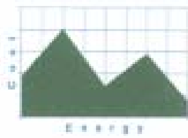

ECMI
energy cost management inc.
1236 Sable Drive Burlington, Ont. L7S 2J6
Phone: (905) 639-7476 Fax: (905) 639-1693

Ontario Energy Board
27th Floor
2300 Yonge Street
Toronto, Ontario
M4P 1E4
ATT: Kirsten Walli, Secretary

July 18, 2007.

Dear Ms. Walli,

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 accordance with the OEB's e-mail and web posting of June 28, 2007 ECMI submits its comments on the above noted matter.

Three paper copies are enclosed. Electronic copies in both Adobe Acrobat and Word have been sent by email to boardsec@oeb.gov.on.ca.

Requested contact details are as follows:-

Roger White, President
Energy Cost Management Inc.,
1236 Sable Drive,
Burlington, Ontario
L7S 2J6

E-mail address: rew@worldchat.com
Phone number: 905 639 7476
Fax number: 905 639 1693

Respectfully submitted for the Board's consideration,

Original signed by R. White

Roger White
President

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ECMI comments on Board Staff Discussion Paper on the implications arising from a review of the electricity distributors' cost allocation filings. Board File No.: EB-2007-0667

Based on the cost revenue distribution diagrams, the residential class and the General Service <50kW group samples are over contributing to the tune of at least 90% for the residential sample and at least 85% for the General Service <50kW sample of identified points. Conventional wisdom persistently stated that the cost allocation process would identify that residential customers were under contributing. It is apparent that for whatever reason conventional wisdom has failed us. ECMI would suggest that the failure stems from several causes. ECMI finishes this submission with 8 specific short term recommendations which will improve the value of the cost allocation process for customers. These actions should bring rates in the province of Ontario more in line with costs.

Fundamentally, this cost allocation process has failed to recognise any economies of scale in delivering large volumes of electricity to individual users or load centres. These economies are generally recognised through a bulk system cost allocation process. Such a system recognises the cost multiplier which flows from supplying radial single phase loads. Notwithstanding these facts, the options available to the OEB are to revisit the cost allocation process with a view to getting it right with all that that entails. The requirements for a much more robust Uniform System of Accounts (USoA) providing data more suitable for cost allocation processes is evident.

On page 10 of the paper it states that

> *"The use of a range or ranges would allow rates to be approved that are just and reasonable and allow for the recognition of unique rate design situations that are dependent upon history or market conditions."*

There is no reason to believe that rates are just and reasonable simply because such rates were in place yesterday. The statement falsely assumes that historical rates are necessarily just and reasonable.

ECMI can agree that the ranges should be broad but not because the results are broad based on history. The ranges should be broad because the base data is not valid enough to change customer's rates in a narrow range of revenue to cost ratios. History stems from the unbundling process established by the OEB. That process was flawed on a number of bases combined with automatic percent changes applied to distribution revenues subsequent to 2001. Applying percentages repeatedly over a number of years might have produced reasonable current state results if initial (at the point of unbundling) cost revenue ratios had included a full Market Based Rate of Return (MBRR). Because bundled rates probably produced a similar return on assets for each class based on a below MBRR, this allowed uniform percentage changes to produce the results generally produced by the current information filings. The combination of percentages and a flawed unbundling process has produced the current results. These factors in combination with a lack of robust accounting data differentiated to the degree required to support a cost allocation system makes the Board staff paper statements that this cost allocation provides sufficient credibility to require apparent outliers to make significant

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changes in the allocation of the revenue between classes or groups inappropriate. The paper is saying that history and a flawed process will be allowed to trump fairness in terms of cost allocation. The “history” referred to in the paper is not historical rates – the history is the flawed unbundling process and the continuing application of uniform percentages.

Notwithstanding the issues stemming from the historical rates and the numbers which they produce, history can provide guidance with respect to important principles which should be considered when establishing rates or a cost allocation system. In determining the historical principles for rate setting for street lighting, the Ontario legislature historically recognised the public safety and material societal benefits which flow from the installation of street lighting. As such, the statute required the then regulator Ontario Hydro to ensure that street lighting pay no more than its direct cost. At that time the street lighting system relied on a pilot wire system for its control and consistent operation and wire mile calculations were utilised so that no more than the direct cost of street lighting would be chargeable to that service. As a result, most LDC's in Ontario required that the costs associated with dedicated street lighting resources either be pooled separately or be owned operated and maintained by the municipal corporation. The separate pool arrangement de facto resulted in the latter situation where the dedicated street lighting system components were implicitly owned operated and maintained by the municipal corporation. Today, most LDCs have replaced the pilot wire system with photo controllers, although a few pilot wire systems are still in service. Although the technology has changed, the guiding principle that only dedicated or direct costs of street lighting should be chargeable to the street lighting class is required to continue to give due recognition to the safety and other societal benefits of street lighting.

On page 9 of the paper it states that:

> *“However, most practitioners and experts in the electricity industry recognize that there are qualitative components in the cost allocation process reflecting unique situations and market conditions that require the use of judgments and non-quantitative decisions concerning rate design.”*

ECMI reminds the Board that “most practitioners and experts” predicted that the cost allocation process would identify a universal fact that residential customers almost without except exception would be underpaying. So much for “most practitioners and experts”. Further, the quantitative impact of any decision can be established. In other words, if you are going to ignore the data, one can quantify the numeric impact of ignoring the data.

The statistical mumbo jumbo purported by Chicken Little who is afraid that if much change is required the sky will fall, if accepted will create so much inertia that the Board will be unable to act. Basically, what the analysis says is the current cost allocation filing produces revenue to cost in a range of results from X to Y in some way validates the range of X to Y and therefore no change is warranted. The conclusion that this circular analysis produces is that, for those who are unlucky enough not to be in the herd, change may be mandated. The requirement for change seems to be independent of the validity of the results. An outlier may in fact be closer in terms of revenue if the cost allocation process were based on solid accounting data and a robust cost allocation method.

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It appears that the authors of the report have so little confidence in the cost allocation process that it is inappropriate to make significant changes.

With good accounting data and a robust cost allocation model it is reasonable to seek a revenue to cost ratio of unity for each class. The valid question is what time period is reasonable to get there and on what basis. To move forward several actions are required:

1. Produce better accounting data more consistent with regulatory requirements including information required to fully support a robust cost allocation model.

2. Revise the cost allocation model to incorporate the aforementioned accounting information and modify the model to recognise the economies of delivery to larger load centres.

3. Specifically, adjust the cost allocation to Sentinel and Street Lighting to recognise the zero incremental cost associated with primary and transformation used to supply these classes. Further, in the case of street lighting it is important to recognise the safety and other societal benefits produced by street lighting.

4. Ignore the flawed history as any basis for establishing required changes save and except customer impact considerations.

5. Recognise the Board's primary statutory requirement to protect residential customers.

6. Recognise that a significant cost was incurred in establishing load shape data. This cost should not be repeatedly incurred without addressing all of the previous required actions.

7. If class revenue adjustments are required, then any amount not recovered because of rate impact constraints should be placed in a deferral account. Such a deferral account should generally be readily accepted. Such deferral account should be pro rata between the classes on the dollars that they are continuing to pay after revenue adjustments have been maximised using customer impacts as a constraint.

8. One should not try to come up with one shoe fits all. **<u>After</u>** the preceding changes are incorporated, if revenue to cost ratios are outside of a plus or minus 10% range a directionally correct **significant** change should be required of any distributor requesting a rate adjustment. Individual LDC impact constraints should be used as a test against the **significant** change.

If the OEB fails to take corrective action in the short term then dissatisfaction with the regulatory process should be expected.