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2006 November 17

*via electronic mail – Original to follow by mail*

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge St  
Toronto, ON M4P 1E4

Dear Ms. Walli:

**RE: Toronto Hydro Comments on EDA Proposal for a Revenue Stabilization Mechanism for Local Electricity Distributors - EB-2006-0267**

By letter dated November 2, 2006, the Board invited interested parties to provide comment on the EDA proposal noted above. This letter sets out the comments of Toronto Hydro-Electric System Limited (Toronto Hydro), and responds to the Board's request to comment specifically on the issues identified by the Board in its letter.

#### Overall Submissions of Toronto Hydro

Ontario distributors face new load erosion risks due to CDM programs, the rollout of smart meters, and the Standard Offer Program. Toronto Hydro agrees with the EDA and several other parties that in the absence of any mitigating measures, unforecast load reductions pose a significant threat to the recovery of distributors' revenue requirements, and consequently to their financial health. Fundamentally, this result is driven by the fact that while distributor costs are essentially fixed with respect to throughput, revenues are heavily dependent on variable, consumption-based rates.

Traditionally, distributors have been at risk for throughput variances, which primarily have been a function of weather and economic fluctuations. However, the emergence of massive expenditures on new CDM programs as well as the province-wide rollout of smart meters and the Standard Offer Program will introduce significant new risks to revenue recovery. The magnitude of the impacts of these initiatives is highly uncertain, especially given the unknown response of consumers to smart metering and the associated pricing. The impacts are also cumulative, so that over even a short period the effects on consumption and revenue could be substantial relative to the current values on which distributor rates are now based.

Toronto Hydro takes the view that a reasonable response to this increased risk is to adopt measures that collectively act to maintain distributors' risk at approximately the current level. Primarily, this should involve an emphasis on annual load forecast updates, which could be undertaken even apart from re-determinations of distributor revenue requirements. However, among the other possible regulatory approaches, the most appropriate measures (or measure) may vary between distributors, and Toronto Hydro opposes the imposition of a single approach on all distributors. The regulatory framework should be flexible enough to permit distributors in different circumstances to adopt the approach best suited to their situation.

The EDA's RSAM proposal could be further defined and developed to serve as one of the regulatory approaches available to respond to the threat of systematic revenue erosion. However, due to concerns expressed below in response to the Board's specific questions, Toronto Hydro does not believe that the RSAM is ready or appropriate for implementation for all distributors.

Toronto Hydro wishes not to be subject to an RSAM, and proposes in its own case to update its volumetric forecast as necessary for use in annual rate re-determinations. In the short term and in a limited manner, Toronto Hydro will continue to rely on the LRAM mechanism in reference to its own CDM programs.

Toronto Hydro also observes that the dependence of revenue on consumption is heightened or reduced according to the percentage of revenue collected through variable versus fixed rates. The issue of the appropriate balance between variable and fixed charges should be examined in the OEB's upcoming review of rate design issues.

#### Toronto Hydro Responses to Issues Identified by the Board

Issue 1: What are the implications, advantages, and disadvantages of adopting the EDA's proposed approach?

Response: Toronto Hydro understands that there are four possible versions of the EDA proposal, and the implications, advantages and disadvantages would differ as between these versions. The versions are defined by whether the mechanism deals with the total or per-customer load variance, and whether or not these variances are weather normalized.

The implications, advantages and disadvantages also depend on how any of these versions may eventually be implemented by the Board.

Toronto Hydro makes the following general observations:

- Any version of the RSAM would act to reduce distributor risk and exposure to load-based revenue fluctuations, but different versions would do so to different degrees.
- The largest effect would be created by an RSAM based on non-weather-normalized total load (for ease of reference, Version 1). In Toronto Hydro's view, this version more than offsets the new risk introduced by CDM and smart meters, since any throughput variance would be deferred for later disposition.
- The smallest effect would be created by an RSAM based on weather-normalized consumption per customer (Version 4). Under this version, distributors would retain risk related to weather fluctuations and variances from the customer numbers forecast.
- Version 1 would be the easiest RSAM to calculate and administer. However, it overshoots the requirement to offset the incremental new risk due to CDM and

smart meters, and in fact results in substantially the same outcome as a move to 100% fixed distribution revenue recovery, but with a significant recovery lag. The lag in recovery would be at least two years assuming that the variance was disposed of over one rate year, but could extend up to five years if the BC model was adopted. Toronto Hydro is not persuaded that the variances would necessarily be self-canceling, and it is plausible that a series of single-year debit balances could compound over time such that sizable balances would be recovered from customers years after the associated consumption occurred. This is undesirable at any time, and is especially a concern for Toronto Hydro, which experiences high levels of customer turnover annually.

- Version 1 necessarily involves a prolonged delay before final costs for customers and final revenues for distributors could be determined. The proposal as stated does not address the implications that may ensue for tax and financial accounting purposes.
- Version 1 would reduce distributor risk (assuming that eventual recovery is assured) relative to current or recent historical levels. However, there is no indication at this time of what reduction in ROE (if any) would follow upon that reduction. Toronto Hydro anticipates that this issue would be highly contentious.
- Version 4 produces the least impact on existing risk levels (assuming that eventual recovery is assured), but would be complicated and controversial to calculate and administer. Toronto Hydro does not assume that weather normalization would be a simple exercise for distributors, and it is not clear how transferable the Hydro One model would be. In addition, a central objective of many CDM programs is expressly to *change* the relationship between weather and consumption, thereby casting doubt on the reliability of normalization parameters based on data from prior periods. Since potentially substantial dollar amounts will rest on the outcome of the normalization process, Toronto Hydro expects that normalization alone could be highly controversial.
- Toronto Hydro has the same concerns around regulatory lag, accumulating debit balances, and delayed finality for Version 4 as were expressed for Version 1. It is also unclear what if any adjustment to ROE may be entailed, and how it would be determined.
- The other two versions (Version 2 – Weather Normalized Total Load, and Version 3 – Non-Weather Normalized Consumption Per Customer) have the obvious intermediate characteristics and attract the corresponding concerns.

In summary, Toronto Hydro does not dismiss the concept of an RSAM, but submits that there are many significant unanswered questions and concerns about its implementation that must be resolved before an RSAM could be properly established. Furthermore, some versions of an RSAM would fundamentally alter the business and regulatory framework applying to distributors, and therefore implementation of an RSAM should be voluntary rather than mandatory for any distributor.

Issue 2: If the Board provided for a revenue stabilization mechanism for distributors, would it affect the distributors' risk? If so, how might it impact on the distributors' allowed ROE, and/or the design of an incentive regulation framework?

Response: As indicated above, Toronto Hydro believes that an RSAM, particularly as in Version 1, would affect distributor risk levels. This is parallel with the view expressed by the BCUC in its March 2006 on an application by Terasen Gas, in which the BCUC stated:

“The second function of the RSAM is to enable TGI to defer margin variances arising from residential and commercial customers consuming more or less gas than forecast. The Commission Panel considers this aspect of the RSAM to be a short-term business risk mitigant, which is not available to TGI’s comparators. By “short term”, the Commission Panel means that it agrees with the Applicants that “the RSAM does not provide for recovery of the return on, or of, capital in the longer-term.” (Decision, March 2, 2006, page 25)

The issue that the Board and stakeholders would have to resolve is how to quantify the change in risk, and how to determine the change in ROE (if any) that would result. Toronto Hydro sees these as complex issues that would need prior determination in a full hearing before being implemented as part of a move to an RSAM framework.

Issue 3: What are the implications of adopting the EDA’s proposed approach if CDM programs, associated expenditures and program results are not reviewed and tested by the Board in the context of rate recovery?

Response: It is not clear to Toronto Hydro that these two matters are interdependent. The operation and the outcome of an RSAM do not appear to be affected by the Board’s determinations of what CDM programs are prudently undertaken and whether the results of the programs reach target.

Issue 4: There are two options set out on page 14 of the report. Do you think one, both, or neither are appropriate? Please provide a detailed explanation for your choice.

Response: Toronto Hydro takes the view that while the alternatives listed in the report may either be, or become practical options (after further development), they are not the only practical options that should be available to distributors.

Toronto Hydro acknowledges that a conventional LRAM does not address exogenous conservation, and that exogenous conservation could be substantial. Toronto Hydro also submits that in the electricity context, it is vital that LRAMs be simple and streamlined, and not present undue regulatory burden. The calculation of an LRAM should depend only on variances in the number of measures installed, something which is objective and easily verified. In this manner, LRAMs can be effective in the short term for program impacts that can be quantified easily. Toronto Hydro believes that an LRAM could supplement the role played by volume forecast updates in responding to the identified problems.

RSAMs in some form may be appropriate, and preferred by certain distributors, if further definition and development work is done to address the issues set out above. However, Toronto Hydro takes the view that this work could be substantial and that key questions such as the impact on ROE must be resolved before an RSAM could be fairly implemented. It is not clear that this work could be done in time for an RSAM to be in place when one is needed, possibly as early as 2007.

Issue 5: Are there alternative approaches to the EDA’s proposal that the Board might consider for setting a lost revenue adjustment mechanism for CDM, including CDM funded by the OPA? If so, what do you think is the most appropriate approach? Please provide a detailed explanation for your proposed approach.

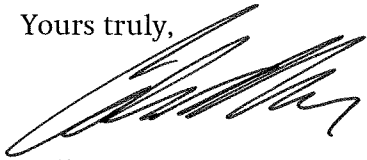
Response: Toronto Hydro intends to submit volume forecast updates as necessary for the purpose of annual rate re-determinations, and to make use of the LRAM mechanism in reference to its own CDM programs.

An LRAM could be applied to any CDM program that can be reliably quantified and explicitly included in the volumetric forecast, whether that program is funded through distribution rates or not. However, LRAMs cannot account for those factors that materially influence consumption but that cannot be readily quantified, such as the effects of smart meters and the associated rates. Over time, the applicability of LRAMs may diminish. Therefore, Toronto Hydro submits that distributors should rely primarily on filing updated volume forecasts as required. Upon approval, these volume forecasts would be used in the calculation of updated rates at the times when rates are revised, likely annually. In producing these forecasts, distributors would be able to draw upon the most recent and relevant information available, such as results reported by the OPA.

It is important to note that the update of the volume forecast is quite independent of, and compatible with, any manner in which the revenue requirement itself is determined. Updating the volume forecast only goes to the determination of rates (not revenue requirement), and to the fair opportunity to recover the revenue requirement. It would not be necessary to adjust the underlying revenue requirement, although it would be open to the Board to do so at the same time as the volumetric adjustment to rates.

Toronto Hydro submits that the combined use of more frequent volumetric forecasts, together with an LRAM where appropriate, effectively addresses the issue of revenue erosion without necessitating complex and protracted determinations of ROE adjustments and weather normalization procedures. Toronto Hydro's proposal is able to be implemented in a timely fashion, and introduces no more, and probably less regulatory burden than the simplest RSAM. Toronto Hydro submits that this approach should be available as an alternative to the status quo and to the RSAM, and should continue to be available to distributors after the introduction of any RSAM.

Yours truly,



Colin McLorg

Manager, Regulatory Affairs