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May 16, 2008

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
27th Floor
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: EB-2007-0673 – LPMA Comments on Staff Proposal for 3rd Generation IR

These are the comments made on behalf of the London Property Management Association ("LPMA") on the 3rd Generation Incentive Regulation for Electricity Distributors Board Staff presentation and proposals of May 6, 2008.

Staff Proposal

The Staff proposal is summarized below.

Core Mechanism

Form	Comprehensive Price Cap Index
Term	4 years
Inflation	GDP-IPI FDD (updated annually in March)
X-factor	Industry TFP growth potential as calculated by PEG (including consideration for IPD and PD), plus stretch factors (simpler groupings)
K-Factor	Continued Migration to Common Capital Structure
Reporting	RRR Annual Requirements (modified as required)
Earnings Sharing	Asymmetrical; +2% non-weather normalized earnings above the calculated ROE; net cumulative amount over plan term shared 50:50 at rebasing

Options

Incremental Capital Module

On application; materiality threshold of 25% of capital budget reflected in base rates going into IR plan; annual reporting on actual spend

Off-ramps	On application or review initiated by stakeholders based on service quality and/or earnings concerns
Z-factor	On application; materiality threshold of 0.5% of total revenue requirement approved going into IR plan
CDM	On application

There are a number of significant changes proposed by Staff since the February 28, 2008 Staff Discussion Paper.

Throughout these comments, LPMA continues to rely on its comments on the Staff Discussion Paper and the PEG Report dated April 11, 2008.

Form

Staff continues to propose a comprehensive price cap index. LPMA accepts this proposal.

Term

Rather than allowing a distributor to choose a term for the comprehensive price cap index ranging from a minimum of 3 years to a maximum of 5 years, Staff is now proposing a fixed 4 year term for all distributors. LPMA is indifferent to this proposal as compared to allowing distributors to select a term of 3 to 5 years.

However, as noted in its April 11, 2008 comments, LPMA is concerned with distributors being able to effectively opt out of the term of the IR plan (whether the term of the plan was self selected at 3, 4 or 5 years, or imposed at 4 years). Distributors should only be able to opt out of the IR plan during its term if an off-ramp is triggered. However, it appears that the Staff proposal for off-ramps is essentially that the distributor can initiate an off-ramp review at any time. LPMA has specific comments related to the Staff proposal on off-ramps later in these comments.

Inflation

Staff has proposed a significant change in the inflation index to be used in the model. This change has apparently been the result of differing views on the details of how such a index should be constructed, including the selection of the sub-indexes, the weighting of the sub-indexes and the method (if any) for smoothing of the volatile capital sub-index component.

LPMA continues to support the use of the IPI price index as modified by the proposals in the April 11, 2008 submission of the LPMA. However, should the Board determine that the calculation of an IPI at this time is not feasible, then LPMA believes that the GDP IPI FDD is the next best option.

However, moving to the GDP IPI FDD is a substantial change in the overall price cap mechanism. An adjustment to the X-factor is required to reflect the move away from an IPI to and economy wide inflation index such as the GDP IPI FDD. This is discussed more fully in the X-factor section below.

X-Factor

As noted in the April 11, 2008 comments, the LPMA supports the base X-factor (excluding the consumer dividend) of 0.88% as proposed by PEG. However, it should be noted that this X-factor was based on using an IPI, not the GDP IPI FDD, as is now proposed by Staff. In addition, LPMA provides comments on the consumer dividend portion of the X-factor in the section below.

In moving to a measure of inflation measured by the GDP IPI FDD in place of an IPI, the X-factor includes a productivity differential and an input price differential (PEG Report, February 2008, pages 11 – 12). This is the same approach taken by PEG in their November 20, 2007 report titled ***"Rate Adjustment Indexes for Ontario's Natural Gas Utilities"*** that was filed by Board Staff as part of the EB-2007-0606/0615 proceeding. LPMA notes that a number of the authors that report and of the February 2008 report titled ***"Calibrating Rate Indexing Mechanisms for Third Generation Incentive Regulation in Ontario"*** are the same (Hovde, Getachew, Fenrick).

In this process, PEG has indicated that given the empirical uncertainty, the best estimate of an inflation differential for IRM3 is zero. LPMA respectfully disagrees. The rationale provided by PEG for a zero inflation differential is that the Ontario differential is pretty much offset by the differential if it is calculated for the United States. With all due respect, the inflation differential in the U.S. is irrelevant for calculating an inflation differential that is applicable to Ontario distributors and ratepayers. There are numerous reasons for inflation rates to be different in Canada and the U.S. including different economic growth, different business cycles, different interest rate policies and regimes along with different interest rate levels, and different inflation policies and targets of the governments and central banks. On top of all of this, add the exchange rate impact and the difference in the fiscal imbalance in Canada (balanced budgets) as compared to that of the U.S. (continued deficits) and there is no wonder why inflation and inflation differentials have been significantly different in the two countries.

PEG has estimated the Ontario inflation differential to be about 1.30% (over the period 1991 to 2006, using GDP IPI FDD as a proxy for material prices). However, this is based on the industry price index that is in dispute. Over the 1991 to 2006 period, this IPI as calculated has grown by an average of 0.40% per year, as compared to 1.70% in the GDP IPI FDD.

LPMA believes that this Ontario inflation differential is relatively accurate and is driven by the smoothing of the capital sub-index and by that fact that interest have declined or remained steady for many years. In addition the cost of capital assets has generally declined over the past number of years, reflecting the strengthening of the Canadian dollar. A significant portion of capital assets are procured offshore, especially in the U.S. The appreciation of the Canadian dollar has made the purchase of these assets less costly than in previous years. The decline in these capital costs associated with imported items would not be fully reflected in the GDP IPI FDD (final domestic demand).

However, if the Board believes that the Ontario inflation differential is overstated, consider the following. Even if the differential of 1.30% is too high by a factor of two-thirds, there would still be positive differential of 0.43% (i.e. 1.30% x 1/3). LPMA believes that this is the bottom of a reasonable rate of inflation differentials that should be added to the base productivity factor of 0.88% and the consumer dividend in arriving at an overall X-factor.

It should be noted that if the Ontario inflation differential is overstated by a factor of one-half, then the differential would be 0.65%. This is 0.22% higher than the figure of 0.43% derived above. This is almost exactly the additional consumer dividend that is being proposed by the LPMA in the following section.

Consumer Dividend

LPMA continues to oppose using the partial comparative analysis based on only OM&A cost data to slot distributors into the three groups now proposed by PEG. As shown in the February, 2008 Staff Report, PEG has estimated that OM&A costs represent less than 37% of the cost shares for distributors. Using this minority share to determine who is or is not productive relative to the industry makes no sense.

Further, LPMA does not believe that the consumer dividends recommended by PEG are reasonable. PEG recommends a consumer dividend of 0 for distributors in Group I, 0.25% for those in Group II and 0.5% for those in Group III. PEG further notes that the highest dividend in IRM3 as proposed by PEG (i.e. 0.5%) is the average dividend level in approved North American plans. LPMA asks the obvious question: Why should ratepayers accept an average dividend level from North American plans as the highest dividend level that will not even be applicable to the majority of distributors in the province? The LPMA submits that they should not.

It is further surprising the PEG now indicates that a consumer dividend of 0.25% for most distributors is appropriate. In their November 20, 2007 report titled ***"Rate Adjustment Indexes for Ontario's Natural Gas Utilities"*** that was filed by Board Staff as part of the

EB-2007-0606/0615 proceeding for a natural gas IRM, PEG recommended a stretch factor (consumer dividend) of 0.50%. PEG relied on two sources in developing this stretch factor recommendation: the historical precedent that the average explicit stretch factor approved for rate escalation indexes in North American energy utilities was around 0.50%; and PEG's incentive power research for Board Staff. LPMA notes that a number of the authors of that evidence in EB-2007-0606/0615 are also authors of the current PEG report being used in this process (Hovde, Getachew, Fenrick). No reason has been provided for the 50% reduction in the stretch factor/consumer dividend recommendation.

As indicated in the April 11, 2008 submission, there is no reason why the average consumer dividend in Ontario should be lower than the average dividend for other North American plans. LPMA, therefore, submits that the consumer dividend should be set at 0.25% for those distributors in Group I, 0.50% for those in Group II, and 0.75% for those in Group III.

In addition, since LPMA does not accept the comparative cost analysis as appropriate for determining which distributors fall into Group I or III, LPMA continues to submit that the Board should allow distributors to select their consumer dividend at the beginning of the IR plan. The default level would be 0.50%, or Group II. If a distributor decides to chose to be in Group I, with a lower consumer dividend of 0.25%, then their asymmetric dead band for earnings sharing purposes would be reduced from the 200 basis points proposed by Staff and supported by LPMA to 150 basis points. This would provide protection to ratepayers from the distributor selecting a lower consumer dividend in order to pocket more earnings, while still providing the distributor with incentive to exceed their target ROE. Similarly, if a distributor opted for the larger consumer dividend (Group III), then the 200 basis point dead band would be increased to 250 basis points before any sharing with ratepayers would take place. This provides an incentive to the distributor to exceed their ROE, while providing additional savings to customers up front.

Comparison of Total X Factor

In EB-22007-0606, parties agreed to an X-factor for Union Gas of 1.82%. The Board subsequently approved the agreement. This X-factor is all inclusive in terms of input price differentials, productive differentials, consumer dividends and so on. This X-factor is applied against the GDP IPI FDD measure of inflation, the same measure now proposed by Staff. Union's IR plan has a five year plan term.

The X-factor proposed by PEG is, on average, 1.13%. This consists of a base productivity factor of 0.88%, 0.00% for the price differential and 0.25% for the average consumer dividend. The X-factor proposed by LPMA is 1.81%. This consists of a base productivity factor of 0.88%, 0.43% for the price differential (see above) and 0.50% for the average consumer dividend (see above). This is very comparable to the Board approved figure of 1.82% for Union Gas, which is also based on a comprehensive price cap incentive mechanism using GDP IPI FDD as the measure of inflation.

No stakeholder has presented any information, rationale or circumstances that would indicate why the X-factor of comparable comprehensive price cap plans using the same measure of inflation should be different between the gas and electric distributors in Ontario. In both cases, the distributors will rebase before commencement of plan term; the plan term is very similar (4 vs. 5 years); the inflation measure is identical; off-ramps are the same or similar; earnings sharing is similar or the same; Z-factors are the same or similar; and both industries are capital intensive relative to the economy in general. In light of the substantial similarities between the two industries, LPMA submits that the X-factor should also be similar. LPMA does note that the electric distributors will have the additional benefit of the proposed incremental capital module, if approved by the Board. The Union Gas plan has no such module. Thus, the LPMA proposal of an all in X-factor of 1.81% is reasonable when compared to the approved figure of 1.82% for Union Gas.

K-Factor

This factor is related to the continued migration of distributors to a common capital structure. There is no change proposed here and as indicated in the April 11, 2008 letter, LPMA supports the need for a mechanism for the continued migration to a common capital structure.

Reporting

Additional reporting requirements associated with earnings sharing should be developed and provided to the distributors. The Board has significant experience, notably with Union Gas, in the reporting for earnings sharing purposes in terms of providing the income and rate base calculations needed to determine a return on equity which can then be compared to the Board approved ROE (adjusted annually as per the Board's formula).

Earnings Sharing

Staff is proposing an asymmetrical earnings sharing mechanism based on non-weather normalized earnings. Earnings in excess of 200 basis points above the Board approved ROE (recalculated annually to reflect long term interest rates) would be shared 50:50 at rebasing with ratepayers. During the May 6, 2008 stakeholder meeting, Staff clarified its proposal to show that the calculation would be done a year by year basis, and that the amount given back to ratepayers would be at rebasing. There would not be any reduction in the ratepayer portion if, for example, a distributor under earned relative to its ROE in any of the term years.

LPMA accepts this proposal, with one change, as it essentially is the proposal put forward by the LPMA in its April 11, 2008 comments. The one change relates to the timing of giving back any of the over earning. The Staff proposal would not give this over earning to the ratepayers until rebasing took place. LPMA does not believe this is appropriate. First, it would add additional costs to the distributors, because interest would be accruing on these ratepayer credits. Second, there is no compelling reason why ratepayers should be expected to wait for a number of years before receiving the credit. The Board has to deal with deferral and variance account balances on an annual basis for all distributors. This earnings sharing account should be included with these other balances and disposed of on an annual basis.

There is also some confusion over how the amount, if any, to be shared with ratepayers would be calculated. LPMA believes that the Board should provide a simple example when it issues its Report in this area. The calculation should be simple. The ROE used for earnings sharing should be calculated as the earnings subject to sharing divided by the appropriate common equity. This ROE would then be compared to the benchmark ROE (which would be based on the relevant consensus forecast). Any excess in the ROE used for earnings sharing in excess of 200 basis points above the benchmark ROE would be used to calculate the earnings sharing amount, which would then be grossed up to a pre-tax amount.

The earnings subject to sharing would be the distributors regulated earnings adjusted for any items that are explicitly outside of earnings sharing (such as shared savings mechanism). The level of common equity would be calculated by first determining rate base (as in a cost of service application) and then multiplying this figure by the deemed equity component of the capital structure. This is important because the equity component that will be built into rates will be changing for many distributors through the K-factor proposed by Staff as companies continue to migrate to a common capital structure.

Incremental Capital Module

If the Board determines that an incremental capital module is needed as an option, then LPMA submits that the operation of the module needs to be clearly defined. Staff is proposing that such a module be available on application. Staff's original proposal was that the incremental capital be 25% or more of the capital budget reflected in base rates going into the IR plan. LPMA does not agree that this threshold is appropriate. As was pointed out at the stakeholder conference, this module could be triggered even if the capital expenditures during the IR plan match the depreciation expense, meaning there would be no growth in rate base. LPMA would like to point out that this module could also be triggered even if rate base is declining (i.e. capital expenditures are less than depreciation expense).

Board Staff has provided a revised proposal for an incremental capital module on May 15, 2008. Under this revised proposal, the threshold for invoking the module would be based on the distributor's average annual capital expenditures since the Board approved base year relative to 150% of the distributor's depreciation expense embedded in base rates. While there are a number of critical questions that need to be answered in the revised Staff proposal, LPMA believes it is an improvement over the original proposal if an incremental capital module is to be included in the IRM package.

The first of these critical questions is the amount that would actually be recovered through the module. It is assumed that the incremental revenue requirement to be recovered would include any amount in excess of 100% of the depreciation expense embedded in base rates. However, this raises two specific issues. First, would this new level of depreciation expense become the new benchmark for the 150% materiality threshold for subsequent IR years? Would any subsequent year incremental revenue requirement be based on the original depreciation expense or the new depreciation expense from the adjusted year? Second, would it be appropriate for the incremental revenue requirement to include the additional depreciation expense in excess of 100% of the amount included in base rates? A distributor that had, for example, a capital expenditure ratio of 140% of the depreciation expense would not be eligible to collect any of the additional depreciation expense (or return on capital, for example). This appears to provide a significant discontinuity between distributors that meet the materiality threshold and those that do not. LPMA submits that this may encourage distributors to over spend on capital expenditures or accelerate their capital spending if they are near the threshold in order to use the module to increase revenue. This would be contrary to the intent of incentive regulation to improve economic efficiency.

Further questions arise around the actual mechanics of the average capital expenditure calculation each year of the Staff proposal. The following table provides four scenarios for consideration.

	Year 1	Year 2	Year 3	Year 4
Scenario 1				
Annual	130.0	170.0	150.0	150.0
Cumulative Average	130.0	150.0	150.0	150.0
Module Qualification	no	yes	yes	yes
Scenario 2				
Annual	170.0	130.0	150.0	150.0
Cumulative Average	170.0	150.0	150.0	150.0
Module Qualification	yes	yes	yes	yes
Scenario 3				
Annual	170.0	120.0	150.0	150.0
Cumulative Average	170.0	145.0	146.7	147.5
Module Qualification	yes	no	no	no
Scenario 4				
Annual	120.0	170.0	150.0	150.0
Cumulative Average	120.0	145.0	146.7	147.5
Module Qualification	no	no	no	no

Over the course of the four year IR plan term, scenarios 1 and 2 have a cumulative average capital expenditure equal to 150% of the depreciation included in base rates. However, in the first scenario, the distributor does not quality for the incremental capital module until the second year. This is because the ratio of the capital expenditures to the depreciation expense is 130% in year 1 and 170% in years 2 (resulting in the average of years 1 and 2 being 150%). In the second scenario, the distributor qualifies for the capital module in all four years of the IR plan term. This is despite the fact that the only difference from scenario 1 is that the 170% figure is in the first year, followed by 130% in the second year. As this example shows, the distributor that front loads its capital expenditures in the IR plan will recover an incremental revenue requirement in all four years of the plan, while the distributor that has lower expenditures is the first year will only collect the incremental revenue requirement in three of the four years. Yet over the IR plan, the spending on capital relative to the depreciation expense in base rates for the two utilities is exactly the same. Clearly this shows the opportunity to game the capital module by moving capital expenditures to the beginning of the IR plan wherever possible. The scenario 2 distributor will ultimately collect more revenue than the scenario 1 distributor and ratepayers of the scenario 2 distributor will ultimately end up paying more.

A comparison of scenarios 3 and 4 provide similarly interesting results. In scenario 3, the distributor qualifies for the capital module in the first year, but not in any of the subsequent years. In scenario 4, the distributor never qualifies to activate the module. Again, however, the two distributors have on average over the four plan term, the exact same level of capital expenditures relative to the embedded depreciation expense. Scenarios 3 and 4 also provide an interesting comparison. In aggregate, both distributors have the same level of expenditures in years 1 and 2 combined. However, because of the higher expenditures in the first year, the distributor in scenario 3 will be able to collect the additional revenue requirement in the first year of the IR plan term. In other words, ratepayers of the distributor in scenario 3 will be worse off than ratepayers of the distributor in scenario 4.

This ultimately leads to the question of whether or not a distributor should be entitled to retain any of the incremental revenue requirement it may recover in any of the IR plan term years if at the end of four years, the actual capital expenditure to depreciation ratio falls below 150%. Ratepayers will have paid more in scenario 3 than they would in scenario 4 for the exact same level of expenditures over the IR plan term. In such a situation, LPMA believes that any revenues collected through the application of the incremental capital module should be rebated to customers (with appropriate interest) at the end of the IR plan term when the final four year average ratio can be calculated and is below 150%.

LPMA also notes that the application of the module will be based on forecast capital expenditures from the distributors. LPMA believes that the capital expenditure forecast should only include those expenditures that will be closed to rate base in the calendar year. In other words, any construction work in progress should not be included. This is because only those assets that are closed to rate base in the calendar year will attract depreciation expense in that year. Conversely any CWIP from the previous year that is closed to rate base in the year under consideration should be included in the capital expenditure numbers. LPMA also believes that the use of forecast information is another reason why a true-up should be used to reflect differences between the actual and forecast amounts. This may be especially importation if the actual expenditures, for whatever reason, do not hit the 150% materiality threshold that they were forecast to hit.

The Board may also want to consider whether an incremental capital module should be symmetric. That is, if a distributor has capital expenditures below the level of depreciation expense over the IR plan term, then there should be a corresponding decrease in rates to reflect the decline in net fixed assets and in rate base. Staff has indicated that without a specialized capital module a distributor may not have explicit adjustments made to its revenue requirement to reflect unusually **high** capital spending requirements. LPMA submits that the opposite is also true. Without a specialized capital module a distributor may not have explicit adjustments made to its revenue requirement to reflect unusually **low** capital spending requirements.

Once again, LPMA urges the Board to not include an incremental capital module. The X factor that is being proposed by PEG is a comprehensive X factor that is based on both OM&A and capital costs. These capital costs include growth in rate base, which is, of course, driven by capital expenditures. If distributors are allowed to invoke the incremental capital module, then the X factor proposed by PEG should be increased significantly to reflect that a significant amount of the capital has been removed from a comprehensive incentive rate mechanism, leaving a partial mechanism.

Staff's expert on incentive regulation, Dr. Kaufmann clearly indicated you do not need any explicit adjustment for capital in the indexing mechanism just because rate base is growing. Dr. Kaufmann states:

> "I just want to make one more point on this, which is similar, but I just -- I don't think people should be left with the impression that you need -- any time a company's rate base is increasing, you need to have some sort of explicit acknowledgement for capital in the indexing mechanism. There are companies all over the world that are increasing their rate base and they're operating under indexing mechanisms that don't have that, and they are funding their capital

> investment.
>
> So it's happening now. I mean, there are workable plans out there where there aren't these provisions and they're working effectively. Again, it's an empirical issue, really. What your investment needs are and what's reflected in the X factor.
>
> It's not a theoretical issue, it's not something that we can say automatically that we have to have this to fund capital investment." (Tr. May 6, 2008, pg. 31)

If a distributor believes that it has significant incremental capital needs, it should be encouraged to file a cost of service or multiple year cost of service filing. It has become apparent throughout this process that incentive regulation mechanisms do not work well when there is significant change taking place. Cost of service has a proven track record when dealing with significant changes. Further, the filing requirements associated with the incremental capital module, which are discussed in more detail below, are consistent with that in a cost of service application.

If the Board allows an incremental capital module, it should do so on the basis that any amounts to be recovered through this module are: 1) recovered through a rate rider that is eliminated when the distributor rebases; 2) the rate rider is outside of the price cap mechanism; 3) there is a true-up on an annual basis to match the actual costs associated with the incremental capital to the amounts recovered through the rate rider; 4) the amount to be recovered should be calculated on an incremental revenue requirement basis; and 5) any over earning above the Board approved ROE, including the 50% retained by the distributor in the event that there is earnings sharing with the ratepayers above a deadband, should be accounted for as an offset to the incremental revenue requirement and taken into account in the true-up process.

The key components of the above is that there be a true-up mechanism similar to a variance account to track the difference between actual and forecasted recovery of a amount through a rate rider. This should not be a controversial proposal. This component covers items 1 through 3 above.

The amount to be recovered through the incremental capital module should be calculated based on an incremental revenue requirement approach. This approach would ensure the complete analysis of the impacts of the incremental capital. For example, if the incremental capital was related to the replacement of an aging asset, then the impact on rate base of adding the new asset would be calculated as it would in a cost of service type filing, showing the gross asset addition and the accumulated depreciation for the year. It would also reflect the removal of the gross asset value and the accumulated depreciation associated with the asset being removed from service. Higher capital cost allowances and interest deductibility would reduce income taxes. OM&A expenses may be changed because of the reduction in maintenance costs for a new asset compared to the asset being replaced. Similarly, if the driver behind the incremental capital is system growth, then the revenue requirement associated with the incremental OM&A costs, rate base impacts and tax impacts of the growth would need to be compared to the impact on revenues of this system growth. Any difference would be recovered through the rate rider.

Applications would have to clearly demonstrate the need for the incremental capital and further would have to provide cost of service evidence related to the impacts of the incremental capital to calculate the amount being requested for recovery in the particular year by the distributor. A volume and customer forecast for the year would also be required, in order to determine the base over which to recover the requested amount. Allocation of the incremental costs based on the last Board approved cost allocation methodology used in the distributor determination of base rates would also be required.

This revenue requirement impact would have to be calculated for each subsequent year to the first year in which the application of the incremental capital module was made that still remains under the IR plan term. This is because the impact of the incremental capital changes in the second and subsequent year. In the first year, only approximately one-half of the capital expenditure is reflected in rate base. In the second and subsequent years, all the gross assets are reflected in rate base, but rate base will decline based on the growth in accumulated depreciation. With some assets, this decline in net fixed assets is slow, but for others, such as computers, software and billing systems, the decline is rapid. The

CCA impact on taxes also changes year by year. In the first year, only 50% of the CCA is deductible. This climbs to 100% of the UCC in the second and subsequent years.

Finally, any over earning on the part of a distributor over and above the Board approved ROE that is determined annually based on the Board's formula and the changes in interest rates should be used as a credit to the ratepayers when the true-up of the incremental capital module costs is done. The distributors claim that they need to be ensured that they can recover sufficient revenues to finance their needs. If the distributor applies for and is granted a rate rider to enable to increase its revenues to finance these needs and for what ever reason exceeds its financial expectations, it should not expect to keep any of that additional revenue. As indicated in the April 11, 2008 comments, any over earnings (not just those above the ESM deadband) should automatically revert back to ratepayers up to the full amount of the increase resulting from the application of the incremental capital module. Distributors and the Board should not expect ratepayers to, in effect, pay twice. In summary, if a distributor believes it needs a rate increase to finance its capital program and then it is able to generate excess earnings, it cannot expect to keep both sources of funds. This is no different, it is submitted than if a distributor applied for an incremental capital module and recovered an amount through a rate rider, but then did not actually spend any of the capital upon which the rate rider was premised. If the need for the capital did not materialize, then the amounts collected from customers would be rebated to them. If the financing of the capital required the rate rider, but then excess earnings were created, then some (or potentially all) of the amounts collected from customers should also be rebated to them.

Off-Ramps

Staff is proposing that a review may be initiated on a case-by-case basis on application by the distributor and/or invoked by stakeholders.

LPMA does not support this proposal. Intervenors do not have access to timely and detailed information needed to determine if a distributor should be compelled to come before the Board and explain why the plan should be terminated or continued.

On the other hand, distributors will have the option of initiating an off-ramp if they are not satisfied with their financial performance. Thus a distributor could over earn up to 200 basis points before any earning sharing took place, but could come to the Board for an off-ramp application if they under earned by 100 basis points in one year of the IR term.

LPMA continues to believe that an off ramp similar to those recently approved for both Union Gas and Enbridge Gas Distribution are appropriate for the third generation IRM for the electric utilities. In particular, if in any year of the IR plan, there is a 300 basis point or greater variance in utility earnings, above or below the amount calculated annually by the application of the ROE formula, then the distributor should file an application with the Board, with supporting evidence, for a review of the adjustment formula. This review would be prospective only (i.e. the review would not result in any confiscation of earnings or increase in rates related to historical earnings). Such an off-ramp would not necessarily mean that the IR plan should not continue, but would allow all parties to propose modifications to the plan, termination of the plan or to continue the plan as is.

Given the current inability of most distributors to estimate normalized revenues, the trigger mechanism would be a 300 basis point variance in actual utility earnings, rather than in normalized utility earnings as is used for Union and Enbridge. If extreme weather were the only reason for a distributor to fall outside of this range, then this would be a reason that stakeholders may bring forward as a reason to continue with the plan unmodified.

LPMA believes this provides a structured approach to the off ramp. Moreover it provides a clear signal to the distributors and other stakeholders that operating results within this band are not reason enough to try and get out of the IR plan before the end of its term.

Z-Factor

The Staff proposal would create a materiality threshold of 0.5% of the total revenue requirement approved going into the IR plan. LPMA agrees with the movement from total expenses or total capital to using the revenue requirement as the base for the materiality calculation. It should be made clear that this is the base revenue requirement for distribution rates only (i.e. no commodity costs included) and that revenues generated through rate riders are not included in this revenue requirement.

As for the level of 0.5%, LPMA believes that this is an appropriate level for each separate and identifiable Z factor event.

The Staff proposal does not clearly identify what costs, if greater than 0.5% of the total revenue requirement approved going into the IR plan, should be used to trigger a Z factor. LPMA submits that the relevant costs are the total impact on the Z factor event on the revenue requirement. This would include costs ranging from the associated cost of debt and equity and depreciation of a capital expense to a change in the OM&A expense. It would also include the tax impacts of these changes in expenses including the indirect impact on the revenue requirement of capital cost allowances available to reduce income, changes in interest expense, and changes in tax rates.

As a very simple example, if a distributor had a total revenue requirement of $100.0 million and there was an increase in OM&A expenses for a particular reason of $600,000 it would appear on the surface that this would exceed the 0.5% materiality threshold. However, the increase in expenses would lower the taxable income, reducing the PILS component of the revenue requirement. If the reduction in PILS was more than $100,000, the event would not longer qualify since the materiality threshold would not have been met.

CDM

If a distributor wishes to apply for an adjustment related to CDM, then LPMA submits that it should be subject to the same materiality threshold as that established for a Z factor.

Please contact me if the Board requires any further information related to these comments.

Sincerely,

Randy Aiken

Randy Aiken
Aiken & Associates