Dear Mr. Richie,

Attached is Energy Probe's final written submission in response to the OEB's informal consultation in the process to develop guidelines for the generic methodology to be used for setting new electricity distribution rates to be effective on May 1, 2006. This submission supplements previous written and oral submissions made on behalf of Energy Probe throughout the consultations for 2006/2007 rates and the LDC efficiency review in February 2004. The attached submissions, overlap in some areas with previous submissions where we thought summarization might be helpful but generally, these submissions should be consider together with, rather than instead of, Energy Probe's previous submissions.

In presenting our recommendations, Energy Probe has not addressed itself to solutions to individual issues but simply to issue identification.

If you have any further questions or requests, please do not hesitate to contact me.

Sincerely,

Tom Adams

Establishing 2006 Electricity Distribution Rates

Revenue Requirement – General Issues

Use of comparator to assist prudence review of LDCs costs:

1. Comparator and Cohorts

Energy Probe supports the use of comparators and cohort, and suggests that these be considered through an analytical, quantitative Benchmarking approach. The purpose of this approach is to get a reference for the recognition of efficiency standards; and, therefore, provide guidelines in setting efficient distribution costs.

A Benchmarking approach should be designed to quantify efficiency drivers. Whereas a Benchmarking approach limited to input data from Ontario LDCs risks systematic bias, Energy Probe recommends that external information be included wherever appropriate.

As Energy Probe discussed at the consultation session, we recommend that the OEB develop, present and maintain an ideal utility model using best practices & external references and recognizing efficiency drivers.

For determining appropriate distribution costs, Energy Probe recommends using in a complementary combination of statistical techniques dealing with aggregate information as well as the individual analysis of the key distribution cost components for individual utilities.

The Ontario electric distribution sector's overall labour cost (price x productivity) should be Benchmarked against external references, like regulated gas distributors.

Revenue Requirement – General Issues

2. Test Year for establishing Rate Base / Revenue Requirement

Energy Probe recommends developing the Issues List based on a prospective Test Year. The development of the Test Year should reflect historical data, current data, trend analysis and forecasts, where each is appropriate.

3. Load Forecast

Load forecasting for the Test Year should include:

- Energy consumption (in MWh) broken down by customer classes
- Average customer uses for general service classes
- Billed Demand (kW) broken down by customer classes
- Number of customers broken down by customer classes

Forecast should be supported by historical information as well as forward information. Items that should be reflected include price elasticity estimates, price forecasts, customer additions forecasts, and anticipated business activity changes. Energy Probe suggests that LDCs support forecasts by providing at least 15 years of historical information and forward looking information related to new developments in their respective area of service for forecast period.

In general terms for energy demand forecasting, we advocate using a combination of statistical tools based on historical data, and other models using cross sectional information. Cross sectional analysis, for example of the residential sector, would consider information on electricity consumption, and other input drivers like dwelling number and population. For industrial consumption, electricity intensity trend analysis could be very useful.

Information on past practices with regard to forecasts and the accuracy of previous forecasts would be useful.

Cooperation among LDC could be beneficial in the forecasting area.

4. Test Year Adjustments

no submissions

5. Weather Normalization

To cope with weather normalization matters, we propose exploring a high, medium and a low scenario in order to forecast energy and demand, taking into account different weather conditions. A common normalization methodology should be considered, particularly for LDCs within regions that are climatically similar.

6. (Maximum) Return on Equity for 2006 Electricity Distribution Rates

Energy Probe suggests that there is a need to review the current method for determining ROE at the Board's earliest convenience, but perhaps for 2007 rates. The review should include consideration of equity risk premiums, Discounted Cash Flow (DCF), and Capital Asset Pricing Models (CAPM).

In addition, Energy Probe suggests discussion of the appropriateness and the consequence of determining a just and reasonable return on equity for a low-risk electricity distribution utility and making adjustments from this base for determining ROE for other utilities based on considerations of different business risk levels.

7. Debt/Equity Structure

Energy Probe has insufficient knowledge to make detailed recommendations. More transparency is needed in this area.

8. Debt Rate / Cost of Capital

See our comments for Item #7.

9. Depreciation Rates

After examining Regulator Assets filings, it appears that a review of depreciation rates would be appropriate. For example, the treatment of CIS depreciation with at least some utilities appears to follow depreciation practices for smaller, less essential IT systems whereas most regulators allow longer depreciation periods for CIS.

10. Transfer Pricing and Shared Corporate Services

Disclosure requirements should include information on holding company parents and business transactions between LDC and counter parties conducting significant business activities with any parent.

11. Low Voltage and Wheeling Costs

This issue is being discussing in the context of Regulatory Assets process. Indeed, the subsequent decision in this matter should be taken into consideration in the treatment of 2006 revenue requirement of Low Voltage charges.

12. 2006 Taxes / PILs

Distribution Rate Base Issues

Distribution Rate Base Issues:

13. Definition of Distribution Rate Base

Normal Board Approved Rate Base accounts must be established, at least on a going forward basis taking into account general practice in the electricity distribution sector.

According to the NARUC Electric Utility Cost Allocation Manual: "In developing rates, because of the various ages of plant and equipment, commissions have adopted a number of valuation methodologies. Three of the more commonly used methods are: (1) original cost, which is the cost of utility property at the time such property was brought into service; (2) fair value, which is based on the regulatory agency's judgment, may include consideration of reproduction cost, original cost, replacement cost, mark value, or other elements; and (3) reproduction cost, which is the estimated cost to reproduced existing plant facilities in their present form and capabilities at current cost levels."[1]

[1] Electric Utility Cost Allocation Manual. National Association of Regulatory Utility Commssioners. Washington. January, 1992.

In light of different rate base determination methodologies, Energy Probe suggests a review of applicable valuation methodologies.

The process for creating Board Approved rate bases should consider prudence. LDCs should provide background information related to the rate base. In particular, it would be appropriate to examine the grid characteristics related to the assets involved in the rate base, its capacity, km of wires, and number, capacity, age and condition of transformers.

14. Rate Base Measurement Date(s)

In order to deal with the timing difference between the calendar (reporting) year and the rate year, in order to determine the rate base Energy Probe suggests taking into account the financing report for the base year, adding complementary information on put-in or put-out assets on service related to the bridge year.

15. Working Capital Component of Rate Base

no submissions

16. Capitalizing Expenses

In the matter of capitalizing expenses, Energy Probe suggests including review of the treatment of the depreciation of capitalized expenses.

17. Capital Projects

Related to the merits of project-by-project, Energy Probe suggests taking into account a materiality level. This level should be related **to the normal level of annual capital expenditures**.

For investments on wires and transformer facilities, LDCs should provide physical and unit cost information. For example, in the case of wires, information should reflect length (km) disaggregated by tension. For transformers, information should be related to capacity (kVA) and number of transformers.

Regarding investment matters, Benchmarking would be useful to determine factor drivers for investments (SQI standards, age of facilities, etc).

The treatment of construction work in progress assets should be taken into account.

Operating Expense Issues:

21. Distribution “Wires Only” Expenses

Benchmarking should be used for operating expenses including the identification of best practices, taking into account particular business conditions of utilities.

22. Post-Retirement Benefits and Pensions

Benchmarking should be used. Regulatory oversight may be needed for associated liability management issues.

23. Site Restoration and Removal Costs

For this item, it should bear in mind decisions that may arise from the Regulatory Asset filings, where some site restoration and removal costs have been identified.

24. Insurance Expense

Benchmarking

25. Bad Debt Expense

Benchmarking. Best practices.

26. Employee Compensation and Staffing

In Energy Probe's Feb./'04 presentation to OEB LDC efficiency review we argued labour cost is key efficiency driver. Labour costs review should not be limited to employee compensation and salaries but also the LDC labour efficiency standards and achievements. A Benchmarking approach, the use of comparators, ratios and external references should provide a useful tool in order to assess overall labour efficiency standards.

27. IT Costs

Benchmarking represents a useful tool for reviewing prudence on IT costs.

31. Time-of-Use Rates

In general, TOU rates should focus on energy, not distribution.

Without any new cost allocation study, it appears that the current rate design must be kept for 2006 rate design. Therefore, the possibility of creating new rate classes based on TOU distribution rate classes is restricted.

33. 2006 Rate Mitigation

Transparency needed for class revenue/cost ratios and LDC costs associated with rate mitigation.

Cost Allocation in 2006

It appears that the alternatives for allocating cost and revenue requirement in order to set rates in 2006, without a new allocation cost study and appropriate load research studies, are very limited.

An alternative for allocating cost in 2006 is to use and adapt the criteria applied in setting initial PBR 1 rates according to the Chapter 4 of the Electricity Rate Handbook.

In light of the current methodology in place described in the Electricity Rate Handbook, initial PBR 1 distribution rates stemmed from the following sequence: a) first, the revenue requirement for each customer classes is calculated, taking into account of 1999 year-end kWh sales for each customer class and its respective existent rates; b) then, the distribution revenue for each customer class is derived extracting the cost of power from its respective revenue requirement; c) finally initial PBR distribution rates for each customer class were calculated based on its distribution revenue requirement, kWh and kW sales, and the number of customers.

PBR 1 distribution rates have maintained the design and structure existent in previous rates. The guidelines defined in the Chapter 4 of the Electricity Rates Handbook should be adapted for allocating revenues and setting rates in 2006.