London Property Management Association Comments on Board Staff Discussion Paper – EB-2007-0031

The following are the comments of the LPMA on the staff discussion paper dated March 30, 2007. Answers have been provided on the questions posed in the report. In addition, some additional, general comments haven been provided.

Are there any principles, beyond the generally accepted, traditional principles of rate-making listed above, that that the Board should consider in designing distribution rates? What is the new principle's importance relative to the others?

It is submitted that an additional principle that should be taken into account is the impact on the revenue requirement of rate design. This principle should be as important as the principles listed in the Staff discussion paper.

Some possible rate design mechanisms may impact on the revenue requirement through a change in the business risk and the associated return on equity. For example, a rate design that includes the recovery of all costs through fixed charges reduces the business risk associated with changes in use due to unforecast conservation, weather and local business conditions. A design that increases reliance on the variable charge would lead to increased risks as the recovery of the revenue requirement would be influenced by more factors beyond the control of the distributor.

Another principle that should be considered is the insulation of customers from the impact of distributor-specific lost or gained customers or industries that ultimately reduces long-term rate stability. A set of province-wide rates by rate class would help reduce individual utility business risk as the impact of the local economy would be factored out for individual utilities and replaced with province wide economic conditions. This would reduce the potential impacts at many utilities that are relatively small and have a significant reliance on a single industry or customer. The impact on the remaining customers of the utility would be minimized, resulting in longer-term rate stability for all customers.

What is the most appropriate basis for determining the service classifications for Ontario distribution customers?

It is submitted that with the advent of hourly data from smart meters, it is no longer necessary to consider the predominant use (i.e. residential, farm, business, etc) in determining the service classifications for distribution customers. When this detailed data was not available, this allowed for a relatively simple method to group customers into classes that were expected to have similar consumption characteristics. This will no longer be necessary as distributors will have actual load data for every customer.

It is submitted that a rate classification based on demand data (when it is available for all customers through smart meters) is the most appropriate approach to follow. The demand data for one hour intervals that will be available would allow for the rates to be based on the customer's peak demand or the customer's share of the distribution system peak, or some combination of both. These peak demands (customer peak and distribution system peak) drive significant levels of costs. A rate design that mirrored the allocation of costs would follow the important rate design principle of cost causality.

This approach would also allow the industry to investigate potential levels for division based on demand, as outlined in the Staff discussion paper. It is also submitted that this approach would allow for the possibility that no level of division is required.

It is submitted that rate classifications based on demand are more appropriate than those based on voltage or amperage. Demand is a widely known measure and customers will be able to track their demand figures through the smart meter. This may lead to additional conservation and/or load shifting, providing benefits to the distribution system.

While the amperage based classifications would be preferable to voltage based classifications, and provides the potential for conservation and/or load shifting decisions to lower the need for larger customer services, it is unclear how this approach could be made available to existing customers without incurring substantial retrofit costs.

Should sub-classifications be maintained? If so, what is the most appropriate method to allocate diversity benefits?

As noted above, a demand based classification system would lend itself to investigating the need for and break points for sub-classifications. However, such break points ultimately result in potential problems such as significant changes in rates for customers above and below such break points, as well as the problems associated with customers that traverse the break point on a regular basis.

As a result, it is recommended that sub-classifications should be eliminated if at all possible. This would simply rate design and cost allocation and provide easier and better customer understanding of rates.

Are there other options for the components described below or other components not discussed here that the Board should consider as it moves forward?

It is submitted that with hourly data being available for all customers, the components used for rate design should include a fixed portion, a consumption portion (kWh) and a demand portion (kW). The demand portion could be based on the individual customer demand or on the individual customer demand contribution to the system peak. The individual customer demand approach is appealing because of its simplicity and the ability of customers to affect their demand. The individual customer contribution to the system peak is appealing on the basis of cost causality, but suffers from the fact that because the system peak changes day to day and month to month. As a result, customers do not know in advance when they should change their demand.

What are the principles that should inform the decision on fixed and/or variable rates?

This is the key question in rate design. The mixture of fixed and variable rates can be influenced by a number of guiding principles. First, there is the principle of matching cost recovery with cost causality. That is, the customer-related costs should be recovered through the fixed monthly charge. Demand related costs should be recovered through a

demand charge per kW and variable costs should be recovered through a change per kWh. This is a middle ground approach.

An extreme approach would see all costs recovered through a monthly customer charge. This would minimize the business risk to utilities, allowing for an overall lower revenue requirement (lower return on equity) and eliminating the disincentive and potential revenue loss from utility initiated conservation efforts. Savings would also be realized by the utilities and regulator in that no Lost Revenue Adjustment Mechanism (LRAM) would be needed, freeing up utility resources to achieve conservation rather than accounting for it. The elimination of the LRAM would also free up OEB resources. On the negative side, this could result in less customer incentive to conserve as the delivery cost would be independent of the amount of power consumed.

At the other extreme, all costs could be recovered through variable costs with no fixed monthly charge. The advantage of this approach would be to reinforce the customer savings related to conservation (charge per kWh) and to load shifting (charge per kW). The disadvantage of this approach is that revenues would fluctuate more widely in response to weather and economic conditions.

At this time, LPMA cannot comment on which approach would be more appropriate. Further research and information is required, as would be the impact of different approaches on different sized customers in different rate classes. More on this topic is found in the general comments provided below.

Should the billing determinants be consistent for all customer classifications?

No. Very large customers should continue to have kVA as a billing determinant. As for the other customer classes (i.e. residential, general service below or above 50 kW), there should be consistency across the customer classifications, given that the implementation of meters capable of providing hourly data will standardize the information available across these customer classes.

What are the most appropriate billing determinants for each customer classification?

LPMA believes that the billing determinants that should be investigated should include the number of customers, the kWh consumption, the customer's kW peak demand and the customer's kW peak demand contribution to the system peak. In addition, several different measures of the peak demand should be investigated. For example, the peak demand could be the one peak hour in the peak period in a month, or it could be the average of the 3 highest peak hours in the peak period in the month, or it could be the average of all of the hours in the peak period during the month. Similarly, there could be demand determinants for the on peak, off peak and shoulder periods calculated in one of the ways listed above. Other possibilities should also be investigated.

The Staff discussion paper raises some of the potential problems that may arise from having a distribution system peak charge and a customer peak rate. Chief among these would be the customer's ability to understand the distinction.

LPMA submits that the benefits that may result from a multi component demand rate would outweigh the negative impacts. In particular, the Board may want to consider a demand rate that mimics the three time-of-use prices under the smart meter regulated price plan. This would reinforce the benefits to customers of conservation and/or shifting of demand.

Should the Board pursue an analysis of use-of-system rates for distributed generation to investigate rates and determinants?

Yes. The Board should include in its analysis the methodologies used in by the Board in Ontario for natural gas distributors. In particular, is the treatment of the connection of natural gas producers in Ontario to the gas distribution utilities comparable to that of distributed generators connecting to the electric utility? In addition, are the standby rate options for load displacement generation comparable to the provision of firm service by

gas utilities through a contracted demand charge? Can the provision of a standby rate be compared to the provision of interruptible service by gas utilities?

How important is consistency of the rate design model across the province?

Given the degree of diversity among utilities and their customers, it is not apparent why each distributor should be constrained by a one-size fits all rate design model if each utility is to continue to have their own distinct rates reflecting their individual revenue requirement. If, on the other hand, there were harmonized rates on a provincial or geographic basis, then this point would be mute as the same set of rates would apply to many distributors.

In either case, policy guidance provided by the Board would be appropriate. In particular, the approach taken to the fixed service rate (avoided costs, directly related customer costs or minimum system approach) could be determined, as could the billing determinants to be used for each rate class.

Is one single rate order (or a few regional rate orders) to be used by all distributors a desirable outcome?

A single rate order (i.e. a single set of rates) across the province would be desirable. Such an approach would eliminate many of the significant differences between rates in neighboring utilities. It would also eliminate the rate harmonization problems associated with utility consolidation. This approach may also reduce the business risk for utilities that are highly dependent on one industry and/or a handful of customers.

A number of issues, however, need to be investigated before a potential move to this outcome. For example, how would rates be set on an annual basis taking into consideration that distributors will have new Board approved revenue requirements on a staggered basis? Who would act as the clearing house for the distributors in allocating the provincial or regional revenues? What is the potential level of cross-subsidization

between utilities of such an approach? What is the impact on business risk, and the required return on equity, of such an approach?

LPMA notes that if a regional approach to setting rates is taken, it may be possible to have all utilities in the region to have their revenue requirements determined in the same year, eliminating this problem. The Board could stagger rebasing applications by region. This approach, however, many not have as significant an impact on the diversification of risk as a province-wide approach. For example, the pulp and paper industry in Northern Ontario would continue to be a significant factor on a regional basis.

Should distributors offer various levels of service? Should distributors be able to buy (offer credit for) services from customers?

It is unclear to LPMA that various levels of service are required. Further information is needed to determine the potential demand for these services, their costs and the allocation of these costs. In general, the cost causality principle should apply in providing these services. That is, any customer who requires or wants "designer power" should be expected to pay for this option. Customers who do not want or need this level of service should not pay any costs associated with this service.

Should the Board investigate a rate design model based on long run marginal costs?

Not at this time. LPMA is concerned that the potential rate design changes are significant, ranging from the fixed/variable cost recovery, the change in billing determinants, distributor-specific vs. regional vs. province wide rates, etc. Adding another significant rate design change at this time could result in rate instability and significant differences in rates between utilities. The marginal costs are likely to differ significantly between utilities (if distributor-specific rates remain the norm). If a standard marginal cost were determined on a regional or province-wide basis, the issue of allocation of the revenues between distributors to cover their individual revenue requirements would be made even more complicated.

The Board's comments from 1979 are still relevant. LPMA believes that marginal cost pricing should not be investigated at this time, but revisited in the future after the current round of rate design changes has been concluded and rates have been in place for a number of years.

Should the Board investigate locational rates for any customers connected to a distribution system?

No. Postage stamp rates have long been the norm in Ontario. Locational rates would not only add to the complexity and instability of rates as indicated in the Staff discussion paper, but they would also lead to customer confusion and dissatisfaction. Customers would not understand or believe that they should be paying different rates than someone else in the same city or municipality for the same service.

Given the simplified bill, can a conservation and/or demand management effect be achieved through distribution rate design?

Distribution rate design can only have an effect on conservation and/or demand management if the results and impact on the bill are easily seen by customers. The level of detail on the existing bills is insufficient to help promote conservation and/or demand management.

While the rate for the commodity is shown on bills today, the distribution (delivery) rate component of the bill does not have the associated rate shown on the bill. This does a major disservice to consumers and does not promote rate-related conservation.

This will become even more important with changes to rate design if one of the principles of rate design is to encourage conservation and/or demand management. In addition to the rates per kWh for delivery (i.e. distribution and transmission), rates for demand per kW should be included on the bills so that customers can see the total potential savings associated with conservation and demand management. Note that this comment also applies to regulatory charges and the debt retirement charge.

It also expected that that the simplified bill will have to be adjusted when detailed meter data is used for the different time of use rates associated with the commodity. The Board should consider an exhaustive customer education exercise when these changes occur. It may be useful for the Board to consider a consultative to recommend changes to the simplified bill, recognizing the changes related to smart meter time of use billing, and the potential benefit to conservation and demand management activities when customers are able to quantify their potential savings for distribution and transmission delivery in addition to the commodity savings.

General Comments

The following comments are provided in addition to the responses provided to the questions posed in the Staff discussion paper.

LPMA views the most important issues to be reviewed to be the fixed/variable splits and whether or not a single rate order or regional rate orders are appropriate. Both of these issues have the potential to significantly alter the business risk faced by distributors, thus affecting their allowed return on equity and thus the overall revenue requirement. The fixed/variable split issue has a potential significant impact on conservation and demand management activities.

LPMA suggests that the Board needs a thorough investigation and understanding of these issues and their collateral impacts on other areas of regulation and government policy. Therefore, LPMA urges the Board to research these topics in other jurisdictions, including the rationale for the approach taken. A consultative approach should be followed, similar to that used for cost allocation and the 2006 EDR Handbook, to solicit input from all stakeholders.

LPMA also urges the Board to review the recovery of transmission related charges through the delivery rates charged by distributors as part of the current process.

Distributors are charged on a per kW basis for transmission service but recover these costs through a charge per kWh from the majority of customers. Variance accounts ensure a true up takes place. With the introduction of smart meters, kW data will be available for all customers. This would enable distributors to bill customers on a kW basis rather than on the current kWh basis, more closely aligning recovery with cost incurrence. As many of the distribution rate design changes currently being contemplated are being driven or facilitated by the increase smart meter data availability, it would appear to be more efficient to deal with the transmission pass through rate design at the same time.