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August 30, 2006

VIA EMAIL AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: Cost Allocation Review (EB-2005-0317)
Further Comments on Selected Issues: VECC'S Response

As Counsel to the Vulnerable Energy Consumer's Coalition (VECC), I am writing, per the Board's letter of August 21st, 2006, to provide our comments on the four issues identified in the correspondence.

1) <u>Load Data Requirements for Optional 3rd Run for Load Displacement Class</u>

The August 21st request suggests that there should be some recognition given to the diversity of generation performance amongst the customers concerned when distributors choose to model a separate Load Displacement Class in a "3rd run" which uses an alternative method where actual/estimated generator loads are added to metered loads. To address this issue, Board staff proposes to add a filing question regarding the degree of diversity reflected in the displaced load added to metered usage.

VECC notes that – subject to the limitations of having only one year's data (as noted on the bottom of page 7 of VECC's initial comments) – the metered load data for load displacement customers recognizes the generation diversity associated with these customers. Therefore, in VECC's view, distributors choosing to use the "alternative method" would do so for one of two reasons:

a) The Distributor is concerned that the one's year's load data is not representative of the generation performance for the customers concerned, or

b) The Distributor believes that its investment and costs to serve the customer are more closely linked with the customer's total load (including standby service) regardless of when it occurs.

In the first instance, one would expect there to be some provision for diversity in the load adjustment. However, in the second instance, this will likely not be the case.

In VECC's view the filing question is reasonable and sufficient. It allows for both circumstances, while requiring the Distributor to provide a supporting explanation.

2) Weighting Factors for Number of Bills

This issue was raised in VECC's initial comments (pages 24-25). While VECC did not specifically recommend the introduction of default weighting factors, VECC supports the current proposal by Staff to introduce some form of weighting.

VECC has no specific insight as to whether the proposed weightings are reasonable for the Ontario circumstances. Indeed, the weightings could vary across distributors depending upon the types of billing systems and billing processes used. However, they are directionally correct and the Staff proposal does make provision for Distributors to substitute their own values (with supporting information) if they are materially different.

3) Weighting Factor for Services (Account #1855)

The use of weighting factors in the allocation of Services (and associated expenses) was also raised in VECC's initial comments (page 21). In this regard, VECC is pleased that the Staff proposal now acknowledges the issue. However, in its initial comments VECC also noted (see pages 9 and 21) that there was some uncertainty as to whether Distributors were including the cost of services (i.e., the connections) for all customers in the "Services" account or just the cost of facilities with voltages of less than 750 V.

Application of weighting factors that involve all customer classes is only appropriate if the Services account captures the costs of the services (connections) for all customers. In VECC's view, there is still need for the types of filing questions suggested on pages 9 & 10 of its initial comments in order to clarify the Distributors' reporting practices with respect to these facilities. If the "services" for all customers are not reported in Account #1855, then this must be brought to light. However, until the reporting is corrected, the allocation of the Services account can only be based on the weighted customer count for those customers whose services are actually reported in the account. For example, if the Services account does not include facilities used to serve > 50 kW General Service customers (i.e., the costs of these facilities are included in accounts #1830-1845), then these customers should not be included in the allocation. Furthermore, until the reporting is corrected, it must be recognized that the resulting allocation will understate the costs associated with servicing this customer class.

Overall, VECC supports the expansion of the proposed allocation of Services costs with the following caveats:

- There needs to be additional filing questions to clarify for which customers connection/service facilities have been reported in Account #1855, as opposed to elsewhere, and
- The allocation (including the use of weighting factors) should be restricted to those customers/customer classes for whom costs are actually reported in Account #1855 and the associated expense accounts. (Note: In this regard it is important to note that distributor-owned service/connection assets that have been financed by contributed capital still need to be reflected in the gross asset base. The recognition of who financed the assets will occur through the allocation of contributed capital)

Again, VECC has no specific insight as to whether the proposed weightings are reasonable for the Ontario circumstances. However, they are directionally correct and the Staff proposal does make provision for Distributors to substitute their own values (with supporting information) if they are materially different.

4) <u>Allocation of Conservation and Demand Management Costs ("CDM")</u>

Board Staff now proposes that all CDM expenses (both capital and direct and indirect operating costs) be directly allocated by participant customer class in the cost allocation review filings. The rationale appears to be that:

- In the 2006 EDR rate applications, most distributors only had direct CDM expenses in the 2004 historical test year and therefore most CDM expenses were allocated directly to customer classes, and
- This is similar to the practice followed by Ontario's natural gas distributors.

VECC notes that there are a couple of factual errors in the material presented. First, while the 2006 EDR Decision (page 114) did conclude that indirect operating costs and capital expenditures should be allocated across all customer classes on a volumetric basis, this was not the approach adopted in the 2006 EDR Handbook and implemented by Ontario Distributors. Rather, the Handbook (see page 77) directed that the capital and indirect expense CDM components be allocated across all customer classes based on their respective share of distribution revenue and this was the approach that was implemented through the EDR model distributed by the Board.

Second, and contrary to the claim in the August 21st request for comments, in most cases where incremental CDM spending was requested as a Tier 1 adjustment the spending request was for <u>not</u> "expense-related" and the costs were generally <u>not</u> allocated directly to customer classes. As the Board is aware VECC actively participated in the 2006 EDR process. A brief review of the roughly 70 applications to which it has ready access indicates that:

- Over half of the applications included only capital-related adjustments for CDM. In these instances, the associated costs (e.g., depreciation and cost of capital) were allocated based on class distribution revenues.
- Only 11 applications included an adjustment for CDM-related distribution expenses. Furthermore, in 3 of these cases[1] there was no specific allocation of expenses to customer classes. Rather the CDM expenses were allocated based on distribution revenues. It should also be noted that 10 of these eleven cases also involved adjustments for capital-related CDM costs.
- Of those few distributors (less than 10) that did apply for CDM funding in excess of the third tranche, in less than half the applications were the post-3rd tranche CDM expenses all directly allocated to specific customer classes.

Based on these facts, VECC concludes that the direct allocation of costs to the customer classes that received the CDM program was not the most predominant allocation method used for CDM costs in the 2006 EDR process. As result, the 2006 EDR process does not provide a precedent for the use of direct allocation as suggested by the August 21st Board letter. Indeed, if one were to rely on the practice most commonly found in the 2006 EDR process, then CDM costs would be allocated based on distribution revenues.

With respect to the second rationale offered for adopting direct allocation for all CDM costs, VECC is of the view that the maintaining consistency between the electricity and gas sectors is only appropriate if the circumstances are the same. In VECC's view this is not the case when it comes to CDM programs and the drivers behind their existence. In the case of natural gas, it is VECC's understanding that the principle rationale for CDM programs is to help consumers manage their gas bills – particularly in light of the fluctuating commodity prices. In this instance, a strong argument can be made for allocating costs to customer classes. However, in the case of electricity, the driver behind the CDM programs is fundamentally different. Electricity supply in Ontario is tight and CDM is viewed by the Government as key resource option (i.e., an alternative to new generation). It was for this reason that VECC suggested in its initial comments (see pages 25-26) that:

- All CDM costs should be allocated to customer classes based on a combination of energy and demand, and
- The energy/demand split should be reflective of avoided costs – roughly 80/20.

VECC also notes that if one were to look at allocation practices by neighbouring Canadian electric utilities as opposed to the province's gas sector, direct allocation is not the norm. In the case of Hydro Quebec, DSM costs have been allocated to customer classes based on the relative commodity costs attributable to each class ever since the Distributor came under regulation by the Régie. In the case of Manitoba

[1] Oshawa (included as a Non-Routine Tier 1 Adjustment), Pennisula West and Blue Water.

Hydro, the Public Utilities Board has recently abandoned direct allocation[2]. Instead, DSM costs are to be netted out against export revenues (which are otherwise allocated to customers based on total allocated costs). The rationale in this case is that DSM reduces domestic consumption and increases export opportunities.

Furthermore, if precedents and concerns regarding consistency of approach are considered important then it is useful to look a how other CDM spending in the Ontario electricity sector will be allocated to customers. The August 21st letter notes the Minister has directed the OPA to invest an additional $400 million in energy conservation over the next three years. The funds spent on CDM by the OPA will all be recovered from customers on a volumetric basis, either through the global adjustment or OPA's uplift charges. Furthermore, in future years, the OPA spending on CDM is likely to far exceed the spending by distributors that will need to be recovered through distribution rates. As result, the need or desire for consistency would suggest that all CDM expenses incurred by electricity distributors should be allocated to customers on a volumetric basis.

Finally, VECC notes that in many instances the CDM programs put forward by electricity distributors do not have readily identifiable participant customer classes. A prime example of this is programs designed to reduce distribution losses.

Based on the foregoing, VECC does not believe that the reasons offered by Board Staff for direct assignment of all CDM costs are either persuasive or valid. VECC believes that the comments and recommendations offered in its July 18 submission are still appropriate and should be adopted by the Board.

VECC appreciates the opportunity to provide these additional comments. If there are any questions or if clarification is required regarding the Comments please contact either Bill Harper (416-348-0193) or myself (416-767-1666).

Yours truly,

Michael Buonaguro
Counsel for VECC

[2] PUB Order 117/06, August 2, 2006, page 76.