



# **ONTARIO ENERGY BOARD**

## **STAFF SUBMISSION**

### **2009 ELECTRICITY DISTRIBUTION RATES**

#### **Northern Ontario Wires**

**EB-2008-0238**

**February 11, 2009**

## **INTRODUCTION**

Northern Ontario Wires Inc. (“NOW” or the “Applicant”) is a licensed electricity distributor serving approximately 6,100 customers within the towns of Cochrane, Iroquois Falls and Kapuskasing. NOW filed its 2009 rebasing application (the “Application”) on August 20, 2008. NOW requested approval of its proposed distribution rates and other charges effective May 1, 2009. The Application was based on a future test year cost of service methodology.

The Vulnerable Energy Consumers’ Coalition (“VECC”), the School Energy Coalition (“SEC”), and the Association of Major Power Consumers in Ontario were granted intervenor status.

This submission reflects observations and concerns which arise from Board staff’s review of the pre-filed evidence and interrogatory responses made by NOW, and are intended to assist the Board in evaluating NOW’s application and in setting just and reasonable rates. Staff has determined that comments on the issues of Cost of Capital, Working Capital Allowance, Depreciation Expense and Smart Meters are not necessary.

## **THE APPLICATION**

In its original application, NOW requested a revenue requirement of \$2,890,752 to be recovered in rates effective May 1, 2009<sup>1</sup>. It should be noted that NOW has proposed a number of changes to the above revenue requirement during the discovery phase of this proceeding. While Board staff will address each change accordingly, staff does note that NOW’s updated revenue requirement as provided in response to VECC (supplemental) IR #26 does not reflect all of the proposed changes. For example, as will be discussed later in this submission, NOW has agreed to remove \$24,214 in truck loan interest expense from OM&A and to reduce its PILs proxy from \$60,503 to \$52,689. Yet, neither of these changes are reflected in the revised revenue requirement of \$2,895,805 provided in response to the VECC interrogatory.

In its reply submission, the Applicant should provide a breakdown of its revenue requirement identifying all the changes that it has proposed following the closing of the evidentiary stage and the updated total revenue requirement requested for 2009. The Applicant should also provide updated bill impacts.

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<sup>1</sup> E1/T2/S4 - Numerical Details of Causes of Deficiency 2009 Test Year

## **RATE BASE**

NOW is requesting approval of \$5.4 million for its 2009 rate base<sup>2</sup>. This amount is a 3.5% increase (\$187,231) from NOW's 2007 actuals and a 0.98% increase (\$53,081) from its 2006 actuals.

## **Capital Expenditures**

### ***Background***

NOW is proposing 2009 capital expenditures of \$391,000 in 2009. This represents a 57% reduction in capital expenditures in 2009 over 2008 (\$615,215) and a 3.4% reduction from the 2007 actuals of \$404,275.

The reason for the spike in 2008 is documented as the purchase of a new bucket truck in the amount of \$225,000 and a new pick up truck in the amount of \$25,000<sup>3</sup>. Staff notes that in response to Board staff IR #14, NOW indicated that an expenditure of approximately \$220,000 in 2007 corresponds to a new digger truck as well.

In terms of asset planning, NOW indicated that it reviews capital projects and expenditures for a three year period with the exception of smart meters for which NOW develops a five year capital budget.<sup>4</sup> NOW's asset planning is based on in-house assessments of NOW's assets to determine upgrade or replacement requirements. NOW's assessment typically includes a review of system or equipment condition, reliability, efficiency and safety, as well as performing a cost benefit analysis when appropriate. NOW did indicate that in 2006, as part of its CDM plan, it used a study conducted by EnerSpectrum Group on NOW's system losses, to identify and prioritize capital projects.

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<sup>2</sup> Response to Board staff supplemental IR #5 b)

<sup>3</sup> Exhibit 2 / Tab 2 / Schedule 3 / page 4

<sup>4</sup> Response to Board staff IR # 15

NOW provided the following table in response to Board staff IR #4:

Year	Capital Expenditures	Annual Depreciation Expense	Capex / Depreciation
2003	\$ 63,390	\$ 371,004	17.1%
2004	\$ 113,179	\$ 372,597	30.4%
2005	\$ 167,266	\$ 363,348	46.0%
2006	\$ 183,655	\$ 329,835	55.7%
2007	\$ 404,275	\$ 337,216	119.9%
2008 bridge	\$ 615,250	\$ 363,270	169.4%
2009 forecast	\$ 391,000	\$ 404,740	96.6%
Total	\$ 1,938,015	\$ 2,542,010	76.2%

### ***Discussion and Submission***

In terms of the appropriateness of the 2009 expenditure level, staff notes that NOW's proposal for 2009 is consistent with their forecasted expenditures for 2008 if one normalizes for the purchase of the bucket truck in 2008 (\$391,000 as compared to \$390,000). However, if one applies the same analysis for 2007, the level of expenditures would be approximately \$184,000 which is in line with NOW's historical spending. That leaves the issue as to whether or not NOW has provided adequate support for doubling its capital expenditures in the bridge and test years.

In response to Board staff supplemental IR # 4, NOW indicated that it had experienced increased costs related to deregulation coupled with cash flow issues due to delays in customer billings. NOW responded to the reduction in cash flow by limiting its spending; with a return to regular billings and cash flow, NOW is moving to a more proactive asset management planning effort.

In response to Board staff supplemental IR # 4 b), NOW admitted that its historical under-spending may lead to increased costs in the long term, however it has no current plans to undertake a significant rehabilitation of its network. Staff notes that NOW's service reliability indices, as reported in response to Board staff IR #16, do not indicate system or service deterioration.

Generally, Board staff has no concerns regarding NOW's proposed 2009 capital expenditures. Board staff observes that, in addition to the utility's decision to limit past capital spending, negligible customer growth may have factored into lower-than-expected capital expenditures for a number of years. Finally, Board staff observes that NOW's

capital expenditures in 2007 and those forecast for 2008 and 2009 are of a quantum similar to or greater than annual depreciation expense, and thus should enable NOW to sustain its existing network and invest to service new demand.

The Board may wish to consider whether or not NOW's three year planning horizon is adequate to justify NOW's current system needs in light of the historical under-spending. Staff submits that requiring NOW to develop a more robust and long-term capital plan to reflect NOW's new "pro-active" approach and provide insight into NOW's future system needs, will enable the Board to better assess NOW's future rate applications.

## **Payments in Lieu of Taxes ("PILs")**

### ***Background***

In its original application, NOW proposed a PILs allowance of \$60,503 for 2009 rates<sup>5</sup>. NOW provided a detailed breakout of Other Additions and Other Deductions in response to Board staff IR #20. These consist of additions of deemed interest and deductions of actual interest. For 2009 the deemed interest added is \$156,466 while the actual interest deducted is \$105,262. Board staff explored this further in supplemental IR #5 by identifying these adjustments as being inconsistent with the Board's policy on calculating PILs, and requesting an explanation for this deviation from Board policy. NOW responded that it believes that PILs should reflect, as closely as possible, the actual tax/PILs filings which are based on actual interest expense. Board staff notes that, at the time of this submission, NOW has not amended its PILs proxy to adjust for this.

### ***Discussion and Submission***

Board staff notes that the Board's policy and practice is not to allow for the additions and deductions proposed by NOW. A recent affirmation of that policy is contained in the Board's Decision in EB-2007-0928 regarding Erie Thames Powerlines 2008 distribution rates. Board staff observes that the Board has articulated its policy in other decisions as well, and that the primary basis for not allowing for the additions and deductions related to deemed and actual interest expense is that the Board is approving a regulatory revenue requirement for rate-setting purposes, and this is based on the deemed capitalization.<sup>6</sup>

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<sup>5</sup> Exhibit 4 / Tab 3 / Schedule 1

<sup>6</sup> See Board Decision EB-2007-0698, pp. 10-11 regarding Brantford Power's 2008 electricity distribution rates, Board Decision EB-2007-0696, pp. 8-9, regarding Halton Hills Hydro's 2008 electricity rates and Board Rate Order EB-2007-0710, pp. 2-3 regarding Oshawa PUC's 2008 electricity distribution rates.

Board staff submits that there is no evidence on the record to support deviating from Board practice and policy to allow the additions and deductions for deemed and actual interest expense as proposed by NOW.

The Applicant has chosen an actual capital structure that differs from the Board's recommended or deemed capital structure. The consequences of deviating from the Board-approved capital structure may result in cost inefficiencies for the utility. There is no reason that these inefficiencies should be visited on the ratepayers. Staff notes that by including these adjustments, NOW's PILs proxy would be inflated.

Board staff also notes NOW's response to VECC IR #15, that it used an incorrect CCA rate for recent computer additions, resulting in an over-collection of \$7,800. In response to Board staff supplemental IR #5, NOW has corrected the appropriate CCA rates to align with the recently announced federal tax changes.

Staff also notes that other changes to NOW's revenue requirement are likely, due to the updating of the Cost of Capital parameters, the Board's decision on rate base, and capital and operating expenditures, and that these may have a flow-through effect on the PILs allowance that may be recoverable in rates. Board staff submits that, in its draft rate order, NOW should flow through applicable changes and update the PILs allowance to determine the revenue requirement and rates resulting from the Board's Decision.

## **OPERATIONS, MAINTENANCE AND ADMINISTRATION**

### ***Background***

For the 2009 Test year, NOW is requesting approval for \$2,092,253 in OM&A expenses excluding taxes, amortization expenses and Low Voltage costs (see table below). This represents an 11.7% increase over NOW's 2007 actuals and a 19.2% increase from its 2006 actuals. NOW's 2009 Test Year OM&A represents a 1.9% increase over the 2008 Bridge year.

<b>Summary of OM&amp;A</b>	<b>2006 Board Approved</b>	<b>2006 Actual</b>	<b>2007</b>	<b>2008 Bridge</b>	<b>2009 Test</b>
Operation	\$ 283,318	\$ 294,145	\$ 330,293	\$ 501,464	\$ 454,973
Maintenance	\$ 97,013	\$ 190,979	\$ 210,169	\$ 178,672	\$ 184,032
Billing and Collection	\$ 614,895	\$ 513,423	\$ 593,010	\$ 731,823	\$ 757,744
Community Relations	\$ -	\$ 20,250	\$ 7,261	\$ 1,545	\$ 1,591
Administrative and General Expenses	\$ 1,034,325	\$ 887,779	\$ 996,731	\$ 908,850	\$ 912,967
<b>Total ( per pre-file)</b>	<b>\$ 2,029,551</b>	<b>\$ 1,906,576</b>	<b>\$ 2,137,464</b>	<b>\$ 2,322,354</b>	<b>\$ 2,311,307</b>
Remove Low Voltage charges *	\$ (225,270)	\$ (115,000)	\$ (225,207)	\$ (225,207)	\$ (219,054)
Adjustment**					\$ 44,043
<b>Updated Total</b>	<b>\$ 1,804,281</b>	<b>\$ 1,791,576</b>	<b>\$ 1,912,257</b>	<b>\$ 2,097,147</b>	<b>\$ 2,136,296</b>
year on year increase			\$ 120,681	\$ 184,890	\$ 39,149
year on year % increase			6.7%	9.7%	1.9%
% increase 2006 to 2009					19.2%
% increase 2007 to 2009					11.7%
* to be confirmed by NOW					
** per VECC IR #26 Suppl.Response					

Over the 2003 to 2007 period, NOW's OM&A actual expenses, based on the numbers confirmed in the response to Board staff IR #13 (and unadjusted for Low Voltage), increased by approximately 5.2% annually. Over the 2007 to 2009 period the average increase is similar, approximately 5.7% annually.

Board staff also notes that NOW's updated revenue requirement includes additional costs noted in NOW's response to VECC (supplemental) IR #26.

The major components of the increase between 2007 actual and 2008 bridge, and 2008 bridge and 2009 test year, as set out in the pre-filed evidence and interrogatory responses, are listed below.

\$184,890 or 9.7% increase between 2007 Actual and 2008 Bridge:

Inflation @ +/- 3%	\$ 53,000
Return of lineman from sick-leave	\$ 38,500
Travel costs back to typical level	\$ 20,000
Interest on variance/deferral accounts	\$ 32,000
Full-time CFO, dedicated management	\$ 30,000
3rd tranche CDM spending	\$ (50,000)
Miscellaneous non-recurring items	\$ 61,000
Other	\$ 390
<b>TOTAL</b>	<b>\$ 184,890</b>

\$39,149 or 2.0% increase between 2008 Bridge and 2009 Test

Inflation @ +/- 3%	\$ 57,000
Temporary Billing Assistance (new system)	\$ 10,500
Interest on variance/deferral accounts	\$ 4,000
Miscellaneous non-recurring items	\$ (56,332)
Prior year pole rental adjustment	\$ (28,000)
Other	\$ 7,928
Contract negotiation consultant costs	\$ 2,500
Regulatory Interrogatory Costs	\$ 3,750
Negotiated lineman rates above 3%	\$ 17,803
Training prior to Superintendent Retirement	\$ 20,000
<b>TOTAL</b>	<b>\$ 39,149</b>

## ***Discussion and Submission***

### ***Inflation***

From 2006 to 2009, NOW indicates that inflation has increased OM&A expenses by \$160,000<sup>7</sup>. This averages about \$53,000, or approximately 3% per year. In response to Board staff IR #4, NOW confirmed that it has used a 3% inflation rate for 2009. NOW stated that, for compensation costs, NOW used 3% based on the contract negotiation results of similar LDCs. For material and expenses NOW referred to the Consumer Price Index for June and July 2008, which indicated 3.1% and 3.4% increases respectively over the previous year.

Board staff has no concerns with the inflationary adjustments used by NOW. In response to SEC IR #12, NOW stated that it has considered productivity gains in the 2009 OM&A forecast by keeping resource requirements to a minimum despite an

<sup>7</sup> Response to VECC IR #13 and SEC IR #11



increase in workload due to increased regulatory requirements (such as rate applications, IFRS, etc.), implementation of a new billing system, staff changes and smart meters. NOW also indicated that it operates with a minimum number of linemen in each of its three communities as appropriate for practical and safety reasons.

#### Employee Compensation and Staff Changes

Total compensation charged to OM&A for 2009 (including the amounts charged by the CTS affiliate) has increased by 16% (\$166,167) over the 2007 level and 20% (\$199,814) over the 2006 figures. The projected 2009 OM&A forecast for compensation is \$1,191,628 and represents 16.5 FTEs (4.2 with the wires company and the remainder with the CTS affiliate).

Other than the 3% inflationary increases (amounting to \$32,000 between 2007 and 2008), NOW indicated that the major drivers for the remaining increases are the return of a permanent full time CFO in 2007 reflecting a higher salary and benefits not applicable to her replacement (\$12,000), an increase in projected time required by NOW by a few shared employees (\$15,000) and the return of a lineman from sick leave (\$38,500)<sup>8</sup>.

In its response to Board staff IR #10 NOW requested two further increases to OM&A for compensation. The first relates to current labour negotiations. NOW expects that it may have to provide an increase to linemen salaries to enable it to achieve parity with the industry over and above the 3% increase already budgeted in NOW's original application. The increase expected is \$2 per hour and NOW stated that this represents an additional \$20,000 increase annually in wages and benefits. In response to VECC (supplemental) IR #26, NOW indicated this amount to be \$17,803.

Board staff questions NOW's rationale for selecting this particular expense item as an add-on in addition to the overall 3% intended to cover inflationary increases. Absent an itemized list forecasting inflationary levels applicable to the expense categories that comprise OM&A, there is little evidence to support the conclusion that these wage costs in excess of 3% would not be offset by instances where the inflation impact on another type of expenditure is less than 3%, or by productivity increases.

The second increase is related to training for a new Electric Superintendent that will begin in 2009. The current Superintendent is scheduled for retirement in 2010. Board

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<sup>8</sup> Response to SEC IR #13

staff notes that in response to Board staff IR #10, NOW identified the incremental cost as \$30,000 for each of 2009 and 2010, but in a subsequent response to VECC (supplemental) IR #24, NOW revised this adjustment from a total of \$60,000 to \$80,000 (due to a longer than originally expected training period). Board staff notes that NOW has increased its 2009 OM&A request by \$20,000 to allow NOW to recover the \$80,000 to be spent from July 2009 to June 2010 over 4 years (2009-2012)<sup>9</sup>.

Staff notes that this adjustment assumes that the new Superintendent will earn a salary comparable to the current one, and that if the Superintendent position is filled internally, the new Lineman that will be taking over for the promoted individual will be earning a salary comparable to the current Lineman. In response to VECC (supplemental) IR #24, NOW indicated that its assumptions regarding compensation levels were based on the need to attract qualified candidates to those positions. Staff has no concerns with this assumption.

NOW also stated that any salary savings associated with internal promotions are expected to be offset by training costs. NOW's request for \$80,000 over the next four years assumes incremental training costs for 2009 and 2010 leading up to the current Superintendent's departure.

Board staff questions the need to include the \$20,000 provision in 2009 OM&A due to the pending retirement of the existing Superintendent. There is little evidence on the record justifying the need to hire a replacement a full 12 months (as compared to 6 months) in advance of the existing Superintendent's retirement; nor is there any information concerning the nature of the training which would cost \$20,000 and eliminate any savings that might result from an internal promotion at the Lineman level.

Board staff also notes that the requested 2009 OM&A includes \$10,000 for Temporary Billing Assistance for the change to a new system. This \$10,000 would be available starting in 2010 to offset the aforementioned cost.

Board staff also requests NOW to confirm how it proposes to record the actual costs associated with the early hiring/training. Will NOW's annual "actuals" that are reported to the Board record the "early hiring/training" costs in the OM&A accounts as actually incurred or will they be amortized (to OM&A) over four years commencing in 2009?

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<sup>9</sup> Response to VECC (supplemental) IR #26

### 2009 Regulatory Costs

From NOW's evidence it appears that NOW uses two accounts to record regulatory costs. OM&A account 5655 (Regulatory Expenses) which totals \$21,625 for 2009, and includes \$16,000 for the Board's quarterly assessment, \$800 for the annual licence fee, cost awards of \$1,075, and intervenor costs of \$3,750 for the 2009 proceeding. The \$3,750 is an amortized amount, being one quarter of an estimated \$15,000. In response to Board staff supplemental IR #3 NOW stated that its other regulatory costs (e.g., legal fees, management fees and consulting fees) are recorded in OM&A account 5630, (Outside Services). NOW indicated that in 2009 these are expected to total \$168,284 and include the following:

#### **A/C#5630-0000 - Outside Services**

##### **2009 TEST**

Legal Fees	\$ 10,000
Actuarial Services	\$ 1,500
EDA Membership	\$ 12,500
ESA Contractor License	\$ 4 00
Management Fees	\$ 94,884
Audit Fees	\$ 22,500
Consulting Fees – Regulatory (RDI)	\$ 24,000

<b>TOTAL as submitted per Original Filing</b>	<b>\$ 165,784</b>
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Negotiation Consulting Costs (4 year amortization) omitted from original application	\$2,500
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<b>TOTAL REVISED OUTSIDE SERVICES</b>	<b>\$168,284</b>
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For account 5630, the 2009 amounts appear to be in line with historical amounts provided in E4/T2/S6 – Purchase of Services with the exception of the Management Fees amount of \$94,884. NOW is asked to confirm that the Management Fees of \$94,884 are included in the total charges of \$985,271 from the CTS affiliate for 2009 (E4/T2/S4).

NOW may also wish to confirm whether or not the \$94,884 is incremental to the compensation expenses (salaries and benefits) identified in E4/T2/S7 for 2009 in the amount of \$1,191,628 that are charged to OM&A.

With respect to the additional costs of \$3,750 per year for intervenor costs, Staff submits that NOW has not taken into account the \$1,075 already included in the forecast for 2009 for account 5655 relating to Cost Awards. The Board may wish to make an adjustment for this. If the \$3,750 is for work involved in responding to interrogatories, as suggested by NOW's response to VECC IR #11 and SEC IR #13, staff is not clear why these costs are incremental to the costs already included in account 5630 for Consulting Fees and Management Fees. In addition, Board staff questions the correctness of including certain expenses, such as audit fees and EDA fees, as regulatory expenses. These expenses do not appear to fall under the category of regulatory expenses.

#### Other Interest Expense

In response to Board staff IR #3 and #12, NOW explained that it has included the following amounts in OM&A:

#### Other Interest Expense

IESO Letter of Guarantee Fee (\$525/month)	\$ 6,300
Regulatory Interest (on Variance Accounts)	50,943
Truck Loan Interest - Digger Truck ( purchased in 2007)	11,000
Truck Loan Interest - Bucket Truck ( purchased in 2008)	13,214
Customer Deposit Interest Expense	<u>6,119</u>
	\$ 87,576

Staff inquired by way of interrogatory about the recording of truck loan interest as an OM&A expense. In its Board staff supplemental IR #1 response, NOW agreed that these interest costs should not be part of Other Interest Expense and that this OM&A account should be reduced by \$24,214 for rate setting purposes.

As noted above, NOW's revised revenue requirement has not yet been adjusted to reflect this change. NOW should confirm this change along with other changes that it has made over the course of the discovery phase of this proceeding and provide an updated calculation of its revenue requirement reflecting its "final request" for 2009.

Staff has a concern with NOW's treatment of "regulatory interest on variance accounts". NOW indicated that the interest expense included above is an expense that is associated with the amounts owing to rate payers for the over collection of RSVA expenses.

In response to Board staff supplemental IR #1 e), NOW confirmed that the variance account balances submitted in response to Board staff IR # 41 a) do in fact include interest. Staff notes that the continuity schedule for the December 31, 2007 principal balances includes interest to April 30, 2009. NOW is showing a debit principal balance for account 1588, Power of \$992,305 and credit principal balances for the remaining RSVAs totaling \$1,586,236.

NOW took the position that recovery of the noted interest expense would not be double counting, and that the \$50,943 is an expense owing to customers. NOW advised it will return the principal and interest portions of the credit variances to customers upon disposition of the variance accounts however without any recovery for the interest expense. NOW believes that it should be able to recover the interest portion as this constitutes a legitimate business expense.

Board staff disagrees. NOW's claim that it should be compensated for the interest charges owing to customers is contrary to the principle of the time value of money and the reason why interest charges (debit or credit) are applied to deferral and variance account balances in the first place. If NOW were allowed to recover the interest expense that it refunds to customers, those customers would effectively not be compensated for their over-payments made for services over the applicable time period. Staff also notes that, just like interest earned arising from the disposition of debit principal balances in deferral or variance accounts does not go to reduce the revenue requirement in the form of Other Distribution Revenue, interest expense incurred from the disposition of credit balances should likewise not impact the revenue requirement.

## **OPERATING REVENUE**

Exhibit 3 of the Application discusses how the customer count and load forecast are developed. The kWh forecast – and the kW forecast for appropriate classes – is presented by customer class. Variance analyses are presented in support of the forecasts.

### **Customer Forecast**

#### ***Background***

NOW is seeking Board approval for a test year customer count forecast of 7,806 customers. The test year forecast is approximately 1% lower (or 66 customers /

connections) than the 2006 Actuals. The residential, GS<50kW and GS 50 to 4999 kW rate classes make up 78% of the total forecast and are the focus of this submission.

### **Customer Count Forecast**

<b>2009 Test Year Customer Count Forecast (Ex 3/T2/S2/P1)</b>		
Rate Classes	No. of Customers	Proportion of Total
Residential	5,200	67%
GS<50	785	10%
GS 50 to 4999 kW	69	1%
USL	15	0%
Street Light	1,737	22%
<b>TOTAL</b>	<b>7,806</b>	<b>100%</b>

The customer forecast, as explained in Board staff IR #23, was developed using a bottom-up approach and is not supported by either regional development plans<sup>10</sup> or housing starts data. In the absence of such supporting evidence, Board staff analysed observed trends in the data and historical customer levels over a five year period (2002 to 2007) to test the reasonableness of the proposed forecast.

### ***Discussion and Submission***

Board staff compared the customer forecast to a forecast developed using a simple linear trend method<sup>11</sup>. The forecast developed based on the trend method is approximately 2% lower than the proposed forecast. While this trend estimate is low, it does illustrate a downward trend in customer growth. Board staff notes that since 2002, NOW lost customers in the above three rate classes (in total) in every year except 2005 when the total customer count increased by a modest three customers. This consistent decline in customer count represents a negative average growth rate of -1.24%, and is likely reflected in the test year customer count forecast.

Board staff is concerned with the lack of evidence provided in support of the forecast, such as regional development plans and housing start estimates, especially when the forecast as stated by NOW, is developed based on "...opinion rather than regional development plans"<sup>12</sup>. However, the test year forecast appears reasonable, given the consistent and long-term rate of decline in customers as is evident from the data.

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<sup>10</sup> SEC interrogatory 1(a)

<sup>11</sup> Board staff interrogatory 23 (c)

<sup>12</sup> SEC interrogatory 1(a)

## Load Forecast

### ***Background***

In response to VECC (supplemental) IR #30 NOW filed a revised load forecast. A summary of the changes by rate class are presented below:

Load Forecast		
Rate Class	As Filed (Ex 3/T2/S2/P3)	As per VECC IR #30
	<u>(kWh)</u>	<u>(kWh)</u>
Residential	41,161,457	40,986,873
GS<50	21,858,575	21,858,575
GS>50 to 499 kW	68,558,740	68,558,740
Unmetered Scattered Load	121,104	121,104
Street Light	1,778,469	1,778,469
<b>TOTAL</b>	<b>133,478,344</b>	<b>133,303,760</b>

NOW developed its load forecast by first weather normalizing historical (2002 to 2007) throughput data. Using this weather normalized throughput data NOW derived the normalized average consumption (“NAC”) estimate, by rate class, which when multiplied by the test year customer count, produces the load forecast. Due to time and resource constraints, NOW was unable to produce an alternate forecast based on an econometric method and weather data specific to its service area<sup>13</sup>.

### ***Discussion and Submission***

Board staff notes that the general method of forecasting load based on the formula “NAC times the test year customer count” was used by a number of 2008 EDR applicants. (The weather normalization methodology proposed is unique and is discussed later in this submission.) In the absence of load forecasts developed based on econometric analysis, the Board has accepted forecasts based on methods similar to the one proposed here, provided the results are reasonable<sup>14</sup>. In addition, the Board may wish to consider that, given the poor quality of the consumption data and the short period of available data, a more sophisticated approach may not produce results that are any more reliable than those proposed.

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<sup>13</sup> Board staff interrogatory 24 (c)

<sup>14</sup> EB-2007-0928 Erie Thames Powerline Corp. 2008 Rates Decision, page 3

While Board staff is concerned with the weather normalization methodology used to normalize historical data, staff submits NOWs overall forecasting methodology is reasonable.

## **Weather Normalization**

### ***Background***

NOW's load forecast is developed by first weather normalizing historical throughput data. The normalization methodology proposed uses IESO consumption data adjusted for NOWs distribution territory, in place of Hydro One data. Board staff is concerned with the appropriateness of this weather normalization methodology, especially in relation to the applied adjustment factor.

For the purposes of weather normalizing historical load, NOW derived a weather normalization factor based on a ratio of actual and weather normalized province-wide consumption, provided by the IESO. To create a weather normalization factor specific to its service area, NOW further adjusted the IESO normalization factor by a factor of 2.101, referred to as the "NOW Factor". The NOW Factor was provided by Hydro One as part of the 2006 Cost Allocation study, however, NOW does not know how the factor was calculated<sup>15</sup>.

### ***Discussion and Submission***

In the absence of utility specific weather data, Board staff is unable to confirm if the proposed methodology accurately captures the impact of weather on NOW's load. The Applicant is proposing to adopt a method without fully understanding how one of the key input variables is calculated. Board staff estimates that if the "NOW Factor" is excluded from the Applicant's normalization calculations, the proposed load forecast will increase by approximately 0.2% (or 203,166 kWh). Board staff also notes that by basing the load forecast on historical actual data, i.e. excluding all weather normalization, the proposed load forecast will increase by approximately 0.3% (or 387,633 kWh).

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<sup>15</sup> VECC (supplemental) IR#30 a)



## COST ALLOCATION AND RATE DESIGN

### Revenue to Cost Ratios

#### ***Background***

NOW filed its Informational Filing which shows the revenue to cost ("R/C") ratios with the existing rate structure. The results are identified in the first column below. In response to VECC (supplemental) IR #35, NOW provided an alternative run of the cost allocation model that reflects the removal of costs and revenues associated with \$50,000 of transformer ownership allowance. The resulting R/C ratios are reproduced in the second column below.

NOW's application involves a re-balancing of class revenues to better reflect the results of the cost allocation model. The proposed R/C ratios are shown in the third column. NOW's proposed ratios are the same for all classes except for Streetlighting. The cost allocation underlying these ratios is the same as the informational filing, not the version produced for VECC.

**Revenue to Cost Ratio [%]**

<b>Customer Class</b>	<b>Informational Filing Run 2</b>	<b>Response to VECC IR #35</b>	<b>Application: Exhibit 8 / Tab 1 / Schedule 2</b>	<b>Board Policy Range</b>
Residential	97.92	99.80 %	102.76 %	85 – 115
GS < 50 kW	107.25	108.58%	102.76 %	80 – 120
GS 50-4999 kW	162.28	141.06%	102.76 %	80 – 180
Street Lights	26.02	27.98%	70.00 %	70 – 120
USL	127.53	132.74 %	102.76 %	80 – 120

The changes from the cost allocation information filing are not phased in. Staff submits that a phase-in is not required given that the impacts on total bill as proposed by NOW in its original filing are less than 10% (except for the Streetlighting and USL classes where the Board has required a phase-in to the nearest boundary of the target ranges whenever the impacts are greater than 10% on the total bill). NOW has not proposed

any other mitigation plan to address the large increases for these two classes (66% and 31% respectively) on total bill.

### ***Discussion and Submission***

Staff notes that the approach proposed by NOW (to achieve identical R/C ratios for most classes) is not the predominant R/C ratio structure that has been proposed by distributors. However, staff notes that a similar proposal was advocated by Erie Thames Powerlines in their 2008 rebasing application (EB-2007-0928) and subsequently approved by the Board. Staff also notes that any final structure should in fact reflect the removal of transformer ownership allowance costs and revenues.

As discussed above, there is no phase-in in NOW's proposal, and the bill impact on Streetlighting is quite high as a result. In response to Board staff IR #39, NOW provided an alternate calculation assuming that the Streetlighting R/C ratio increases from 26.02% to 50% (approximately midway to the bottom of the range), together with a smaller decrease for the GS 50-4999 kW class. NOW stated that the R/C ratio for the GS 50-4999kW class would be 120% (rather than the proposed 102.76%), and the bill impact for the average GS 50-4999 kW customer would be a decrease of 2.4% in place of the decrease of 3.31% in NOW's proposal. The total bill impacts for Streetlighting would be 38% (down from 66% as proposed).

NOW submitted that the alternate calculation provided in response to Board staff IR#39 does not constitute a proposed treatment by NOW. Staff submits that this alternate calculation is an appropriate one given that Board policy in past applications has been to phase in the move to the bottom of the range for the Streetlighting class thereby resulting in more favourable bill impacts for the first year. Increasing the rate for the GS 50-4999 kW class would result in delaying the full benefit to the large customers but nevertheless provides a smaller benefit for that class arising from the re-balancing as the class would still experience a decrease to its R/C ratio.

## **Monthly Fixed Charges**

### ***Background***

In NOW's rate impact calculations, it is evident that the proportion of revenue from the fixed charge would decrease for the Residential class, because the Monthly Service Charge would be increased by 6.6% while the volumetric rate would be increased by 65.5%. The same is true for the GS<50 kW class, where the increases would be 6.7% and 53.3% respectively. For the GS 50-4999 kW class, the opposite would occur,

because the Monthly Service Charge is decreased by only 1.9% while the volumetric would be decreased by 54.0%.

### ***Discussion and Submission***

The Monthly Service Charge is higher than the ceiling in the cost allocation filing for the GS 50-4999 kW class. Staff submits that the Board's usual approach in the 2008 cost of service decisions was to leave the fixed/variable proportions unchanged from the status quo in this situation. In a situation where the rates are being re-balanced to the extent that revenue from the class is decreased, this would imply an equal percentage reduction in the monthly service charge and the volumetric rate. In response to Board staff supplemental IR #9, NOW indicated that it was attempting to set the fixed charges in order to balance revenue stability, rate stability and OEB guidelines. Staff submits that NOW may wish to propose a lower fixed charge together with a higher volumetric charge than those in the application, in order to maintain the existing fixed/variable ratio.

## **Rate Design – Unmetered Scattered Load**

### ***Background***

NOW proposed that the USL class would be charged rates such that the R/C ratio would be 102.8% along with other classes, down from the ratio of 127.5% in the Informational Filing. However, even attaining this lower ratio required an increase in the Monthly Service Charge of 9% together with a tripling of the volumetric rate. In response to Board staff IR #39, NOW clarified that the 2004 customer count had been 48 and the projected number for 2009 is 15. The lower class revenue requirement is recovered from many fewer customers, and when calculated on a per customer basis the outcome is a total bill impact of 31% as found in NOW's application.

### ***Discussion and Submission***

Staff notes that the NOW tariff sheet does not specify whether the Monthly Service Charge is levied per customer or per connection. Staff submits that the validity of the R/C ratios from the Informational Filing depends on relative stability in the composition of the customer base, and where this stability is not found then the rebalancing of class revenues may not be consistent with good rate design principles.

Staff submits that it might be preferable to simply disregard the cost allocation results for this class for this re-basing, and to increase the rates to USL by the same proportions as the GS<50 kW class. The R/C ratio can be considered at the next rebasing of rates. As

NOW has noted in its response to the interrogatory, there is not a large portion of revenue involved and a new run of the cost allocation model with different USL data methodology would have only a marginal impact on other classes.

## **Low Voltage Costs**

### ***Background***

In its original filing, NOW requested low voltage ("LV") costs of \$219,054. However, in response to Board staff IR #36, NOW indicated that the total LV billed by Hydro One in 2007 was \$178,478. The 2008 figure (\$136,846) was provided to September 30.

In response to Board staff supplemental IR #8 b), NOW indicated that it will use the billing demand for the November 2007 to October 2008 period (44,856 kW) and the new Hydro One charges as approved in Hydro One's 2008 cost of service application (EB-2007-0681) to determine the final LV amount to be incorporated into rates for 2009.

NOW advised that as of December 2008, Hydro One was still using the interim rates. Based on the rates applied for by Hydro One together with the above demand, the estimated LV cost would be \$149,845.

### ***Discussion and Submission***

Staff notes that two events have occurred that affect the cost forecast. The final Hydro One LV rates were approved on January 28, 2009, and are lower than the interim rates. Second, Hydro One has applied for new rates to take effect May 1, 2009 (EB-2008-0187). Staff submits that NOW should assume that the latter rates will determine its costs in 2009. NOW may wish to provide an update to its LV cost forecast in its reply submission.

In its original application, NOW proposed to allocate the LV costs as per NOW's distribution expenses. NOW recorded these amounts in account 5665, Miscellaneous General Expenses. In response to Board staff IR #37 b), NOW proposed to allocate the costs based on the weighted average of billed connection costs over two years (2007 and 2008). In response to VECC (supplemental) IR #31 c), NOW indicated that an acceptable alternative would be to allocate the LV costs based on 2009 billed connection charges although NOW felt that using a two year actual average will produce a more accurate value than a forward looking estimate. Staff submits that since this is a future

test year cost of service application, NOW should remain consistent and allocate the LV charges based on the 2009 figures.

Staff also notes that NOW confirmed, in response to VECC (supplemental) IR #31 b), that NOW's OM&A expenses for 2009 do in fact contain \$219,054 for LV costs and that NOW will reduce the 2009 OM&A expenses by this amount when filing its draft rate order.

## **Retail Transmission Service Rates**

### ***Background***

In its original application, NOW filed no information on transmission costs. NOW applied to continue its 2008 retail transmission service ("RTS") rates.

The response to Board staff IR# 40 c) includes a new calculation of RTS rates that would reflect the Uniform Transmission Rates (wholesale) that came into effect January 1, 2009. NOW's proposed RTS rates match the change in the wholesale rates.

Board staff supplemental IR #10 c) requested that NOW calculate a set of RTS rates that would address the tendency of its retail rates to over-collect. NOW provided an analysis of its expenses and revenues which showed a 6% over-recovery for the Network charges and a 7% over-recovery for the Connection charges for the periods January to December 2007 and January to September 2008. NOW proposed a set of rates that are 5% lower than those in the earlier interrogatory response.

### ***Discussion and Submission***

The Board's guidelines on RTS rates states, "The pattern over time of the amounts being recorded in these accounts can guide the distributor as to what adjustments may be needed to maintain the balance of the deferral accounts at a reasonable level."<sup>16</sup> Staff notes that the balances are negative \$87,347 in account 1584 and negative \$1,431,220 in account 1586. These accounts reflect historic disparities in the Network and Connection rates respectively. The amounts are the balances as of December 31, 2007 plus interest to April 30, 2009. As noted above, the amounts continued to increase at least through September 2008.

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<sup>16</sup> Page 3, second paragraph

In response to Board staff supplemental IR #10 c), NOW provided revised RTS rates that reflect an increase in the Uniform Transmission Rates less a 5% reduction. NOW indicated that it was not opposed to adjusting its RTS rates by 5% although it did indicate that it did not believe that a 21 month snapshot in time can accurately reflect the future direction of these accounts.

Staff notes that Hydro One began charging its embedded distributors on reduced interim rates in May 2008, at the same time as NOW began charging its own reduced retail rates per its 2008 IRM application (EB-2007-0853). In Hydro One's current 2009 IRM application (EB-2008-0187), Hydro One has applied for approval of RTS rates for the Sub-transmission class that have an adjustment that will mirror the increase in the Uniform Transmission Rates.

Staff submits that if NOW were to increase its RTS rates to mirror the changes in the Uniform Transmission Rates, there would be no correction of the over-recovery that occurred during 2007-2008. Staff submits that NOW's proposal for a 5% reduction to the already revised RTS rates (provided in response to Board staff IR #40 c)) is appropriate. While the 5% reduction does not exactly match the calculated over-collection of 6% and 7% for Network and Connection respectively, any remaining disparity will be reflected in the variance accounts.

## **Other Distribution Revenue**

### ***Background***

Revenue offsets decrease the need for revenue from distribution rates. NOW provided a breakdown of its revenue offsets in E3/T1/S2 – Summary of Operating Revenue Table. NOW is forecasting \$297,503 in revenue offsets for 2009. This includes revenues from Late Payment Charges, Specific Service Charges and Other Electric Revenues. NOW's forecast for Other Electric Revenues for 2008 was \$150,502, representing a 26% decrease relative to the 2007 actual amounts.

### ***Discussion and Submission***

In response to Board staff IR #31, NOW provided a detailed accounting of the decrease to Other Electric Revenue. The principal components are one non-recurring item from 2007 (a meter exit rebate from Hydro One) and one permanent change (loss of compensation for providing billing services to the Town of Iroquois Falls). Board staff does not have any concerns with the decrease to revenue offsets.

Staff notes that in response to Board staff IR #33, NOW indicated that a \$2,000 general administration fee for unauthorized energy use, identified at section 2.4.6 in NOW's Conditions of Service, is absent from NOW's Tariff of Rates and Charges.

NOW did indicate that the need for a separate fee arose from the fact that administration costs are indirect costs and recorded without information linking them to specific charges. NOW also confirmed that this fee has never been applied and so the revenues for 2002 to 2007 are nil.

Staff submits that any charge to be applied by distributors should be approved by the Board and included on an approved Tariff. No information was provided by NOW to support the basis for this charge. Although staff has no concerns with the purpose for the fee, staff submits that the level of the charge has not been justified and if NOW intends on applying this charge in the future, it should seek approval from the Board in its next application.

## **Loss Factors**

### ***Background***

NOW has proposed an increase to its total loss factor ("TLF") from the deemed 4.29% to 4.33%. This is driven by an increase to its distribution loss factor ("DLF") from the deemed 3.82% to 3.86% for 2009. NOW provided historical figures for 2002 to 2007 and used a three year average (2005-2007) for the 2009 DLF estimate. NOW did not change the default supply facilities loss factor ("SFLF") of 1.0045.

### ***Discussion and Submission***

The original application did not indicate if the Hydro One loss factor of 1.034 is included to the appropriate extent. In response to Board staff IR #42, NOW indicated that the Hydro One SFLF is included in the calculation of NOW's TLF. But according to the evidence at E4/T2/S9 – Loss Adjustment Factor Calculation, NOW has used the default 1.0045 as the SFLF.

Staff notes that the TLFs approved for Hydro One at embedded delivery points are 1.034 (metering away from station) and 1.006 (metering at station)<sup>17</sup>. Staff submits that as an embedded distributor, NOW should use one of these factors, or possibly an average of

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<sup>17</sup> Hydro One's Rate Order p.559, EB-2007-0681

the two if the metering situation differs at its delivery points, and should not rely on the default SFLF that applies to non-embedded distributors.

NOW may wish to confirm in its reply submission which SFLF it has used in the calculation for the 2009 TLF.

## **Deferral and Variance Accounts**

### ***Background***

NOW did not request disposition of any variance accounts. In response to Board staff supplementary IR #11, NOW calculated illustrative rate riders that would result from disposing of accounts in two scenarios: 1) deferral and variance accounts except for RSVA accounts and accounts associated with Smart Meters, PILs and CDM, and 2) the same accounts plus the RSVA accounts.

Should the Board be inclined to dispose of certain variance accounts, Board staff offers the following comments on NOW's treatment and adherence to the Board's *Accounting Procedures Handbook* and *Regulatory Asset Filing Guidelines*.

In response to Board staff supplemental IR #41 a), NOW provided a continuity schedule for all variance and deferral account balances, including interest for various time periods. Staff notes that NOW reported an aggregate credit balance of \$30,914. This reflects the principal balance to December 31, 2007 and interest to April 30, 2009. Staff also notes that this balance includes a debit balance of \$642,396 for account 1590, Recovery of Regulatory Asset Balances. Since the approved regulatory asset rate riders were in effect until April 30, 2008, it has been the Board's practice not to dispose of account 1590 until the 2008 Audited Financial Statements are available to confirm the residual balance.

If account 1590 is excluded, the aggregate balance would be a debit of \$611,482. The RSVA and Low Voltage account balances total a credit of \$818,263 and the non-RSVAs (setting aside the smart meter, CDM and PILs accounts which may be reviewed by separate independent processes) have a total debit balance of \$144,953. As a result, the illustrative rate riders provided by NOW are positive amounts that would be charged to customers if the accounts other than RSVAs were disposed of, and are negative amounts that would be rebated to customers if the RSVAs were disposed of as well.



## ***Discussion and Submission***

Board staff notes that NOW has followed the Board's guidelines and is using its Deferral and Variance Accounts in a manner consistent with the definition in the Board's *Accounting Procedures Handbook* and with the procedures outlined in the *Regulatory Asset Filing Guidelines* with the exception of the accounts identified below.

Staff will discuss the disposition of the RSVAs first. Staff notes that the credit balance submitted for the RSVA and low voltage variance accounts is approximately 28% of the proposed revenue requirement for 2009. Staff submits that the Board may wish to consider disposing of these balances at this time rather than waiting for the separate initiative that the Board will undertake for the review of the commodity account 1588 (RSVA-Power) and other related RSVAs. The rules or guidelines with respect to that process are not yet known. Although it has been the Board's practice not to dispose of RSVAs until such time as the initiative noted above is established, the Board may wish to consider disposition at this time as it has done in previous applications where certain distributors were carrying extraordinarily large balances<sup>18</sup>.

With respect to the non-RSVAs or deferral accounts, staff notes that the main drivers of the \$144,953 balance are account 1508, Sub-Account Pension Contributions and account 1571, Pre-Market Opening Energy Variances. Staff has no concerns with account 1508 as these type of costs have been approved for recovery in previous decisions.

Staff notes that account 1571 was discontinued as of April 30, 2006. This account was disposed of as part of the process for the Recovery of Regulatory Assets, Phase 2 for the remaining distributors. NOW indicates that it erred in 2006 by not including interest charges allowed by the Board's December 9, 2004 Decision with Reasons. Consequently, the amount approved as part of the 2006 EDR process was \$50,975 less than what it should have been.

Staff notes that the Board has opined on the treatment of errors made by certain distributors during their reporting of the 2006 Regulatory Asset review process. In the Board's decision on Lakefront Utilities' 2008 EDR application, the Board stated,

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<sup>18</sup> Decision for Hydro 2000 – EB-2007-0704, page 10

The Board notes that Lakefront is responsible for the data in its applications. If the application of the 2006 EDR model resulted in the inappropriate treatment of an account, or part of an account, it was Lakefront's responsibility to identify this and bring it to the Board's attention.

.....Had the error been reported sooner it might have been appropriate to review Lakefront's 2006 rates. Those rates have already been superseded by 2007 rates, which in turn are soon to be superseded by 2008 rates. An adjustment now for this error would result in significant retroactivity. Such a retroactive adjustment might be appropriate if there were evidence that Lakefront was not responsible for this error; however, that is not the case, as already set out above.<sup>19</sup>

In Halton Hills' 2008 EDR decision, the Board allowed a retroactive adjustment of a small credit to accounts 1570 and 1571 for the following reasons:

It appears that Halton Hills discovered that the amounts applied for in the 2006 EDR were overstated for these two reasons, and is attempting to refund the balance to customers. Given the circumstances, namely that the amounts are not large, that the result is a refund to customers and that Halton Hills has initiated the adjustment, the Board will allow for the balances in these two accounts to be rolled into account 1590 to be cleared along with the true up of the residual balance of this account, and not refunded to ratepayers via a rate-rider at this time.<sup>20</sup>

Staff submits that if the Board decides to order disposition of the deferral account balances, the Lakefront case most clearly mirrors the circumstances existing in the current case and should be applied to NOW. The evidence establishes NOW is responsible for the \$50,975 error and that it failed to bring the error to the attention of the Board promptly. The amount involved is clearly a material amount given NOW's materiality threshold of \$4,219 (.2% of 2006 distribution expenses)<sup>21</sup>. If the Board ordered disposition of the deferral account balances, NOW would be recovering a historical under-collection which has occurred solely because of an error on its part. Staff

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<sup>19</sup> Decision for Lakefront – EB-2007-0761, page 26

<sup>20</sup> Decision for Halton Hills – EB-2007-0696, page 23

<sup>21</sup> Materiality is maintained if the variance explanation threshold of 1% is used (\$21,095)

submits that in accordance with past practice, the Board should not allow for recovery of this amount if it chooses to dispose of NOW's deferral accounts. To do so would constitute retroactive ratemaking. The amount should be deemed out of period.

- All of which is respectfully Submitted –