility a distributor requires to determine its proposed distributor-specific microFIT charge, if it wishes to make such an application.

MicroFIT charge as miscellaneous revenue

The Board confirms that revenues collected through the microFIT charge are to be treated by distributors as miscellaneous revenue.

2.3 TREATMENT OF LOAD DISPLACEMENT GENERATION

2.3.1 DESCRIPTION OF ISSUE

Some distributors' customers have their own generation facilities that supply all or part of the customer's electricity needs. At times when the customer-owned generation is unavailable, those needs or a part thereof have to be met by the distributor. The costs incurred by distributors in having facilities ready to supply these customers should be recovered from the same customers, and the rate used for that purpose is called a "standby rate".

In its March 21, 2006 Decision in EB-2005-0529, the Board declared "all existing and proposed standby rates" interim pending further review of the associated principles. Currently, 16 distributors have standby rates. For 15 of these distributors, the standby rates remain interim, whereas one distributor has had its interim standby rates declared final. [3]

In 2007, the Board initiated a consultation on distributed generation that included consideration of the development of a standard methodology for quantifying the benefits of distributed generation (EB-2007-0630). Power Advisory LLC was retained by the Board to prepare a report on the subject, and that report was released for stakeholder comment. By letter dated January 29, 2008, the Board informed interested participants that the issues of rate classification and standby rates for load displacement generation were being moved to the Rate Design for Electricity Distributors consultation (EB-2007-0031). By letter dated April 16, 2009, the Board informed participants in EB-2007-0031 that it had decided "to defer the completion of the rate design project."

[3] Enersource 2008 Distribution Rates, EB-2007-0706, April 18, 2008.

2.3.2 RECOMMENDATION OF ELENCHUS

Elenchus recommended the following:

- Standby rates should be established for new load displacement generation above 500 kW. This threshold was chosen to reflect the level that could represent significant load for distributors.
- In determining new standby rates, the costs imposed on distributors by customers with load displacement generation should be determined by undertaking a customer-specific avoided cost analysis. As a simplified approach, values for default avoided costs could be used in lieu of a specific customer analysis. Similarly, a simplified approach should be used to establish the benefits that load displacement generation may provide. A value of 5% should be used to reflect these benefits, and be deducted from the allocated costs.
- Existing standby rates should be allowed on an interim basis until more research has been conducted on the standby rates issue, including rate design issues. Distributors that currently have interim standby rates should be allowed to choose whether to establish new standby rates based on an avoided cost analysis or use a default value for avoided costs.
- A separate customer class should be created for customers with load displacement generation in circumstances where the load represents a significant load for the distributor. A threshold of more than 10% of the distributor's total sales was suggested for that purpose. The costs allocated to the separate customer class would then be reduced by an estimate of the benefit of load displacement generation in order to determine the standby rates.
- For rate design purposes, if the generator is above a certain size, (e.g., above 5 MW), then the rated capacity of the generator should be used and not the customer's demand profile, as this size of generation would be a significant load for distributors.

2.3.3 STAKEHOLDER COMMENTS

Although several stakeholders (LPMA, EnWin, Oakville Hydro and PWU) supported Elenchus' recommendation to establish standby rates for new load displacement generation above 500 kW in principle, the prevailing view is that there is insufficient information and analysis to support Elenchus' recommendations or any alternate approach to allocating costs to load displacement generation and establishing standby rates. There is widespread concern that the issues that need to be carefully examined in order to resolve the issue go well beyond the scope of this Review.

Oakville Hydro, for example, suggested that standby rates should be established for new load displacement generation above a certain size. But it believes the determination of that size merits further study.

VECC observed that Elenchus did not undertake any analysis to determine the appropriateness of "costing" Standby Service using the Board approved avoided cost estimate which are based on estimates developed by Hydro One in 2005 for customers supplied from its system and were characterized as "preliminary in nature". VECC has been long concerned about continuing use of these estimates as representative avoided costs for all distributors and urges the Board not to expand the use of questionable and dated estimates. It is therefore VECC's view that it would be inappropriate for the Board to adopt a new approach to setting standby rates as part of a cost allocation review. Setting new standby rates should be part of the Board's rate design initiative undertaken at a future date.

CLD expressed a similar view recommending that the CA Model should not be changed at the present time and that the issue of standby rates would be better addressed via a consultation on rate design for embedded generation to be re-convened by the Board.

In a similar vein, AMPCO stated that the requirements to provide standby power equal to the generator output is not based on any research and does not take into consideration the customer's facilities configuration and operating characteristics. This assumption, AMPCO stated, is unfair to the customer if the generation project reduces costs for distributors, since customers would still have to pay for distribution as though generation did not exist. AMPCO also noted that the Ontario Government policy is to encourage customer owned Distributed Generation that provides process heat and that if a formula is applied to calculate standby rates, it could result in the inability of the best projects to realize the benefits of a reduced demand on distribution system. Given these concerns, the appropriate way to address the issue in AMPCO's view is to undertake a separate review mechanism and consultation. This review should consider a reduction in the standby rate for load displacement projects where customers do not require the full standby capacity. This could be achieved as a joint review of standby requirements by the distributors and the customer.

LPMA also suggested that the Board should initiate a more comprehensive review of standby rates that encompasses both cost allocation and rate design options, along with a review of other jurisdictions. The review should look at issues such as firm or interruptible service, contracted demand levels versus generation capacity and the system planning implications of different scenarios. In LPMA's view, the key principle in determining standby rates is cost causality; standby customers should be responsible for the costs they impose on the distribution system and that other distribution customers should not subsidize customers who own generation behind their meter.

SEC stated that the absence of available research on what other jurisdictions have done to assess costs/benefits of load displacement generation results in a major weakness in Elenchus' recommendation, because according to SEC, the costs/benefits of load displacement generation are a common concern of distributors around world, and a lot of work has been done, particularly in the U.S. SEC says the recommendation assumed that costs/benefits would be calculated on an incremental basis, although no justification has been provided for treating these customers as incremental. SEC also

believed it is not clear why the Board would consider avoided costs developed for CDM purposes to be appropriate for load displacement generation, when there is no information on whether generator-specific benefit analyses are worth the cost of carrying them out, or even what that costs might be.

Given these concerns, CLD suggested that if the Board directs distributors to establish standby rates based on Elenchus' methodology, this should only apply to new load displacement generation.

Benefit valuation

Most stakeholders consider it inappropriate to adopt an arbitrary valuation for the system benefits of load displacement generation, be it 5% as recommended by Elenchus or any other value. Only the Power Workers' Union ("PWU") supported adopting the 5% value as a placeholder until more analysis can be conducted. Most others are concerned that the benefits of load displacement generation have not been adequately studied or quantified.

Given the absence of supporting analysis, EDA is concerned that most of distributed generation load is not dispatchable by distributors and would thus not be of any direct benefit. EDA stated that distributors incur costs for keeping distribution system facilities ready to deliver the customers' electricity requirements and those costs have to be recovered from the customers responsible for causing them. If a customer wants to avoid paying for distribution facilities by installing load displacement generation, that customer should give up any claim to any capacity effectively reserved to serve them, otherwise other customer classes end up subsidizing the load displacement generation customer. EDA believed that distribution system costs remain the same regardless of whether a generator is connected or not and that capacity cannot be 'un-built' in response to the installation of load displacement generation.

SEC wondered, if existing standby rates are reflective of cost causality, why would the Board change them and, if they are not cost reflective, why would the Board allow them to be continued. SEC stated that in neither case does it appear the matter should be at the discretion of individual distributors.

VECC stated that Elenchus' recommendations were not based on any work undertaken by Board staff or Elenchus during any earlier consultations and that Elenchus did not acknowledge the difficulties these earlier works had in determining the appropriate benefits to be attributed to Distributed Generation. VECC noted that once a factor is adopted by a regulator it is viewed as having credibility and any change frequently requires justification. As a result, VECC is of the view that it is important that such factors have at least some basis in reality before being adopted.

Use of avoided cost for standby rates

No stakeholder other than PWU was supportive of Elenchus' recommendation to use customer-specific avoided costs as a basis for determining new standby rates. There was also significant concern with adopting an "arbitrary" simplified approach, leaving no available option other than undertaking a further process to investigate the relevant issues more fully.

EDA indicated that it is impractical to consider, on a case by case basis, any reduction in new capital investment in distribution or transmission assets due to each load displacement generation. Reinforcing that point, North Bay Hydro ("NBH") expressed the view that customers installing load displacement generation might have facilities serviced by different distributors.

AMPCO believed this is unfair to some customers with generation and also perhaps in some cases to distributors. AMPCO feels that default values can act as a disincentive to developing load displacement generation that constitutes a "highest and best use" of energy resources.

In supporting the recommendation, PWU suggested that each distributor be given the option to determine an appropriate value for avoided costs, benefits and the reduction to allocated costs based on management judgement and expertise. PWU believed that, in the absence of quantitative analysis, allowing this flexibility would help to ensure the use of values that better reflect the unique circumstances of the distributor. If a distributor opted to use its own values instead of default values, the distributor should be required to justify those values to Board.

NBH and Cornerstone Hydro Electric Concepts Association ("CHEC") each suggested that, if the consultant's recommended approach is adopted, a detailed explanation with good examples should be provided to show how to conduct a specific customer avoided costs analysis and how to incorporate the results of the analysis in the CA Model. If default avoided cost values are used, the source of default values should be established by Board.

Cost allocation versus rate design issues

A number of stakeholders raised issues that they considered integral to any resolution of the matter, although they are beyond the scope of the Cost Allocation review.

VECC noted that the recommendation deals primarily with how rates for standby service should be established and not how they should be treated in cost allocation. VECC stated that the most relevant cost allocation issue is whether standby service should be included as a separate customer class in the CA Model. If a separate class, according to VECC, the options are: (a) 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 CA Model; or (b) establishing a separate service

directly assigning costs. If not a separate class, VECC raised the issue of how should revenue from standby service be allocated to customer classes. With respect to the relevant cost allocation issues noted by VECC, VECC stated that either the Board have the consultant or Board staff fully evaluate the relevant options and recommend an approach for comment or the Board establish a work group that should focus strictly on incorporating a standby class into the CA Model. If included in the CA Model, the resulting revenue-to-cost ratios should not be used to adjust existing or new standby rates. Rather, the methodology used to establish interim rates would continue until an appropriate basis for setting standby rates is established.

Existing interim rates

With respect to Elenchus` recommendation that existing standby rates continue to be allowed on an interim basis, the EDA recommended that the Board should continue to apply approved standby rates on an interim basis, until a complete analysis, including rate design options, is carried out.

On the other hand, EnWin Utilities ("EnWin") had concerns with the interim status of standby rates. EnWin stated that interim rates represent a significant concern because they are exempt from the rules pertaining to retroactivity. That means distributors could be forced to retroactively adjust with customers, years of standby rates against any final rates that may be approved by Board. Continued use of interim rates puts distributors in a difficult position from a risk management perspective. Distributors have to choose between financial under-recovery or the regulatory, operational and financial burden of "truing up" potentially years of rates that have been applied due to lack of regulatory clarity. Distributors, according to EnWin, also face the risk of spending substantial resources to implement an interim rate that may be replaced in near future.

2.3.4 THE BOARD'S APPROACH

The Board agrees with the prevailing view of the stakeholders that resolution of the load displacement generation issues requires additional research and consultation.

The Board therefore does not consider it appropriate to develop a cost allocation methodology for load displacement generation at this time. However, the Board believes that these issues warrant attention in the short term, and will to that end initiate a separate consultation in the near future.

In the meantime, the current interim standby rates will remain in place. The Board acknowledges the concerns regarding regulatory uncertainty that were most forcefully expressed by EnWin in relation to the interim nature of the standby rates, and will therefore entertain applications by distributors to have those rates made final as part of their next cost of service application.

2.4 TREATMENT OF MISCELLANEOUS REVENUES

2.4.1 DESCRIPTION OF ISSUE

Distributors collect miscellaneous revenues from their customers in addition to collecting revenues tied to delivery.

Miscellaneous revenues are comprised of 30 different accounts. However, based on data from the 2006 Electricity Distribution Rates process, 92% of miscellaneous revenues are typically accounted for by only four accounts (late payment charges, account set up & changes, collection charges and access to poles).

2.4.2 RECOMMENDATION OF ELENCHUS

Elenchus recommended that the four major components of miscellaneous revenues should be allocated to customer classes in a manner that follows the allocation of the corresponding costs. The four major components identified by Elenchus were:

1. Late Payment charges;
2. Account set up charge/change of occupancy charge (plus credit agency costs if applicable);
3. Specific Charge for Access to the Power Poles $/pole/year; and
4. Collection of account charge - no disconnection.

The remaining miscellaneous revenues should be allocated to the customer classes in the same proportion as composite operations, maintenance and administrative ("OM&A") expenses. Miscellaneous revenues and related costs should be included in the determination of revenue-to-cost ratios within the CA Model.

2.4.3 STAKEHOLDER COMMENTS

All stakeholders acknowledged that refinements could be made to the allocation of miscellaneous revenues in the CA Model so that it would better reflect cost causality principles. However, there was disagreement over the practicality of implementing these changes and a number of specific suggestions were made related to the treatment of specific miscellaneous revenue accounts.

For example, VECC stated that while Elenchus recommendation sets out appropriate principles for allocating miscellaneous revenues, further work would be required before these principles can be properly reflected in the CA Model. VECC suggested that if the Board wishes to move in this direction, then either Board staff should prepare a proposal that could be commented on, or the Board should establish a small work group of interested parties to develop detailed recommendations on how the CA Model could be changed in the near term.

Issues of practicality

CHEC stated that allocating miscellaneous revenues to rate classes in a manner similar to the allocation of corresponding costs is not doable because cost details are not available for late payment charges, account set-up charges and collection of account charge. Similarly, NBH and CLD were concerned that the data required to implement Elenchus recommendation are not kept by distributors. Significant effort would be required to determine these costs and the additional administrative costs would not be justified by the added allocation precision; hence, it was the view of NBH and CLD that the current treatment of miscellaneous revenues in the CA Model should not be changed. Similarly, SEC was concerned that the additional costs associated with greater precision may not be justified by the results, particularly since Elenchus did not review whether there is any other, more accessible cost driver that could be used to avoid the additional work.

CHEC suggested that an analysis should be completed to determine whether this change would have a material impact on revenue-to-cost ratios. If no material change results, then no change should be made.

AMPCO, LPMA, EnWin, Oakville Hydro and PWU supported Elenchus` recommendation. However, LPMA only supported Elenchus` recommendation as an interim measure in the evolution of the allocation of miscellaneous revenues. LPMA was of the view that the end-state should be similar to the allocation of miscellaneous revenues in the natural gas industry. Oakville Hydro suggested that distributors be permitted to define which accounts are to be considered major components and to define the OM&A accounts where the costs incurred to provide these services reside.

Allocation of remaining miscellaneous revenue accounts

No stakeholder opposed the recommendation that the remaining miscellaneous revenues be allocated to customer classes in the same proportion as composite OM&A.

Inclusion in revenue-to-cost ratios

There was no stakeholder opposition to the recommendation that miscellaneous revenues be included in the determination of revenue-to-cost ratios in the CA Model.

Comments on the treatment of specific miscellaneous revenue accounts

VECC observed that the Elenchus` approach requires that both cost and revenues associated with major sources be properly attributed to customer classes. For the major sources of miscellaneous revenues derived from customers, revenues by customer class should be readily available and, ideally, the costs of providing associated services would similarly be allocated to each customer class. VECC stated that the current model generally uses “weighted number of bills” to allocate costs associated with billing to and collecting from customer classes. The exception is bad

debt expense which is allocated on the basis of bad debt history by class. Implementation of Elenchus` recommendation would require “costs” associated with these activities be more precisely identified and then allocated in a manner that reflected activity by customer class. In the alternative, VECC suggested that revenues should be assigned to customer classes based on history/forecast of these revenues by customer class, on the assumption that current cost allocation properly assigns “costs” to customer classes.

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

Oakville Hydro suggested that miscellaneous revenues should be excluded from the calculation of the following costs: Customer Unit Cost per month - Avoided Cost; the Customer Unit Cost per month - Directly Related; the Customer Unit Cost per month - Minimum System with PLCC Adjustment on tab O2, Fixed Charge; and the Floor Ceiling of the CA Model. Oakville Hydro was of the opinion that allocation of miscellaneous revenues for purpose of calculating floor and ceiling is inappropriate unless those revenues have a direct relationship to the customer class.

Hydro One was of the view that the best approach is the direct allocation of miscellaneous revenues where possible. Oakville Hydro similarly suggested that the CA Model should permit the direct allocation of miscellaneous revenues.

2.4.4 THE BOARD’S APPROACH

To ensure that customers are treated fairly, the allocation of revenues to customer classes for the provision of the services should be the same as the allocation of the underlying costs. This is in keeping with an allocation that is based on the cost causality principle. The Board therefore expects distributors to allocate the major components of miscellaneous revenues to customer classes in the same proportion as the corresponding cost drivers are allocated to customer classes, to the extent that the distributor has the relevant information.

Those major components are, as identified from 2006 information and confirmed by Elenchus, namely: late payment charges, account set up & changes, collection charges, and access to poles. The remaining miscellaneous revenues should be allocated to the customer classes in the same proportion as composite OM&A.

Where a distributor does not have the information necessary to enable it to determine the associated costs by rate class for the major components of miscellaneous revenues,

the distributor may allocate those miscellaneous revenues to customer classes using composite OM&A as the allocator. However, the Board expects such distributors to explain why the information is not available and to provide a plan describing how they intend to gather the data and identifying when the data will be available.

As is currently the case, miscellaneous revenues and related costs should be included in the determination of revenue-to-cost ratios.

2.5 TREATMENT OF UNMETERED LOADS

2.5.1 DESCRIPTION OF ISSUE

Unmetered Load refers to three customer classes - Street Lighting, Sentinel Lighting and unmetered scattered load ("USL") - that are not metered because they consist of relatively small dispersed loads with electricity consumption that is predictable and can be determined based on the characteristics of the connected load (for example, light size or cable TV amplifier rating). In the current CA Model, different allocation factors are used for these customer classes and metering costs are not allocated to them.

If USL is not treated as a separate customer class by a distributor, it is included in the General Service ("GS") below 50 kW customer class.

The fact that these classes are not metered creates unique issues in ensuring that the CA Model appropriately allocates costs in a manner that is reflective of the cost causality principle.

2.5.2 RECOMMENDATION OF ELENCHUS

The Elenchus Report recommended adding a separate sheet to the CA Model that would include the default weighting factor values used for these types of customers and would clearly indicate to distributors the option of proposing their own weighting factor values in place of the default values. A description of how the default weighting factor values were developed would be included to assist distributors in developing their own values.

For distributors that do not have a separate customer class for USL, 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 for USL. Elenchus is of the view that there is no need to direct distributors to create a separate customer class for USL.

2.5.3 STAKEHOLDER COMMENTS

Many stakeholders were of the view that the recommendations of Elenchus do not go far enough to adequately address existing concerns related to the unmetered classes. Many believe a separate USL class is required and, if a separate class is not

established, a more refined approach to allocating costs is needed. Many stakeholders also believe that the allocation of costs to street lighting requires significant additional work in order to develop a more appropriate approach to determining the causal costs of street lighting.

USL as a separate class

The treatment of USL as a separate customer class in the CA Model was recommended by Rogers Cable, LPMA and AMPCO.

LPMA suggests that transparency is lost when distributors include USL with the GS < 50 kW class. In those cases, the distributor should be required to calculate the appropriate credit to the appropriate subset of GS < 50 kW customers while at the same time ensuring that the revenue-to-cost ratios for this subset of customers falls within the Board's target range for the USL rate class.

Rogers Cable believes that the Elenchus Report does not provide adequate reasons for its not adopting a separate class, especially since the information before the Board in the EB-2007-0031, Rate Design for Recovery of Electricity Distribution Costs consultation shows this is not the preferred alternative. The presumption in the Elenchus` report that a metering credit alone will ensure the fairness of rates oversimplifies the issue in Rogers' view. For example, a metering credit does not take into account any differences in per-connection billing, collection, call centre and other customer service costs and differences in load factor that may exist between the USL customers and metered customers. These differences, when taken into account in the CA Model, may result in a revenue-to-cost ratio outside the acceptable range, even after the application of a metering credit. Creation of a separate class would allow the USL revenue-to-cost ratio to be adjusted and a separate rate structure to be created without changing the rate structure applicable to metered customers. Rogers Cable also stated that regardless of whether a separate class for USL is implemented at this time, the record on this issue before the Board indicated that USL customers have generally overpaid relative to the costs to serve them, and have generally experienced rates that vary significantly between distribution territories.

AMPCO said the Board may wish to consider establishing a separate class or classes for USLs, with class definitions and guidance on matters such as consumption limits for unmetered connections, bill aggregation, etc. AMPCO's view was that the question of how best to allocate costs for USL has been a significant issue for the Board for several years. AMPCO stated that the issue is aggravated by calculated revenue-to-cost ratios for some USLs that seem to suggest that this class is being significantly subsidised and by concerns of the CATV industry that they may be over-charged for service in some instances.

SEC noted that while the Elenchus` report recommends that USL need not have a separate rate class, Elenchus proposes that calculation of the revenue-to-cost ratio for those customers should still be required, as if it were a separate rate class. SEC

agreed that calculating the USL revenue-to-cost ratio is appropriate. What SEC was not able to determine is how doing that without having a separate rate class would save money or other resources. It would seem to SEC that this is an unnecessary complication in a cost allocation and rate design system that already has enough complications.

In SEC's view, if it is sufficiently important to match USL costs to rates, then the Board already has a way to do that and it is to establish a rate class. However, the value of establishing a completely different approach for USL is not clear to SEC. Further, continued SEC, one can foresee that if calculating the revenue-to-cost ratio for this subclass is considered appropriate, then there will be other customer groups with special situations (schools, for example, with multiple similar locations for a single customer) who will legitimately ask for the same treatment.

Meter related costs if USL not a separate class

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

- The cost allocation to the GS<50 kW 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).

Should the Board decide not to proceed with the implementation of a separate USL rate class at this time, Rogers Cable concurred with Elenchus` recommendation that a revenue-to-cost ratio for USL be developed, and that distributors be required to demonstrate that the USL revenue-to-cost ratio is within the Board's target range. This is consistent with the Board's decision in relation to Hydro One's 2010-2011 distribution rates, as referred to in the consultant's report.

Rogers Cable said this will require all distributors, including those that do not already have a separate USL rate class, to isolate USL costs in their CA Models by running the CA Model with a separate class for USL. As a result, USL customers will be better able to assess and advocate. In addition, the Board will be better able to determine the fairness of USL rates.

Weighting factors

EnWin, CLD, PWU, LPMA and Rogers Cable supported Elenchus` recommendation to include a separate sheet in the model with the default values and explaining that distributors can use their own values since it would lead to more consistency across the province and reduce any subsidization between the USL class and other customers.

In LPMA's view, there appeared to be substantial confusion and differences across distributors in the use of or the calculation of the services weighting factor as well as in the differences in the billing weighting factors.

VECC was of the view that the default sheet should do more. It should also clearly explain the distinction between fixtures, connections and customers and how the relationship between the three is assumed for purposes of setting the default values. This sheet should also outline the billing approach 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, VECC suggested the distributor should be required to develop its own weighting factors. In the alternative, the CA Model could include different default values which reflect different circumstances.

While Rogers Cable supported Elenchus` recommendation to clarify the existing default factors in the CA Model, it was concerned that distributors will not be required to justify their choice of the default factors. Revenue-to-cost ratios will change with the selection of a weighting factor, and clearly the relative impact of weighting factors that are fixed relative to consumption will be more important to a class like USL where the load per connection is small. Consequently, Rogers Cable submitted that the choice of weighting factor, default or otherwise, should in all cases be subject to appropriate scrutiny when a distributor's cost allocation study is before the Board.

SEC was of the view that as with microFIT, Elenchus` recommendation that distributors be invited to insert their own weighting values in the CA Model had the potential to create significant consulting and other costs, and the value of doing so was not apparent. Elenchus did not review whether the cost was justified by the potential benefit.

Street Lighting class

CHEC was concerned that the Elenchus` report did not address known issues with street lighting that have arisen in the preparation of cost allocation studies over the past three to four years. Specifically, it referred to the need for consistent treatment of allocating cost to street lighting by distributors across the province. In the case of Kitchener-Wilmot Hydro's 2010 cost of service rate application (EB-2009-0267) and Kingston Hydro's 2011 cost of service rate application, relay/service entrance switches, or daisy chains, have been used as the connection points. That has significantly reduced the number of connections for these two distributors and improved the street lighting revenue-to-cost ratio. In the evidence from Kitchener-Wilmot Hydro's 2010 rate application, using relay/service entrance switches as the connection points for the street lighting class moved the revenue-to-cost ratio from 26.2% to 127.3%. The Board approved Kitchener-Wilmot Hydro's approach. As a result, the 2010 street lighting rates for Kitchener-Wilmot Hydro were reduced when the revenue-to-cost ratio was adjusted downward to be within the Board's range. AMO and several municipalities also highlighted these decisions.

In CHEC's view, the steps taken by Kitchener-Wilmot Hydro and Kingston Hydro to improve the street lighting ratio is an acceptable practise.

The Association of Municipalities of Ontario ("AMO") did not take issue with the Board's targeted revenue-to-cost ratios of 0.7 to 1.2 for the street light class, as long as the method used to determine these ratios fairly represents the actual costs to service street lights. AMO stated that, as a result of the post 2007 CA Model, most municipalities were hit with high rate increases for street lights between 2007 and 2009. AMO was concerned about the objective in the current review stating that there "are potential for refinements" because distributors have already adjusted their revenue-to-cost ratios to fall within the current target ranges. AMO believed that unless the existing problems are corrected, any further adjustments to the revenue-to-cost ratios will undermine the Board's objectives and unfairly punish AMO's municipal members.

As a result, AMO had three requests related to the manner in which costs to service street lights are determined. First, the Board should clearly and strongly state that distributors are to use the daisy chain approach to determining the number of street light connections from this point onwards. All future rate applications should reflect this method as it more fairly reflects the actual costs to service street lights and avoids the street light class subsidizing other rate classes. All distributors should also be required to provide an explanation on how they have determined the number of street light connections as part of their rate application just as Kitchener-Wilmot Hydro has done. Second, the Board should define connections more clearly in its existing documentation and communicate this clarification to distributors and other stakeholders. Third, the Board should place a moratorium on any further movement in revenue-to-cost ratios until the first two requests have been evenly and consistently implemented across all distributors in the province. Similar recommendations were advanced by CHEC, the Town of Oakville, Oakville Hydro and NBH.

SEC observed that Street Lighting is often owned or operated by the local municipality, who in many cases will be an owner of the distributor. According to SEC, one of the advantages of using default values that are not changed by the distributor is that the potential for the distributor to consciously or unconsciously favour the interests of the shareholder is removed. If distributors regularly change the weighting factors, it would be expected that this would become an issue engaging time and resources in cost of service applications. Unless there is some evidence that locally-developed weighting factors would be materially better – and Elenchus` report gives no indication of such evidence – it would seem to SEC to be a change that cannot justified.

2.5.4 THE BOARD'S APPROACH

USL as a separate class

The Board agrees with Elenchus and most stakeholders that the costs and load characteristics of customers in the USL classes are sufficiently different from those of

other customers to justify being treated as separate classes in most cases. The Board therefore expects each distributor to include as part of their cost of service application a separate USL rate class in their CA Model and on their proposed Tariff of Rates and Charges.

A distributor that does not believe that it is necessary to create a separate USL rate class would have to demonstrate to the Board the benefits of not creating such a class. For example, the creation of a separate class may not be warranted in certain instances where a distributor has very few USL customers, or that their combined load is minimal. A distributor requesting an exemption for a separate USL class may also wish to consider requesting an exemption to demonstrate that the revenue-to-cost ratio of their USL customers does fall within the Board's target range.

The Board notes VECC's proposal for the treatment of meter related credit in situations where there is no separate USL rate class. In the Board's view, there is no need to apply VECC's proposed refinement to these cases.

Weighting factors for USL and Street Lighting classes

The Board agrees with the recommendation expressed by a number of stakeholders that some aspects of the terminology surrounding the USL class (for example, the definition of a customer, an account, a device) and the associated modeling methodology require clarification. The Board also agrees that clarification of the issues raised by various stakeholders related to the terminology and methodology used to allocate costs to the Street Lighting class is necessary. The need for clarification is demonstrated by the significant impact of a change in methodology that was observed in the Kitchener-Wilmot Hydro case discussed above. The Board believes that these issues are best addressed in the context of a separate consultation process focussed on the terminology and modeling methodology for the Street Lighting and USL classes.

Once that consultation process is completed, the underlying methodology and principles for allocating costs to the Street Lighting and USL classes will be identified and embedded in a separate worksheet in the CA Model. This worksheet will provide examples for how to derive weighting factors and will contain illustrative weighting factors.

The Board expects each distributor to assess the circumstances specific to its service area and ensure that the weighting factors they use appropriately reflect them. For example, if a distributor proposes to use a weighting factor included in the CA Model, the distributor should be able to show that the value is appropriate given its specific circumstances. Otherwise, it should propose customized weighting factor.

The Board notes that the current CA Model is already sufficiently flexible to allow distributor-specific circumstances to be taken into account. As mentioned above, a distributor should use weighting factors appropriate to its specific circumstances, and should make use of the CA Model's flexibility as required. The Board expects that the

separate consultation process it plans to undertake will provide further guidance on how this flexibility can be used.

2.6 WEIGHTING FACTORS FOR SERVICE AND BILLING COSTS

2.6.1 DESCRIPTION OF ISSUE

Weighting factors are used in the CA Model to allocate certain costs to customer classes to better reflect cost causality. Where a distributor does not apply the weighting factors consistently or appropriately in its cost allocation studies, costs are not properly allocated to customer classes.

2.6.2 RECOMMENDATION OF ELENCHUS

Elenchus recommended that a separate input sheet be developed in the CA Model that would include default weighting factors for services and billing. Documentation should also be provided that explains the rationale for the different weighting factors.

Distributors should have the option of using their own values instead of the default values, if appropriate. Elenchus did not recommend updating the default values as distributors would have the option of using their own values if the default values are not appropriate.

2.6.3 STAKEHOLDER COMMENTS

The stakeholders were generally supportive of the recommendation, although participants differed on the extent to which default values should be relied upon. In addition, some stakeholders commented on specific implemented considerations.

There was widespread support for allowing distributors to substitute their own weighting factor values provided they could support their proposed factors analytically. Some stakeholders were of the view that default values should only be used where the distributor did not have the necessary information to determine an appropriate distributor-specific value. However, others recommended that the default values should be used unless the distributor could support a significantly different weighting factor.

LPMA and AMPCO, for example, suggested that the Board should require cost-based justification for any departure from default values and more exceptional departures should require more detailed justification. AMPCO also suggested that any departure from default weights should not be allowed simply on the basis of local policy preference. Furthermore, where a distributor requests an unusual departure from the default weight, it should also outline the cause of the departure and how it plans to bring any exceptional costs under control in the future.

Stronger support for the default values was provided by SEC in arguing that default values will be fine, for most or perhaps all distributors, and the additional cost to develop

local default values would not be justified. In the interests of keeping costs down, SEC recommended that the Board update default values so they are as good as possible, and encourage all distributors to adopt them. In extreme case where distributors believe the default values are materially wrong for their customers, SEC suggests that distributors always have the right to make their case for a different approach.

Specific issues

VECC mentioned that during the Stakeholder meeting questions were raised regarding the treatment of customers (e.g., school boards) that have many connections which are separately metered but who are sent only one "aggregated bill". Such arrangements could have an 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.

VECC noted 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 costs that are allocated to a class are properly attributed to individual customers in that class. This would be similar to the credit provided to USL customers and the transformer ownership allowance ("TOA").

2.6.4 THE BOARD'S APPROACH

The Board is of the view that default weighting factors should be utilized only in exceptional circumstances. In general, distributors have had sufficient time since preparing their 2006 Cost Allocation Information Filings to have gained the experience necessary to enable them to propose appropriate distributor-specific weighting factors.

To facilitate the introduction of such factors into the CA Model, a separate worksheet will be added to the CA Model that can be used to derive distributor-specific weighting factors. This worksheet will include weighting factors for unmetered loads in keeping with the approach set out in the previous section of this Report.

As recommended by Elenchus and supported by most stakeholders, this new worksheet will be accompanied by documentation describing the standard methodology for deriving the weighting factors in order to provide further guidance to distributors . As mentioned in section 2.5.4, additional guidance is expected to be provided on terminology and methodology for the Street Lighting and USL rate classes after the completion of a separate consultation process that the Board plans to initiate in the near term.

Default values and the basis on which they were derived will be included in the documentation; however, any distributor that proposes to use those default values will be required to demonstrate that they are appropriate given their specific circumstances.

2.7 TREATMENT OF TRANSFORMER OWNERSHIP ALLOWANCE

2.7.1 DESCRIPTION OF ISSUE

The transformer ownership allowance (TOA) compensates customers for providing their own transformation facilities instead of having the distributor provide transformation facilities for them. The distribution rates charged by distributors to customers include the cost of providing transformation facilities and the TOA reflects the savings to the distributor of not having to provide transformation assets.

The default in the current CA Model is not consistent with the Board's updated Filing Requirements for Transmission and Distribution Applications (the "Filing Requirements"). With the update in the Filing Requirements, it may be possible to streamline the CA Model.

2.7.2 RECOMMENDATION OF ELENCHUS

Elenchus recommended that the CA Model be modified to ensure that only customer classes that include customers that provide their own transformation facilities are included in the determination of the TOA. Furthermore, the updated TOA treatment now set out in the Filing Requirements, including the requirement that the credit be calculated on a $/kW basis, should be reflected as clearly as possible within the CA Model.

2.7.3 STAKEHOLDER COMMENTS

Most stakeholders supported the recommendation, pointing out that the revision is essentially an administrative matter that ensures that the CA Model does not contain any complicating artefacts of the approach that was originally embedded in the CA Model.

VECC and CHEC noted the Filing Requirements issued in 2010 already accomplish the objective of Elenchus` recommendation as the "cost" of the TOA is excluded from the revenue requirement to be allocated and distribution revenues by class used in the CA Model are net of the TOA. The "costs" of the TOA are then included in the rate design for affected customer classes.

SEC and VECC also emphasized that the cost of the TOA should be charged only to other customers in the same class and there should be no impact on other customer classes.

LPMA suggested that simpler instructions, including a numerical example, would allow distributors and other intervenors to better understand and apply this aspect of the CA Model.

AMPCO was of the view that Elenchus` recommendation is a step in the right direction but that additional guidance should be provided. AMPCO suggested that distributors should be required to track costs of the transformation specific to these classes (typically GS 50 KW and above). AMPCO provided another alternative, which it considers to be the simplest way to resolve the issue, and that is to remove transformation services from the cost allocation process.

Oakville Hydro stated that Option 3 in Elenchus` report calls for establishing customer classes that include the requirement that the customer provides their own transformation facilities. These customer classes would include all customers that own their transformation assets and therefore there would be no need to determine the TOA. Oakville Hydro suggested that Elenchus` recommendation should be combined with Option 3. Distributors would then be permitted to include classes that have some customers that provide their own transformer assets in the calculation of the TOA, and exclude classes for which all customers provide their own transformer assets.

2.7.4 THE BOARD'S APPROACH

The Board agrees with VECC and CHEC that the workaround to the default TOA treatment in the CA Model, as set out in Chapter 2 of the Filing Requirements for Transmission and Distribution Applications issued by the Board in June 2010 (the "Filing Requirements"), achieves the objective reflected in the Elenchus recommendation, with the distribution revenues by class being net of the TOA. The Board finds that this treatment of the TOA is appropriate and that the CA Model should be streamlined to reflect it so that a workaround is no longer required. Supporting documentation will be provided to ensure that the methodology, as updated to accord with the Filing Requirements, is clear and easy to follow in the CA Model.

2.8 ALLOCATION OF HOST DISTRIBUTOR COSTS TO EMBEDDED DISTRIBUTORS

2.8.1 DESCRIPTION OF ISSUE

There are many instances of host/embedded distributor relationships in Ontario. This situation arises where one distributor (the host) uses its facilities to carry electricity to another distributor (the embedded) that is located in or adjacent to the host distributor's service area. The charges levied by a host distributor on its embedded distributor are ultimately recovered from the embedded distributor's customers.

In many instances, host distributors do not group embedded distributors in a separate customer class. Instead, the embedded distributors are included in the host distributor's General Service customer class. The customer classification assigned to the embedded distributor affects the costs that are allocated to the embedded distributor and ultimately paid by its customers.

2.8.2 RECOMMENDATION OF ELENCHUS

Elenchus recommended that Schedule 10.7 of the 2006 EDR Handbook should continue to be used to identify the assets used by host distributors in supplying their embedded distributors, and that this should be incorporated into the CA Model.

Elenchus also recommended that the Board establish a threshold above which host distributors would have to establish a separate rate class for their embedded distributor(s). Under Elenchus' recommended thresholds, separate charges would be applicable if the embedded distributor represents more than 10% of the host distributor's total volume of sales, or if the embedded distributor accounts for more than 500 kW in average demand per month.

2.8.3 STAKEHOLDER COMMENTS

Elenchus' recommendation to use Schedule 10.7 of the 2006 EDR Handbook was supported by all stakeholders with the caveat that it should be updated to reflect subsequent refinements that have been accepted by the Board. However, many stakeholders questioned the proposed threshold for requiring distributors to establish a separate class for embedded distributors.

Use of Schedule 10.7 of the 2006 EDR Handbook

VECC was concerned that Schedule 10.7 from the 2006 EDR Handbook was developed prior to the development of the Board's CA 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 submitted, the approach as set out in Schedule 10.7 needs to be updated. VECC suggested that such an update could be accomplished by either Board staff preparing a proposal that could be commented on by interested parties, or the Board could establish a small working group of interested parties to develop detailed recommendations as to how the schedule could be revised in the near term.

CHEC also noted that Schedule 10.7 of the 2006 EDR Handbook was revised and enhanced in EB-2007-0900, the Cambridge and North Dumfries Hydro 2008 IRM Rate Application. This revision takes into consideration costs that were not in the original Schedule 10.7. CHEC suggested that a revised Schedule 10.7 could be used for allocation of host distributor costs to embedded distributors.

Threshold for a separate embedded customer class

The views of stakeholders were split with respect to Elenchus' recommended threshold.

VECC noted that Elenchus' recommendations appeared to assume that embedded distributors are generally served only by "bulk facilities" instead of primary and/or

secondary assets and that, since most distributors' models do not separate out "bulk assets", the models themselves are not sufficiently refined to determine the appropriate costs. VECC believed this may not be the case and that the types of assets used to serve the embedded distributors may be no different from those used to service other similar sized customers. As a result, VECC submitted that before adopting Elenchus' approach, the distributors 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 Elenchus' recommended approach and the relevant costs would be determined through a separate process. Otherwise, the embedded distributor should simply be treated as a separate customer class within the standard model (i.e., no direct cost assignment).

VECC also stated that 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 included in the appropriate GS class(es), there is no need for Schedule 10.7 for the purposes of cost allocation. If they are to be considered a separate rate class, in VECC's view, then either:

a) They should be included in the CA Model as such and the relevant allocation factors should be applied to determine the costs that need to be recovered from them, or
b) They should be included in the CA Model and the relevant costs should be determined through a separate process (i.e., direct allocation).

LPMA and SEC were concerned that the creation of an artificial threshold for delivery points is not appropriate. LPMA suggested that the Board should move cost allocation for embedded distributors, regardless of size, to a methodology more in line with the historical practices in the natural gas industry. LPMA recommended that a separate rate class should be established for embedded distributors currently served in the GS 50 kW to 4,999 kW rate class. This is an existing break point for GS customers. SEC's concern was based on the view that it would be unusual for the Board to establish conditions, rates, or thresholds without some evidentiary basis, and in SEC's view the unsupported judgment of a consultant is not an appropriate basis.

In contrast, distributors generally agreed that the Board should adopt the thresholds recommended by Elenchus, above which host distributors would be required to run the analysis to determine whether or not separate charges for embedded distributors should be set. NBH, however, added the caveat that once a distributor exceeds the recommended threshold, there should be a review of the embedded distributor to determine whether there are unique characteristics, along with a material difference in costs that would justify a separate rate class. The recommendation that host distributors be required to set separate charges, with the only stipulation being a threshold test, does not take into account that in some instances an embedded distributor has commonality with the class that it is in. Immaterial cost differences may not justify setting up a new rate class. NBH also commented that the Board should

provide clear instructions that would guide a utility in determining the costs of an embedded distributor.

Hydro One noted that the wording of Elenchus' recommendation needs to be revised slightly since it does not necessarily require the establishment of a separate charge applicable only to embedded distributors.

AMPCO was of the view that the threshold test for establishing separate charges for embedded distributors seemed reasonable and appropriate, but recommended that the effect of the recommended 500 kW threshold should be determined before implementation.

LPMA and AMPCO stated that, in the stakeholder session, questions were raised related to costs that perhaps should not be allocated to embedded distributors (CDM, bad debt, etc.) and that Elenchus had not researched this issue. LPMA and AMPCO recommended that the Board should review the CA Model to ensure that all allocated costs are appropriate to embedded distributors.

AMPCO also suggested that since Hydro One is the dominant host distributor in Ontario and has a specific Sub-Transmission ("ST") class with similar threshold criteria as those recommended by Elenchus, the Board should consider allowing Hydro One to continue classifying embedded distributors as ST-class, perhaps with modifiers to avoid what is referred to as rate pancaking.

LPMA noted that Elenchus did not do any research on the number of embedded distributors that would qualify for a separate rate class if the Board accepted its recommended thresholds or how many would not qualify for the separate rate class. LPMA believed the Board should undertake to obtain information on the number and the associated load of the embedded distributor delivery points, and feels this information would be useful in determining the validity of Elenchus' proposed thresholds.

LPMA also suggested that the design of rates, which is outside of this process, may be different based on the size of the customer, as it is in the natural gas industry. LPMA stated that the key issue is the allocation of costs to embedded customers should be based on cost causality. Categories of costs that are not incurred to serve these customers should not be recovered from these customers.

2.8.4 THE BOARD'S APPROACH

Use of the Schedule 10.7 of the 2006 EDR Handbook Methodology

The Board is of the view that the methodology outlined in Schedule 10.7 of the 2006 EDR Handbook, as updated in proceeding EB-2007-0900 referred to above, provides an appropriate basis for estimating the costs to be allocated to an embedded distributor customer class. That methodology considers the portion of the host distributor's Low Voltage ("LV") facilities that are used to serve the embedded distributor, as well as the

proportion of the load on those facilities that is bound for the embedded distributor's service area.

Threshold for a separate embedded customer class

The Board is of the view that it is generally appropriate for any distributor with total embedded distributor load that exceeds (a) defined threshold(s) to treat its embedded distributor(s) as a separate customer class.

The Board accepts the view of several stakeholders that more analysis regarding the appropriate threshold(s) is required prior to adopting (a) specific percentage of load or aggregate demand threshold(s). The Board believes that this further analysis will require the collection of additional data on embedded loads from distributors. The Board will issue a letter shortly to all rate-regulated electricity distributors providing further details on this information request. Upon review and analysis of this information, the Board will determine what the threshold(s) should be. The Board expects that any threshold it will determine will be considered in cost of service applications starting with the 2013 rate year.

Once the Board has determined the threshold(s), any distributor that does not establish a separate class for its embedded distributor(s) even though the characteristics of the embedded distributor(s) exceed the threshold(s) will be expected to provide justification for not creating a separate class. The justification should include a description of the customer class to which embedded distributors are assigned (for example, an existing General Service class defined by demand over 1000 kW), and an analysis showing that the revenues collected from the embedded distributor(s) are sufficiently similar to the costs of serving the embedded distributor(s).

2.9 CHANGES TO REVENUE TO COST RATIO RANGES

2.9.1 DESCRIPTION OF ISSUE

The Street Lighting, Sentinel Lighting and General Service 50 kW to 4,999 kW customer classes have revenue-to-cost ratio ranges that are wider than the Board's ranges for other customer classes. Given that distributors have now gained experience with using the CA Model and have started to move these three customer classes closer to the Board's revenue-to-cost ratio ranges used for other customer classes, it is an appropriate time for a review of the revenue-to-cost ratio ranges for these three customer classes.

2.9.2 RECOMMENDATION OF ELENCHUS

The Elenchus Report recommended narrowing the revenue-to-cost ratio ranges for the three customer classes. The recommended revised range for the Street Lighting and Sentinel Lighting classes was 0.8 to 1.2, compared to the current Board-approved range

of 0.7 to 1.2. Elenchus recommended that this change should be achieved over three to four years as distributors apply to the Board to have their rates rebased.

For the General Service 50 kW to 4,999 kW class, Elenchus recommended a revenue-to-cost ratio range of 0.8 to 1.4 compared to the current Board-approved range of 0.8 to 1.8.

2.9.3 STAKEHOLDER COMMENTS

Stakeholder comments were generally supportive of narrowing these three widest target ranges, although several did not consider a phase-in to be necessary and several expressed concern about the asymmetry of the proposed range for GS 50 kW to 4,999 kW class and the timing of the transition for the Street Lighting class.

Three ratepayer representatives commented that the pace of any revenue-to-cost ratio adjustment should only be limited by concerns about the rate or bill impacts, in which case a mitigation plan, such as a phasing-in, should be proposed. One of these ratepayer representatives specified that, unless the adjustment would lead to a total bill increase over 10% for any rate class, the adjustment should be performed in one step.

GS 50 kW to 4,999kW rate class

While no stakeholder objected to the narrowing of the target range for the GS 50 to 4,999 kW rate class, stakeholders expressed different views as to what the narrower target range should be. Comments received from most municipal and utility representatives supported the range proposed by Elenchus of 0.8 to 1.4. In contrast, four ratepayer representatives and Oakville Hydro argued for a range of 0.8 to 1.2. There was concern that the need for the asymmetric range proposed by Elenchus was not supported by statistical analysis. In particular, AMPCO argued that standardization in the calculation of the TOA has removed a major source of variation and that “the statistical spread that may have justified a broad range should no longer apply.” AMPCO was also of the view that, given it estimated that the GS 50 to 4,999 kW rate class accounts for 10% or less of total distribution revenues, phasing-in any adjustments over 3 to 4 years to the proposed upper end of the range of 1.2 is not likely to have a significant impact on other customer classes.

LPMA suggested lowering the upper end of the range to 1.2 in two steps: for each utility’s next cost of service the target range should be 0.8 to 1.4 and for their subsequent cost of service it should be brought down to 0.8 to 1.2.

Street Lighting and Sentinel Lighting rate classes

Two municipality representatives and CHEC recommended that the target ranges for street lighting and sentinel lighting be maintained at 0.7 to 1.2 until the impact of modelling refinements are known. Furthermore, CHEC suggested that distributors under incentive regulation that are still phasing-in the implementation of revenue-to-cost

ratio adjustments of their street lighting rate class be allowed to apply, as part of their annual incentive regulation application, for a stay of such implementation. In CHEC's submission, such applications would have to be supported by evidence that the street lighting ratio already falls within the Board approved-range based on revised cost calculations that take into account the recent Kitchener-Wilmot Hydro and Kingston Hydro decisions.

Hydro One, on the other hand, considered the Elenchus proposal to gradually increase the bottom of the range from 0.7 to 0.8 for the street lighting and sentinel lighting rate classes over a period of 3 to 4 years to be appropriate. CLD also supported this approach for the street lighting rate class.

CLD submitted that adjusting the target range for the sentinel lighting rate class was unwarranted given that it is a legacy rate class.

Additional comments

SEC submitted that, in addition to establishing common ranges for all rate classes, the Board's goal should be to move towards a narrower range within a reasonable period of time, "with a goal of getting to the 0.95 to 1.05 revenue-to-cost ratio range that is common across Canada." In contrast, while VECC recognized that well established cost allocation models that are supported by long-standing statistically valid load research programs typically use revenue-to-cost ratio ranges of 0.9 to 1.1 or 0.95 to 1.05, it was of the view that given the limited load research data supporting the cost allocation models for most Ontario distributors and the acknowledged the need for improved cost data. VECC believes the ranges should be 0.8 to 1.2 or 0.85 to 1.15 at best.

VECC noted that the some distributors have been approved in recent cost of service applications to adjust their revenue to cost ratios closer to 1.0 even though they were already within the Board's target range. VECC also noted that other distributors have only sought to reach the end of the target ranges without any further adjustments. VECC recommended that "a more standard/principled" approach to this issue is required.

2.9.4 THE BOARD'S APPROACH

As noted in its September 2, 2010 letter, the Board considered that it was appropriate to consider narrowing the three widest target ranges, based on the Board's experience to date with cost allocation and the fact that most distributors have now adjusted or are phasing-in an adjustment to their revenue-to-cost ratios to fall within or at the end of the existing revenue-to-cost ratio target ranges. The Board notes the general agreement among stakeholders that these three widest ranges can be narrowed at this time.

The Board agrees with the comments of stakeholders that the pace at which revenue-to-cost ratios should be adjusted to a Board-approved ratio should only be affected by

concerns regarding the impact on any rate classes. The Board notes that it has a consultation process underway as part of the RRF that will review, among other things, circumstances where the need for rate mitigation may arise as well as rate mitigation options (EB-2010-0378). To the extent that the application of the Board's cost allocation policies results in a significant shift in the rate burden amongst classes relative to the status quo, distributors should be prepared to address potential mitigation measures. As in the past, and until a review of alternative options is completed as part of the Board's rate mitigation consultation, the general approach to mitigating rate impacts should be to bring the affected class into the allowed range over multiple years; in other words, going beyond the cost of service year and completing the transition during the subsequent Incentive Regulation Mechanism ("IRM") period.

GS 50 kW to 4,999 kW rate class

With regard to the GS 50 kW to 4,999 kW class, the Board agrees with that there is no evidence at this time to suggest that the revenue-to-cost ratio should remain asymmetric. The Board finds that a target range of 0.8 to 1.2 for the GS 50 kW to 4,999 kW class is appropriate at this time. As noted above, the pace at which the top of the range for this class is moved to 1.2 should only be affected by concerns regarding the impact on any other rate classes.

Street Lighting and Sentinel Lighting rate classes

As discussed above in section 2.5.4, a separate consultation will be initiated involving the Street Lighting class. As such, the revenue-to-cost ratio for the Street Lighting class will remain at 0.7 to 1.2 pending the outcome of that consultation.

With respect to the Sentinel Lighting class, the Board is not convinced that any adjustments to its target range would be unwarranted by reason of the class being considered a legacy rate class, assuming that to be the case. In the Board's view, cost causality is an overarching principle that should be applied regardless of whether a rate class can be considered legacy or not. In addition, there is no indication that the Sentinel Lighting rate class will be phased out by all distributors imminently. The Board has concluded that the revenue-to-cost ratio for this rate class should be narrowed to 0.8 to 1.2.

For ease of reference, the Board's revenue-to-cost ratio ranges to be implemented through cost of service applications starting with the 2012 rate year are outlined in Table 1 below. Except for the ranges for the GS 50 to 4,999 kW and Sentinel Lighting classes, all other ranges remain unchanged from the 2007 Report.

Table 1: Revenue-to-cost Ratio Ranges

SERVICE CLASS	RANGE
Residential	85 to 115%
General Service < 50 kW	80 to 120%
General Service 50 to 4,999 kW	80 to 120%
Large User	85 to 115%
Unmetered Scattered Load	80 to 120%
Street Lighting	70 to 120%
Sentinel Lighting	80 to 120%

As indicated in its September 2, 2010 letter, the Board expects that with the installation of smart meters and the availability of sufficient smart meter data, better cost allocators for the CA Model will become available and a more comprehensive review of the Board's cost allocation policies will become feasible. The Board anticipates that such a comprehensive review may provide an opportunity to further refine its target ranges. In the meantime, the Board's policy remains that distributors should endeavour to move their revenue-to-cost ratios closer to one if this is supported by improved cost allocations.

2.10 CHANGES RELATED TO THE TRANSITION TO IFRS

2.10.1 DESCRIPTION OF ISSUE

There are a number of accounts that have been identified which have not been previously included in the CA Model. In addition, publicly accountable enterprises are to transition to IFRS by 2012, which could have implications for the CA Model.

2.10.2 RECOMMENDATION OF ELENCHUS

Elenchus recommended adding a set of identified accounts to the CA Model that are not used in the CA Model, for the purpose of making the fact that these accounts are not allocated to customer classes more explicit and transparent.

With respect to IFRS, Elenchus suggested that unless there are changes to the existing accounts of the Uniform System of Accounts ("USoA") that affect the way in which the costs should be allocated, or new USoA accounts are created, IFRS would have no impact on the CA Model. To date, no such changes have been identified.

2.10.3 STAKEHOLDER COMMENTS

Inclusion of Additional Accounts for Completeness

Most stakeholders were silent on the issue of adding to the CA Model, for the sake of completeness, the list of USoA accounts not required for cost allocation purposes. VECC had no objection to inclusion of the additional accounts if it makes it easier for distributors to use the CA Model, even though the accounts have no impact on the distributor's revenue requirement. CLD was of the view that adding the set of accounts recommended by Elenchus may cause unneeded confusion, as the accounts would be added only for information purposes and would not be allocated because they are not related to distribution revenue. LPMA was also of the view that the accounts identified should not be included in the CA Model, as these accounts do not impact the revenue requirement of distributors.

Transition to IFRS

No stakeholder identified specific changes to the CA Model due to the transition to IFRS. Most stakeholders agreed with Elenchus' views that IFRS alone should not necessitate changes to the CA Model, unless it triggers need for the Board to make changes (e.g., definition) to the USoA accounts currently used.

It is recognized however, that the transition to IFRS is likely to result in an increase in the total number of USoA accounts since some categories of accounts will require more detail. CHEC suggested that if new accounts are added to the CA Model, the Board may want to include some dummy accounts in the current CA Model for future use.

LPMA suggested that until IFRS rules are known with certainty, any changes to the CA Model would be based on speculation, and could end up being counterproductive.

SEC was concerned that Elenchus did not look at whether IFRS would cause the CA Model to produce materially different results. Elenchus looked at whether the CA Model was no longer correct, but not whether new inputs would produce less reasonable results.

SEC stated that given some distributors have reported significant potential impacts of IFRS for particular cost categories, it would appear appropriate to model those changes within the CA Model to see if there are material changes in results and, if so, whether those changes are justified.

As an example, SEC mentioned the significant impact expected with regard to capitalization rules. To the extent that costs, when capitalized, are allocated differently than OM&A costs, this may represent a shift in cost responsibility. SEC suggested that it is appropriate for the Board to determine through research whether any such shifts are material and/or appropriate.

CLD stated that many costs currently recorded by most distributors within capitalized overheads may be disallowed for capitalization purposes under IFRS. Currently, the Accounting Procedures Handbook ("APH") is silent or not prescriptive on the treatment of these costs (e.g., engineering supervision, employee training and other indirect employee benefits, as well as procurement costs related to inventory and stores items). CLD suggested that now may be an appropriate time for the Board to provide direction to distributors on the accounting treatment of these costs to ensure consistent treatment by distributors. In light of this, CLD believes Elenchus should provide recommendations on the appropriate treatment in the CA Model.

Oakville Hydro observed that the Board initiated a work group to develop recommendations on how IFRS should be adopted in an IRM environment. Oakville Hydro suggested that the Board consider whether the work group could also identify the impact of IFRS on the balances in the USoA accounts so that stakeholders can assess their impact on cost allocators.

2.10.4 THE BOARD'S APPROACH

The Board concurs with the view of Elenchus and stakeholders that no changes to the structure of the CA Model are anticipated as a result of the transition to IFRS. Nevertheless, as a result of the transition to IFRS, it may be necessary to expand the CA Model to accommodate the adoption of additional USoA accounts. As part of the implementation process for the approach set out in this Report, the ability of the CA Model to accommodate an increased number of accounts should be ensured. The inclusion of dummy accounts may be a convenient way to accomplish this.

Once changes to the USoA to implement IFRS have been finalized, it will be appropriate to consider whether any refinements in the allocators used for any resulting new or broken down accounts are necessary or desirable. It would be premature to attempt to implement IFRS-related changes to the CA Model until that time.

3 NEXT STEPS

As noted in Chapter 1, a CA Working Group will be established to work with Board staff to identify the need for and recommend necessary revisions to the CA Model, and to provide input on the development of supporting documentation.

Specifically, the implementation issues to be addressed by the CA Working Group will include, but may not be limited to:

- Development of a separate worksheet in the CA Model for the calculation of microFIT administrative costs;
- Development of a separate worksheet in the CA Model for allocating the major components of miscellaneous revenues to customer classes in a manner that matches the allocation of the corresponding costs;
- Revisions to the CA Model that allocate the remaining miscellaneous revenues on the basis of composite OM&A;
- Development of a separate worksheet in the CA Model for deriving all weighting factors on a distributor-specific basis, including appropriate weighting factors for allocating costs to unmetered loads:
    - This separate worksheet is intended to make the CA Model more user-friendly and to emphasize the "customizable" aspect of the weighting factors. The CA Working Group will focus on the technical recommendations for the proposed CA Model worksheet.
    - As mentioned earlier in this Report, the provision of further guidance on the terminology and modelling methodology for the Street Lighting and USL classes will be provided through a separate consultation process.
- Streamlining of the existing CA Model worksheets to clarify the proper treatment of the Transformer Ownership Allowance in accordance with Chapter 2 of the Filing Requirements;
- Expansion of the CA Model, if necessary, to ensure that additional USoA accounts can be conveniently and consistently accommodated once changes to the USoA due to the transition to IFRS have been finalized; and
- Provision of input on the development of supporting documentation to clarify the proper use of the CA Model by distributors with respect to each of the above issues.

Once the work of the CA Working Group has been completed, the Board will issue a revised CA Model.

As noted in section 2.5.4, the Board will initiate a separate consultation process on the terminology and modeling methodology for the Street Lighting and Unmetered Scattered Load classes. Further details on this consultation will be communicated in the near future.

This Report also indicates that another separate consultation will be undertaken in the near term to further examine issues associated with load displacement generation (see section 2.3.4). Further information on this consultation will also be communicated in the near term.

Finally, the Board noted in section 2.8.4 the need for more analysis on proposed threshold(s) above which a host distributor would be expected to create a separate customer class for its embedded distributor(s). This further analysis will require the collection of data from embedded and host distributors. Details of the data request will be communicated to distributors in the near future.

Appendix A: List of Stakeholders

The October 15, 2010 Elenchus Report, entitled *Cost Allocation Policy Review: Options and Preferred Alternatives*, is available on the Board's web site at:

http://www.ontarioenergyboard.ca/OEB/_Documents/EB-2010-0219/Cost%20Allocation%20Policy%20Review%20Report%20Oct%2015.pdf

Below is the list of stakeholders that provided written comments on the Elenchus Report.

- Association of Major Power Consumers in Ontario ("AMPCO")
- Association of Municipalities of Ontario ("AMO")
- Cornerstone Hydro Electric Concepts Association Inc. ("CHEC")
- City of Welland
- City of Windsor
- Coalition of Large Distributors ("CLD")
- Electricity Distributors Association ("EDA")
- EnWin Utilities Ltd. ("EnWin")
- Hydro One Networks Inc. ("Hydro One")
- London Property Management Association ("LPMA")
- North Bay Hydro Distribution Ltd. ("NBH")
- Oakville Hydro Electricity Distribution Inc. ("Oakville Hydro")
- Power Workers' Union ("PWU")
- Rogers Cable Communications Inc. ("Rogers Cable")
- School Energy Coalition ("SEC")
- Town of Oakville
- Vulnerable Energy Consumers Coalition ("VECC")