

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
S.O. 1998, c.15, Schedule B

AND IN THE MATTER OF the preparation of a handbook for
electricity distribution rate applications.

**WOODSTOCK HYDRO SERVICES INC.
("WOODSTOCK HYDRO") WRITTEN SUBMISSIONS
ON CONSERVATION AND DEMAND MANAGEMENT**

FEBRUARY 14, 2005

This submission is organized as follows:

PART ONE: INTRODUCTION

PART TWO: THE MERITS OF THE 100% FIXED CHARGE APPROACH

**PART THREE: PERCEIVED DRAWBACKS OF THE 100% FIXED CHARGE
APPROACH**

PART FOUR: CONCLUSIONS

PART ONE: INTRODUCTION

1. Woodstock Hydro participated in the Ontario Energy Board's (the "OEB's") Motions Day, held on December 6, 2004, in respect of the motion brought by Pollution Probe in the matter (RP-2004-0203) of the applications of 6 large Ontario local electricity distribution companies ("LDCs") for an Order permitting local distribution companies ("LDCs") to establish Lost Revenue Adjustment Mechanisms ("LRAMs") and Shared Savings Mechanisms ("SSMs") related to their 2005 Conservation and Demand Management ("C&DM") activities.
2. At that time, Woodstock Hydro filed a written submission in response to that of Pollution Probe. Woodstock Hydro's submission, now entered as Exhibit D.9.1 in this "2006 EDR" proceeding, recommended that the OEB permit LDCs to adopt 100% fixed distribution charges and eliminate their variable component, on the basis that eliminating the variable component of the distribution charge would eliminate the need for an LRAM and the regulatory burdens and utility revenue uncertainties associated with it. LDCs would be indifferent as to reductions in volume attributable to C&DM programs, thereby eliminating disincentives for LDCs to support conservation initiatives. The Woodstock Hydro submission illustrated how its current distribution rates could be readily converted to 100% fixed rates while maintaining revenue neutrality within each rate class and creating minimal customer bill impacts.
3. On December 20, 2004, London Economics, a consulting firm "retained by the Ontario Energy Board to assist the Board in identifying options for a ratemaking framework that will account for electricity distributor conservation and demand management (C&DM) in 2006 electricity distribution rates"¹, issued its report, "Overview of C&DM practices in North America and potential alternatives for Ontario."² AJ Goulding, President of London Economics International LLC, testified in respect of the London Economics report. The London Economics report and Mr. Goulding emphasized that London Economics' "mandate was to present alternatives; recommending which alternative is most

¹ Exhibit C.1, at p.1

² Exhibit C.1

appropriate is not within the scope of work which we were assigned."³ Both the report and the evidence of Mr. Goulding contained favourable comments with respect to the alternative that the report refers to as "flat rate access", which corresponds to the approach proposed by Woodstock Hydro. Woodstock Hydro notes that Mr. Goulding emphasized that while he had become aware of the Woodstock Hydro submission and knew that its proposed approach and discussion of the merits of the 100% fixed charge are very similar to the comments found in the London Economics report, the findings set out in the report with respect to this option were arrived at independently of the Woodstock Hydro submission.

4. A copy of Exhibit D.9.1, the Woodstock Hydro submission in RP-2004-0203, accompanies this submission. Woodstock Hydro repeats and relies on that submission, and requests that it be considered as forming part of Woodstock Hydro's final argument in this proceeding, on the issue of Conservation and Demand Management. Accordingly, Woodstock Hydro's comments in this submission will be brief.
5. Woodstock Hydro has organized the remainder of this submission as follows:
 - (a) Part Two addresses the merits of the 100% fixed charge approach;
 - (b) Part Three addresses perceived drawbacks of the 100% fixed charge approach; and
 - (c) Part Four sets out Woodstock Hydro's conclusions.
6. In short, Woodstock Hydro submits that the use of a 100% fixed distribution charge mechanism minimizes regulatory burdens on Ontario electricity distributors and the OEB; guarantees that distributors will not be affected by revenue losses due to conservation efforts, thereby removing a significant disincentive to LDC participation in C&DM initiatives; and maximizes the funds that can be dedicated to C&DM activities by avoiding significant expenditures on the processing and defence of an LRAM. It is forthright with consumers, in that, unlike an LRAM, it does not create a misleading impression that the consumer will realize savings on the distribution portion of its bill through conservation, only to have those "savings" taken back through the LRAM.

³ Exhibit C.1, at p.1

7. Woodstock Hydro acknowledges the importance of mechanisms that go beyond the maintenance of financial indifference to the success of C&DM programs (i.e. LRAM mechanisms or the 100% fixed charge) and provide utilities with "the incentive to maximize resource savings per dollar spent on energy efficiency measures"⁴, and Woodstock Hydro supports the implementation of SSMs and/or other forms of incentives. However, Woodstock Hydro will not be addressing those incentives in this submission.

PART TWO: THE MERITS OF THE 100% FIXED CHARGE APPROACH

Introduction – the burdens of an LRAM process:

8. There appears to be acceptance on the part of all parties that have filed C&DM evidence in this proceeding that it is appropriate to establish mechanisms that will "allow utilities to recover all of the revenues that they would have recovered had they not promoted sales reductions through energy efficiency. Their principal purpose is to compensate for the fact that utility costs are spread over a smaller sales base as a result of C&DM activities. These mechanisms are designed to make C&DM a revenue-neutral activity and eliminate the disincentive to minimize savings from C&DM. This leaves the utility financially indifferent to the level of C&DM that is achieved."⁵
9. Woodstock Hydro agrees that this is an essential objective.
10. There are, however, burdens associated with the implementation of an LRAM mechanism. Mr. Goulding acknowledged these in Exhibit C.1 and in cross-examination. At page 38 of Exhibit C.1, the report states:

"7.2 the number of distribution utilities

Despite a recent round of consolidation, Ontario continues to have over 90 distribution utilities. From an administrative standpoint, this poses challenges. Any initiative undertaken by the OEB must take into account the potential for data submissions, inquiries, filings, rebuttals, and sur-rebuttals from each of these 90 utilities. Thus, programs which require significant active interaction, either verbally or in writing, between the utilities, their customers, and the OEB must be carefully considered and appropriately resourced. Overall benefits of any program must take into account not only the costs to the utility, but the

⁴ Exhibit C.1, at p.20

⁵ Exhibit C.1, at p.15

overall costs of the associated regulatory infrastructure, and the associated transaction costs for interested participants."

11. Mr. Goulding also acknowledged, in cross-examination, the burdens that the LRAM approach will impose on the province's regulatory system.⁶
12. In addition to the regulatory burdens that will arise out of the implementation of the LRAM system, LDCs will expect to recover their regulatory costs associated with participation in the LRAM process. Those cost recoveries will come either from the C&DM budget or from the LDC's customers.⁷ Ideally, then one would want to establish mechanisms that will keep LDCs whole and financially indifferent to C&DM, while minimizing regulatory burdens and maximizing funds available for C&DM initiatives.⁸
13. The concerns identified by Mr. Goulding are similar to those identified by Woodstock Hydro, at para. 18 of Exhibit D.9.1, in respect of the Pollution Probe proposal that was the subject of the December 6, 2004 Motions Day:

There are various issues in the Pollution Probe's evidence that concern Woodstock Hydro as the proposed LRAM would be implemented. In particular, Woodstock Hydro is concerned with:

- (a) the recovery of lost distribution revenue in a subsequent year after the revenue has been forgone;
 - (b) the need to substantiate the incremental reductions in kWh and kW;
 - (c) the need to quantify the impact of free-riders;
 - (d) the need to prove that the LDC's conservation program has been the driver for incremental saving in kWhs or kW as opposed to another external driver;
 - (e) the need to support an audit process;
 - (f) the additional cost associated with justifying the LRAM before the OEB and other stakeholders; and
 - (g) the regulatory risk of not recovering the expected LRAM.
14. During cross-examination by counsel to Pollution Probe,⁹ Mr. Goulding expressed a similar concern with respect to the Pollution Probe approach to LRAM:

MR. ZBOGAR: So I guess we agree that the purpose of an LRAM is to make a utility revenue- and profit-neutral with respect to the promotion of conservation, and what Mr. Gibbons has outlined in his testimony wouldn't meet that test?

271

272

⁶ For example, at Transcript Vol.9, paras.621-623 and 656-657

⁷ Transcript Vol.9, at paras.522-530

⁸ Transcript Vol.9, at paras.531-532

⁹ Transcript Vol.9, at para.272

MR. GOULDING: There's two different aspects. In terms of the LRAM, I don't think that there's any disagreement. Effectively, regardless of why a utility is losing revenue, provided that it's not due to their own incompetence - somebody went out to cut a line or something - generally, they should be made whole. So, even if the gas company is going out and -- effectively resulting in conservation efforts, the position is that the LRAM should make that utility whole.

273

Now, if we move to the incentive portion, that's a different question entirely.

The benefits of the flat rate access alternative:

15. In Exhibit C.1,¹⁰ Mr. Goulding discusses "flat rate access" as an alternative to the LRAM approach. He begins by describing the cost characteristics of electricity distribution networks:

"One of the characteristics of a distribution network is that costs are largely fixed. Once the distribution network is built, costs to the distribution company are largely a function of the network topology, rather than the amount of throughput. As the network grows, the fixed costs may undergo step changes, as additional transformers, substations, and other network equipment are purchased and put into service. However, these additional costs do not arise as a result of hour-by-hour changes in load on the distribution system, but rather are due to load growth over time. Distribution systems are considered natural monopolies precisely because, until the system is operating at maximum capacity, average costs decline with each additional unit delivered."¹¹

16. He goes on to describe this approach as one that "more closely reflects the economic realities of the overall electricity supply chain."¹² Consistent with this view, Mr. Goulding confirmed¹³ that "...in many jurisdictions, the current over-reliance on volumetric charging is actually distinct from cost causation, and in many cases, it would actually be more economically efficient to have a fixed charge for the distribution services."

17. The report speaks to several other benefits of flat rate access:

(a) "A distribution utility is no longer at risk of lost revenues if volumes fall. As such, the need for an LRAM disappears. Because Ontario has already separated generation from distribution, there is no possibility that distribution utilities can be harmed by a decline in demand for generation. Thus, under flat rate pricing,

¹⁰ At pp.34-35

¹¹ Exhibit C.1, at p.34

¹² *Ibid.*

¹³ Transcript Vol.8, at para.195 (examination in chief) and Vol.9, at paras.537-542

any incentive at all to encourage conservation on the part of distribution companies comes without any kind of conflict of interest. For example, a shared savings mechanism (SSM) does not need to be accompanied by an LRAM. Furthermore, if the SSM incorporates a measure for compensating the utility for avoiding the cost of new distribution system investments – costs that would otherwise cause an increase in the flat rate – the distribution company becomes incentivized to engage in C&DM investments which reduce both demand for generation and to configure the system so as to minimize future increases in the flat rate";¹⁴ and

- (b) It compares favourably to other models identified in the report, when considered in light of the evaluative criteria set out at pages 45 and 46:
 - (i) With respect to administrative simplicity, it is simple after the initial transition to flat rate access;¹⁵
 - (ii) With respect to bill impacts, it should reduce bills if the SSM component is effective;
 - (iii) With respect to regulatory consistency, it can be continued year on year;
 - (iv) With respect to incentives compatibility, it aligns customer and company incentives;
 - (v) With respect to financial stability, the report suggests that there is a time lag in the recovery of SSM, but as Mr. Goulding acknowledged in cross-examination, this is an issue related to the design of the SSM approach, and SSM design are common to all models that have SSM associated with them.¹⁶ This is not an issue related to the flat rate access model itself. Moreover, Mr. Goulding has acknowledged that the guarantee that the LDC will be able to recover the funds it needs to meet its revenue requirement regardless of reductions in consumption will play a significant role financial stability of the LDC, and that this constitutes a positive characteristic of flat rate access in the context of financial stability;¹⁷ and

¹⁴ Exhibit C.1, p.35

¹⁵ See also Transcript Vol.8, at paras.251-252.

¹⁶ Transcript Vol.9, at paras. 564-565

¹⁷ Transcript Vol.9, at paras. 568-571

(vi) It can be applied broadly.

18. Mr. Goulding also confirmed that the avoidance of regulatory burdens and costs associated with an LRAM can result in additional funds being applied to C&DM programs, or in the avoidance of additional charges to the distribution customers.¹⁸
19. Woodstock Hydro agrees with the findings of the OEB's consultant with respect to the benefits of the flat rate pricing approach, and notes also, as it did in Exhibit D.9.1, that the flat rate pricing approach is relatively simple to implement, would not need to be supported by additional calculations, would not need any ongoing regulatory approval and would be more cost effective than the Pollution Probe proposal (although that was the context in which this comment was originally made, it is applicable to the LRAM approach generally). A full fixed charge would eliminate the need for a LRAM as the LDC would be indifferent to reductions in kWhs and kW. The full fixed charge would be designed to be revenue neutral within each rate class and there could be a provision made to have a full fixed charge for various levels of consumption as a transition mechanism. The end state rate classes would be based on the findings of cost allocation analysis related to the fixed assets required to serve as opposed to the nature of the electricity use. With a full fixed charge, the current disincentives to promote conservation would be eliminated for a LDC as there would be no adverse effect on its net income when a conservation program was implemented. In Woodstock Hydro's view the full fixed charge is further supported by cost causality principles and the Government's policy to have one line on the customer's bill for delivery charges.¹⁹

PART THREE: PERCEIVED DRAWBACKS OF THE 100% FIXED CHARGE APPROACH

The London Economics Report:

20. As discussed above, the London Economics report and the testimony of Mr. Goulding were generally quite positive with respect to the flat rate alternative, and that alternative compared favourably with the LRAM approach. However, Mr. Goulding suggested to

¹⁸ Transcript Vol.9, at paras. 545-548

¹⁹ See Exhibit D.9.1, at paras.10-12.

OEB counsel that "The flat rate mechanism, while simple to administer after the initial transition, does require a change in thought processes. That means that the initial implementation would be somewhat challenging, and in addition, obviously, when we look at regulatory consistency, clearly you are looking at somewhat of a new paradigm with regards to changing to flat-rate pricing of distribution services."²⁰

21. However, the calculations that would have to be done are not onerous, and the LDCs already have the information that they need for the transition.²¹ Ontario's electricity distribution rates already contain a fixed component. In any event, the move to an LRAM process (which would be new for LDCs) would also create challenges for LDCs, beyond the simple establishment of variance or deferral accounts.²²

22. If customer bill impacts resulting from the shift to a 100% fixed charge are a concern, both the report and Exhibit D.9.1 offer similar methods of addressing those impacts. The London Economics report recommends adjusting the definitions of the various customer classes, or adding customer classes.²³ In Exhibit D.9.1, Woodstock Hydro states that to be completely consistent with the cost causality principles, full fixed charges should be designed to recover costs at different levels of service, which would reflect the design demand of the infrastructure serving its customers. However, as a transitional approach, Woodstock Hydro has proposed establishing sub-classes of customers based on consumption levels in order to minimize bill impacts. In the example given for residential customers in Exhibit D.9.1, class revenue neutrality is maintained and the bill impacts range from \$1.10 per month for a residential customer consuming 100 kWh/month to \$3.00 per month for a residential customer using over 1,000 kWh/month. Woodstock Hydro suggests that these impacts are reasonable for a change in rate structure, and that they are less than those associated with the initial unbundling of Woodstock Hydro's distribution charges, another revenue neutral exercise, but Woodstock Hydro intends to review those impacts further prior to filing a rate application

²⁰ Transcript Vol.8, at para.132

²¹ See Transcript Vol.9, at paras 574 and 575, and Exhibit C.1, at p.48

²² See Transcript Vol.9, at paras 647-657

²³ Exhibit C.1, at p.48, and Exhibit D.9.1, at paras.31-32

based on a 100% fixed charge, in order to ensure that bill impacts are minimized to the greatest extent possible.

23. A second concern expressed in the report is that, while the flat rate approach is considered viable, it suggests that it is likely not feasible for 2006, apparently because cost allocation studies will not be performed until 2007. In this regard, Woodstock Hydro acknowledges that cost allocation studies will ultimately determine the proportions of the LDC's revenue requirement that should be borne by each customer class, but a move to a 100% fixed charge, which is revenue neutral on a customer class basis, does not affect that process, nor is it any more redundant than the continued use of old cost allocation data since the initial unbundling of distribution rates in 2000 and 2001. The move to the 100% fixed charge does not create new anomalies or exacerbate any existing anomalies with respect to cost allocation, and Mr. Goulding acknowledged this during cross-examination.²⁴ When considered against the additional regulatory burdens and costs associated with the implementation of the LRAM, Woodstock Hydro submits that the flat rate approach is to be preferred.

The Chernick Evidence:

24. Mr. Chernick prepared a report and testified on C&DM-related matters for the Green Energy Coalition ("GEC"). He wrote and spoke briefly about the Woodstock Hydro approach. Counsel to GEC also questioned Mr. Goulding on the flat rate alternative.
25. Mr. Chernick and counsel to GEC appear to be suggesting that improper price signals (that is, signals that would discourage conservation) are being sent to distribution customers as a result of the flat rate approach, apparently because they would not be bearing the consequences of increasing their loads. Mr. Chernick also suggests that the flat rate approach would be complicated to implement.
26. With respect to the latter point first, Woodstock Hydro submits that it has already shown, in Exhibit D.9.1, that it is possible to establish a 100% fixed distribution rate that imposes

²⁴ Transcript Vol.9, at paras.613-618

minimal bill impacts on its customers. As noted above, Woodstock Hydro intends to review those impacts further prior to filing a rate application based on a 100% fixed charge, in order to ensure that bill impacts are minimized to the greatest extent possible. While Woodstock Hydro does contemplate establishing sub-classes based on consumption, that is proposed as a transitional solution, pending the development of customer classes based on service levels, which is more reflective of cost causality, as discussed above.

27. With respect to the former, Woodstock Hydro refers the OEB to p.35 of the London Economics report. Specifically, footnote 17 states:

"We note that the contention that flat rate pricing reduces conservation incentives for customers is somewhat spurious. As described, the customer still experiences volumetric charges for generation, and can experience meaningful savings by avoiding consumption. Furthermore, under volumetric distribution pricing with an LRAM, customers as a whole end up paying precisely what they would have paid under flat rate pricing."²⁵

28. With at least 50% of the customer's bill accounted for by the electricity commodity, and with transmission- and wholesale market-related charges being based on consumption and/or demand, the customer clearly still has an incentive to conserve. It could even be suggested that the LRAM is misleading compared to the 100% fixed charge, in that it gives the customer the false impression that savings can be realized on distribution charges through conservation. While the LRAM and the 100% fixed charge are both intended to maintain the distributor's revenue requirement, the 100% fixed charge accomplishes this directly, while the LRAM accomplishes it indirectly.

PART FOUR: CONCLUSIONS

29. In light of the foregoing, and the submissions contained in Exhibit D.9.1, Woodstock Hydro recommends that the OEB endorse in the 2006 EDR Handbook the adoption by LDCs of 100% fixed distribution charges and the elimination of the variable component of those charges.

²⁵ See also Transcript Vol.9, at paras.495-498.

30. Woodstock Hydro submits that the use of a 100% fixed distribution charge mechanism minimizes regulatory burdens on Ontario electricity distributors and the OEB; guarantees that distributors will not be affected by revenue losses due to conservation efforts, thereby removing a significant disincentive to LDC participation in C&DM initiatives; and maximizes the funds that can be dedicated to C&DM activities by avoiding the significant expenditures on the processing and defence of an LRAM that would come out of C&DM budgets, or minimizes the impacts on customers if the costs associated with the processing and defence of an LRAM were to come out of rate increases rather than from the C&DM budgets. It is acknowledged that the calculations that would have to be done are not onerous, and the LDCs already have the information that they need for the transition. Finally, the 100% fixed distribution charge mechanism is forthright with consumers, in that, unlike an LRAM, it does not create a misleading impression that the consumer will realize savings on the distribution portion of its bill through conservation, only to have those "savings" taken back through the LRAM.
31. In the alternative, in the event that the OEB is not prepared to generally allow LDCs to change their rate structures in this way, Woodstock Hydro requests that the OEB allow a small number of LDCs, including Woodstock Hydro, to make the change on a test basis, in order to determine the feasibility of this approach. This is an idea that the OEB's consultant considers worthy of exploration,²⁶ and Woodstock Hydro is concerned that if at least some utilities are not permitted to proceed in this way for 2006, then distributors that still wish to pursue this approach in the process leading to the next EDR Handbook will be faced with the same reservations as are currently expressed in Exhibit C.1, with respect to the need for changes in thought processes as a result of a new paradigm.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 14th DAY OF FEBRUARY, 2005.

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²⁶ Transcript Vol.9, at paras.631-633