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July 21, 2004

BY COURIER AND E-MAIL

Peter O'Dell
Acting Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
26th Floor
Toronto, Ontario M4P 1E4

Dear Mr. O'Dell:

Re: Ontario Energy Board 2006 Ratemaking Methodology Consultation (EDR 2006) – Written Submission of Aurora Hydro Connections Limited

Introduction:

We are counsel to Aurora Hydro Connections Limited ("Aurora Hydro") in the above captioned matter. Aurora Hydro is the local electricity distribution company (the "LDC") serving approximately 15,000 customers in the Town of Aurora. Aurora Hydro welcomes this opportunity to make a written submission to the Ontario Energy Board's (the "OEB's") 2006 Ratemaking Methodology consultation. We must emphasize that these are preliminary comments only; Aurora Hydro expects to have further input into this consultation as it progresses.

Aurora Hydro wishes to address the following two matters in this brief submission:

- The appropriate treatment of LDCs that experience negative returns in a test year; and
- The ongoing growth of the balances in the RSVA accounts of embedded LDCs resulting from the differential treatment of host and embedded distributors with respect to transmission charges and the discrepancy between

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loss factors applied to embedded LDCs and applied by those LDCs to their customers.

The appropriate treatment of LDCs that experience negative returns in a test year

Aurora Hydro was represented at the OEB's consultation session on July 6th, and has had an opportunity to review the summary of Brantford Power's oral presentation to that session on the OEB's web site. Like Brantford Power, Aurora Hydro experienced a negative return in 1999. In Aurora Hydro's case, the negative return was the result of Ontario Hydro, in its role as the regulator of municipal electric utilities ("MEUs") before the OEB assumed that role in 1999, having directed the Aurora Hydro Electric Commission (Aurora Hydro's predecessor) to reduce its rates in order to reduce what Ontario Hydro considered an unacceptably high level of working capital. That decision was made a number of years before 1999, and was not reversed prior to restructuring of the distribution sector under the *Energy Competition Act, 1998*. Accordingly, with reduced rates, the utility showed negative returns in the 1999 test year. Regardless of the reason for the negative return, Aurora Hydro's initial distribution rate application in November 2000 was subject to Section 3.4.1.4 of the OEB's Electricity Distribution Rate Handbook (the "Handbook"), which provides that "Any utility with a negative ROE in 1999 will be subject to the floor value of 0 per cent."[1]

As has been the case with Brantford Power, throughout first generation PBR, despite having elected a Market Based Rate of Return of 9.88%, Aurora Hydro has been prevented from earning a regulatory return equal to other Ontario LDCs. If this is not remedied in the next generation of PBR, Aurora Hydro's regulatory returns will continue to lag behind those of other LDCs, simply by virtue of an unfortunate choice of test year. In their presentation, Heather Wyatt and John Loucks of Brantford Power noted that Issue 6 of the current potential issues list is titled "(Maximum) Return on Equity for 2006 Electricity Distribution Rates", and suggested that this would be an appropriate place to discuss the appropriate floor value for LDCs with negative returns in the test year. Aurora Hydro agrees with this approach, and wishes to stress the importance of this issue.

The ongoing growth of the balances in the RSVA accounts of embedded LDCs resulting from the differential treatment of host and embedded distributors with respect to transmission charges and the discrepancy between loss factors applied to embedded LDCs and applied by those LDCs to their customers.

Aurora Hydro recommends that the issue of "Recovery of ongoing and growing Retail Settlement Variance Accounts ('RSVA' Accounts) in Distribution rates" should be included in the review of 2006 Electricity Distribution Rates. There are least two cases, as outlined below, that cause the continuous growth in RSVA balances for Aurora Hydro as a result of it being embedded in the Hydro One service territory.

[1] OEB Electricity Rate Handbook, Revision 1.0, issued November 3, 2000, at p.3-8

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Case 1: The differential treatment of host and embedded distributors with respect to transmission charges

Transmission rates are charged on a monthly demand basis for all customers that have monthly demand readings. For those LDCs that are directly connected to the Hydro One transmission grid, the Independent Electricity Market Operator (the "IMO") charges these LDCs for transmission service based on the monthly demand measured at the transmission delivery point assigned to the LDC. Generally, a transmission delivery point is a transformer station that could have a number of feeders that deliver power from the transformer station to the LDC. Aurora Hydro understands that for an LDC that is directly connected to the transmission grid, there is no penalty for moving power from one feeder to another where the feeders are connected to the same delivery point.

Aurora Hydro understands that for those LDCs that are connected to the Hydro One Low Voltage system (i.e. embedded distributors), Hydro One charges these LDCs for transmission service based on the monthly demand measured at each delivery point to the LDC in the Hydro One service territory. This translates into the monthly demand measured on each feeder serving the LDC.

When an embedded LDC conducts maintenance on its distribution lines and moves power from one feeder to another in order to maintain supply to its customers during the maintenance period, or when it switches power from one feeder to another in an emergency in order to reduce the outage time to its customers, it is effectively double-charged for transmission service. For example, assume two low voltage feeders service an embedded LDC. In a typical month, each feeder carries 10 MW of demand. Hydro One distribution would charge the embedded LDC for retail transmission service based on 20 MW of monthly demand. However, during a non-typical month, the LDC needs to shut down feeder #1 for maintenance and move the 10 MW of demand to feeder #2. This means feeder #2 would have a monthly demand of 20 MW in that month, and feeder #1 would have a monthly demand of 10 MW based on its peak demand before or after the maintenance took place. In this example, Hydro One would charge the LDC for retail transmission service based on an artificially high peak of 30 MW of demand. In other words, the load on feeder #1 would be counted, and billed, twice for that month.

The retail transmission service rates that Aurora Hydro charges its customers were based on the Standard Retail Transmission Service Rates outlined by the Ontario Energy Board on October 19, 2001. These Standard Retail Transmission Service Rates represented the average of 11 applications for retail transmission service rates that the OEB was reviewing at the time. It is our understanding that these 11 submissions were from LDCs that were directly connected to the transmission grid. Consequently, the Standard Retail Transmission Service Rates did not reflect the double counting of demand for embedded distributors by Hydro One.

As a result, until retail transmission service rates are adjusted, the amount Aurora Hydro collects from its customers will always be less than the amount paid to Hydro One for retail transmission service. This in turn will result in the continued growth of the balances in Aurora Hydro's RSVA accounts for transmission services (and in the RSVA accounts for other embedded LDCs in similar circumstances).

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Aurora Hydro recommends that the issue of ongoing growth and recovery of RSVA account balances for transmission services should be addressed during the review of 2006 distribution rates. It is suggested that addressing the root issue of double counting of demand for embedded distributors could assist in reducing the growth in the RSVA balances, which will in turn reduce the adjustments to customer bills that may be necessary in the future.

Case 2: The discrepancy between loss factors applied to embedded LDCs and collected by those LDCs

On October 15, 2001 the OEB issued a standard procedure to determine the total loss factor for LDCs to be applied to the customer's metered energy consumption for the purposes of charging for commodity, transmission and wholesale market services. In the case of Aurora Hydro, the procedure produced a total loss factor of 1.0506.

The calculation of the total loss factor assumed that the LDC was directly connected to the transmission grid, and metered at the transformer station. That loss factor addresses losses from the high voltage side to the low voltage side of the transformer station, and losses within the Aurora Hydro distribution system. It did not take into consideration the additional losses on the Hydro One low voltage system for those LDCs embedded within that system, and where, as in the case of Aurora Hydro, those embedded LDCs are metered at their service area boundaries. For an embedded LDC metered at the boundary, an additional loss factor should have been included in the calculation of the total loss factor to reflect the losses on the Hydro One low voltage system.

The result of this discrepancy is that Aurora Hydro is collecting less from its customers than it is paying to its host distributor on account of commodity, transmission and wholesale market service charges. As with the differential treatment described in Case 1, the incomplete accounting for losses incurred by embedded LDCs contributes to the ongoing growth of the balances in Aurora Hydro's RSVA accounts.

This situation provides additional support to Aurora Hydro's recommendation that the issue of ongoing growth and recovery of RSVA balances should be addressed during the review of 2006 distribution rates. Aurora Hydro also suggests that addressing the core issue of updating the total loss factor for embedded LDCs could assist in reducing the growth in the RSVA balances.

We thank the OEB for the opportunity to make this written submission, and we trust that these comments will be of assistance to the OEB.

Yours very truly,
BORDEN LADNER GERVAIS LLP

Original signed by J. Mark Rodger — *Original signed by James C. Sidlofsky*

J. Mark Rodger — James C. Sidlofsky
JMR/JCS/llv
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