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June 24, 2005

To: Licensed Electricity Distributors and Electricity Stakeholders

Re: Cost Allocation Review (EB-2005-0317)

The Chair of the Ontario Energy Board advised stakeholders in a letter dated March 9, 2005 that a review of cost allocation in the electricity distribution sector will proceed.

This review will require distributors to file updated cost allocation information that will be used by the Board to consider the need for adjustments in the current share of distribution costs paid by various classes of ratepayers. Changes to current monthly service charges and rate classifications will also be considered by the Board following analysis of the filings.

Scope of the Board Review

The March 9, 2005 letter indicated that the cost allocation review will be based “primarily on the existing rate classifications and a limited number of rate design issues”. Certain potential rate design priorities have been added to the scope of the present review. A detailed list of planned consultation topics for this review is attached in Appendix A to this letter.

The March 9th letter also noted that the Board will begin a comprehensive study of distribution rate design. This new initiative is separate from the cost allocation review. Discussions regarding density rates, seasonal rates, polyphase rates, new Time of Use (“TOU”) distribution rates, smoothing of rate classification boundaries, and substantial changes to the fixed/variable distribution rate philosophy will be deferred from the present set of consultations. Staff will release a comprehensive distribution rate design discussion paper by the first quarter of 2006.

The need for generic updating of non-competitive charges and transformer allowances will be considered by the Board after this review is completed. Any Board actions on distribution line loss incentives or distributed generation will be considered outside of this initiative.

Objectives of this Review

In late 2006, the Board will review the results from the updated cost allocation studies filed by distributors. After considering the filing results and the overall regulatory context, the Board will decide upon the priorities for, and timing of, adjustments to future rates. Certain distributors may then be directed by the Board to address specified matters in their 2007 or subsequent rate applications. Before any adjustments or changes are implemented in rates following this review, the Board will consider transition and mitigation measures.

Cost Allocation

The Board will analyze the cost allocation filings to identify with greater certainty the actual share of costs for serving different classes of customers. Distributors with significant variations between class costs and revenues may be directed to start addressing the matter in a 2007 rate application.

Rate Design

The cost allocation filings will also contain updated information that is helpful to assess the cost basis of current monthly service charges. After analyzing the filing results and other relevant considerations, the Board will consider whether adjustments should be implemented for 2007 to address any monthly service charges of significant concern. Further examination of the appropriate balance between fixed versus variable distribution rates will occur later following the separate comprehensive rate design discussions.

The review will also examine the need for, and implications of:

- adding a new rate class for scattered unmetered loads
- adding a new rate class for embedded distributors by host distributors
- eliminating the legacy rate class identified as "Time of Use".

This review will include discussion of whether an additional rate grouping is desirable for larger users in the General Service >50 kW classification.

Consultation Process

To be placed on the contact list for the upcoming cost allocation review consultations, please forward your name, organization, e-mail address and telephone number to CAreview@oeb.gov.on.ca .

On July 20, 2005, Board staff will be holding a public meeting to review the consultation process. Parties wishing to attend should send an e-mail to the above address by July 8, 2005 indicating their name and organization (note space constraints may require limiting attendance to one person per organization). The meeting will be held at the Board's premises.

Any submissions on the planned scope of consultations should be forwarded in writing by July 27, 2005. The comments will be posted on the OEB web-site.

Board staff will release a cost allocation review discussion paper in early September 2005. A small, knowledgeable advisory team will be established to provide preliminary technical input to Board staff. Electricity distribution-sector stakeholders with directly relevant expertise are invited to join the Technical Advisory Team. Interested persons should forward a short statement of professional experience to CAreview@oeb.gov.on.ca by July 11, 2005. The Technical Advisory Team will meet in three concentrated phases between September 2005 to March 2006. Board staff will chair these meetings.

Three Technical Workshops will also be organized by Board staff to allow for broad initial stakeholder discussions. A Workshop will follow each phase of the advisory team meetings. The following topics will be discussed at the Workshops:

- Phase 1: OEB cost allocation principles and methodologies
- Phase 2: Priority rate design and rate classification matters
- Phase 3: Mandatory OEB filing requirements, OEB model design and data inputs.

Proposals regarding cost allocation principles and methodologies, and select rate classification/rate design matters, will be released for written comments from stakeholders in January 2006. Proposals regarding mandatory OEB filing requirements will be released for written comment in May 2006.

The Board wishes to encourage participation in the consultations by affected stakeholders. Costs will be awarded to eligible ratepayer or public interest organizations under section 30 of *The Ontario Energy Board Act, 1998* (see Appendix B below for details). The costs to be awarded will be recovered from all licensed Ontario electricity distributors based on their respective distribution revenues. All requests for cost eligibility must be forwarded in writing to the Board Secretary by July 11, 2005 and will be posted on the OEB web-site.

Cost Allocation Informational Filings

In March 2006, following stakeholder consultations, the Board will issue a Report adopting common cost allocation principles and methodologies for the OEB cost allocation review. Select rate design priorities will also be addressed in that Report.

The Board will release its mandatory cost allocation review filing requirements and its cost allocation filing model in July 2006.

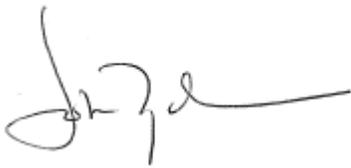
All Ontario electricity distributors will be required to file new cost allocation studies for Board informational purposes in tranches during the Fall of 2006. The filings will be public. The studies must be consistent with Board-approved cost allocation principles/methodologies and filing requirements.

Distributors must use updated, statistically-reliable load data in their cost allocation studies, as directed in the Board's November 10, 2003 letter. The Board understands that a distributor consortium gathered new provincial load data for the period April 2004 to March 2005, and that their data collection may extend through to August 2005.

For any questions regarding the cost allocation review consultations, please contact Board staff John Vratsidis at 416-440-8122, or Pascale Duguay at 416-440-7739, or e-mail CAreview@oeb.gov.on.ca .

The Board looks forward to the assistance of all stakeholders in meeting the timelines and deliverables in this important initiative.

Yours truly,

A handwritten signature in black ink, appearing to read 'John Zych', with a long horizontal flourish extending to the right.

John Zych
Board Secretary

Appendix A – Planned Technical Consultations

Schedule

Date	Consultation Milestone
September 2005	1st Phase Technical Advisory Team meetings commence regarding electricity distribution sector cost allocation principles and methodologies (meetings to conclude in early October).
October 2005	1st Technical Workshop for initial public discussion on phase one topics.
November 2005	2nd Phase Technical Advisory Team meetings regarding fixed/variable splits and select distribution rate classification/design changes.
December 2005	2nd Technical Workshop for initial public discussion on phase two topics
January 2006	Release proposal for stakeholder written comment on OEB cost allocation principles and methodologies for electricity distributors (proposal to also address priority rate design matters).
March 2006	Release of Board Report on cost allocation principles and methodologies. 3 rd Phase Technical Advisory Team meetings regarding mandatory cost allocation filing requirements/design OEB cost allocation model/data inputs.
April 2006	3 rd Technical Workshop for initial public discussion on phase three topics.
May 2006	Release proposal for stakeholder written comment on OEB mandatory cost allocation review filing requirements.
July 2006	Release of OEB cost allocation review mandatory filing requirements. Release of OEB cost allocation review filing model.

Organization of Technical Workshops

Three Technical Workshops will be arranged to obtain broad initial discussions on the concepts under development by Board staff. Each Workshop will be organized around a review by industry and ratepayer/public interest stakeholders of specific topics.

Composition of Technical Advisory Team

A small advisory team will be formed to provide early technical input to Board staff. All team members will be required to possess relevant technical knowledge, for example as acquired through:

- Prior experience in completing a distribution-related cost allocation study.
- Detailed knowledge of accounting for electricity distributors, or of distribution system engineering.
- Practical experience with electricity distribution rate design or active involvement in earlier OEB rate design consultations.
- Acquaintance with past cost allocation models used by Ontario electricity utilities.

Technical Advisory Team Meetings

The Technical Advisory Team discussions will be divided into three phases. Each phase of the Technical Advisory Team will be expected to manage its time appropriately to meet the project schedule. Staff have estimated the maximum meeting time for each phase. Two meetings will be required per week if parties wish to utilize the full amount of time allocated.

Staff discussions will build upon the extensive technical work undertaken in the 2003 cost allocation consultations (meeting notes to be made available on this project's web page), the detailed comments in the Board's Load Data Collection Directions (issued November 10, 2003 and to be added to project's web page), and the cost allocation/rate design components of the 2006 EDR consultations (see Chapters 9 and 10 of the 2006 Electricity Distribution Rate Handbook and associated schedules).

Substantial continuity is desirable in Technical Advisory Team composition over the three phases. However, given stakeholder time availability and expertise, some parties may be selected for participation in a single phase.

Technical Advisory Team Meetings - Phase One Topics OEB Cost Allocation Principles and Methodologies for Electricity Distributors

Planned Schedule:

- Meet for up to 6 days from September 19th to October 7th, 2005
- Technical Workshop 2 days - target date October 20-21, 2005
- Additional meeting early January 2006 to review case studies

1) Directly assignable costs

Update prior list of OEB accounts to be directly assigned, using traditional principles. Confirm that the proposal is consistent with the data available to a distributor following the OEB system of accounting.

2) Functionalization and allocation of various customer costs

Development of a simple and fair approach to be used as the standard Board methodology for the various subcomponents of customer costs for a typical distributor. Confirm that the data assumed in the proposal is generally available.

3) Categorization (division of costs into customer v. demand)

- a) Use of basic customer charge method: What specific items should be taken into account in this calculation? Confirm that the data required for the calculation is generally available.
- b) Application of the prior industry "modified" minimum system study results to the present unbundled environment. To what specific costs should a minimum system approach be applied (for example to lines and transformers, with subtransmission to be 100% demand)?

4) Functionalization and allocation of demand costs

- a) Review proposal (see Chapter 5, Cost Allocation Working Group Report September 23, 2003) to use Non-coincident Peak (NCP) as the main demand-cost allocator, but to use Coincident Peak (CP) where facilities are designed taking into account load diversity (such as sub-stations).
- b) Review suggestion (see above Report) to use 12 NCP as the default Non-coincident Peak Demand allocator.
- c) Review prior suggestion that use of class NCP versus customer NCP might be more appropriate in certain circumstances.

- d) Produce a list of specific demand-related costs that are proposed to be allocated using the above principles. Confirm that suitable data is generally available to implement these proposals.

5) Weather normalization of updated load data (to be used for allocating demand costs)

- a) Review discussion in 2003 Report on the benefits of requiring weather normalization. Discuss impact of the atypical Ontario weather conditions over the period new load data was collected.
- b) Discuss development of a common load data weather normalization methodology for Ontario electricity distributors. Review previous weather adjustment models developed in this Province (e.g. based on Ontario Hydro experience).

6) Functionalization and allocation of other costs

- a) *CDM* - Discuss use of the methodology set out in the 2006 EDR Handbook to allocate CDM expenditures in the present cost allocation review filings.
- b) *Wheeling and LV shared line charges* - Discuss allocation of wheeling services provided through distribution lines and “low voltage” (44 kV and 27.5 kV) shared line charges. To include examination of the methodology set out in the 2006 EDR Handbook (Sch. 10-7) to allocate wheeling/LV costs incurred by host distributors in the upcoming studies.
- c) *Other Costs* - Are there other common group of costs (for example, transmission assets reclassified as distribution assets) that should be dealt with in the standard OEB functionalization methodology? Review grouping of costs in the 2006 EDR model.

7) Composite Allocation

Review list of anticipated residual costs that must be allocate using a composite allocator.

8) Draft OEB Model Case Studies

As the team meetings progress, the first draft of the new OEB cost allocation model will developed. It will be introduced at the October Technical Workshop. Two medium-sized distributors will be asked to test the first draft. The case study results will be discussed at a meeting in early January 2006.

Technical Advisory Team Meetings - Phase Two Topics

Select Rate Design

Planned Schedule:

- Meet for up to 6 days during November 1 to November 18, 2005
- Technical Workshop 1 day - target date December 9, 2005

1) Review of Monthly Service Charge Anomalies

- a) What is the Provincial average, as well as highest and lowest, fixed monthly service charge for various classes of customers?
- b) Can the results of the Fall 2006 informational filings produce an updated cost-based floor and ceiling for each distributor's fixed monthly service charge (discuss using both the basic customer charge and minimum system approaches)?
- c) What are the advantages and disadvantages of adjusting apparent fixed monthly service charge anomalies for 2007, pending the outcome of the separate comprehensive rate design discussions.

2) Other Rate Classification/Design Priorities

Other rate classification/design topics will be discussed, but their scope will be limited so as to not significantly overlap with the forthcoming comprehensive rate design study. The present priorities are to examine the need for, and implications of:

- a) Adding a new rate class for scattered unmetered loads, and associated rate design issues (for example, per connection versus per customer charge).
- b) Adding a new rate class for embedded distributors, and examination of the resulting wheeling or LV rates.
- c) Eliminating the legacy rate class identified as "Time of Use".

The meetings should also cover what supporting evidence must be filed if a distributor adds or removes one of the above rate classifications for 2007.

3) General Service > 50 kW Discussion

Examine treatment of the larger GS >50 kW customers across the Province. Identify what are the causes of any unjustifiable variations in distribution rates (e.g. fixed/variable misallocations, lack of suitable intermediate classification, or other factors). Identify possible options (pending the comprehensive rate design study), and analyze the pros and cons of each.

Technical Advisory Team Meetings - Phase Three Topics OEB Filing Requirements, Design OEB Cost Allocation Model, Data Inputs

Planned Schedule:

- Meet for up to 5 days during second to fourth weeks of March 2006
- Technical Workshop 1.5 days - target date second week of April 2006
- Additional meetings to comment on three case studies of the second draft of the OEB model and on the draft model instructions

1) Mandatory OEB cost allocation review filing requirements

a) Mandatory filing information necessary for a review of class allocations, based on principles and methodologies approved by the Board regarding:

- Functionalization
- Categorization
- Allocation of direct costs
- Allocation of demand costs
- Allocation of customer costs
- Allocation of energy-related distribution costs (if applicable)
- Composite allocation of remaining costs.

b) Additional mandatory filing information necessary for examining:

- Monthly service charge anomalies
- Select rate classifications changes (and related rate design) - see Phase Two agenda.

c) The meetings should confirm that the data required for the above will be generally available to distributors for each proposed mandatory filing requirement.

2) OEB Load Data Requirements

Review of the updated load data collected by distributors for various rate classes in accordance with Board's Directions of November 10, 2003.

3) Financial Data

a) Which year(s) of financial data should be used in the cost allocation review filings due in the Fall of 2006?

- b) Source of the needed financial data where a distributor outsources a function (review enhanced information disclosure requirements in the 2006 EDR Handbook).

4) Design of inputs and outputs to OEB cost allocation review filing model

- a) Identify all data required for the new Board cost allocation model.
- b) Identify level of detail of accounting inputs.
- c) Identify the major outputs of the Board's cost allocation review filing model: class revenue to cost ratios, and the fixed cost components of monthly service charges, etc.
- d) Explain use of model results to support potential rate classification changes (see Phase Two agenda).

5) OEB Model Case Studies

A second draft of the new OEB cost allocation model (to also address selected rate design matters) will be introduced at the April Technical Workshop.

Thereafter three utilities (one large, medium and small) will be asked to test this draft and report at a team meeting in mid-June 2006. The utilities volunteering must have access to updated load data.

In early July 2006, a final team meeting will be held to review the draft instructions for the new OEB cost allocation model.

Appendix B - Stakeholder Cost Awards

Eligibility

The Board will apply its Practice Direction on Cost Awards to determine eligibility for the costs to be awarded in this process. All interested ratepayer or public interest stakeholders must file a written request with the Board explaining how their interests and views are related to electricity distribution cost allocation, or to the select rate design issues to be reviewed as part of this process. An explanation of any other funding to which the participant has access must be provided.

If the stakeholder wishes to nominate someone for participation in the Technical Advisory Team, a summary of the relevant professional experience and training of that person must be provided.

Stakeholders must provide 3 hard copies and a PDF version of their request. Hard copies must be sent to the attention of the Board Secretary, at the address indicated in the covering letter. PDF versions can be e-mailed to BoardSec@oeb.gov.on.ca.

Major Consultation Stages

a) Technical Advisory Team

The Board may select up to three eligible ratepayer/public interest stakeholder groups to participate in the first and second phases of the Technical Advisory Team, provided that the person nominated to attend for each organization has significant relevant technical expertise. The Board-selected parties will be eligible to subsequently seek cost awards.

The expected maximum number of full day meetings for each phase has been indicated (see Appendix A). The standard full working day will consist of 7 hours. If the total allocated time is exceeded for any phase without the prior agreement of Board staff, no costs for additional meeting time will be allowed. Eligible stakeholders will be allowed to claim for meeting preparation up to 45% of the total time in actual attendance at advisory team meetings (subject to the allowed maximum).

b) Technical Workshops

A series of Technical Workshops will be organized to provide initial public discussion of the concepts under development by Board staff regarding:

- Cost allocation principles and methodologies (October 2005)
- Select rate design (December 2005)
- OEB filing requirements, OEB model design, data inputs (April 2006).

Eligible stakeholders may seek a cost award in respect of their attendance at the working portion of the above Workshops. The standard full working day will be 7 hours. Eligible

stakeholders may claim, for time spent in preparation for each Workshop, up to 45% of the maximum time that can be claimed for actual attendance at the Workshop.

c) Written Submissions on proposed OEB cost allocation principles and methodologies

Written comments will be invited on the proposal to be released in January 2006 regarding the OEB cost allocation review principles and methodologies, and select rate design matters.

Eligible ratepayer/public interest groups may claim costs for their submissions. In light of the extensive preliminary consultations, the Board will set an upper limit on the number of additional hours for which costs may be awarded. It is anticipated that the limit will be set at 25 hours per eligible party.

d) Written Submissions on proposed OEB filing requirements

In May 2006, the proposals regarding the mandatory cost allocation review filing requirements will be released for written comments. The Board will set an upper limit on the number of additional hours for which costs may be awarded. It is anticipated that the limit will be set at 20 hours per eligible party.

Cost Awards

When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of its Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied. The Board expects that groups representing the same class of users will communicate and co-ordinate their participation.

Cost awards will be calculated following the conclusion of the policy phases (Phases 1 and 2), and the implementation phase (Phase 3).