EB-2006-0267

Ontario Energy Board

EDA Proposal for a Revenue Stabilization Mechanism for Local Electricity Distributors

November 17, 2006

Ontario Power Authority Comments

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INTRODUCTION

The Ontario Power Authority ("OPA") wishes to thank the Ontario Energy Board (the "Board") for the opportunity to provide comments on the Electricity Distributors Association ("EDA") proposal regarding a lost revenue adjustment mechanism or a revenue stabilization mechanism for electricity local distribution companies ("LDCs").

BACKGROUND

In a letter to the OPA dated October 25, 2006 (the "October 25 Letter", attached), the Board concluded that the Minister of Energy's July 13, 2006 Directive regarding the coordination and funding of CDM programs by LDCs effectively addresses the long-term role of LDCs in the delivery of CDM. The Board concluded that the Directive does not preclude an ongoing role for CDM that is funded through distribution rates, but declared that it is important that any continued role for such CDM is coordinated with the OPA's new responsibilities with respect to lost distribution revenue arising out of the achievement of the conservation targets.

In the October 25 Letter, the Board wrote:

> The Electricity Distributors Association (EDA) has recently provided the Board with a proposal that contains recommendations for revenue loss protection associated with CDM activity. The proposal anticipates LDC compensation for revenue losses irrespective of the delivery agent or source of CDM funding. Such a proposal has the potential to affect the OPA's programs and, specifically, the form and type of compensation the OPA might consider offering as part of its CDM procurement policies. (p.1)
>
> The Board will be seeking written comment on the EDA's proposal. It will be important for the OPA to participate in that initiative. (p.2)

In light of these statements by the Board, the OPA has reviewed the report entitled, *Designing an Appropriate Lost Revenue Adjustment Mechanism (LRAM) for Electricity CDM Programs in Ontario*, that was developed for the EDA by Elenchus Research Associates ("the ERA report"). Below are the OPA's specific responses to the Board's questions on the proposal, as well as the OPA's general comments.

OPA COMMENTS AND RESPONSES TO OEB QUESTIONS

The OPA recommends that the Board provide, as quickly as possible, a clear signal that it will remove disincentives for the participation of LDCs in CDM programs funded both by the OPA and from other sources, via a mechanism to address lost revenues. The OPA believes that the revenue stabilization mechanism ("RSM") proposed in the ERA report appears to have significant merit and should be given serious consideration by the Board.

1. *What are the implications, advantages, and disadvantages of adopting the EDA's proposed approach?*

The OPA believes that there is significant merit in the recommendation of the ERA report that the Board implement a simplified RSM as a practical alternative to a targeted LRAM. The primary advantages to this approach over other alternatives are:

- less of a barrier to conservation; and
- greater regulatory efficiency.

Any mechanism for addressing lost revenue that requires LDCs to, in some fashion, quantify the CDM savings, inevitably raises issues such as assumptions about free-ridership that introduce an element of regulatory risk. This additional risk makes LDCs more reluctant to actively participate in CDM programs.

Further, the proposed RSM has the benefit of removing any motivation for LDCs to be a barrier to CDM efforts in which they are not directly involved. There is a natural reluctance for LDCs to support activities that might have even a minimal financial cost. Risk-avoidance behaviour by LDCs can become a barrier to all conservation efforts including, for example, naturally occurring conservation and those initiatives of retailers and other providers of CDM products and services.

The EDA's proposed approach is clearly more efficient to administer in terms of time and costs than a more traditional LRAM. Currently, each LDC is required to provide significant detail in its regulatory filings in order to justify Board approval of its LRAM, such detail including a calculation of the energy savings by customer class and a determination of the value of those energy savings by the Board-approved distribution charge appropriate to that class, verification of the participation levels, and duration of the program.

The ERA report proposes a much simpler process which requires LDCs to record revenues attributable to variances from forecast (possibly normalizing for weather or adjusting for variances in customer growth) in a deferral account, which is disposed of over a three-year amortization period. This is straightforward, transparent, and easy to administer.

The reality of 90 LDCs in Ontario requires the Board to focus its regulatory scrutiny of the LDCs in those areas where it is of most value to ratepayers. It is difficult to understand what value would be obtained for ratepayers that would justify the additional costs incurred by both the LDCs and the Board to administer a more traditional LRAM.

2. *If the Board provided for a revenue stabilization mechanism for distributors, would it affect the distributors' risk? If so, how might it impact on the distributors' allowed ROE, and/or the design of an incentive regulation framework?*

The OPA takes no position on these questions.

3. *What are the implications of adopting the EDA's proposed approach if CDM programs, associated expenditures and program results are not reviewed and tested by the Board in the context of rate recovery?*

The fact that the majority of CDM programs in which the LDCs will be involved will likely be funded by the OPA rather than through distribution rates strengthens the argument in favour of the approach put forward by the ERA report. An LDC's rates case may not be the appropriate venue to scrutinize the results of programs that have not primarily been designed by LDCs and that are not recovered through distribution rates. A mechanism that was derived in the context of two gas utilities designing their own programs and funding them through distribution rates does not necessarily fit the context of 90 electricity LDCs being funded by a government entity to carry out programs designed by that entity.

4. *There are two options set out on page 14 of the report. Do you think one, both, or neither are appropriate? Please provide a detailed explanation for your choice.*

The two options are:

a) Implementing an LRAM with limited scope, which will risk creating a conflict for LDCs between their conservation responsibilities and their fiduciary responsibilities; and
b) Adopting a simplified RSM that eliminates the impact of all variances from forecast in electricity demand, without the need to quantify the impact of specific CDM programs.

For the reasons set out above, the OPA believes that the second option has greater merit.

5. *Are there alternative approaches to the EDA's proposal that the Board might consider for setting a lost revenue adjustment mechanism for CDM, including CDM funded by the OPA? If so, what do you think is the most appropriate approach? Please provide a detailed explanation for your proposed approach.*

The OPA is not recommending an alternative approach for the reasons set out above.

URGENCY

The OPA and LDCs have a very tight timeline in which to execute contracts for the implementation of programs to meet the Minister's directive of July 13, 2006. The OPA currently anticipates executing such contracts in early 2007. Given the significance of the issues raised by the EDA's proposal, the OPA believes that it is very unlikely that the Board will be able to reach a conclusion on the matter in this proceeding by that date. However, it is crucial that the Board urgently provide LDCs with assurance that lost revenue will be addressed for the applicable time period of those contracts being negotiated.

The OPA has reviewed the Board's Filing Requirements for Transmission and Distribution Applications released November 14, 2006 in which the Board provides, among other things, guidance to assist LDCs in their applications for LRAM and SSM for CDM programs. The LDCs will be assisted by the Board's guidelines on lost revenue treatment **applicable to the revenue gap period from May 1 to September 30, 2007**. It is evident that the Board sees the need to address the LRAM issue and to provide clear and immediate direction on it to LDCs.

However, it is regulatory treatment for lost revenues sustained in the period subsequent to September 30, 2007 which has not yet been addressed. Therefore, the OPA strongly urges the Board to commit as early as possible to the use, at a minimum, of an LRAM in accordance with the current model, for the retroactive filing of 2007 CDM program results, whether funded through LDC rates or via OPA procurement contracts. This minimum may be exceeded by the adoption of the simplified RSM but the assurance that nothing less than the current LRAM will be in place post September 30, 2007 would provide the OPA and LDCs with the basis for arriving at a contract.

OTHER ISSUES

The OPA is pleased that the Board is considering the EDA's proposal with respect to lost revenue, but notes that there are other issues related to the activities of LDCs in delivering CDM that must be addressed on an urgent basis. These include the relationship between the LDCs' CDM activities under contract with the OPA and how the LDCs are rate regulated by the Board, and the rules related to how LDCs and their affiliates may carry out CDM activities.

The OPA wishes to thank the Board for this opportunity to provide its comments on the ERA report, and would be happy to provide further clarification if needed.

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Ontario

BY EMAIL ONLY

October 25, 2006

Mr. Mike Lyle
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Dear Mr. Lyle,

Re: Conservation and Demand Management Funding for Electricity Local Distribution Companies

Thank you for your letter of July 21, 2006 in which you describe the Ontario Power Authority's (OPA) plans to implement the Minister of Energy's Directive regarding the coordination and funding of conservation and demand management (CDM) programs by local distribution companies (LDCs). In that letter, the OPA states that the Directive effectively addresses the long-term role of LDCs in the delivery of CDM and instructs the OPA to assume responsibility for coordinating and funding the delivery of CDM programs by LDCs in Ontario.

The Board believes the Directive has clarified the LDCs' role in both the delivery and the funding of CDM. The Directive does not preclude an ongoing role for CDM that is funded through distribution rates, but it is important that any continued role for such CDM is coordinated with the OPA's new responsibilities with respect to lost distribution revenue arising out of the achievement of the conservation targets. The Electricity Distributors Association (EDA) has recently provided the Board with a proposal that contains recommendations for revenue loss protection associated with CDM activity. The proposal anticipates LDC compensation for revenue losses irrespective of the delivery agent or source of CDM funding. Such a proposal has the potential to affect the OPA's programs and, specifically, the form and type of compensation the OPA might consider offering as part of its CDM procurement policies.

The Board understands that the OPA has only recently begun work to implement the Directive in respect of the $400 million to be spent procuring LDC-delivered CDM. As such, the Board intends to limit its review in the upcoming OPA fees case to the operational costs to be incurred in 2007 to implement the Directive. This review will include a consideration of the principles and objectives guiding the OPA's CDM initiatives, but not the details of the programs themselves.
Normally, among the principles expected to be addressed would be that of the compensation of LDC's for revenue losses due to the implementation of CDM programs. The Board believes, however, that it is more efficient to address this issue separately from the fees case. The Board will be seeking written comment on the EDA's proposal. It will be important for the OPA to participate in that initiative. Details of the process to review the EDA's proposal will be posted on the Board's web site.

Your letter of July 21, 2006 also asks the Board to continue to review CDM proposals funded from distribution rates until October 2007, at which time the OPA expects to be in a position to begin delivery of CDM programs funded under the Directive. In respect of the need for this funding, the Board will shortly provide LDCs with guidance on how to apply for incremental CDM program funding as part of the 2007 rate setting exercise. This process will be similar to that used for incremental funding in the context of 2006 rates.

Yours truly,

Original Signed by

Peter H. O'Dell
Assistant Board Secretary