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Hydro One Networks Inc.,
8th Floor, South Tower,
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ATT: Glen MacDonald, Senior Advisor, Regulatory Research and Administration

August 15, 2008.

Dear Mr. MacDonald,

**Energy Cost Management Inc (ECMI) Argument
on
EB-2007-0681 – Hydro One Networks' 2008 Distribution Rate Application Evidence**

ECMI's Argument on the above noted application is attached below.

Requested contact details are as follows:-

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Yours truly,

Original signed by R. White

Roger White
President

Cc Board Secretary OEB
Registered intervenors and observers

**Energy Cost Management Inc (ECMI) Argument
on
EB-2007-0681 – Hydro One Networks' 2008 Distribution Rate Application Evidence**

ECMI's comments will be focussed on a discussion of Hydro One Networks Inc. - Distribution (HONI) proposed Sub Transmission (ST) class and its price determinants. The Argument will test Hydro One's improper use of customer size and connection configuration as the sole criteria for establishment of its proposed new subtransmission class.

The proposed ST class is a new class not a legacy class and as such the standard of scrutiny must be higher than for that of a legacy class. When new classes are being formed, one needs to revisit the fundamentals of customer classification. The establishment of a new class or migration of customers into an existing class is fundamentally an act of discrimination. The act of discrimination results in the customers being treated differently from a cost allocation and/or pooling of cost perspectives. A customer class should be homogeneous to the extent practicable. The homogeneity tests applied to a proposed class are imposed to attempt to ensure that customers in a class impose similar costs on the distributor. That homogeneity has three fundamental tests.

The three tests are to establish the appropriateness of the act of discrimination to establish the new ST class. The choice to group customers in the same class must pass the following tests:

1. utilise similar distribution assets in a similar manner,
2. have similar load shape and energy use patterns, imposing similar needs in terms of demand energy and losses on the distribution system and
3. produce similar business risk for the distributor

These three tests are examined below.

1. **Utilise similar distribution assets in a similar manner**

Of the three tests, Hydro One got the first one partially right insofar as the customers in the proposed ST class use similar assets on the basis of voltage. However, when it comes to metering, the proposed ST class is not homogeneous as the class has Wholesale Market Participating delivery points and non Wholesale Market Participating delivery points. The Wholesale Market Participating delivery points (customers) have their own metering facilities and either own their own metering or have paid for it. Over 80% (289 out of 358) of Hydro One's embedded LDC delivery points in the proposed class are Wholesale Market Participating delivery points (WMPdp).

Ref: Response to ECMI Interrogatory #3

Exhibit H

Tab 4

Schedule 3

Page 1 of 1

The embedded delivery points to LDCs are generally not for an individual customer but are an aggregating meter which captures a diversity of the LDC's customers' loads, often from different classes. The number of units on the customer side of the meter is an accepted criterion for changing the classification of a particular load. For example, individual residential customers are classed as residential while multiple residential apartment units behind a common meter are classed as one General Service customer. Similarly, individual companies which are individually metered and proposed for the ST class are suggested as appropriate for the proposed ST class while multiple load deliveries to embedded LDCs are quite different from those individual commercial activities.

2. **Have similar load shape and energy use patterns, imposing similar needs in terms of demand energy and losses on the distribution system**

Larger commercial customers are typically high load factor customers, they are more subject to material shifts in load factor than are LDC delivery points. For example, large automotive sector customers may decide to eliminate a production shift temporarily or entirely. LDCs on the other hand tend to have stable loads which are the sum of the diversity of the many individual customers connected to those loads.

The total number of delivery points in the proposed ST class is 670. Of that total, 312 are individual customers other than embedded delivery points to LDCs. Even if every LDC in the province had embedded delivery points from HONI, that would add less than 90 paying entities to the ST class, for a class total of not more than 402 customers. Therefore less than 25% (90/402) of the paying entities in the proposed ST class are accepting delivery of 80% of the energy. The dominance and unique nature of the LDC component warrants the establishment of a separate class.

Ref:

Exhibit G1

Tab 2

Schedule 3

Page 9 of 9

3. **Produce similar business risk for the distributor**

The aggregating nature of an individual delivery point to an LDC tends to make the deliveries by HONI more predictable and more stable. With respect to other aspects of business risk, the responses by Hydro One Networks to ECMI Interrogatories indicate that LDCs with embedded delivery points are low business risk customers of HONI. The interrogatory responses indicate that **NONE** of the LDCs with embedded delivery points delivery points have:-

- Resulted in underbilling by HONI due to metering errors

Ref: Response to ECMI Interrogatory #4

Exhibit H

Tab 4

Schedule 4

Page 1 of 1

-Resulted in theft of power by the LDC resulting in losses by HONI

Ref: Response to ECMI Interrogatory #5

Exhibit H

Tab 4

Schedule 5

Page 1 of 1

- Been abandoned by the LDC and resulted in loss of revenue by HONI

Ref: Response to ECMI Interrogatory #4

Exhibit H

Tab 4

Schedule 7

Page 1 of 1

With respect to embedded delivery points which are Wholesale Market Participating delivery points none have resulted in a requirement for HONI to provide surety or similar guarantees to the IESO.

Ref: Response to ECMI Interrogatory #6

Exhibit H

Tab 4

Schedule 6

Page 1 of 1

This latter point results in a lower working capital requirement for HONI.

The Wholesale Market Participant delivery point for the non-LDC members of the proposed ST class are less than 6% of that non-LDC sub class group.

Ref Undertaking J4.1 dated July 17 2008.

This 6% level is not material when compared with the 80% for embedded LDC delivery points.

As regulated entities, LDCs with embedded delivery points have additional largely unique characteristics which further reduce their business risk to Hydro One:

1. LDCs with embedded delivery points have negligible risk in terms of payments of bills for both those which pay distribution charges only (WMPdp) or those which pay distribution and commodity charges (non - WMPdp)
2. LDCs with embedded delivery points which are WMPdp have three element metering for which a higher standard is required than for regular commercial customers and which should reduce any losses due to metering error.
3. LDCs with embedded delivery points have nothing to gain in terms of theft of power because under OEB regulation the cost of commodity purchases by the LDC must, over time, match revenue from commodity sales. Any departure from that match would be captured during a review of variance account balances as part of a regular audit process and result in an adjustment to the LDC's loss

- factors. LDCs with embedded delivery points are therefore unlikely to be involved in theft of power activities.
4. HONI has established discrete Conditions of Service for LDCs with embedded delivery points in its application. (Section 3.4 of Conditions of Service, Exhibit G2, Tab 96 Schedule 1). This indicates that the nature of these delivery points warrant special and unique Conditions of Service.
 5. LDCs which are WMPdps present no commodity settlement exposure for HONI.
 6. HONI has little risk of regulated LDCs supplied at embedded delivery points going out of business.

The proposal to introduce a second separate and distinct fixed price meter charge (Exhibit G1, Tab 4, Schedule 4, Page 4 of 4) for "*Meter Charge for Hydro One Owned Meter*" seems to be a poor effort to patch one of the small and less significant characteristics associated with the majority of HONI deliveries to LDC delivery points. Further, where customers have provided contributed capital to cover the cost of the metering for the delivery even though HONI owns such metering, the charge would certainly not be based on HONI's capital cost or it would not be cost based as contributed capital does not earn an allowed regulated return or an allowed regulated depreciation expense for the purposes of rate making. The proposed meter charge for the proposed ST class appears to require LDCs who have provided their metering through contributed capital to pay a metering facilities charge as in this case HONI owns the metering even though the asset related costs of the metering were provided by the LDC as the charge is to apply for "*Meter Charge for Hydro One Owned Meter*."

Given the fact that the embedded LDC delivery points represent 80% of the deliveries to the ST class, (Ref: *Response to ECMI Interrogatory #10, Exhibit H, Tab 4, Schedule 10, Page 1 of 1*), it seems that given the special unique and material differences of the embedded delivery points to LDCs (identified above) the fact that the majority of the other customers do not bring the same lower cost characteristics as the embedded delivery point to LDC's bring to HONI's distribution system and business risk it appears the other customers (non LDC delivery points) are getting a free ride or inappropriately reduced cost as a result of the introduction of HONI's proposed ST class. On the surface, this indicates that HONI is proposing NON cost based rates for the delivery points which are not associated with LDCs. Therefore, in ECMI's view, embedded delivery points to LDCs should be treated as a separate class because in part because of the materially lower business risk associated with deliveries to regulated LDCs. This class could be called "Sub Transmission LDC embedded delivery points" (ST LDC EDP).

Given the preceding, the question is whether or not there should be two ST classes or three ST classes. One class would be the "regular commercial customers over 500kW" while the second and third ST classes delivering to LDCs would be differentiated only on the basis that the delivery point was a Wholesale Market Participating delivery point or not.

LDCs which have chosen to have their delivery points from Hydro One's distribution system deregistered to establish those delivery points as non Wholesale Market Participating delivery points could be treated as "Sub Transmission LDC embedded delivery points". The Board may choose to group non Wholesale Market Participating delivery points with "regular commercial customers over 500kW." This latter action would recognise the lower real working capital requirement cost and metering standards

associated with the Wholesale Market Participating delivery points within the “Sub Transmission LDC embedded delivery points.”

In the alternative, even if the Board chooses to leave LDCs with embedded delivery points in HONI's proposed ST class it should be recognised that they present both lower working capital requirement in that the WMPdp deliveries are settled directly with the IESO and lower business risk for both WMPdp and non-WMPdp. One way to recognise part of the lower risk and lower cost is to apply no monthly service charge to this group.

HONI's application does not recognise the contribution of Wholesale Market Participants to reduced distribution system costs and reduced distribution system rates.