July 19, 2007

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319, Suite 2700
2300 Yonge Street, 26th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli:

Re: Board Staff Discussion Paper on the implications arising from a review of the electricity distributors' cost allocation filings.

Board File No. EB-2007-0667

In response to the Board's invitation on this issue, the Association of Major Power Consumers of Ontario has prepared its submission.

AMPCO's Interest

The majority of AMPCO's members are large users served by LDCs and the Hydro One distribution business. AMPCO has noted several times in the past that LDC rates for large users in Ontario display a breadth of variability that is difficult to explain on a basis of cost causation and this prompted AMPCO's support of and involvement with the OEB cost allocation review process. AMPCO and its members believe strongly that all customers should pay fair rates for distribution services, based on the costs they cause.

Accordingly we have prepared a submission on the subject discussion paper. In it, we present our serious reservations that this discussion paper, if accepted as written, would only lead to a continuance of the status quo, which is an inequitable allocation of the costs of many LDCs to their different customer classes. It would be a very unfortunate outcome if, after two years of effort by the OEB, stakeholders and LDCs, the only noticeable change would be minor adjustments to a few "outlier" situations.

The attached submission has been prepared by AMPCO's consultant, Mr. Wayne Clark. Who represented AMPCO members in the cost allocation review process that preceded the distributors' filings.

Yours truly,

Adam White
President

c.c.: Hydro One Networks (Glen Macdonald)

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AMPCO

Submission
Board Staff Discussion Paper – File EB 2007-0667

On the Implications arising from a review of the electricity distributors' cost allocation filings

Introduction

AMPCO has for several years questioned the fixed charges that Ontario distributors apply to large users. AMPCO members that are served by Ontario distributors often have operations in different locations in Ontario and other jurisdictions and can readily discern significant differences in cost for similar service. Moreover, AMPCO's membership generally is well informed on the wide variation in distributor rates across Ontario. Such variation without transparent justification does little to inspire confidence in the manner in which rates are established.

The cost allocation review process and the subsequent cost allocation filing direction provided by the OEB in RP-2005-0317 was intended, to AMPCO's understanding, to provide a fair and transparent cost allocation process that would ultimately serve to support fair and reasonable rates for all customers.

In this context, the staff discussion paper is a potentially important element in the process of improving rate equity for all customers. Since the revenue/cost ratio information for any particular customer class is a key test of equitable treatment, most of AMPCO' submission is focused in this area.

This discussion paper appears intended to provide policy guidance on the acceptability of an LDC's current cost allocation, with the apparent assumption that, where cost allocation to a particular customer class is within limits, no change may be needed except when the distributor must re-allocate costs associated with other classes.

With this understanding, it is clear that this paper, if accepted as written, could result in an indefinite continuation of all but the most serious examples of cross subsidisation among customers. This would not be an acceptable outcome from two years of effort to achieve transparency and fairness in rate setting.

It is particularly concerning that the staff paper does not articulate any principles against which words such as "just and reasonable" (p10) may be measured. Rather, the tenor of the paper appears to repeatedly introduce qualifiers that would permit current rate inequities to continue. For example, on page 10, reference is given that the ranges proposed would "allow for the recognition of unique design situations that are dependent on history or market conditions". For customers that believe they are paying rates disproportionate to the cost of service, such

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language appears to provide distributors with a ready rationale for preserving an unjust status quo.

AMPCO's specific comments on the paper follow, according to the indexing of the paper.

3. Revenue/Cost Ratios

The analysis in the discussion paper reveals a large variability on revenue/cost for GT 50kW, LU and USL classes. This is not a surprise; AMPCO has noted this problem repeatedly in different forums for several years. It is also unsurprising that classes such as street lighting show subsidisation from other customers, since both the LDC and streetlights historically had the same owner in many cases.

It should also be expected that the statistical confidence levels for classes with fewer members should be lower than for those with many members.

3.1 Significance of the Revenue to Cost Ratios

The methodology for defining "acceptable" revenue/cost ratios is questionable.

The use of one method (current revenue/cost ratio) for residential and small GS and another method (sensitivity of revenue/cost to alteration of selected parameters) for other customer classes is inherently flawed, since revenue/cost allocations interact between classes. This use of separate methods for different classes effectively precludes like-for-like comparisons.

3.2 Sensitivity Scenarios

It is unclear in Table 1 what the direction of the statistics were when the sensitivity tests were run. Presumably, allocations would go up for one class and down for another in any particular scenario. The statistical changes should be signed.

The technical working group in the cost allocation review process put considerable effort into determining the appropriate settings for the parameters the staff paper has adjusted in this analysis. While not perfect, the values recommended by the group reflected the consensus of several experts in distribution. By arbitrarily adjusting parameters or removing their effect entirely, staff appears to be asserting level of uncertainty for these values that is without justification. If there is sound reason for arguing that this level of uncertainty is factually justifiable, this justification should be provided, with supporting analysis.

An additional problem with the sensitivity analyses is the statistical base that was used. According to the paper, sensitivity analysis was used because the statistical data from all filings could not provide clear guidance on the revenue/cost ratio for some customer classes. However, the sensitivity analyses themselves were run on a small subset of the whole population (10 distributors), which necessarily will provide a broad distribution of results for a customer class with relatively few members. In turn, relying on such analysis to set an "acceptable range" for revenue/cost will necessarily produce a broader range than if more comprehensive data were used. Technically, using such a small sample for sensitivity analysis may produce results that are not statistically significant.

Accordingly, the closing statement that "The sensitivity analyses point out the levels of uncertainties surrounding the results that need to be considered in the establishment of appropriate ranges of revenue to cost ratios" should not be accepted based on the information that has been provided.

3.4 Establishing the Revenue to Cost Ranges for Each Class

Aside from the objections noted earlier concerning the use of different methods for determining acceptable ranges for different customer groups, the reasoning in this section is flawed. The determination of an "acceptable" range of revenue/cost based on a simple statistical analysis of current distributor filings is basically an uncritical acceptance of the status quo. As noted earlier, the determination of an acceptable range of revenue/cost should be guided by a stated principle other than status quo.

3.4.1 Residential and General Service less than 50kW

Actual data were not presented, so these comments rely on an interpretation of the graphical date provided.

The graphs for both these classes show clear clustering around a revenue/cost ratio greater than one. Taken together with a recommended symmetrical range around 100% that is tight relative to the recommendation for other classes, this would suggest a downwards adjustment of residential rates for about 25% of customers and an upwards adjustment for something less than 5%. A similar pattern exists for the GS<50kW class.

Before this is accepted, the current mean revenue/cost ratios for these classes needs to be analysed and explained. It is difficult to reconcile the graphical data provided throughout this paper, which appear to suggest an overall revenue/cost ratio greater than unity. Whatever the cause, this artifact needs to be understood and either removed or mitigated by an adjustment to the mean of the acceptable range for all customer classes.

3.4.2 General Service 50 to 4,999kW and Large User

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The paper notes that "there could be reasons for having an asymmetric bias to the right of 100%" and that "These customers are, generally, over contributing" (p20, third paragraph).

The paper then proposes, based on a subjective sensitivity analysis, that a wildly asymmetric range of -20% to +80% should be regarded as acceptable, in part to "limit the movement of revenue to cost ratios below unity". There is no corresponding concern stated about allowing revenue/cost ratios to remain highly above unity for these customers.

It is extremely difficult to understand the logic of the staff paper in this section. AMPCO has repeatedly noted that these customer classes are over contributing and that this is an issue that needs to be addressed. To suggest that large users should continue to be open to paying an 80% premium above the cost of service while other customer groups are assured more just and reasonable rates is wrong.

A view of the graphical information provided suggests that, for the large user class, the majority are paying rates that produce revenue/cost ratios above the range recommended as acceptable for the GS<50kW and residential classes. Moreover, the asymmetrical recommendation in the staff paper would appear to place only about 16% of this class outside the "acceptable" range.

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3.4.4 Street Lighting and Sentinel Lights
The analysis and logic used for the streetlight class in particular follows the same approach as with GS>50kW and large users, but in the opposite direction.

The cost allocation filings for this group show clearly that it is subsidized by other customer classes, with a mean revenue/cost ratio somewhere between 0.3 and 0.4.
In this case, the staff paper takes an opposite approach to the one adopted for the large users, stating an objective to "limit the movement of revenue to cost ratio above unity" (p22).

Why large users should not have the benefit of ratios below unity while streetlights should be protected from rates above unity is not stated. The only reasonable conclusion a customer in the >50kW classes could reach from these inconsistent statements is that the staff paper is clearly biased in how it views the appropriate treatment for different customer classes.

3.5 Implications Arising from the Determination of Class Specific Revenue to Cost Ratios
AMPCO does not agree that the ranges suggested would result in rates that could be considered cost related. As noted, these ranges appear to be based on continuance of status quo situations which the data reveal to be unrelated to cost, on subjective sensitivity analyses and on clearly articulated biases with respect to the appropriate treatment of different customer classes.

5.1 Metering Costs
AMPCO does not have a direct interest in the metering credit for USLs, except to the extent that it should not result in USL subsidisation by other customer classes.

There are several reasons for the wide variation in metering costs across utilities, of which some are readily justifiable (e.g., density) and some are less so (e.g., local practices or contract vs. staff decisions).

For fairness in the short term, local costs should probable be used in determining the credit. Longer term, the advent of smart metering should tend to narrow the cost distribution to the point that the density factor will be the dominant remaining source of difference.

5.2 Line Transformer Costs
The arithmetic average of the filings ($0.78) is likely about right. It is quite likely that the high and low values are computationally incorrect and result from differences in approach by LDCs.

Standby Rates
The board staff recommendation is the only reasonable one possible for this situation (case by case), since the breadth of specific situation types is quite large.

Recommendations
The above comments are clearly critical and on their own, do not provide the Board with a useful positive direction to pursue. It is not usual for AMPCO to comment so strongly on a staff paper.

However, in AMPCO's view, the analysis, discussions and recommendations in this paper are all biased in favour of the status quo generally, even though the data reveal the status quo to be inequitable. In this circumstance, there is no alternative but to comment strongly.

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Nonetheless, there are positive steps that can be taken to improve the analysis and to provide direction to distributors.

Improving the analysis

There are three improvements to the analysis that may help:

1. The apparent bias in all customer groups except for lights toward a mean revenue/cost ratio greater than unity needs to be examined and/or explained in detail. It is unlikely that cross-subsidisation of lighting classes can fully account for this effect. Once understood and corrected, this may improve the quality of the filing information overall.

2. All customer classes should be analysed similarly. Using sensitivity analysis as the key source of guidance on one class and relying on filing statistics for another is not a sound approach.

3. The graphical data provided examines the revenue/cost ratios within a customer class, across the distributor population. Working with the same data to characterize the distribution of revenue/cost ratios across customer classes, within distributors, may be helpful, as it should reveal the distribution of skewed treatment across different customer classes. For example, one analytical measure that might prove helpful would be to identify the amount of a distributor's total revenue that is allocated in total to customers outside a band of, say 0.9 – 1.1 in revenue/cost ratio. This may reveal a measure of the amount of cross-subsidisation of customers within and across distributors, leading to Board guidance on reasonable limits to cross-subsidies.

Providing Direction to Distributors

Setting wide, asymmetric bands for some customers and narrower, symmetric bands for others may be seen as license to continue with unfair rates, or even to worsen existing situations. As a matter of principle, all "acceptable" bands should be symmetrical and equal. Ultimately, the notion of an acceptable range of revenue/cost ratios should be an explicit reflection of factors other than strict cost causality that can influence rate design. Asymmetrical treatment of specific customer groups should fail such a test.

Whether or not the Board feels it is practical to achieve full rate equity in a single step is a different matter from what should be regarded as acceptable in the longer term.

Accordingly, the acceptable range of revenue/cost should be the same for all customers.

A further improvement on the guidance for distributors should include a limit on the proportion of total distributor revenue by customer class that is outside a revenue/cost ratio of unity. While the acceptable range for the revenue/cost ratio calculated for individual customer classes may be relatively large, the total proportion of revenue in a utility that can be effectively seen as cross-subsidisation should be held to a much tighter band, say 10% or less.

A measure that limited a distributor's ability to favour one customer class over others would go a long way towards removing perceptions about unjust rates.

There may well be other constructive measures that can be taken to improve on this paper. As always, AMPCO is prepared to assist to the best of its ability and resources.

Prepared by:

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