

Ontario Energy
Board

Commission de l'énergie
de l'Ontario



EB-2010-0133

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Hydro Ottawa
Limited for an order approving or fixing just and reasonable
rates and other charges for the distribution of electricity to
be effective January 1, 2011.

BEFORE: Marika Hare
Presiding Member

Cynthia Chaplin
Vice Chair

DECISION

October 27, 2010

BACKGROUND

Hydro Ottawa Limited (“Hydro Ottawa”) filed an application with the Ontario Energy Board (the “Board”), received on June 14, 2010 under section 78 of the *Ontario Energy Board Act, 1998*, (the “Act”) seeking approval for changes to the rates that Hydro Ottawa charges for electricity distribution, to be effective January 1, 2011. The Board assigned the application File Number EB-2010-0133.

The Board granted intervenor status and cost award eligibility to the Consumers Coalition of Canada (“CCC”), Energy Probe Research Foundation (“Energy Probe”), the School Energy Coalition (“SEC”), and the Vulnerable Energy Consumers’ Coalition (“VECC”). PowerStream Inc. was also granted intervenor status. The Board received one letter of comment from an individual customer opposing Hydro Ottawa’s rate adjustment.

The Preliminary Issue

Hydro Ottawa has been under the 3rd Generation Incentive Ratemaking Mechanism (“IRM”) framework. In the normal course, the company would have applied for rebasing on a cost of service basis for 2012 rates. However, the company made its current application on a cost of service basis.

On April 20, 2010, before the application was filed, the Board sent a letter to all distributors. In the letter (“the April 20th letter”), the Board stated that a distributor that seeks to have its rates rebased in advance of its next regularly scheduled cost of service proceeding must justify, in its cost of service application, why an early rebasing is required notwithstanding that the “off ramp” conditions have not been met. Specifically, the distributor must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan term. The letter states that the Board may determine, as a preliminary matter (“the preliminary issue”), whether the application for rebasing is justified, or whether the application as framed should be dismissed. The letter also advised that the Board may, where an application for early rebasing does not appear to have been justified, disallow some or all of the regulatory costs associated with the preparation and hearing of that application, including the Board’s costs and intervenor costs.

Hydro Ottawa identified eight factors as supporting its rationale for rebasing in 2011: asset management plan/aging infrastructure, workforce planning strategy, declining

usage per customer and impact of conservation, conclusion of the smart meter program, Green Energy Act plan, cost of capital, January 1 as the effective date for rates, and clearing of deferral and variance accounts.

In Procedural Order No. 3 issued on September 24, 2010, the Board made provision for written submissions to address the preliminary issue of whether an early rebasing had been justified by Hydro Ottawa.

Positions of the Parties

Hydro Ottawa filed its submission on September 29, 2010. CCC, Energy Probe and SEC filed their submissions on October 7, 2010. VECC filed a letter on October 8, 2010 adopting the submission of Energy Probe. Hydro Ottawa filed its reply submission on October 14, 2010. The intervenors generally took the position that Hydro Ottawa had not justified the early cost of service application. Most argued that the application should be dismissed.

Submissions were made in three areas: the Board's IRM policy framework, Hydro Ottawa's reasons for early rebasing related to implementation of recent Board policy determinations, and Hydro Ottawa's reasons for early rebasing related to its specific circumstances.

The IRM Policy Framework

Under the Board's IRM policy framework (Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, or "the Report") distributors are expected to be able to manage their resources and financial needs during the term of their IRM plan. The Board's multi-year rate setting approach contemplates the potential need for early rebasing by making provision for an off-ramp. Specifically, when a distributor performs outside of the annual ROE dead band of +/- 300 basis points, a regulatory review (or off-ramp) may be initiated. In support of this approach, a distributor would be required to make a report to the Board no later than 60 days after the company's receipt of its annual audited financial statements, in the event that the distributor falls short of or exceeds its ROE by 300 basis points. Any such review would be prospective only, and could result in modifications to the IRM plan, termination of the IRM plan, or continuation of the IRM plan.

Hydro Ottawa submitted that the Report sets out policies and guidelines for the IRM but does not (and cannot) fetter the statutory discretion set out in section 78 of the Act.

Hydro Ottawa argued that notwithstanding the policies and guidelines set out in the Report, it remains the case that the methodology applied in the determination of Hydro Ottawa's rates for 2011 may be a cost of service methodology. Hydro Ottawa stated that a cost of service proceeding is the only regulatory mechanism that will comprehensively address its concerns. The company also suggested that it would be unfair to deny it a cost of service hearing when Toronto Hydro Electric System Limited (Toronto Hydro) and Hydro One Networks Inc. (Hydro One) had been permitted to pursue cost of service applications.

CCC submitted that Hydro Ottawa previously elected to apply for rates under the IRM regime (for the 2009 and 2010 rate years) and by doing so, accepted a number of conditions, express and implied. Included in those conditions was the requirement that it meet certain criteria when seeking an early termination of its IRM plan. CCC argued that if those criteria are not met, then the Board has the authority to dismiss the application.

Energy Probe noted that Hydro Ottawa's actual ROE for 2009 was 10.7% and that the estimated ROE for 2010 is 8.9%.¹ Energy Probe added that under current rates, the 2011 ROE is projected to be 6.7% which is above the bottom of the range for the earning dead band of 5.57% (8.57% less 300 basis points). Energy Probe submitted that no off-ramp was triggered based on 2009 actual results and that no off-ramp would be triggered based on Hydro Ottawa's bridge year and test year forecasts for 2010 and 2011 respectively.

SEC submitted that where an applicant has a legitimate reason for filing early, that reason should be addressed in the cost of service context, but that any "collateral" benefits that would be achieved by applying Board policies through a cost-of-service application should not be available to the applicant.

The Implementation of Recent Board Policy Determinations

Cost of Capital

Hydro Ottawa included in its rationale for rebasing the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* issued on December 11, 2009.

¹ VECC Interrogatory #12 (b)

CCC submitted that Hydro Ottawa is earning more than its current Board approved ROE and forecasts being able to continue doing so.

Energy Probe argued that the opportunity to take advantage of a higher Board approved ROE is not a reason that the Board should accept as a justification for an early rebasing application.

SEC submitted that were the Board to determine that the updated ROE formula should apply to Hydro Ottawa, the implementation should be deferred until 2012 (i.e. the year when Hydro Ottawa was scheduled to rebase).

In its reply submission, Hydro Ottawa made reference to the Cost of Capital report, stating that meeting the Fair Return Standard is not optional, it is a legal requirement.

Alignment of Rate Year with Fiscal Year

Hydro Ottawa stated that the proposal to align its rate year with its fiscal year was also a reason to file a cost of service application at this time. Hydro Ottawa noted that the Board indicated in a letter dated April 15, 2010, that the Board will consider the merits of an alignment of the rate year with the fiscal year, on a case-by-case basis, as part of a distributor's cost of service application.

Energy Probe noted that the impact of the change in rates effective January 1, 2011 instead of May 1, 2011 as compared to the 2010 existing rates staying in place until May 1, 2011 results in an accelerated recovery of revenue by more than \$4.4 million over this four month period. Energy Probe submitted that the desire to align the fiscal year with the rate year is not a rationale that the Board should take into account when determining if the early rebasing application is justified. Energy Probe added that in its April 15, 2010 letter, the Board did not indicate that the alignment of the fiscal year with the rate year was a justification for an early rebasing application.

CCC submitted that, if the Board proceeds with the application, new rates should be set on the basis of a calendar year but should be effective from May 1, 2011 in order to mitigate the impact of the new rates on customers. SEC submitted that if the Board determines that the rate year and the fiscal year should be aligned, the Board should set 2011 rates effective May 1, 2011, but allow Hydro Ottawa to accelerate its 2012 IRM application so that 2012 rates will be effective January 1, 2012.

In its reply submission, Hydro Ottawa reiterated its desire to align costs with revenues and the fact that this matter has been a concern to Hydro Ottawa for a number of years.

Green Energy Act Plan (“GEA Plan”)

As part of the EB-2009-0397 Filing Requirements: Distribution System Plans – Filing under Deemed Conditions of Licence dated March 25, 2009, the Board indicated that a GEA Plan must be filed as part of a distributor’s cost of service application and that this requirement applies to applications for rates for 2012 and subsequent rate years, unless the Board otherwise requires a distributor to prepare and submit a GEA Plan at an earlier or other date.

As part of its application, Hydro Ottawa acknowledged that the Board provided other funding mechanisms for spending related to the GEA Plans. Hydro Ottawa stated that it wants to proceed with its initial smart grid pilot projects and expansion and enhancement projects to facilitate the connection of renewable generation. Hydro Ottawa wants assurance that the Board has approved the proposed plan and has permitted the spending to be included in Hydro Ottawa’s cost of service.

Energy Probe suggested that Hydro Ottawa cannot use a GEA Plan as an excuse to file an early cost of service rebasing application.

SEC submitted that for purely practical reasons, the Board should consider the GEA Plan in this proceeding in the normal manner, if it decides to proceed with this application.

In its reply submission, Hydro Ottawa stated that leadership on green energy issues is important at this time and that its effort to bring a GEA Plan forward for approval should be viewed positively by the Board.

Disposition of Deferral and Variance Accounts

Hydro Ottawa indicated that in the course of an IRM application, it would be unable to clear balances for at least another year, and that these balances are already three years old.

No parties filed submissions on this point.

Hydro Ottawa Specific Circumstances

Asset Management/Aging Infrastructure

Hydro Ottawa submitted that the incremental capital module (“ICM”) feature under IRM does not address its capital spending planned for 2011 to deal with aging infrastructure and other significant emerging capital requirements.

Energy Probe submitted that the Hydro Ottawa has not provided any evidence that the ICM would not provide it with sufficient relief to deal with the issue of required capital additions, and that the use of the ICM within the IRM plan, as allowed for by the Board, is the approach that Hydro Ottawa should be taking, not a cost of service application. Energy Probe also observed that Hydro Ottawa’s 2011 capital spending forecast is within the range of the previous year’s capital spending.

SEC noted that Hydro Ottawa’s infrastructure is not the most “aged” in the province and that the infrastructure of all distributors is aging. SEC observed that the issue of aging infrastructure was known to the Board when it issued the Report setting the framework for the IRM.

Hydro Ottawa replied that the evidence explains in some details that the ICM does not work in Hydro Ottawa’s circumstances.

Workforce Planning

Hydro Ottawa indicated in its pre-filed evidence that like Toronto Hydro and other utilities in the sector, it also faces the challenges of an aging workforce and a scarcity of available resources.

Energy Probe and SEC submitted that long term workforce requirements are not unique to Hydro Ottawa. Energy Probe opined that since this is a long-term issue, it would be hard to see how coming forward one year in advance of the scheduled application would have any significant impact on the company. Energy Probe submitted that this is not a justification for a cost of service application.

In its reply submission, Hydro Ottawa argued that the point is not that Hydro Ottawa’s circumstances are unique but rather its circumstances should be examined on their own merits.

Declining Usage per Customer and Impact of Conservation

Hydro Ottawa stated that it has achieved significant participation in conservation and demand management (“CDM”) programs over the years and as a result, it has experienced a steady decline in average consumption per customer.

Energy Probe submitted that the mandatory CDM targets and the impact of achieving these targets may have on the load forecast are not unique to Hydro Ottawa.

In its reply submission, Hydro Ottawa reiterated that as an early adopter of CDM programs, it has experienced a significant participation in these programs and that a comparison of the approved 2008 load forecast and the 2011 forecast load reveals a 1.62% kWh reduction.

Conclusion of Smart Meter Program

Hydro Ottawa suggested that it will substantially complete its smart meter deployment program by the end of 2010, and as such, Hydro Ottawa sought approval of the smart meter spending and the inclusion of capital additions to the end of 2010 in its 2011 rate base. Hydro Ottawa stated that this could only be done as part of a cost of service application.

Energy Probe agreed that the inclusion of the capital additions to the end of 2010 can only be included in rate base as part of a cost of service application, but noted that Hydro Ottawa could continue to use the smart meter related deferral accounts. SEC argued that if the Board were to be satisfied that these costs are appropriate, they should be added to rate base in 2012.

Recommendations by the Parties

CCC submitted that the reasons provided by Hydro Ottawa to justify its application to rebase rates prior to the termination of its IRM plan are not credible. CCC noted that the Board should not undermine the integrity of the IRM framework, particularly in circumstances where no credible reasons, other than the desire to earn more revenue, have been provided. CCC also submitted that if the Board hears the application, it should do so on the following conditions:

1. That the Board's new ROE formula should not be embedded in rates until 2012, to ensure a consistent policy for all electricity distributors;
2. That all regulatory costs should be borne by the shareholder and not the customers; and
3. The new rates should be set on the basis of a calendar year approach but should be effective from May 1, 2011 and not January 1, 2011, in order to mitigate the impact of the new rates on customers.

Energy Probe concluded that Hydro Ottawa has not justified an early rebasing, and has not demonstrated that it cannot adequately manage its resources and financial needs during the final year remaining in its IRM plan. VECC adopted the submission of Energy Probe.

SEC submitted that there is ample evidence on the record to justify the Board declining to proceed with this application on the basis that it is one year premature, but recommended a less categorical response. SEC suggested that the Board should consider the issues in this proceeding but order deferral of the implementation of some issues (e.g. higher cost of capital, alignment of rate year and fiscal year) until the 2012 rate year that is the year that they would have otherwise been available. SEC also submitted that regulatory costs associated with this early application, if prudently incurred, should be charged to a deferral account, to be cleared in 2012 without interest.

BOARD FINDINGS

Section 78 of the Ontario Energy Board Act does not specify or restrict the methodology to be applied by the Board in determining just and reasonable rates. The Board's IRM policy framework also does not fetter the statutory discretion set out in section 78 of the Act. However, the Board has also made it clear, both in the Report and in the April 20th letter, that it expects a distributor to stay on IRM unless there are legitimate reasons to do otherwise. The threshold issue in this case, as articulated in the April 20th letter, is whether Hydro Ottawa has justified in its cost of service application and through further examination of evidence "why an early rebasing is required notwithstanding that the "off ramp" conditions have not been met". Any distributor applying to rebase early was instructed to "clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period".

Hydro Ottawa has raised arguments about fairness in how the Board has previously dealt with distributors who chose to come in for early rebasing. The Board finds that comparisons to Toronto Hydro are not pertinent, given that Toronto Hydro was never on incentive regulation. While it is true that Hydro One was on incentive regulation and applied to rebase early, the panel in that case did not address this issue; nor was the issue identified in advance as a potential preliminary issue. The circumstances are different in the case of Hydro Ottawa and all other distributors seeking early rebasing this year. As of the April 20th letter, the Board made it very clear that an applicant must demonstrate to the Board why it cannot continue on the IRM mechanism in order to justify a departure from the Board's IRM policy framework in the form of early rebasing.

The Board finds that arguments from intervenors about "jumping the queue" or the administrative burden associated with reviewing a cost of service application this year are not persuasive. The only issue for the Board to determine is whether Hydro Ottawa was justified in coming forward with a cost of service application for rate-setting and terminating its participation in the IRM framework 16 months early. This issue is an important aspect of the Board's IRM policy framework. The multi-year approach contains various trade-offs, and balances a variety of ratepayer and utility concerns. As with all its policies, the Board will consider alternative approaches, but these alternatives must be justified. In this case, the Board has made its expectations clear in the April 20th letter regarding the nature of the justification needed to support an early application for rebasing.

Hydro Ottawa provides eight reasons for filing a cost of service application with the Board. These are the need for continued investment in implementing an asset management plan due to aging infrastructure; implementation of a workforce planning strategy; addressing declining throughput as a result of conservation and demand management; the conclusion of the Smart Meter Program; a desire to include a higher return on equity in rates; a change in the start of the rate year; implementation of the Green Energy Act Plan; and the desire to clear deferral and variance account balances.

The Board finds that although these are reasons why a distributor might want to come in early for rebasing, none of these, either singly or taken together, justify why Hydro Ottawa could not stay on the IRM framework in setting rates for another year. To the contrary, the evidence has shown that Hydro Ottawa has performed very well financially throughout the IRM plan, having achieved an actual ROE for 2009 of 10.7% and a projected ROE for 2010 of between 8.9% and 9.3%. Hydro Ottawa projects a ROE for

2011 of 6.52%, which Energy Probe submits ought to be adjusted to 6.7%.² Even without the adjustment, the return does not approach the off-ramp of 300 basis points as measured against the Board approved return on equity of 8.57% included in 2008 rates. From a financial perspective then, the Board finds that Hydro Ottawa has not justified the need to terminate the IRM plan early.

Hydro Ottawa's desire to apply the Board's current return on equity policy and to align its fiscal and rates years are not sufficient justification to proceed with an early cost of service application. The Board's policies are clear that they are to be adopted in the context of a cost of service application – in other words a cost of service application provides an opportunity to implement the Board's policies in these areas; but the policies themselves are not a reason to advance a cost of service application early.

Likewise, the Board's policy with respect to Green Energy Act plans does not trigger a requirement for a cost of service application. The policy sets out a framework which provides funding alternatives until a distributor makes a cost of service application.

With respect to distributor specific issues, the Board finds that there is no reason why Hydro Ottawa cannot implement its asset management plan or workforce planning strategy now, within the IRM plan period. Asset management and workforce planning are ongoing issues for distributors and the company should be able to accommodate those requirements – indeed is expected to do so – within the IRM framework; there is no evidence that it cannot do so.

The urgency in disposing of deferral and variance accounts (contrary to the Board's policy as set out in EB-2008-0046), accounting for conservation effects, and adding smart meter capital costs to rate base was also not demonstrated. Variance accounts and smart meters costs can be addressed in the next regular rebasing with no adverse financial impacts on Hydro Ottawa. Similarly, CDM impacts can be captured through the Lost Revenue Adjustment Mechanism for disposition either in the IRM application or the next cost of service application.

The Board finds that Hydro Ottawa has not justified the need for an early rebasing and has not shown that it cannot adequately manage its resources and financial needs during the one year remaining in the IRM plan. The Board therefore will not proceed

² EP submission p. 6

with reviewing this cost of service application and directs Hydro Ottawa to apply for 2011 rates based on the IRM formula.

The Board and intervenor costs associated with this application will be held in a deferral account. All other costs incurred by Hydro Ottawa in preparing and filing this application must be absorbed within the current revenue envelope. No additional recovery will be allowed.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. The Board will determine eligibility for costs in accordance with its Practice Direction on Cost Awards. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

All filings with the Board must quote the file number EB-2010-0133, and be made through the Board's web portal at www.errr.oeb.gov.on.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must be received by the Board by 4:45 p.m. on the stated date. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.oeb.gov.on.ca. If the web portal is not available you may e-mail your documents to the attention of the Board Secretary at BoardSec@oeb.gov.on.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's Practice Directions on Cost Awards.

THE BOARD DIRECTS THAT:

1. Hydro Ottawa shall file an application for 2011 rates based on the IRM formula.
2. Hydro Ottawa shall record the Board and intervenor costs associated with this proceeding in a sub-account of Account 1508 'Other Regulatory Assets' for disposition in the 2012 cost of service application.
3. Intervenors shall file with the Board and forward to Hydro Ottawa their respective cost claims within 10 days from the date of this Decision.

4. Hydro Ottawa shall file with the Board and forward to intervenors any objections to the claimed costs within 24 days from the date of this Decision.
5. Intervenors shall file with the Board and forward to Hydro Ottawa any responses to any objections for cost claims within 31 days of the date of this Decision.
6. Hydro Ottawa shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, October 27, 2010

ONTARIO ENERGY BOARD

Original signed by

Marika Hare
Presiding Member

Original signed by

Cynthia Chaplin
Vice Chair