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BY EMAIL

February 1, 2010

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

Dear Ms. Walli:

**Re: Board Staff Submission on Niagara Peninsula Energy Inc.
2010 Electricity Distribution Rates Application
Board File Number EB-2009-0205/EB-2009-0206**

Please see attached Board staff's submission for the above proceeding. Please forward the attached to Niagara Peninsula Energy Inc. and any intervenors and observers in this proceeding.

Niagara Peninsula Energy Inc. reply to submissions is due February 17, 2010.

Yours truly,

Original Signed by

Martin Benum
Advisor, Applications and Regulatory Audit

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

Niagara Peninsula Energy Inc.

EB-2009-0205/EB-2009-0206

February 1, 2010

Board Staff Submission
Niagara Peninsula Energy Inc.
2010 IRM2 Rate Application
EB-2009-0205/EB-2009-0206

<u>Introduction</u>

Niagara Peninsula Energy Inc. ("NPEI") is a licensed distributor of electricity providing service to consumers within its two licensed service areas – Niagara Falls and Peninsula West. NPEI filed two applications with the Ontario Energy Board (the "Board"), received on October 20, 2009, under section 78 of the Ontario Energy Board Act, 1998, seeking approval for changes to the distribution rates that NPEI charges for electricity distribution, to be effective May 1, 2010. The application is based on the 2010 2nd Generation Incentive Regulation Mechanism.

On December 27, 2007 the Board approved an application (EB-2007-0749) by Niagara Falls Hydro Inc. and Peninsula West Utilities Limited seeking an order for leave to amalgamate and the issuance of a new electricity distribution licence to the amalgamated corporation, Niagara Peninsula Energy Inc. Harmonization of the rates for the two services area is to be completed within five years of the amalgamation or the next rebasing. NPEI filed two applications as no harmonization has been effected yet.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by NPEI.

Board staff makes submissions on the following matters:

- Disposition of Deferral and Variance Accounts as per the Electricity Distributors' Deferral and Variance Account Review Report (the "EDDVAR Report");
- Adjustments to the Retail Transmission Service Rates; and
- Accounting for the implementation of the Harmonized Sales Tax ("HST").

DISPOSITION OF DEFERRAL AND VARIANCE ACCOUNTS AS PER THE EDDVAR REPORT

General Background

For purposes of 2010 IRM applications, the EDDVAR Report requires a distributor to determine the value of its December 31, 2008 Group 1 Deferral and Variance account balance and determine whether the balance exceeded the preset disposition threshold of $0.001 per kWh using the 2008 annual kWh consumption reported to the Board. When the preset disposition threshold is exceeded, a distributor is required to file a proposal for the disposition of Group 1 account balances (including carrying charges) and include the associated rate riders in its 2010 IRM Rate Generator for the disposition of the balances in these accounts. The onus is on the distributor to justify why any account balance in excess of the threshold should not be cleared.

Any distributor exceeding the preset disposition threshold was required to file a Deferral and Variance Account Workform.

NPEI Specific Background

Annual Disposition

NPEI's initial filings requested that the deferral and variance account balances be combined for the two service territories being amalgamated. Board staff interrogatory #1a inquired if NPEI could confirm whether the combination of the deferral and variance account balances would not materially harm the customers in one service territory in favour of benefitting the customers in the other service territory. NPEI stated that the differential between the rate riders using the combined account balances as originally submitted and the rate riders that would result if the account balances were kept separate up to March 31, 2008 would materially favour the NPEI - Peninsula West customers. NPEI subsequently provided separate rate rider calculations up to March 31, 2008 and combined balances from April 1 to December 31, 2008.

Global Adjustment

In response to Board staff interrogatory # 2a NPEI stated it had reviewed the Regulatory Audit & Accounting Bulletin 200901 and confirmed that it had accounted for its Account 1588 RSVA power and global adjustment sub-account in accordance with this Bulletin. In response to Board staff interrogatory #2b, NPEI confirmed that no adjustments subsequent to its initial application were necessary to comply with the Regulatory Audit & Accounting Bulletin 200901 with respect to account 1588 and the global adjustment sub-account.

In response to Board staff interrogatory #3a, NPEI agreed that a separate rate rider be prospectively applied to non-RPP customers to dispose of the global adjustment sub-account balance would be appropriate on the basis of cost causality. In response to Board staff interrogatories #3b, NPEI stated that it did currently have the billing capability to have a separate rate rider applicable to non-RPP customers to dispose of the global adjustment sub-account balance.

As of November 1, 2009 the MUSH sector (Municipalities, Universities, Schools and Hospitals) and other designated institutional customers that remained as RPP customers were required to switch to non-RPP customer status as per O. Reg. 95/05 of the Ontario Energy Board Act, 1998. In response to Board staff interrogatories #5d, NPEI indicated that the rate rider should not apply to RPP customers, and should exclude customers in the MUSH sector.

NPEI - Niagara Falls & Peninsula West have requested that the Board review and approve the disposition of the December 31, 2008 balances of other Group 1 Deferral and Variance accounts as defined by the EDDVAR Report. The total balance of the Group 1 accounts, excluding the 1588 RSVA power is a credit of $9,162,979 and the 1588 global adjustment sub-account balance is a debit of $1,388,149. NPEI have included interest, using the Board's prescribed interest rates, on these account balances up to April 30, 2010. Debit balances are recoverable from customers.

NPEI did express some concern with respect to the impact on its cash flow were it to use the one-year default disposition period contemplated in the EDDVAR Report to clear its deferral and variance account balances. In response to Board staff interrogatory #7b NPEI noted "In view of substantial Smart Meter capital expenditures and current levels of bad debt and receivables balances, NPEI is now of the opinion that a two year disposition period would be preferable, to mitigate cash flow impacts. For this reason, along with the response to 7a) above, NPEI respectfully amends its proposal for disposition to a two year period."

In addition, in response to Board staff interrogatory #7a, NPEI noted that: "NPEI notes, however, that we intend to file a Cost of Service rate application for rates effective May 1, 2011, and we acknowledge that we do not, at this time, have any estimates as to what bill impacts may arise due to the coincident timing of the credit rate riders ending and the COS rates coming into effect. As such, NPEI is now of the opinion that it may be more prudent to spread the disposition of the credit balance over two years, instead of one year. For this reason, along with the response to 7b) below, NPEI respectfully requests that the Board consider a two year disposition period, rather than the one year period that was originally proposed."

Submission

Board staff suggests that the Board may wish to consider establishing a separate rate rider for the disposition of the global adjustment sub-account balance. The rate rider would apply prospectively to non-RPP customers, and would exclude the MUSH sector and other designated customers that were on RPP. Board staff submits that recovering the global adjustment sub-account balance solely from non-RPP customers would be more reflective of cost causality since it was that group of customers that were undercharged by the distributor in the first place. However, the Board may wish to consider, as an alternative, to recover the allocated global adjustment sub-account balance from all customers in each class. This approach would recognize the customer migration that might occur both away from the non-RPP customer group and into the non-RPP customer group.

In addition to the decision on whether a separate rate rider should be established for the disposition of the global adjustment sub-account, the Board must decide on the time period over which the rate riders should apply. As previously noted, customer migration might occur in the low volume group. For this group of customers, there would be a benefit to dispose of the global adjustment sub-account balance over a relatively short period of time in order to reduce inter-generational inequities. Board staff submits that a disposition period no longer than one year would be appropriate. These balances have been accumulating over the last four year period and to delay immediate action is not in the customer's best interest. Board staff recognizes that some volatility in electricity bills may result. That aside, Board staff believes that a one year disposition period would be in the interest of all parties.

In order to reduce inter-generational inequities, Board staff submits that the disposition period for all Group 1 accounts should not exceed one year.

The EDDVAR Report includes filing guidelines for the disposition of deferral and variance account balances. With respect to the reliability of account balances, the EDDVAR Report at page 27 states"…The Board believes that …additional audit certification is not necessary. The Board however will require a distributor to file a reconciliation of the regulatory trial balance that is reported to the Board as part of RRR and the audited financial statements."

Board staff notes the original balances proposed for disposition (and supported by audited financial statements) might have been adjusted to account for events subsequent to the release of the EDDVAR Report. They include, but are not exclusive to the following:

1. The Regulatory Audit & Accounting Bulletin 200901 ("accounting bulletin") dated October 15, 2009 and accounting frequently asked questions issued in October 2009 clarified the accounting rules for account 1588 RSVApower and global adjustment sub-account. The accounting bulletin required electricity distributors to review and correct misstatements since January 1, 2005 or since the last time Account 1588 RSVApower and global adjustment sub-account were cleared by the Board on a final basis. Due to the changes to account balances arising from the accounting bulletin Board staff asked distributors to confirm their compliance to the accounting requirements specified in the bulletin.

2. Applicants retroactively reviewing, and correcting Group 1 account balances over the January 1, 2005 to December 31, 2008 period.

Board staff notes that the final proposed balances for disposition may no longer reconcile with previously audited balances nor with NPEI's RRR filings. Board staff has reviewed the balances and notes that the changes do not result in material differences.

Board staff notes that NPEI stated in response to staff's interrogatory # 6e) that NPEI has complied with the Board's accounting policies and procedures. Board staff is mindful of the importance of a timely disposition of deferral and variance account balances and does not believe that the disposition should be delayed. For this reason Board staff suggests that the Board consider approving the proposed deferral and variance account balance disposition rate riders on a final basis.

ADJUSTMENTS TO THE RETAIL TRANSMISSION SERVICE RATES (RTSR)

General Background

Electricity transmitters in Ontario charge Uniform Transmission Rates (UTR) to their transmission connected customers. These UTRs are charged for network, line connection and transformation connection services. Based on the Decision and Rate Order of the Board in the EB-2008-0272 proceeding, the new UTRs effective July 1, 2009 were as follows:

- Network Service Rate was increased from $2.57 to $2.66 per kW per month, a 3.5% increase;
- Line Connection Service Rate remained unchanged at $0.70 per kW per month; and
- Transformation Connection Service Rate was decreased from $1.62 to $1.57 per kW per month, for a combined Line and Transformation Connection Service Rates reduction of 2.2%.

On July 22, 2009 the Board issued an amended "Guideline for *Electricity Distribution Retail Transmission Service Rates*" ("RTSR Guideline"), which provided electricity distributors with instructions on the evidence needed, and the process to be used, to adjust Retail Transmission Service Rates ("RTSRs") to reflect the changes in the UTRs effective July 1, 2009. The Board set as a proxy at that time an increase of 3.5% for the Network Service Rate and reduction of 2.2% for the combined Line and Transformation Connection Service Rates. The Board also noted that there would be further changes to the UTRs in January 2010.

Based on the Decision and Rate Order of the Board in the EB-2008-0272 proceeding, a Rate Order issued January 21, 2010 revised the UTRs effective January 1, 2010 as follows:

- Network Service Rate has increased from $2.66 to $2.97 per kW per month, an 11.7% increase over the July 1, 2009 level or 15.6% over the rate in effect prior to July 1, 2009;
- Line Connection Service Rate has increased from $0.70 to $0.73 per kW per month; and
- Transformation Connection Service Rate has increased from $1.57 to $1.71 per kW per month, for a combined Line and Transformation Connection Service Rates increase of 7.5% over the July 1, 2009 level or 5.2% over the rate in effect prior to July 1, 2009.

NPEI Specific Background

NPEI has applied for an adjustment to its RTSR rates based on the July 22, 2009 RTSR Guideline proxy rate adjustments.

Submission

Board staff notes that very few distributors, including NPEI, effected in their 2009 rates the July 1, 2009 level of UTRs since for most of them, distribution rates would have been implemented on May 1, 2009. Therefore, in accordance with the July 22, 2009 RTSR Guideline, Board staff submits that the revisions to the RTSRs ought to reflect the changes from the current level to the January 1, 2010 level, that is an increase of about 15.6% to the RTSR Network Service rate, and an increase of about 5.2% to the RTSR Line and Transformation Connection Service Rate.

Board staff has reviewed the evidence provided by the applicant and submits that the proposal by NPEI may no longer be reasonable, based on the January 1, 2010 level of the UTRs. Board staff submits that the applicant’s proposed rates be revised to reflect the January 1, 2010 values.

ACCOUNTING FOR THE IMPLEMENTATION OF THE HARMONIZED SALES TAX

General Background

The Ontario provincial sales tax ("PST") (currently at 8%) and the Federal goods and services tax ("GST") (currently at 5%) will be harmonized effective July 1, 2010, at 13%, pursuant to Ontario Bill 218 which received Royal Assent on December 15, 2009.

The PST is currently an incremental cost applied to the price of goods purchased by an electricity distributor and is included in a distributor's OM&A expenses and capital expenditures. The PST is therefore included in the distributor's revenue requirement and is recovered from ratepayers through the application of distribution rates.

When the PST and GST are harmonized, distributors will pay the HST on purchased goods and service but will now claim an input tax credit for the PST portion. The mechanics of HST as a value added tax means that the distributor will no longer incur that portion of the tax that was formerly applied as PST (i.e. the 8%) on goods purchased. However, the current rates as applied will continue to effect cost recovery as if the PST was still in place. If no action is taken, the distributor will realize a savings in the cost of goods purchased while applying rates which do not reflect those savings.

NPEI Specific Background

In response to Board staff interrogatory # 9a which asked if NPEI agrees that a deferral account should be established to capture the reductions in OM&A and capital expenditures, NPEI stated "NPEI proposes that the provincial related portion of the harmonized tax be captured in two accounts similar to the GST ITC account; one account for OM&A related tax and the other account for tax on capital expenditures. All debits recorded in these accounts technically would equal the reductions to OM&A and capital that are due to the harmonized tax. Reporting to the OEB on the amounts of the reductions would be based on these two accounts, which are the same accounts that would be used in preparing the monthly HST filings."

Submission

Board staff agrees with NPEI and submits that the Board may wish to consider establishing a deferral account to record the amounts, after July 1, 2010 and until NPEI's next cost-of-service rebasing application, that were formerly incorporated as the 8% PST on capital expenditures and expenses incurred, but which will now be eligible for an HST Input Tax Credit ("ITC"). The intention of this account would be to track the incremental change due to the introduction of the HST that incorporates an ITC from the 5% to the 13% level. To qualify for this treatment, the cost of the subject items must be in the category of distribution revenue requirement. Tracking of these amounts would continue in the deferral account until NPEI's next cost of service application is determined by the Board or until the Board provides guidance on this matter, whichever occurs first.

NPEI would apply to clear the balance in the account as a credit to customers at the next opportunity for a rate change after the account balance information becomes available and is supported by audited financial statements.

All of which is respectfully submitted