



Low-Income Energy Network

May 17, 2010

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, Suite 2700
Toronto, Ontario M4P 1E4

**Re: Consultation on Distribution Revenue Decoupling Board File Number EB-2010-0060
Issuance of Consultant's Report and Notice of Stakeholder Meeting**

Dear Ms. Walli,

Enclosed are LIEN's comments on the seven issues identified by Board staff as questions that are relevant to this consultation. These comments are informed by the Pacific Economics Group Research report entitled *Review of Distribution Revenue Decoupling Mechanisms* (the "PEG Report").

Thank you for the opportunity to make this submission to the Board. LIEN looks forward to further opportunities for comment to the Board on the staff Discussion Paper and at subsequent steps in this consultation process.

Sincerely,

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Coordinator
Low-Income Energy Network

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EB-2010-0060 Consultation on Distribution Revenue Decoupling

Submission by LIEN

Introduction

The Low-Income Energy Network (LIEN) represents more than 40 member groups across Ontario. As a network representing the intersection of interests related to low-income consumers and energy and the environment, LIEN's focus is on reducing the energy bills of all low-income consumers, ensuring that all low-income consumers across Ontario have access to conservation programs, technologies and services as well as conservation education, and realizing the environmental, energy and economic benefits associated with the more efficient use of energy. To achieve these objectives, low-income consumers require a comprehensive array of assistance that includes: aggressive conservation and demand management/demand side management (CDM/DSM) defined as providing deep energy savings per low-income consumer and broad consumer participation across the province, consumer protection policies and education, bill assistance, and emergency financial assistance.

In order to eliminate the obstacles to utilities carrying out aggressive CDM/DSM for low-income as well as its other customer groups, LIEN supports having a revenue decoupling true up plan which ensures that the gas and electric utilities are protected from all revenue losses due to energy efficiency and conservation. However, eliminating these obstacles will not ensure that the utilities are motivated to pursue the types and levels of CDM/DSM that low-income consumers require. The CDM/DSM regulatory framework (e.g. budgeting/target-setting process, program screening and utility incentive structure) must also be aligned effectively with this objective. Issues related to the natural gas DSM framework and to the electricity conservation code will be addressed in other Ontario Energy Board (Board) proceedings. An approach to integrating rate design, the DSM and CDM regulatory frameworks and utility customer care is needed to address overlapping issues.

LIEN's submission addresses each of the questions posed by Board Staff regarding distribution revenue decoupling mechanisms and the PEG Report entitled *Review of Distribution Revenue Decoupling Mechanisms*.

Response to Board Staff questions

- 1. In light of developments in metering, CDM and demand side management ("DSM"), among possible others, is the implementation of further or modified revenue decoupling mechanisms for electricity and/or gas distributors warranted at this time and if so, why? For example, is the Board's current Lost Revenue Adjustment Mechanism adequate in light of the contemplated introduction of CDM targets for all electricity distributors in the Province?**

The natural gas and electricity regulatory regimes have different levels of revenue protection in place. Both natural gas and electric utilities have a LRAM and SSM. However, natural gas distributors also have a DSMVA and an average use per customer tracker that tracks and true up the difference between forecast and actual volumes per customer.

The partial decoupling true up plans that the gas utilities have in place appear adequate to protect the utilities from revenue losses due to DSM as well as other conservation and energy efficiency within their franchise areas. This partial decoupling has removed obstacles to pursuing aggressive DSM and has contributed to the success in DSM of the gas distributors. Should either Enbridge or Union find that additional declining average use protection is required (e.g. Union needs to expand the coverage of their average use tracker to their large volume customers), LIEN would support such expansion in principle to remove remaining obstacles to pursuing aggressive conservation.

LRAM is not adequate in light of the contemplated introduction of CDM targets for all electricity distributors in the Province. The implementation of further revenue decoupling for electricity distributors is warranted. LRAM only addresses the distributor revenue losses associated with the CDM programs of the LDC and of the OPA in the LDC service territory, and not of other conservation initiatives, for example, federal or municipal programs, building code improvements in energy efficiency, or customer use of more energy efficient appliances not related to any incentive programs.

According to the PEG Report Ontario electricity distributors face significant declines in average electricity use per customer. A key driver of declines in average use is conservation, either through CDM, natural conservation, or both. Since the electricity distributors only have LRAM, they still face obstacles to pursuing aggressive CDM. This includes, for example, obstacles to pursuing fuel-switching with federal or municipal partners for residential customers who would switch from electricity to natural gas or renewable based space heating.

Low-income consumers have disproportionate amounts of electric space and hot water heating compared to other residential customers. The lowest household income quintile in Ontario has a far greater proportion of households that use electricity as the principal space heating fuel (27% of households compared to 12.9% of the average income household) and for hot water heating (39.3% compared to 26.4% for the average income household) ¹. Fuel-switching off

¹ Statistics Canada, Income Statistics Division, *Survey of household spending 2006; Dwelling characteristics and household equipment by household income quintile, Ontario*. Custom tabulation compiled for the Advocacy Centre for Tenants Ontario and the Income Security Advocacy Centre. February 26, 2008.

these costly uses of electricity to more appropriate heating sources would result in a significant load loss, and therefore significant revenue losses for the affected electricity distributors. Without revenue loss protection, electricity distributors will likely resist the loss of these loads, and this could result in unnecessary delays in this fuel-switching.

To help ensure that electricity distributors pursue aggressive CDM for their low-income consumers, they must become revenue neutral for all load losses that are beneficial to lowering the electricity bills of low-income consumers. Therefore, further revenue protection beyond LRAM is warranted. A partial decoupling mechanism that protects electricity distributors from load losses due to all conservation within its service territory would provide this needed revenue neutrality.

The removal of any additional revenue risk beyond risk due to revenue losses caused by conservation may be necessary. For example, going to a full decoupling true up plan would reduce the overall utility risk profile and this should make it easier for the distributor to obtain access to capital. This improved access to capital may contribute to the distributor's ability to provide aggressive CDM. Should the distributors find conservation and/or other benefits to going to a full decoupling true up plan, LIEN would not oppose it.

2. What factors should be considered when assessing the suitability of Ontario's current mechanisms and of alternative approaches? Are any of these factors more or less important than others? If so, why?

LIEN agrees with criteria used in the PEG Report to assess the suitability of Ontario's current mechanisms and alternative approaches to revenue decoupling. However LIEN would add an additional factor, and that is, neutrality to fuel-switching off electricity for appropriate end uses. This addition results in the following list of factors:

- Ability to remove disincentives for utilities to pursue a wide range of CDM/DSM initiatives
- Neutrality to fuel-switching off electricity for appropriate end uses
- Ability to alleviate earnings attrition from external sources of average use decline
- Administrative cost

LIEN suggests that the first three factors are equally important, and that administrative cost, while important, should be a secondary rather than a primary consideration. The first three factors address what is needed to pursue aggressive conservation. Cost is an important consideration, but should be a

consideration in ensuring that the first three factors are pursued in an administratively efficient manner.

3. What, if any, are the implications of the wide-spread deployment of smart meters for the Board's approach to revenue decoupling?

The Ontario government has mandated that over time each separately metered home in Ontario will be fitted with a smart meter that can report on how much electricity is being used and when it is being used. This is being done by the Province to encourage conservation of electricity, particularly at times of peak usage through the use of time of use rates (TOU).

However, as expressed in previous Board proceedings, LIEN is concerned about the ability of low-income consumers to pay for the higher rates during mid- and peak periods. Low-income consumers have less capacity than the average residential consumer to adapt to TOU pricing without potential damage to health and welfare. Typically, a significant number of low-income consumers (e.g. elderly, infirm, disabled, single moms with young children) are at home during the day and must use electricity during mid- and peak times; they also do not have the financial resources to purchase more energy efficiency appliances, or implement energy efficiency home renovations²; and have high electricity bills compared to residential consumers with gas heating and hot water. This is even more problematic in winter as these consumers are likely to be in electrically heated homes. To address this problem, LIEN has and continues to argue that it is imperative that the Board establish a rate assistance program for low-income consumers.

The adoption of straight fixed variable (SFV) pricing as a decoupling approach would undermine the use of smart meters and TOU rates, leading to the underutilization and at worst, the stranding of the smart meter assets. SFV would force customers to pay the same customer charge no matter how much of the distribution system they use, likely resulting in higher electricity bills for small electricity consumers such as residential consumers. As a result, LIEN does not support the adoption of SFV.

² Most low-income consumers are renters and therefore, will not be able to replace energy inefficient appliances or do energy efficient renovation, as this is a landlord responsibility. About 2/3 of low-income people in Ontario live in tenant households (Advocacy Centre for Tenants Ontario, *Rental Housing in Ontario – quick facts*. November 5, 2003.)

4. What scope for further or modified revenue decoupling might be appropriate? For example, should the impact of all variances from forecast in commodity demand be eliminated regardless of the cause (i.e., distributor-provided CDM/DSM programs, other CDM/DSM programs, the economy, weather, customer growth, etc.)? Why or why not?

The impact from all the variances from forecast associated with conservation – CDM/DSM and natural conservation – must be eliminated to remove any disincentive for the distributors, both gas and electricity, to pursue aggressive conservation. Such revenue protection makes the distributors revenue neutral regarding conservation.

LIEN is not opposed to other variances from forecast beyond conservation being eliminated. LIEN notes that a risk averse electricity distributor may need other protections to feel comfortable with load losses from traditional loads such as electric hot water and space heating. As well, broader risk protection may make it easier for a distributor to invest in CDM/DSM as access to capital will be easier. Therefore, while there is no direct conservation gain in reducing risk from weather related and other non-conservation related revenue losses, the improvement to the risk profile of the distributor may benefit conservation through access to capital improvements and the comfort level that the distributor may gain regarding CDM/DSM.

The electricity distributor should be compensated for revenue losses based on the decoupling true up plan. However, lost revenues due to CDM should still be calculated as a tracking metric to provide information on the contribution that CDM is making to overall utility revenue losses. This will provide information on whether further decoupling is needed to address utility risks beyond conservation risk.

5. Are there any alternative approaches, beyond those identified in the PEG Report, which better address revenue erosion due to changes in consumption? What are the costs, benefits and implications of implementing the alternative approach?

An additional approach to revenue decoupling that can be added to the partial decoupling plans of the natural gas distributors and to a partial decoupling plan of electricity distributors is a customer tracker. Customer trackers track the variance between forecast and actual customers in a test period for a given rate class and calculate the total revenue loss or gain in that class, and then calculate the cumulative revenue loss or gain over the customer base for true-up. A

customer tracker will mitigate utility risk related to customer losses in the test period.

Some of the pros of customer trackers include:

- A customer tracker that only tracks revenue losses is relatively straightforward to administer
- This mechanism tracks variance that is not currently tracked by the Ontario gas distributors
- The exact variance in revenue between forecast and actual revenue as a result of customer changes is known

Some of the cons associated with customer trackers include:

- There may be resistance from stakeholders to implement a customer tracker
- Dispensing of the customer tracker can be complex
- This tracker eliminates the opportunity for a utility to earn profits on forecasts that underestimate the number of customers in a test period

Revenue stabilization, also referred to as rate stabilization, provides controls on revenue recovery by also putting controls on the utility's approved rate of return. It provides greater risk protection by guaranteeing the utility a particular rate of return. Revenue stabilization readjusts a utility's rates to ensure that the company's revenues achieve a certain approved return and revenue target. It ensures that the utility does not over-recover or under-recover its authorized distribution charge by setting a specific allowed rate of return. In some cases, a deadband is put in place that allows for slight over- and under-recovery around the allowed rate of return, or a sharing mechanism can exist between customers and the shareholder around a graduated rate of return. Some revenue stabilization mechanisms benchmark expenses and disallow ones greater than the benchmark.

Some of the pros of revenue stabilization mechanism include:

- It stabilizes utility earnings
- It reduces utility business risk
- It reduces customer rate volatility
- It can lead to more efficient cost recovery for maintaining and expanding natural utility infrastructure
- The exact variance in revenue between forecast and actual revenue as a result of customer changes is known

Some of the cons include:

- It caps utility profits

- It may lead to cost inefficiencies as there is reduced incentive to lower utility costs unless costs are benchmarked, benchmarking must be appropriate to the utility

As of 2009, Louisiana, Mississippi, Oklahoma, Alabama, South Carolina and Texas have instituted revenue stabilization, at least for their natural gas utilities.³

Revenue stabilization guarantees a rate of return and therefore provides both revenue and cost protection. This revenue protection mechanism should not be implemented without cost benchmarks, and only should be considered where a particular distributor faces a very uncertain environment over which it has little control. For example, it may be applicable to electric distributors in vulnerable communities where load loss from a major industry threatens the utility viability⁴.

6. Is there a preferred approach (or elements of an approach) and if so, what are the important implementation matters that must be considered? What are the costs, benefits and implications of implementing the preferred approach or of refraining from doing so?

The existing revenue decoupling true up plans for natural gas utilities should remain in place. These plans have removed obstacles to DSM and have contributed to the success of natural gas distributors in pursuing successful DSM. Should either Enbridge or Union find that additional declining average use protection is required (e.g. Union needs to expand the coverage of their average use tracker to their large volume customers), LIEN would support such expansion in principle to remove remaining obstacles to pursuing aggressive conservation.

The preferred revenue decoupling mechanism for electric distributors is a decoupling true up plan with a revenue adjustment mechanism consisting of a revenue per customer revenue tracker. This revenue per customer revenue tracker would track variance from forecast monthly in a variance account and true up annually. This partial decoupling mechanism protects electricity distributors from load losses due to all conservation within its service territory and would therefore remove the obstacles to aggressive CDM.

No cap should be placed on the amount of revenue recovery permitted at the outset. If a cap is required down the road, it should be a soft cap to permit a

³ American Gas Association. *The Changing Regulatory Environment*. August 2009. p.23.

⁴ For more information on customer trackers and the revenue stabilization mechanism, see IndEco. *Rate Design Options*. Prepared for the Canadian Gas Association. January 26, 2010.

phased in approach to full revenue recovery of revenue losses. This phased in approach will continue to eliminate obstacles to aggressive CDM, but will avoid rate shock to low-income consumers.

Lost revenues from CDM should be tracked, however the variations should not be backed out as they are in the gas framework. Lost revenues from conservation should be tracked as a metric to understand the contribution of CDM to the total utility revenue losses. The electricity distributors decoupling true up plan should also include a shared savings mechanism (SSM) which incents the electricity distributors to do aggressive CDM and the option for a distributor to have a DSMVA to provide greater flexibility to the distributor to exceed its CDM targets.

The removal of any additional revenue risk beyond risk due to revenue losses caused by conservation may be necessary. For example, going to a full decoupling true up plan would reduce the overall utility risk profile and this should make it easier for the distributor to obtain access to capital. This improved access to capital may contribute to the distributor's ability to provide aggressive CDM. Should the distributors find conservation and/or other benefits to going to a full decoupling true up plan, LIEN would not oppose it.

7. Can or should the preferred approach need to be the same in both the gas sector and the electricity sector? Why or why not? Would any other form of differentiation based, for example, on a specific distributor characteristic(s) be appropriate? If so, what might be the defining characteristic(s)?

The approach to decoupling should be tailored to the particular energy sector – gas or electricity – and take into account the differing regulatory needs, market conditions and customer base. As a result, a ‘one size fits all’ approach is not appropriate across the sectors and within the sector. However, with 80 electricity distributors, LIEN appreciates that the Board requires some regulatory simplicity for cost control. This should be balanced against the need for some variability in decoupling plans across the electricity distributors to address particular needs.

The partial decoupling true up plans of the natural gas utilities should remain in place. The partial decoupling true up plan advocated by LIEN for the electricity distributors, described above, are not geography dependent and are also applicable to both large and small distributors. Smart metering infrastructure makes the tracking of revenue losses relatively easy to do even for small distributors. Since the revenue true up is symmetrical and tracks all variations in revenue, this approach would be applicable for LDCs that are experiencing load growth (e.g. through the addition of customers) as well as those facing declines.