



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2009 ELECTRICITY DISTRIBUTION RATES

Hydro One Remote Communities Inc.

EB-2008-0232

For March 6, 2009

INTRODUCTION

Hydro One Remote Communities Inc. ("Remotes") is an integrated generation and distribution company which serves 20 communities that are not connected to the provincial transmission grid and has approximately 3,400 residential and general service customers. Remotes filed its 2009 rebasing application (the "Application") on August 29, 2008 and filed updated evidence on November 28, 2008. Remotes 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.

Energy Probe, the Department of Indian Affairs and Northern Development and the Nishnawbe Aski Nation ("NAN") were granted intervenor status.

This submission reflects Board staff's review of the pre-filed evidence and interrogatory responses made by Remotes' and is intended to assist the Board in evaluating Remotes' application and in setting just and reasonable rates. Board staff are commenting only on issues of concern and have determined that comments on Operations, Maintenance and Administration are not necessary.

THE APPLICATION

In the Application filed August 29, 2008 Remotes requested a revenue requirement of \$45,236,000 to be recovered in rates effective May 1, 2009. The revenue requirement was revised to \$42,500,000 in the November 28, 2008 update of which \$14,655,000 was proposed to be recovered through customer rates and \$27,845,000 from the Rural and Remote Rate Protection program ("RRRP").

Rate Base

According to the updated evidence filed on November 28, 2008, Remotes is requesting approval of \$30.3 million as rate base for the 2009 Test Year. This amount is a 10.7% increase (\$2.9 million) from Remotes' 2007 actuals and a 14.2% increase (\$3.8 million) from its 2006 actuals.

Capital Expenditures

Background

Remotes has proposed 2009 capital expenditures of approximately \$5.1 million. This reflects a reduction of \$279,000 as compared to the original filed amount of \$5.4 million. Remotes' 2009 proposed expenditure represents an increase of approximately 67% compared to the 2008 projected level of approximately \$3.1 million and an increase of approximately 37% over 2007 actual capital expenditures of approximately \$3.8 million.

Discussion and Submission

Table 1 lists the percentage change of the capital expenditures from the 2007 actual to the 2009 Test year.

Table 1

	2007 Actual	2008 Bridge	2009 Test
Capital Expenditures	\$3,755,000	\$3,077,000	\$5,138,000
% change as compared to the prior year		-18.1%	67%

The update to the Application filed by Remotes on November 28, 2008 trimmed 2008 capital expenditures from \$4.1 million to \$3.1 million, a reduction of almost 25%. Proposed expenditures for 2009 were also reduced from \$5.4 million to \$5.1 million or 5% from its previous forecast. Despite the reduced forecast, 2009 proposed capital expenditures show an increase of 37% over 2007. A large portion of the increase relates to replacement and overhaul of diesel engines (\$1.4 million versus \$884,000 in 2007). Another major contributor to the significant increase is expenditures related to distribution system improvements (from \$59,000 in 2007 to \$481,000 in 2009). At the same time, expenditures in 2008 under the same category were reduced from \$318,000 to \$125,000 in the update of November 28, 2008. It is not clear what system improvements have been reduced for 2008 and why no system improvements were reduced in 2009.

A list of the major expenditures for 2009 include:

- Replacement of diesel engines (\$1.4 million)

- Replacement – Emergency System Breakdown (\$539,000)
- SCADA, Protection and PLC Upgrades (\$553,000)
- Road Site Replacements (\$419,000)
- Armstrong Zero Emissions Project (\$358,000)
- Big Trout Lake Tank Farm Improvements (\$280,000)
- Distribution System Improvements (\$481,000)
- Planned Facility Improvements (\$639,000)

Responding to Board staff interrogatory # 5, Remotes provided an update on the status of its 2008 projects. Of the 34 projects listed, 16 are pending or partially completed. Despite the number of pending projects for 2008, Remotes has confirmed that it expects to complete all planned expenditures in 2009. The resource limitations experienced in 2008 that resulted in project delays have been addressed by the addition of three full-time engineering positions, two of which have already been filled.

Considering the number of incomplete 2008 projects that could flow into 2009, it would be difficult for Remotes to complete all its 2009 scheduled projects. Board staff invite Remotes to comment on how it intends to complete all its proposed 2008 and 2009 planned expenditures and whether some of the 2009 capital expenditures need to be postponed to 2010 or 2011.

Payment in Lieu (PILs) of Taxes

1. Income Tax

Discussion and Submission

Remotes updated its evidence on November 28, 2008. As part of its update, it reduced its regulatory income tax from \$1.5 million to \$223,000. Consequently, the revised amount required for income tax is \$223,000 as indicated in Exhibit H, Tab 1, Schedule 7, Page 2.

Remotes has reported a net loss of \$1.1 million for the 2007 tax year¹ and a taxable loss of \$2.8 million for the 2006 tax year². In response to interrogatories, Remotes has indicated that it has carried back the 2006 loss (\$2.8 million) and applied it to the 2004 and 2005 taxation years³. Similarly, it has carried back the 2007 loss (\$1.1 million) and applied it to the 2004 tax year⁴.

Board staff notes that Remotes has not provided a tax forecast for 2008. It is therefore not known whether Remotes will have any taxable loss for the 2008 tax year. Board staff invites Remotes to provide a tax forecast for 2008 and comment on whether there will be a loss for the 2008 tax year.

Cost of Capital

Background

Remotes is 100% debt financed and operates as a break-even company. Remotes does not intend to seek a return on equity. As such, Remotes' capital structure consists of 100% debt; 4% short-term debt and 96% long-term debt. Table 2 summarizes its proposals in this area:

¹ Revised Exhibit C2, Tab 6, Schedule 2, Attachment A, CT23, pg.14

² Exhibit C2, Tab 6, Schedule 1, Attachment C

³ Response to Board staff interrogatory number 9

⁴ Response to Board staff interrogatory number 10

Table 2

Cost of Capital Parameter	Applicant's Proposal
Capital Structure	100% debt
Short-Term Debt	Requesting a 4% short-term debt component with a rate of 4.47% in accordance with the letter from the Board of March 7, 2008 regarding cost of capital updates for 2008 cost of service applications, consistent with the <i>Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors</i> , issued December 20, 2006 (the "Board Report").
Long-Term Debt	Proposing a weighted average long-term debt cost rate for 2009 of 5.74%

Discussion and Submission

Short Term Debt

Remotes has a 4% short-term debt component and is proposing a short-term debt rate for the 2009 Test year of 4.47% in accordance with the letter from the Board of March 7, 2008 regarding cost of capital updates for 2008 cost of service applications.

The Board has recently updated its Cost of Capital Parameters in a letter dated February 24, 2009. The Short-Term Debt rate for use in the 2009 rate year cost of service applications is 1.33%. Board staff submit that Remotes should use the revised rate in its cost of capital calculation.

Long Term Debt

Remotes is requesting a weighted average cost of long-term debt of 5.74%. This includes \$23 million of third party long-term debt matched to the actual terms of a note issued by Hydro One Inc. on April 1, 1999 to the Ontario Electricity Financial Corporation. Hydro One refinanced the debt and it now has a maturity date of May 19, 2036, bearing an effective cost rate of 5.60%.

Remotes also has a deemed long-term debt component of \$6.9 million. In its pre-filed evidence, Remotes has indicated a deemed long-term debt rate for 2009 of 6.19% based on the Board's Report, using the April 2008 consensus forecast. On February 24, 2009, the Board issued its Cost of Capital Parameter Updates for 2009 Cost of Service Applications. The Board's revised deemed long-term debt rate for 2009 Cost of Service Applications is 7.62%. Using the revised rate, Remotes weighted average cost of long-term debt is calculated in Table 3:

Table 3

Particulars	(\$000s)	%	Cost Rate (%)	Return (\$000)
Third Party long-term debt	23,000	73.8%	5.60%	1,288
Deemed long-term debt	6,913	22.2%	7.62%	527
Total	29,913	96.0%	6.07%	1,815

Board staff invite Remotes' to confirm that it is seeking a weighted average cost of 6.07% for its long-term debt.

Smart Meters

In the original Application, Remotes' indicated that it is planning to begin deploying smart metering technology in 2009 after other distribution companies have deployed smart meters to rural communities. In a response dated August 4, 2006, to a Board directive issued in Remotes EB-2005-0511 proceeding, Remotes maintained that smart metering systems recommended for grid connected customers were not appropriate to its service territory. Of the three primary objectives (reducing usage during peak periods, time of use pricing and greater information to customers) that support the smart metering initiative, the only objective that applies to Remotes is to offer customers better, more timely information.

In response to Board staff interrogatories #11 and #12, Remotes has indicated that it intends to deploy smart metering technology to all customers in 2010 and 2011. Remotes has not completed a pilot or conducted a cost/benefit analysis keeping in mind the limited benefits to Remotes' customers of the smart metering initiative.

Unlike other utilities, Remotes has not requested a smart meter rate adder but has confirmed in response to Board staff interrogatory #13 that it intends to incur expenditures of \$32,000 for 2009. The costs are associated with planning and determining available infrastructure and modifications for implementation. Accordingly, \$32,000 has been included in the capital program with 50% of it included in 2009 rate base. It is not clear to Board staff if the \$32,000 has been previously approved or if it is a new request.

In the recently released guideline⁵ to Smart Meter Funding and Cost Recovery, the Board has indicated that a utility should apply for recovery of smart meter costs after a distributor achieves at least 50% penetration of smart meters within its service area. Until then, distributors should continue to use the established accounts 1555 and 1556 to track smart meter related capital and operating costs, respectively. Based on Remotes' evidence, it seems that it has added \$16,000 to rate base. Board staff submit that Remotes should include all smart meter related expenditures to the appropriate deferral accounts.

Board staff invite Remotes to provide clarity on the source of the \$32,000 that it intends to spend in 2009 related to smart meters and its rationale for including the expenditure in rate base.

Line Losses

Background

Remotes did not file any evidence with respect to loss factors or line losses, though did note in its Application that it has sets of isolated distribution and transformation assets which it owns and operates. Staff sought through interrogatories guidance for future years with respect to system losses.

Remotes indicated that distribution systems in remote communities are small, and therefore technical losses are small.⁶ Using a measure of generator output versus

⁵ G-2008-0002 Smart Meter Funding and Cost Recovery Guideline, October 22, 2008

⁶ Response to Board staff interrogatory number 46

metered usage, Remotes determined that the typical community total loss factor which includes both technical and non-technical losses is 1.3%.

Discussion and submission

Staff submits that Remotes does not appear to have material technical losses which it can control, however Remotes does track total losses on its system in its communities. Non-technical losses are monitored through community visits. Board staff submits that Remotes tracking and monitoring of line losses appears adequate given the small scale of its distribution and general assets.

Cost Allocation and Rate Design

Block Rate Implementation

Discussion and Submission

Remotes indicated that the introduction of block rates does not appear to have had a large effect on average monthly kWh usage. Remotes indicated that it has been able to discourage the installation of electrical heat by citing the tiered rate structure to its customers.⁷ Staff submits that, Remotes' proposed block rates are as they appeared in the EB-2005-0511 Decision and that Remotes is applying the block rate properly.

Deferral and Variance Accounts

Scope and Structure of Accounting the RRRP Variance Account

Background

Remotes is requesting clearance of the Rural and Remote Protection ("RRRP") Variance Account, account 2320. The balance for disposition in this account as of April 30, 2009 is estimated to be \$4.013M.

Remotes states that this account was established in order to track differences between Remotes revenues and costs. Remotes quoted from the 2006 Decision that "the Board is satisfied with the approach taken by Remotes in the application of this account, and notes this account will be reviewed for disposition by the Board on

⁷ Response to Board staff interrogatory number 37

an ongoing basis.”⁸ Remotes continues, “The intent of the account is to serve as a tool to achieve a breakeven result over time.”⁹

With respect to tracking of amounts, the difference between customer rate revenue and RRRP revenue, and expenses are booked to the RRRP Variance Account on a consolidated basis, not account by account. Because these differences are not booked account by account, the RRRP Variance Account can only be examined at a high level. In Board staff’s submission this is not transparent.

Discussion and Submission

Staff submits that, the Board should be genuinely concerned with how Remotes is using the account to capture an increasing variety of amounts that the Board may not have originally contemplated for inclusion and recovery through this account. Staff submits that, the “total profit/loss” nature of the account as opposed to “account by account” recording is an inappropriate mechanism to track the amounts and to determine if the variances are reasonable for disposition. The Board has the responsibility to ensure that amounts in the RRRP variance account are reasonable and prudently incurred and, therefore, being able to examine and review the component contributions to the account is desirable.

Staff submits that the current set-up of the RRRP variance account as a ‘catch-all’ is not transparent and may not incent the utility to operate efficiently and contain costs. While Board staff is sensitive to the fact that Remotes operates as a break-even company, Board staff believes that the operation of the account should ensure transparency.

Staff submits that for its next rebasing the Board should require Remotes to provide sub-totals for the various factors that contribute to the overall balance in the RRRP

⁸ Response to Board staff interrogatory number 39

⁹ Ibid, part (d)

Variance Account, as per its response to Board staff interrogatory #r39, which are shown below. In addition to the categories shown at interrogatory response #39, staff submits that the “Operations, maintenance and administrative expense” should be broken out to show what amounts in this category are directly attributable to bad debt.

Components as described in response to Board staff interrogatory #39:

- Fuel Expense
- Operations, maintenance and administrative expense
- Depreciation
- Asset removal expense
- OPEB amortization
- Amortization of environmental regulator assets (LAR)
- Financing charges
- Capital tax

- All of which is respectfully Submitted –