RP-2000-0023
EB-2001-0016

IN THE MATTER OF the Ontario Energy Board Act, 1998;

AND IN THE MATTER OF an Application by Hydro One Networks Company Inc., for an Order or Orders approving rates for the distribution of electricity.

BEFORE: Paul Vlahos
Vice Chair and Presiding Member

Sally Zerker
Member

Art Birchenough
Member

Fred Peters
Member

DECISION WITH REASONS

June 12, 2002

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1. INTRODUCTION

1.1 THE APPLICATION

1.1.1 Hydro One Networks Company Inc. (“Networks” or the “Applicant”) is the regulated subsidiary of Hydro One Inc. that owns and operates the transmission and distribution businesses of Hydro One Inc.

1.1.2 On May 1, 2000, Networks filed an application (the “Application”) with the Ontario Energy Board (the “Board”) under section 78 of the *Ontario Energy Board Act, S.O. 1998, c.15, Sch. B*, (the “Act”or the “OEB Act”) for an order or orders approving or fixing just and reasonable rates for the distribution of electricity. The Applicant indicated that it would, at a future date, file its submissions with respect to rates for the provision of regulated power supply (“standard supply service”) as well as other non-competitive electricity distribution rates (“other non-competitive rates”). The Board assigned file number RP-2000-0023 to the Application.

1.1.3 On May 24, 2000, the Board issued a Notice of Application and Notice of Hearing.

1.1.4 On January 19, 2001, Networks re-filed its application (the “Revised Application”) for an order or orders approving rates for the distribution of electricity, the provision of standard supply service, and other non-competitive electricity distribution rates.

1.1.5 On February 28, 2001, the Board ordered that for all licensed electricity distributors that had filed submissions for unbundled distribution rates on or before February 28, 2001, and that had not yet received a final rate order, their respective transitional distribution rates were interim as of March 1, 2001.

1.1.6 On March 1, 2001 and May 25, 2001, the Board issued Procedural Order No.1 and Procedural Order No. 2, respectively, outlining a series of matters under consideration for interim approval and inviting municipal corporations and intervenors to file submissions with respect to these matters. On July 4, 2001, the Board issued an Interim Order approving the matters under consideration in the Procedural Orders.

1.1.7 On March 30, 2001, the Government of Ontario (the “Government”) made Ontario Regulation 77/01 authorizing Ontario Power Generation Inc. (“OPG”) to increase the wholesale cost of power by 0.7 cents per kWh to electricity distributors, effective June 1, 2001. By letter dated April 26, 2001, the Board provided a standard method of implementing this increase in rates for distributors (the “Standard Method of Implementation”) using a default loss adjustment factor of 5%. On May 2, 2001, Networks filed an amendment to its RP-2000-0023 application seeking to recover this increase from its retail customers effective June 1, 2001, using the Board’s Standard Method of Implementation. On May 30, 2001, the Board approved this request on an interim basis.

1.1.8 On May 11, 2001, the Government amended Regulation 77/01, authorizing OPG to further increase the wholesale cost of power charged to Networks by 1.15 cents per kWh, effective October 1, 2001. On August 8, 2001, Networks proposed to use the Standard Method of Implementation as the basis for the recovery of this increase from its customers, but proposed to use its own loss factor in place of the default loss factor used in the May 2, 2001 filing. Networks also proposed that the increase be phased-in to mitigate the impact of the increase on its customers in three incremental stages, the first to be effective October 1, 2001, the second March 1, 2002, and the third March 1, 2003. On September 19, 2001, the Board approved the rates requested to take effect on October 1, 2001 on an interim basis, but did not approve the remaining proposed increases.

1.1.9 On October 5, 2001, the Board issued Procedural Order No. 5, establishing dates for an issues conference and Issues Day, November 8, 2001 and November 9, 2001, respectively.

1.1.10 On November 16, 2001, the Board issued Decision and Procedural Order No. 6 with the approved Issues List.

1.1.11 On December 3, 2001, Networks requested that the Board provide interim approval for the second and third incremental increases in Networks' bundled retail rates to recover the increase in the wholesale cost of purchased power, to be effective as of March 1, 2002 and March 1, 2003 respectively, the latter increase to be imposed in the event that the market did not open in the intervening period. On January 11, 2002, the Board approved the rates requested for March 1, 2002, on an interim basis, but not those requested for March 1, 2003.

1.1.12 On January 25, 2002, Networks applied for partial recovery of eligible market readiness transition costs in an amount of $8.153 million. The Applicant requested an implementation date of March 1, 2002, if approval was granted on or before February 20, 2002, or an implementation date of May 1, 2002, if approval was granted after February 20, 2002.

1.1.13 On January 28, 2002, Networks requested that the Board modify its July 4, 2001 Interim Order to provide interim approval of unbundled rates, effective upon the date of market-opening, to allow the Applicant to maintain the revenues established on a bundled basis in the Board's January 11, 2002 Interim Order.

1.1.14 On February 7, 2002, Networks revised its January 25, 2002 application requesting an implementation date of May 1, 2002, regardless of whether or not approval was granted on or before February 20, 2002. The Applicant explained that, since the time it had made the request on January 25, 2002, it had further reviewed its billing situation and was concerned that the originally proposed plan for partial recovery of market readiness costs could not be effectively implemented by March 1, 2002.

1.1.15 On March 4, 2002, the Board issued Procedural Order No. 8, which directed intervenors who wished to respond to Networks' above referenced applications of January 25, 2002 and January 28, 2002, to file submissions in this respect by March 11, 2002. Networks was to respond to any such submissions by March 14, 2002.

1.1.16 On March 26, 2002, the Board approved the requested rates on an interim basis, effective the date that subsection 26(1) of the *Electricity Act, 1998* comes into force.

1.1.17 An Alternative Dispute Resolution ("ADR") Settlement Conference was held from March 4 to March 11, 2002. A document entitled "RP-2000-0023 Hydro One Networks Inc. Settlement Proposal" was filed with the Board on March 12, 2002. The Board informed the parties during the hearing that it would accept the Settlement Proposal. The Settlement Proposal is attached as Appendix 1.

1.1.18 On March 19, 2002, Networks amended its Revised Application to provide transitional rate mitigation for existing retail time-of-use customers and to capture the foregone revenue in a deferral account.

1.1.19 On April 30, 2002, the Government proclaimed subsection 26(1) of the *Electricity Act* into force, effective May 1, 2002.

1.2 THE HEARING

1.2.1 The oral hearing of evidence on the unresolved issues commenced on April 2, 2002, and lasted until April 8, 2002. The Applicant submitted oral argument in chief on April 10, 2002. Intervenor argument was submitted on April 17, 2002, and the Applicant's reply argument on April 24, 2002.

1.2.2 The following parties and their representatives participated in the oral phase of the proceeding:

Hydro One Networks Inc.	Don Rogers
Association of Major Power Consumers in Ontario (AMPCO)	Jim Fisher
Borden Ladner Gervais Coalition on behalf of certain distribution utilities (BLG)	James Sidlofsky
Electrical Contractors Association of Ontario (ECAO)	Ian Mondrow
Energy Cost Management Inc. (ECMI) on behalf of certain distribution utilities	Roger White
Federation of Ontario Cottagers' Association Inc. (FOCA)	John McGee
Ontario Federation of Agriculture (OFA)	Ted Cowan
Power Budd Coalition (Power Budd) on behalf of certain distribution utilities	Andrew Taylor
Toronto Hydro-Electric System Limited (Toronto Hydro)	Colin McLorg

Vulnerable Energy Consumers Coalition (VECC)	Michael Janigan

1.2.3 Board Staff were represented by Jennifer Lea and Martin Davies.

1.2.4 The following parties participated in the proceeding but did not participate in the oral hearing or submit argument:

Canadian Meter Services
City of Elliot Lake
Municipal Electric Association
Niagara-on-the-Lake Hydro Inc.
Power Workers' Union

1.2.5 The following parties intervened in the proceeding but did not participate actively:

Aegent Energy Advisors Inc., Consumers' Association of Canada, Direct Energy Marketing Limited, Enbridge Consumers' Gas, Goldcorp Inc., HealthPro Services Inc., Independent Power Producers' Society of Ontario, Ontario Ministry of Finance, Placer Dome (CLA) Limited, Pollution Probe Foundation, PremStar Energy Canada Ltd., Jim Richardson, Shibogama First Nations Council Technical Services, Union Gas Limited, Wahnekewening Beach Association.

1.2.6 The following witnesses testified in the oral hearing:

<u>For the Applicant:</u>

A. Poray	Director, Pricing and Strategic Support
S. Frank	Director, Financial Planning and Regulation
A. Horton	Director, Customer Relations
O. Hubert	Director, Network Strategy

For AMPCO:

K. Snelson President, Snelson International Energy

For Power Budd Coalition:

R. Aiken Principal, Aiken & Associates

1.2.7 Copies of all the evidence, exhibits and argument filed in the proceeding, together with a verbatim transcript of the hearing are available for review at the Board's offices. While the Board has considered all of the evidence and submissions presented in this hearing, the Board has chosen to reference these only to the extent necessary to clarify specific issues on which it has made findings. Further, the Board has chosen not to address matters raised in parties' arguments that were already settled in the Settlement Proposal, or those that went beyond the scope of the proceeding.

1.2.8 This Decision and Order deals with the contested issues first. The last chapter incorporates the Board's findings in the previous chapters as well as the cost consequences arising from the settled issues.

2. LOW VOLTAGE RATES

2.0.1 Network's low voltage ("LV") system is comprised of facilities with voltage ratings less than 50 kV, delivering service to local distribution companies ("LDCs"), embedded direct (large) end-use customers ("Embedded Directs"), and a conventional distribution system which delivers electricity to Networks' approximately 925,000 retail customers (as of 1999). The definition of these assets as distribution assets was first made in the *Electricity Act, 1998*. Prior to the passage of this bill, when the *Power Corporation Act* was the governing law, there was no formal definition of transmission and distribution.

2.0.2 Up to market opening, the LV costs have been recovered through the use of wholesale bulk power rates that are administered by OPG. Under the terms of the Revenue Allocation Agreement, signatories of which are all the successor companies of the former Ontario Hydro, Networks has been receiving an annual amount of $29.2 million for the use of its LV assets. However, this arrangement would cease with market opening, and those customers who are embedded within Networks' distribution system would become Networks' customers. Therefore, a new method of identifying and allocating costs and charges for the LV portion of the distribution system had to be inaugurated.

2.0.3 According to the Applicant's proposals, of the $512 million of costs associated with the LV system, $473.5 million is included in Networks' retail customer rates and $38.6 million is allocated to other users of the LV system. Of the $38.6 million, $6.3 million would be collected from specific line or connection charges (specific LV lines, specific distribution lines, high-voltage distribution stations, shared distribution stations, and specific distribution stations). The remaining $32.3 million would be recovered by a shared LV line charge of $0.17 per kW from all LDCs and Embedded Directs, whether or not an LDC is connected to the LV System. There are 33 LDCs that are not connected to the LV system, and 33 LDCs that are connected to both the IMO-controlled grid and the LV system (partially or dually connected). The former would not remain as Networks' distribution customers after market opening. Networks' term for maintaining this pattern for LV cost allocation is the "status quo", in essence because Networks' plan is designed to allocate the $32.3 million pool of costs in a manner similar to that which was operative under the Revenue Allocation Agreement. Those who were charged for LV services by OPG would continue to be charged by Networks after the market opens.

2.0.4 According to Networks' testimony, the status quo is a reasonable approach since the monies it received from OPG for LV charges was not based upon any cost allocation study. The problem, according to Networks, is that customer data that pertains to OPG's payments are deficient and less than reliable. Networks' current application for LV costs is based upon its own cost allocation study. However, Networks stated that it would be filing a connectivity study, a harmonization study, and a LV cost allocation study in its next rates application, which will include the effects of Networks' acquisitions and mergers.

2.0.5 Networks proposed that the billing determinants for the LV charges be based on 1999 actual data, thereby resulting in fixed billing charges.

2.0.6 Networks proposed that any new over 5 MW Embedded Direct customers would not be charged the $0.17 per kW rate that would apply to the existing over 5 MW Embedded Directs. Rather, any such new customers would be assigned to the Industrial Commercial Sub-Transmission T-class, a class of customers below 5 MW.

2.0.7 Networks sought continuation of the deferral account previously authorized to record the foregone LV-related revenues for the period between market opening and the date of implementation of the new rates.

2.0.8 Mr. Snelson, witness for AMPCO, and Mr. Aiken, witness for the Power Budd Coalition, criticized Networks' proposal and advanced a "user pay" approach, whereby only those who are physically connected to the LV system would be paying for LV-related costs. Under this approach, Mr. Aiken calculated an additional $12.9 million would be recovered from Networks' retail customers and the shared LV line charge would become $0.56 per kW. Mr. Snelson also advocated a billing determinant based on current use, rather than on 1999 actual data.

2.0.9 Networks held that its proposal, which it characterized as the status quo, is the best option available, given the deficiency in necessary customer information, and the fact that Networks inherited a hybrid distribution system which had both the low voltage and the conventional distribution voltage facilities. The Applicant argued that the LV facilities were constructed as the least-cost transmission solution to meet the demand on behalf of the pool of customers at large. Accordingly, all LDCs and direct industrial customers benefitted from lower costs as members of the pool, and they contributed to those costs. The pool of customers remains the same (as of 1999) and therefore all continue to contribute to the costs currently. Networks submitted that since these costs were incurred for the benefit of all, it is fair and just and in accordance with sound rate making principles that all should contribute to the cost. Networks submitted that it is at least as important to look at the reason the facilities were built, what caused those costs, and who benefitted from them, as it is to consider which customers are physically connected to them.

2.0.10 OFA held that Networks' proposed $0.17 per kW rate to all the LDCs should be adopted, but opposed the proposal to treat new Embedded Directs as T-class customers, as this would be detrimental to rural and small town Ontario. OFA is not satisfied that the LV system now is classified as distribution; they believe that it should be part of transmission.

2.0.11 FOCA submitted that no change should be made at this time to Networks' proposed $0.17 per KW rate, and that this rate should be continued until Networks brings forth better cost allocation studies. FOCA also termed inequitable Networks' proposal to classify new Embedded Directs as T-class customers.

2.0.12 VECC argued that without having the benefit of a full comprehensive cost allocation study for Networks' distribution as well as transmission activities, it is not possible to fully ascertain whether or not the proposed LV charge is reasonable. VECC submitted that it is therefore appropriate at this time for the Board to accept Networks' proposed LV charge as a transitional measure. VECC noted that it is opposed to a strictly-defined user-pay approach, given the current level of information regarding the use of the LV system by Embedded Directs, and the historical basis of the costs. VECC concurred with Networks that an in-depth cost allocation study has to be done in order to appropriately determine the recovery of the costs of facilities between the categories of transmission and distribution. As for the issue of new Embedded Directs, VECC concurred with Networks that its proposal to set rates for such new entrants at the T-class level represents an acceptable transitional measure.

2.0.13 The BLG Coalition stated that it is prepared to accept the Applicant's proposal for treatment of LV rates as a transitional measure, with the expectation that the Applicant will complete the various planned studies in order to accurately analyze and justify the costs of operating and maintaining the LV lines.

2.0.14 ECMI stated that it might have been sympathetic to a user-pay approach as the basis for allocating LV line costs, had there been sufficient information to fully analyze the costs of the LV system for the new market environment. It was ECMI's view that the decision to exclude some LDCs from the pooled LV costs, and to partially exclude some other LDCs, is untenable at this time. Such a determination is sufficiently complex to warrant a comprehensive review with all stakeholders' participation. ECMI also questioned the validity of using one LV pool for all shared LV lines, noting that inherent in the one pool concept is the questionable assumption that the maintenance costs on higher voltage lines are the same as those on lower voltage lines.

2.0.15 AMPCO argued that the Board should adopt the user-pay principle, noting that this principle is nothing more than a statement of normal business practice; the user of a service should pay for the service, and those who do not use it, should not have to pay for it. If transmission-connected utilities are charged for LV line service they do not use, they will undoubtedly pass these charges on to all their distribution customers, including large users. This additional charge will exacerbate the difference between the relatively low charges for the use of distribution facilities to Embedded Direct customers of Networks, and the much higher charges under approved distribution rates to similarly situated customers who are large users of other LDCs. The user-pay approach would increase the charge to Embedded Directs of Networks from $0.17 per kW to $0.56 per kW, while large users of LDCs would avoid a charge of $0.17 per kW being added on to the large-user rate of their host LDC. Thus, although charging the LV line costs to only those users of the LV lines would substantially increase the LV line rate, it would nevertheless result in a cost-based rate that would significantly narrow the difference in charges between large users of LDCs and Embedded Direct customers of Networks.

2.0.16 AMPCO submitted that were the Board to approve Networks' LV rate application, the resulting rates would not be just and reasonable. Further, AMPCO questioned whether the Board had the jurisdiction to approve Networks' LV rate proposal, claiming that such approval would allow Networks, as a distributor, to apply charges to transmission customers who are not part of this proceeding, while also charging these customers for a service they do not use.

2.0.17 AMPCO recommended that the Board find in favour of billing determinants based on current data as opposed to 1999 actual data.

2.0.18 AMPCO also noted that Networks' proposal not to allow new over 5 MW customers to become Embedded Direct customers and rather force these new customers to pay the T-class rate, will result in a cost to these customers 30 times greater per kW than that proposed by Networks, ($0.17 vs. $6.52). The T-class rate would still be approximately 10 times greater than the Embedded Direct customer rate if the user-pay principle were to be applied, ($0.56 vs. $6.52). AMPCO submitted that fairness demands that all new over 5 MW customers should be allowed on the Embedded Direct rate instead of being subjected to the higher T-class rate.

2.0.19 AMPCO submitted that there is no reason to delay decisions on the LV issue until a future hearing. Networks' own current cost allocation study for the LV system is sufficient for the task at hand.

2.0.20 The Power Budd Coalition argued that the allocation of costs for the shared lines should be based on the actual use of the LV system. Such an approach is essential for identifying and correcting any cross-subsidies that may exist. The continuation of cross-subsidies, even for a transitional period, inhibits the development of just and reasonable rates. The Power Budd Coalition noted that Networks admitted that its current LV cost allocation study allows for some cross-subsidies, and Networks also conceded that rate design should move in the direction of lessening cross-subsidization. The Power Budd Coalition also noted that Networks' proposal is meant to allocate the costs of one regulated entity based partially on the use of the system of another regulated company. Networks has presented no evidence to show that the Ontario Energy Board has approved a cost allocation methodology that includes the allocation of costs to non-customers of the system or to customers based on their use of a separately regulated entity, or that the allocation of the shared LV line costs should deviate from the cost causality principle. Networks' argument for retaining the status quo is not relevant to the upcoming new competitive market. The existing system was designed and applied by the former Ontario Hydro in a non-competitive market. Approval of Networks' proposal would send the wrong signals to market participants.

2.0.21 The Power Budd Coalition noted that the $12.9 million shift to Networks' retail customers reflects appropriately allocated costs, without which there is indeed a cross-subsidy benefit to Networks' retail customers. According to the Power Budd Coalition, the evidence shows that the total impact of this shift on an average retail customer would be very small.

2.0.22 With regard to dual-connected LDCs, the Power Budd Coalition indicated that although the portion of the power delivered to these entities represents a relatively small portion of their overall power deliveries, nevertheless Networks proposes to base their LV charges on their total deliveries. According to the Power Budd Coalition, just and reasonable rates, however, should reflect that only those customers who use the LV system and only their actual use of that system should be the basis for their billing charge.

2.0.23 The Power Budd Coalition suggested that if the shared LV line rate is to be phased-in, a significant portion of that phase-in should take place immediately, and the remainder of the phase-in should be scheduled for January 1, 2004.

2.0.24 Toronto Hydro argued that Networks' justification of its LV rates proposal on the basis that those who benefitted in the past should pay, is clearly outside the normal basis of rate-making. The mere existence of 'benefits', particularly those existing through avoided costs, does not justify the imposition of costs on non-users of a given system and is not a substitute for actual service. Moreover, it perpetuates cross-subsidies embedded in the historical Ontario Hydro system. The current trend in legislation and policy, as exemplified in the Board's RP-1999-0044 Decision, is away from cross-subsidies and towards a transparent user-pay system. Networks' pooling proposal, which involves charging entities not even connected to the pooled assets, goes well beyond the accepted limits of cost pooling. Since the Rate Handbook was not intended to provide specific direction in the LV area, the issue requires attention now.

2.0.25 Toronto Hydro expressed similar concerns to those of AMPCO, relating to the Board's jurisdiction to approve Networks' LV proposal.

2.0.26 Toronto Hydro noted that Networks' proposal can result in similarly situated customers paying pronouncedly different rates for substantially similar services and submitted that the Board cannot consider a rate proposal with this kind of consequence to be just and reasonable.

2.0.27 Toronto Hydro opposed Networks' proposal to bill customers based on fixed historical demand levels since, first, the risk of load fluctuations would be unduly shifted from Networks to the LDCs, and second, this would result in gains and losses among the end-use customers of different LDCs.

2.0.28 Toronto Hydro noted that if the user-pay approach resulted in abrupt rate impacts, a two year phase-out of the proposed rates could be adopted.

2.0.29 In its reply argument, Networks reiterated that its proposal is a transitional measure and that the Applicant will address issues of cross subsidy and rate alignment as part of the second generation Performance Based Regulation ("PBR"). It noted that, while the user- pay approach advocated by certain parties is the simplest solution to the problem, Networks did not fully explore alternatives since it approached the issue as an unbundling exercise in the spirit of the Rate Handbook. It stated that the issue for the Board to decide is whether the simplicity of the physical connection test advocated by proponents of "user-pay" outweighs what it perceived as the potential unfairness resulting from the mismatch of costs and benefits inherent in that approach.

2.0.30 As far as the jurisdictional issue raised by AMPCO and Toronto Hydro is concerned, Networks argued that the Board does have the jurisdiction to approve the LV rates proposal, as the proposed rates are just and reasonable. This is because Networks, in developing these rates, had taken into account the historical benefits received by transmission connected customers. In Networks' view, the Board clearly has the jurisdiction to weigh all the considerations it considers relevant in defining what is just and reasonable from a system-wide perspective.

Board Findings

2.0.31 The *Electricity Act, 1998* specifically defines lines under 50 kV to be distribution lines, unless otherwise designated by the Board under Section 84 of the *Ontario Energy Board Act, 1998*. The evidence was that the LV lines serve Networks' retail customers, Embedded Directs and embedded LDCs in such an interwoven and complex way that it is not possible to separate the facilities serving one group of customers from another. In any event, there is no application before the Board to consider designating LV lines as transmission lines. The Board is asked to set just and reasonable rates and charges for recovering the costs associated with the LV assets as distribution assets.

2.0.32 The central issue is whether recovery of the costs in the LV cost pool should extend to entities which are not users of the assets in the pool, or conversely, if the costs should be recovered only from those using those assets. In justifying its proposal for including non-users of the pool, Networks relied on the "spirit" of the Rate Handbook. That document deals specifically with the process of unbundling the rates for a traditional electricity distributor, and the establishment of a regulatory framework for first generation PBR. Although the Rate Handbook was meant to serve as a guide for unbundling rates, deviations are permitted either to address unique situations or if there should be better information upon which to make a decision. Such deviations from the Rate Handbook have been a common occurrence in the rates unbundling process. Indeed, the evidence revealed that Networks itself has deviated and continues to deviate from the Rate Handbook in a number of areas where there is justification for doing so.

2.0.33 Since the Rate Handbook is silent on the treatment of costs associated with LV assets, Networks' reliance on the "spirit" of the Rate Handbook is inadequate in this matter. Given the uniqueness and importance of the LV issue to customers and other stakeholders, as well as the new regulatory paradigm, Networks' approach in this matter is too limited. Various objectives of the new legislation and Board decisions on related matters could have, and perhaps should have, been given more consideration as possible and more appropriate guides on the LV issue.

2.0.34 The Applicant justified its proposal on equity considerations and on the allegedly essential unfairness of the user-pay approach advocated by some parties. Networks claimed that even though certain customers are not direct users of the LV system, they have nevertheless benefitted from its existence since it resulted in lower transmission costs than otherwise would have been the case. From economic, social and other perspectives, each customer on a public utility system receives a benefit from the existence of other customers; the same customer provides a benefit to the other customers. But rate-making is not generally driven by benefit or pooling of benefits. Rather, it is generally driven by the pooling of customers and costs attributed to these customers; indeed, pooling of customers and costs in utility rate-making is an indispensable regulatory tool. In any event, the benefit in this case is questionable. To the extent that the non-users of the LV system were paying for LV costs, the benefit in reality is a lower cross-subsidization than would otherwise be the case.

2.0.35 It is important to be clear that this is not an issue of whether specific loads should continue to pay, having left the pool. In such cases, stranded assets and costs would be of particular concern, especially if the assets are viewed as dedicated to these loads. The present case is one where the loads were not users of the LV assets. To burden these identifiable loads with costs of a service they have not used and are not using amounts to cross-subsidization. Excluding these loads from the pool would amount to nothing more than an exercise of normalizing historical data to conform with the new regulatory paradigm.

2.0.36 The Board therefore does not accept Networks' proposal. In reaching this conclusion, the Board also considered Networks' repeated testimony and argument that its proposal is meant to be transitional, until such time that cost allocation reviews have been completed and options other than its current proposal are weighed, including the user-pay approach advocated by certain parties in this proceeding, or variations of this approach. The Applicant anticipates that such studies and reviews would be forthcoming as part of its application within the scope of the second generation PBR. The Board is always assisted by better information regarding allocation of costs. However, in the Board's view, the issue here is one of principle, not better quantification.

2.0.37 The Board accepts the position of those parties advocating inclusion in the LV pool of only those customers who are physically connected to the LV facilities. While the Board does not necessarily endorse the notion that the user-pay approach may be the only consideration in rate-making in every circumstance, for purposes of this proceeding the Board approves a cost shift of $12.9 million to Networks' retail customers and a shared LV line charge of $0.56 per kW.

2.0.38 Having made this decision, the Board need not address the arguments raised regarding the Board's jurisdiction to approve or set a rate which recovers costs from certain LDCs which are technically not customers of Networks' distribution system.

2.0.39 With respect to recommendations for phasing-in the higher LV rate, the Board finds that this is not necessary. In reaching this conclusion, the Board noted the evidence that the impact on the negatively affected LDCs would amount to less than 0.6% on their power bill, and the impact on a typical Networks retail residential customer would be in the range of 1%. Further, phasing-in would add to the complexity of implementing the LV rates. The level of impacts noted were in fact a consideration in the Board's finding to adopt the user-pay approach in this proceeding.

2.0.40 Networks' proposed billing determinants are based on 1999 actual data. Certain parties advocated the use of current data. To the extent that 1999 actual data differs from current data, the use of actual data as proposed by Networks poses some risk to the LV customers. On the other hand, the use of current demand data exposes Networks to a degree of risk, which may not be reflected in the approved revenue requirement. The potential for gaming, in that dually connected customers may divert demands between the IMO-controlled grid and Networks' LV system, was recognized as a potential risk even by the proponents of the use of current demand. On balance, the Board finds that, given that the prime purpose of this proceeding is to unbundle rates on the basis of a given revenue requirement for Networks, the use of 1999 data is the preferred alternative as the beginning point of introducing LV rates. The Board expects that in the longer term the use of current data may be more appropriate. The Board directs the Applicant to review this matter and report at its next main rates case.

2.0.41 Networks' rationale for not including any new over 5 MW customers under the LV rate schedule is that the LV shared line rate is not representative of the average LV costs. This may or may not be the case. Until such time as Networks proposes new rates based on better information, which it plans to do, it would be unfair and contrary to good rate-making principles to treat any new loads so divergently from existing equivalent loads. The Board directs the Applicant to apply the Board-approved LV rate schedule to any new customer over 5 MW for whom it does not have historical data. For these customers, if any are forthcoming, Networks shall apply current demand data.

2.0.42 The Applicant's request for continuing the deferral account to record the uncollected revenue from May 1, 2002, till the date of implementation of the LV rates, is reasonable and the Board approves it.

3. TIME-OF-USE MITIGATION RATES

3.0.1 The distribution rates proposed by Networks eliminate time-of-use (“TOU”) rates. According to the evidence, ten of the fifty-six customers previously served on TOU rates will experience significant negative bill impacts, ranging from a low of approximately 35% to a high of approximately 110% on their total bills, assuming a constant cost for the commodity. Networks noted that these ten customers had taken significant steps to modify their operations to take advantage of the TOU rates. The remaining 46 customers, who had not changed their usage profiles in response to the TOU rates, were expected to experience much lower impacts, ranging from -6% to 15%.

3.0.2 Networks noted that this situation had been brought to its attention in late August of 2001, but due to the considerable complexity of the matter, the limited number of employees available to deal with the problem, and the necessity to consult with the various internal and external stakeholders, it had only been able to finalize its proposed strategy for dealing with the matter by March 2002.

3.0.3 Networks proposed a transitional mitigation rate. To qualify for the mitigated rate, a customer’s load ratio between off-peak and on-peak usage would have to be two to one or greater, based on 1999 actual customer data. The above-noted ten customers met those qualifications. Networks’ recommended rates for these ten customers were designed to contain bill impacts to 10% or less in the first year of the two-year transitional period, and a maximum impact of 30% in the second year.

3.0.4 Networks also requested an accounting order which would enable it to record, for future recovery, revenue shortfalls related to the rate mitigation plan for these ten TOU customers. The accounts would come into effect as of the date of market opening and end upon implementation of the 2004 approved tariffs. Networks noted that its proposals regarding disposition of the balance in the deferral account will be made at the next rate proceeding.

3.0.5 FOCA was the only party to address this issue in argument. FOCA recommended that Networks should reveal at this time from whom it intended to collect the balances in the deferral account; it suggested that since the load shift was intended to benefit all customers by deferring new transmission, the deferred costs should be collected from as large a customer base as possible, perhaps even from the transmission network pool.

Board Findings

3.0.6 The Board notes that the estimated impacts on the affected customers' total electricity bill were based on an assumed constant cost of commodity. As Networks acknowledged, in an open market, it would be logical to expect that customers with a heavy off-peak consumption profile would be able to benefit from lower commodity prices expected during off-peak hours. Therefore, under a competitive commodity market, the estimated impacts on total bills appear to the Board to be somewhat speculative.

3.0.7 The Board also notes Networks' testimony that these customers "would need an unrealistically low commodity price, or, in fact, in some instances, as strange as it sounds, a negative commodity price to avoid a 20% or greater impact to their overall bill". The Board finds that this prospect might indicate that the existing TOU rates had been set at levels that caused these customers to be recipients of substantial cross-subsidies from other customers.

3.0.8 The Board further notes that the anticipated impacts submitted by Networks were calculated in reference to total electricity bills, not impact on these customers' operations. This is an important distinction. Regulatory principles and long-standing regulatory practices of treating customers in a class equally, cannot and should not be compromised on the basis of bill impacts, without placing such impacts in an operational perspective. Networks acknowledged that its proposal is out of "a moral obligation" to assist these customers. As the Board has found in other circumstances, and, while it is sympathetic to the potential impact of the new regime on certain customers or customer groups, it is not unexpected for such a major restructuring of the electricity industry to bring about some unwelcome financial impacts on specific customers or customer groups in the short term.

3.0.9 The Board thus finds that providing a very small number of customers special treatment primarily based on historical considerations, even on a transitional basis, is not in the public interest in this case. Therefore, the Applicant's request is denied.

4. LOSS FACTORS

4.0.1 Networks sought approval for distribution loss factors (“DLF”), effective upon market opening, of 2.8% for losses in the LV distribution system, 5.5% for primary voltage customers, and 8.5% for secondary voltage customers.

4.0.2 The proposed 2.8% loss factor was derived from analyzing data from the performance of 140 sub-transmission feeders. The loss factors for retail customers were calculated using the total losses in delivering to retail customers, and incorporating an observed 3% differential in loss rates between delivery to primary and secondary customers, instead of the 1% differential provided for in the Retail Settlement Code.

4.0.3 Subsequent to its original request, Networks determined that a station serving Niagara-on-the-Lake Hydro and two other comparable stations, Vineland and Fallowfield, constituted unique situations where the supply facility loss factor of only 0.6% should apply, in place of incorporating also the embedded distributor’s loss factor of 2.8%, for a total loss factor of 3.4%. Networks stated that the impact of introducing the proposed DLF for these three stations did not alter the previously filed loss factors for the other distributors.

4.0.4 ECMI recommended the use of site-specific loss factors or voltage-specific factors for low voltage facilities.

4.0.5 AMPCO submitted that Networks should be required, in its next round of cost allocation studies, to determine customer-specific loss factors for large users and embedded utilities, and average loss factors for other customers on a voltage-specific or customer class basis.

4.0.6 FOCA argued that LV line losses should be specific to delivery points, not averaged for all system users. Further, it suggested that the information to do this is available within OPG; Networks should contract the billing of embedded LDCs to OPG until it can modify its own billing system. FOCA disagreed with the 5.5% loss factor proposed by Networks for the entire G3 and F3 customer classes and suggested this rate should only apply to the few primary G3 and F3 customers, with the remainder using the 8.5% loss factor.

4.0.7 OFA noted that distribution system losses seem unusually high and that there was no evidence of any efforts to significantly reduce them. OFA proposed putting in place an incentive system that would include a target reduction in the dollar value of line losses with Networks' shareholders to be penalized if targets are not met.

4.0.8 Networks justified the higher distribution loss factors for its retail customers, compared to the average of other electricity distributors, primarily on the basis that its system is characterized by lower densities.

4.0.9 Networks disagreed with the proposals for customer-specific loss factors, arguing that the averaging of loss factors was the only practical way of proceeding. It does not have the data to allow customer-specific loss factors to be determined, and such data cannot be developed without considerable and as yet undetermined expense. Networks also submitted that, because of the historical context in which the LV facilities were constructed, the design and location of facilities should not be the basis for deriving line loss costs to be recovered from any particular customer.

Networks also noted that the issue of line losses has been assigned to and should be dealt with through the Retail Settlement Code.

Board Findings

4.0.10 For purposes of this proceeding, the Board accepts that, in the absence of more specific site or customer data, Networks' proposed loss factors are reasonable, including the proposed departure from the current procedures outlined in the Retail Settlement Code in determining line losses. For the longer term, the issue is the extent to which the current pooling of costs and customers in determining loss factors, as opposed to determining customer-specific loss factors, remains appropriate. The Board expects the Applicant to review these issues further and report to the Board at the time of its next main rates filing.

5. QUALITY OF SERVICE

5.0.1 The Board dealt with the definition of the Service Quality issue as it related to this proceeding in Decision and Procedural Order No. 6. In that Order, the Board expressed the concern that if this issue was not specifically defined, it could lead to the discussion of matters that were beyond the scope of this proceeding. However, the Board recognized that the provision of an acceptable level of service quality was a proper issue in assessing a rates application. Therefore, the Board decided to restrict its consideration of this issue in this proceeding to the review of customers' letters received by the Board up to the commencement of the oral hearing.

5.0.2 In the oral hearing, Networks addressed the contents from some forty letters in the Board's files, and responded to questions from ECAO and Board Staff.

5.0.3 Networks stated that it was responsive to concerns on service quality raised by its customers. It noted that escalated customer complaints, (calls that cannot be immediately resolved by the Customer Call Centre staff), number about 1,500, representing only 0.1% of total calls. Networks added that it was working to continuously improve its proactive communications with customers in general, and to expeditiously address issues as they arise. Networks submitted that it had appropriately addressed the issue of service quality as raised by the letters of concern on file with the Board.

5.0.4 FOCA asked that the Board give some direction to Networks to review and update density classifications to avoid incorrect density classifications that may give rise to complaints, such as those experienced by the City of Elliot Lake.

5.0.5 ECMI suggested that Networks publicize detailed LV supply point performance to enable supply comparisons between acquired and other LDCs.

5.0.6 OFA alleged that service has declined in the past 18 months and that outages are longer and more frequent.

5.0.7 ECAO focused on letters that expressed concern that Networks competes with an unwarranted advantage over competitive energy services providers, including ECAO's constituents. ECAO noted that while certain aspects of this issue have been dealt with in the Settlement Agreement, Networks is still out of compliance with those portions of the Board's Distribution System Code that deal with alternative bids for contestable distribution connection work. ECAO submitted that compliance with this portion of the Distribution System Code should be a priority. Compliance will have to include clear communication to distribution customers of the connection work for which they have a choice of obtaining alternative bids, codification of fair and reasonable criteria, the establishment of a list of pre-qualified contractors, and processes by which contractors for the contestable work can pre-qualify to work with utility personnel on a connection project.

Board Findings

5.0.8 The Board observes that the number of complaints received by the Board is not unreasonable for a utility of Networks' size.

5.0.9 The Board notes that the majority of the complaints relate to billing issues, including a lack of understanding on the part of individual customers of aspects of their bill. The Board endorses Networks' plan to expand its communication strategy and to work on improving communication with customers on billing issues.

5.0.10 Some letters question the criteria used to determine customer classification of full-time or part-time residents. The Board notes that Networks has stated that it intends to review these criteria in its next main rates submission.

5.0.11 Some letters expressed concerns about emergency response times and an increased number and length of outages. The Board accepts that Networks' emergency response times are better than those required by the Rate Handbook, and endorses its plan to work with local utilities and large customers regarding complaints of increased outage times.

5.0.12 The Board has noted Networks' acknowledgment that it was not yet in full compliance with the Distribution System Code regarding connection policies. The Board expects Networks to address these matters expeditiously.

6. PARTIAL RECOVERY OF ELIGIBLE MARKET READINESS COSTS

6.0.1 On January 25, 2002, Networks filed an application with the Board for partial recovery of eligible market readiness transition costs in an amount of $8.153 million. On March 6, 2002, the Board received a submission on this matter from FOCA in response to Procedural Order No. 8, which had requested submissions from intervenors on this and other matters related to requests by Networks for interim approval of certain rates. FOCA raised a number of concerns about Networks' proposal for the partial recovery of market readiness transition costs. These concerns related both to the customers from whom the costs were to be recovered, and how these costs were allocated among customers. FOCA expressed concern that Networks was allocating all of these costs to its existing rural retail customers in the less than 5 MW category and none to the acquired municipal electric utilities ("MEUs"), the large user greater than 5 MW class, and embedded LDCs. Further, FOCA noted that Networks allocated over half of these costs to the fixed monthly service charge.

6.0.2 In its response, Networks stated that the costs it was seeking to recover were incurred in 2000. Most of the municipal electric utility acquisitions were completed in 2001, and the acquired customers were not integrated into Networks' business until 2001. Therefore, Networks submitted that it was inappropriate to allocate any of the 2000 market readiness transition costs to customers of the acquired MEUs. Networks also submitted that the pertinent cost driver to determine the allocation of market readiness transition costs was the number of customers. On this basis, no material portion of these costs would in any event be allocated to the approximately 200 LV customers, given the relative proportion of LV customers to Networks' total customer base of approximately 925,000 (excluding the customers of the acquired MEUs).

6.0.3 In its Interim Decision and Procedural Order No. 9 dated March 26, 2002, the Board approved Networks' proposal on an interim basis. While it was mindful of FOCA's concerns, the Board adopted Networks' proposal for the reasons outlined by Networks, especially the practicality and materiality issues that would be raised by FOCA's proposal to also recover these costs from large users (former LV Directs) and the customers of acquired MEUs. On this basis, and in accordance with the Board's letters to all electricity distributors dated November 9, 2001, December 21, 2001 and January 18, 2002, which dealt with this issue, the Board approved the proposed interim transition cost amount.

6.0.4 During cross examination in the oral proceeding, FOCA enquired why Networks was not proposing any monthly service charge for its LV customers. Networks responded that this was because the LV charges are structured on the same basis as the existing rate design, which they are proposing to maintain on a transitional basis. Networks was asked how costs for metering, customer care, billing, collection, and similar charges are recovered if large users do not pay a monthly service charge. Networks responded that, while some portion of metering costs were included in the miscellaneous charges which are allocated to the LV costs, the customer care costs were not allocated, as these were not Networks' customers in 1999; these costs were allocated to Networks' distribution customers only.

6.0.5 In its argument, FOCA expressed concern that there is cross-subsidization from Networks' retail customers to other customers. OFA stated that it shared FOCA's concerns in these matters.

6.0.6 Networks noted that it had addressed FOCA's concerns during the proceeding that gave rise to the Board's Interim Decision and Procedural Order No. 9.

Board Findings

6.0.7 The Board finds that the evidence adduced and argument subsequent to the Board's findings in Interim Decision and Procedural Order No. 9, does not change the conclusions reached by the Board in that Order. Accordingly, the Board confirms its earlier interim decision to allow for the partial recovery of eligible market readiness transition costs as proposed by the Applicant.

7. IMPLEMENTATION AND COST AWARDS

7.1 IMPLEMENTATION

7.1.1 This Decision dealt with the contested issues not agreed to in the attached Settlement Proposal. In the Board's view, its findings on the contested issues do not negate the settlement on the non-contested issues. The Board therefore accepts the rate consequences flowing from the Settlement Proposal. The Board also approves as final all rates previously approved on an interim basis.

7.1.2 The Board directs the Applicant to file a draft order with the Board, with dispatch, which shall reflect the Board's findings in this Decision. The draft order shall:

- include the appropriate rate schedules and deferral accounts;
- incorporate an effective date of May 1, 2002, which is the date that subsection 26(1) of *the Electricity Act* came into effect;
- reflect an implementation date for the new rates as soon as practical;
- list interim rate approvals that will be final as a result of this Decision.

7.2 COST AWARDS

7.2.1 For purposes of expediting the issuance of this Decision, the Board will issue a supplemental Decision on cost awards.

DATED AT Toronto, June 12, 2002.

Paul Vlahos
Vice Chair and Presiding Member

Sally Zerker
Member

Art Birchenough
Member

Fred Peters
Member