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Ontario

October 28, 2002

To: All Local Electricity Distribution Companies
Registered Parties to RP-1999-0034 and RP-2000-0069 Proceedings

Re: Phased Development of Second-Generation Performance Based Rate Regulation and Commencement of Cost Allocation Studies

On August 19, 2002, the Board issued a letter to stakeholders advising of the extension of the current PBR plan by one year, with the result that the Second-Generation Performance Based Regulation plan ("PBR II") is now scheduled to commence on March 1, 2005.

In that letter, the Board also indicated that it had asked staff working on the second generation PBR project to follow a 'phased' approach. The present letter communicates the Board's general plans in respect of phasing the development of a new PBR plan.

Phased Development

The Board has decided to adopt a dual approach to the phased development of PBR II. Under this approach, issues relating to the determination of the "going-in" 2005 rates will be discussed in a working group(s) over 2002-03, leading to a Board proceeding in 2003. The remaining PBR II design issues will be examined in separate working groups over 2003, leading to a Board proceeding in 2004.

Determination of 2005 ("going-in") rates methodology

In broad terms, the "going-in" rates methodology will address the following issues:

1) Determination of the 2005 Revenue Requirement

In the RP-1999-0034 decision, the Board specifically reserved its position on whether rebasing should be required at the commencement of the new PBR plan. The Board expects that rebasing will occur, and the consultations by Board staff with stakeholders will discuss how to implement this.

Other aspects of setting the 2005 revenue requirement may also be considered by a working group. It may be determined that certain issues are best dealt with in other proceedings or processes.

2) Allocation of revenue requirement between rate classes

The Electricity Distribution Rate Handbook requires that utilities develop cost allocation studies “prior to the implementation of 2nd generation PBR” (see paragraph 1.4). In order that the cost allocation studies for all LDCs can be processed by the start of PBR II on March 1, 2005, it is expected that the studies should be ready for filing by the Spring of 2004.

The Board considers it imperative that LDCs commence these studies, particularly the collection of the necessary load data, as soon as possible, and no later than early 2003.

Cost Allocation Working Group

The Board recognizes that there are various approaches to undertaking cost allocation studies, and that the information requirements may vary by approach. Accordingly, a cost allocation working group will be established.

A preliminary list of cost allocation issues is set out in the attached Appendix. The working group will commence shortly. The initial sessions will identify and discuss the specific cost allocation issues (such as load data collection) for which early resolution is necessary.

In the upcoming discussions, stakeholders are urged to consider what cost allocation methodologies are appropriate and practical, given the Ontario context and the planned timelines identified above.

Following the consultations, proposed generic cost allocation principles and methodology will be submitted to the Board for approval as part of a 2005 “going-in” rate-setting methodology proceeding planned for 2003.

3) Rate Design

At this time, the Board anticipates that at least two rate design issues will be examined as part of the “going-in” rates-setting methodology, since they closely relate to the cost allocation studies: determination of the number and definitions of customer classes; and the design of fixed (monthly) versus variable (consumption-related) rate elements. Consideration of these issues as part of the development of PBR II was discussed in the Board’s Decision with Reasons RP-2000-0069 (reference section 3.5: Rate Restructuring).

2005 "going-in" Rate Applications

Given the time required to review the "going-in" rate applications, the Board could request LDCs to file their complete 2005 rate applications (including cost allocation studies) as early as the Spring of 2004.

PBR II Issues

A separate process will deal with the remaining elements of PBR II such as the rates adjustment mechanism, service quality regulation ("SQIs"), and Demand Side Management ("DSM"), as well as various implementation matters such as the length of the new plan.

To better organize staff discussions with stakeholders, one working group will be established to examine rates adjustment mechanism issues such as productivity, yardsticking and alternative PBR II rate adjustment mechanisms, and another working group will examine SQIs. A third working group will examine the role of electricity distributors in Demand Side Management ("DSM").

Communications on the planned organization and operation of the three working groups will be provided in due course.

Further Information

For further information on the PBR II project, please contact Keith Ritchie, Research and Policy Analyst, at 416-440-8124 or ritchike@oeb.gov.on.ca, and for further information on cost allocation please contact John Vrantsidis, Research and Policy Analyst, at 416-440-8122 or vrantsjo@oeb.gov.on.ca.

Yours truly,

P. O'Dell

Peter H. O'Dell
Assistant Board Secretary

Appendix

Cost Allocation Studies Consultations - Preliminary Issues List

Board staff have reviewed prior electricity distribution cost allocation methodologies used in Ontario and in other jurisdictions, and have developed the following preliminary list of issues requiring resolution. Set out below are those issues which Board staff believe merit early attention in the consultations (to commence in 2002), so that LDCs can start load data collection for the required cost allocation studies:

- Traditionally, the average cost approach has been used for cost allocation studies in Ontario. However, the marginal cost approach is an alternative. What are the relative merits of each approach in the Ontario context?

- The non-coincident peak approach is often used to allocate demand costs in cost allocation studies for electricity distributors. What are the alternative approaches? What are the relative merits of each approach? What impact would the choice of method have on different customer classes? Should one method be specified as the default in Ontario? If so, under what circumstances is it appropriate to allow or require an LDC to use another method (such as coincident peak)?

- What type of load data should be collected? In answering this, consideration should be given as to the specific methodology to be employed (e.g. coincident peak versus non-coincident peak for allocation of demand to customer classes), since data requirements differ according to the approach used.

- Traditionally, 12 months of load data is recommended for cost allocation studies. Is this appropriate for Ontario LDCs? What considerations should be taken into account?

- In order to ensure adequate reliability of the load data gathered, what sampling methodologies are appropriate?

- Is additional metering needed to collect the appropriate load data? Are there any practical constraints if additional metering is required?

- The Distribution Rate Handbook presently recommends “achieving economies where possible through joint development of load data” (para. 1.4). How can joint collection of load data be best implemented?

In addition to the above issues, others matters warranting attention include:

- The “minimum system” approach, and modifications to it, have been used often in cost allocation studies to categorize distribution plant costs into demand-based versus customer fixed charge components. Alternatives to the “minimum system” approach exist. What are the other approaches, and what are the relative merits of the various approaches?

- What year’s financial data should be the basis of the cost allocation studies? Should utilities be required or allowed to update these figures (i.e. use a forward test year)?

- Should a range be established such that changes to rates in a class resulting from the cost allocation would not be implemented if they are within the range? If so, what is an appropriate margin of error?

- Should any adjustments to rates based on cost allocation be phased-in, if necessary, to mitigate significant adverse rate impacts on specific customer classes and profiles? If so, how?

Finally, note that some rate design issues (such as number of rate classes), to be examined as part of the 2005 going-in rate-setting methodology consultations and proceeding, may have an impact on the completion of the cost allocation studies.