PALIARE ROLAND
BARRISTERS

Richard P. Stephenson
T 416.646.4325 Asst 416.646.7417
F 416.646.4335
E richard.stephenson@paliareroland.com
www.paliareroland.com

File 10329



May 17, 2010

**VIA COURIER AND RESS FILING**

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

Dear Ms. Walli

**Re: Distribution Revenue Decoupling (EB-2010-0060)**

Power Workers' Union ("PWU") represents a large portion of the employees working in Ontario's electricity industry. Attached please find a list of PWU employers.

The PWU is committed to participating in regulatory consultations and proceedings to contribute to the development of regulatory direction and policy that ensures ongoing service quality, reliability and safety at a reasonable price for Ontario customers. To this end, please find the PWU's comments on issues identified by Ontario Energy Board staff as relevant to the consultation on distribution revenue decoupling and on Pacific Economics Group's report entitled *Review of Distribution Revenue Decoupling Mechanisms* (EB-2010-0060).

We hope you will find the PWU's comments useful.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson
RPS:jr
encl.

cc: John Sprackett
Judy Kwik

Doc 756722v1

## List of PWU Employers

Algoma Power
AMEC Nuclear Safety Solutions
Atomic Energy of Canada Limited (Chalk River Laboratories)
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power – Lake Superior Power
Brookfield Power – Mississagi Power Trust
Bruce Power Inc.
Capital Power Corporation Calstock Power Plant
Capital Power Corporation Kapuskasing Power Plant
Capital Power Corporation Nipigon Power Plant
Capital Power Corporation Tunis Power Plant
Coor Nuclear Services
Corporation of the City of Dryden – Dryden Municipal Telephone
Corporation of the County of Brant, The
Coulter Water Meter Service Inc.
CRU Solutions Inc.
Ecaliber (Canada)
Electrical Safety Authority
Erie Thames Services and Powerlines
ES Fox
Great Lakes Power Limited
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Infrastructure Health and Safety Association
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kincardine Cable TV Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
London Hydro Corporation
Middlesex Power Distribution Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Waste Management Organization
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Sioux Lookout Hydro Inc.
Sodexho Canada Ltd.
TransAlta Generation Partnership O.H.S.C.
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

**EB-2010-0060**

# Ontario Energy Board
# Consultation on Distribution Revenue Decoupling
# Issues and Pacific Economics Group Research's Report

## Comments of the Power Workers' Union

## 1. BACKGROUND

On March 22, 2010 the Ontario Energy Board ("OEB" or the "Board") initiated a consultation on revenue adjustment and cost recovery mechanisms currently available to electricity and natural gas distributors to address revenue erosion related to unforecasted changes in the volume of energy distributed. The intent of the consultation is to enable the Board to confirm whether the existing mechanisms remain adequate under current conditions, including the amendments to the *Ontario Energy Board Act, 1998* resulting from the *Green Energy and Green Economy Act, 2009* with regard to the requirement for distributors to achieve conservation and demand management ("CDM") targets. Board staff invites comments on issues relevant to this consultation and on a report prepared by Pacific Economics Group Research ("PEG") entitled *Review of Distribution Revenue Decoupling Mechanisms* (the "PEG report"), which investigates established approaches to decoupling for the consideration of a strategy appropriate for Ontario, where decoupling measures are already in use.

The PEG report was presented by its lead author, Dr. Mark Lowry, and discussed at a stakeholder conference held by Board staff on April 19, 2010. The Power Workers' Union ("PWU") was an active participant at the conference. At that time, Board staff stated that stakeholder submissions would be considered in the preparation of a Staff Discussion Paper on Distribution Revenue Decoupling Mechanisms, to be followed by a further opportunity for stakeholders to comment once the Discussion Paper was issued. The PWU's comments at this point are premised on this process outlined by Board staff.

## 2. PWU COMMENTS

The PWU's comments stem from the PWU's energy policy:

> **Reliable, secure, safe, environmentally sustainable and reasonably priced electricity supply and service, supported by a financially viable energy industry and skilled labour force is essential for the continued prosperity and social welfare of the people of Ontario. In minimizing environmental impacts, due consideration must be given to economic impacts and the efficiency and sustainability of all energy sources and existing assets. A stable business environment and predictable and fair regulatory framework will promote investment in technical innovation that results in efficiency gains.**

As an overarching comment the PWU emphasizes the need for the Board to provide for flexibility by making new revenue decoupling mechanisms ("RDM") available to the distributors on an optional basis thereby addressing the diversity of utility-specific circumstances.

### 2.1 Board staff Issues

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 PWU is of the view that the introduction of new RDMs is warranted at this time. As noted by Dr. Lowry, although the vast majority of Ontario electricity distributors have engaged in CDM activities, relatively few have availed themselves of the opportunity to make a claim under the Board's Lost Revenue Adjustment Mechanism ("LRAM"). The PWU understands that the incremental costs of filing for the existing LRAM, especially those related to the delivery of evidence needed to quantify the revenue loss directly attributable to their CDM initiatives would be a significant reason for distributors to refrain from such a filing. LRAM claims are also subject to significant regulatory risk and controversy, as underlying assumptions are thoroughly argued to address all doubts. Therefore, relative to the potential magnitude of a claim under LRAM, the risks, costs and efforts are often disproportionately large for smaller and mid-sized distributors.

The absence of compensation for revenue losses arising from CDM programs contributes to distributors not achieving an optimal rate of return on investment. This situation creates a disincentive for those distributors to pursue CDM initiatives as aggressively as they might otherwise. The PWU notes that a diminished rate of return can also act as a disincentive for distributors to make all prudent investments in their distribution systems, to maintain and improve service quality and reliability.

This situation would be exacerbated by the impending aggressive conservation targets imposed on distributors – targets that are not based on the distributors' analyses of potentially achievable CDM savings – that emanate from the Ontario government's energy policy and the *Green Energy and Green Economy Act, 2009*. The historical experience of the CDM funding from the third tranche to achieve the market-adjusted rate of return has already demonstrated that an obligation to invest in CDM programs does not necessarily result in distributors making claims for revenues lost as a direct result of those programs, where the potential benefits of the LRAM are not commensurate with the risks and costs associated with the claim.

The PWU submits that for these reasons, the Board should ensure there is a revenue decoupling method available to distributors that does not impose a similar degree of cost and regulatory risk and controversy as the LRAM.

**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?**

The PEG report identifies three criteria in considering various approaches to revenue decoupling:

a. Administrative cost;

b. Ability to remove disincentives for utilities to pursue a wide range of CDM/DSM initiatives; and

c. Ability to alleviate earnings attrition from external sources of average use decline.[1]

As the PWU notes above, administrative cost is a major reason many distributors abstain from filing for LRAM. The PWU is also of the view that cost should be viewed in relation to the associated regulatory risk. The LRAM only compensates distributors for the effects of CDM programs delivered by distributors, thus offering limited benefits given that there are also non-utility CDM programs that impact load. However, the requirements of a claim for LRAM not only generate significant regulatory costs, but a high risk of at least some disallowance. As such, it can be expected that many distributors do not see the potential rewards of LRAM as being commensurate with the associated costs and risks.

In addition to regulatory costs and regulatory risk, regulatory lag is another factor that should be considered. LRAM is a retrospective mechanism, whereby utilities can only apply for relief after financial results have been subject to audit and CDM program achievements can be verified. As a result, significant time elapses before revenue losses can be recovered in rates while utilities experience revenue shortfalls that may require them to postpone work programs. Alternative RDMs that function on a timelier basis would serve to diminish these undesired effects.

Finally, thorough consideration should be given in designing decoupling mechanisms that can be implemented in a timely manner, balanced with the potential implications of such mechanisms on other regulatory policies or objectives. Depending on the specific elements of an alternative mechanism's design, either true-up plans or straight fixed variable ("SFV") pricing can have varying degrees of impact on rate design, which may bring into question a number of other issues, such as:

- Cost Allocation: would current customer class definitions remain appropriate? Does the Board's existing model generate appropriate boundaries for fixed charge levels?

[1] PEG report, page iv

- Incentive Regulation: to what extent would the existing price-cap factors remain appropriate, if partial or full revenue decoupling is implemented?

- Customer Rate Impact: what effect would rate design changes have on amounts charged to various types of customer? To what extent could such changes in rates signal, promote or interfere with, provincial policy objectives?

At present, the Board has deferred completion of its ongoing rate design initiative (EB-2007-0031). Given the relationship between rate design and RDMs, it would be advisable for rate design principles and implications to be thoroughly considered within a rate design forum, before requiring distributors to implement any new RDM(s) which may constitute significant departures from the current rate design.

That said there are some forms of revenue decoupling with less significant implications on rate design. Given the need for such mechanisms as submitted by the PWU in response to the previous question, a reasonable approach would allow utilities to elect to implement such a mechanism, at least for a transitional period, based on specified alternatives defined by the Board. Such possible alternatives are described in response to Question #6 in this submission.

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

The deployment of smart meters should increase the quantity and quality of data available on consumption patterns, which may be very useful in assessing a RDM's impacts on customer behaviour. As noted in the PEG report, in theory smart meters also enable more innovative approaches to rate design under decoupling true-up plans, for example time-of-use pricing for distribution or broader use of peak demand pricing. However as the PWU noted in response to the previous question, certain changes in rate design may have widespread implications that would need to be examined before such mechanisms could be generally adopted.

**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 PWU submits that RDMs should be capable of addressing all demand variances regardless of the cause. A major source of cost, risk and controversy with the LRAM is the onus to associate a particular quantum of revenue loss with specific CDM initiatives. In making this observation the PWU is not minimizing the need for robust Evaluation, Measurement and Verification of CDM programs, but rather makes the observation relative to the potentially controversial and adversarial regulatory review process related to a LRAM. It is reasonable to expect that any attempt to isolate one or more causes of revenue loss and to quantify the associated revenue loss would lead to similar costs and risks faced in the absence of a full RDM.

In the short to medium term, and certainly within the four-year rebasing cycle now typical for Ontario distributors, given that almost all of a distributor's costs are fixed rather than variable, distribution costs are essentially insensitive to load. Thus distributors have very little flexibility in containing cost levels when experiencing a shortfall in demand, without jeopardizing service quality and reliability over the longer term.

It is also important to recognize the impact of recent economic changes on distributors. In the last two years, a number of utilities have suffered significant earnings attrition due to loss of large customer load. Such an event is not within the distributor's control and in many cases, not reasonably foreseeable. However, there is no established mechanism for relief under the present incentive regulation framework. A distributor's only recourse to restore a fair rate of return is to bring forward a new cost of service application, which itself carries considerable cost and risk for the utility.

This situation arises from the importance of a distributor's load forecast under the current regulatory framework in setting the appropriate rate levels required to collect the required revenue. The most significant variances to load forecasts typically stem from factors not reasonably foreseeable. If we consider the example of distributors who rebased for their 2008 rates, none would have foreseen the impacts of the recession which began late in that year, or the unusually moderate weather experienced in 2009. Recent economic conditions have raised the sensitivity to load forecasting, for example with certain utilities now tracking demand variances from one or more major customers. An effective RDM would mitigate, if not eliminate, all major risks associated with load forecasting.

**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?**

The PEG report identifies the most fundamental approaches to revenue decoupling. The alternatives would essentially be instances or variants of one of the three defined approaches: LRAM; true-up plans; SFV pricing.

The PWU sees one such variant of the SFV pricing approach as allowing distributors to increase their share of revenue from (fixed) monthly service charges, where these charges account for less than a given proportion (e.g. 50%) of their distribution revenues from a given customer class, while reducing but not eliminating the volumetric charge. At present, there is considerable disparity between various distributors' degree of reliance on volumetric charges. As a result distributors face different levels of revenue loss exposure related to load reductions. A mechanism which allows utilities to move towards a reduced dependence on volumetric charges, notwithstanding the fixed charge boundary levels produced by the Board's standard cost allocation model, would allow those utilities with the greatest exposure to reduce their level of volumetric risk. This variant of the SFV pricing would keep rates within the current electricity distribution rate design introduced by the Board in 2000. While higher reliance on the distribution volumetric charge provides incentive for customers to control their consumption, this does not reflect cost causality.

**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 preferred elements of an approach would strive for low regulatory risk, low regulatory burden and low regulatory lag, as noted in response to Question #1. Furthermore, if a major change in rate design were contemplated as a RDM, a review of all implications of the change would be desirable to ensure that all fundamental aspects of rate design are reviewed from first principles.

In the interests of making a RDM available in a timely manner, the PWU submits that initial approaches should not infringe on key aspects of the existing regulatory framework, including rate design and the incentive regulation mechanism ("IRM"). One such approach would be to allow reductions to the portion of distribution revenue realized from volumetric charges, as described in response to the previous question.

Another acceptable approach would be an automatic true-up mechanism that supports full decoupling. As noted in the PEG report, a decoupling true-up plan would typically include a RDM and a Revenue Adjustment Mechanism ("RAM"). The RDM could take the form of a "Group 1" variance account, as defined by current Board policy,[2] which would operate in a way similar to existing retail variance settlement accounts ("RSVAs") that are not subject to a prudence review. Variances in demand/consumption would drive the account balances, rather than price variances. The existing price escalator under the IRM would serve as an acceptable RAM.

The PWU submits that distributors should initially be permitted to elect a RDM on a voluntary basis, from a menu of acceptable mechanisms defined through Board guidelines. This approach would recognize the diversity of utility-specific circumstances with respect to the degree of exposure to earnings attrition. Also, the PEG report emphasized the number of U.S. jurisdictions using pilots on RDMs. The PWU notes that

---

[2] *Report of the Board on Electricity Distributors' Deferral and Variance Account Initiative (EDDVAR)* (EB-2008-0046), page 6

pilot studies would allow the Board to gain further insights into the effects of one or more decoupling mechanisms.

**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)?**

Revenue decoupling approaches for the gas sector and electricity sectors should recognize the inherent differences between and within the sectors without creating an uneven playing field.

**All of which is respectfully submitted**