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Ontario

BY E-MAIL

February 2, 2010

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

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Board Staff Submission on Hydro 2000 Inc.
2010 Electricity Distribution Rates Application
Board File Number EB-2009-0229

Please see attached Board staff's submission for the above proceeding. Please forward the attached to Hydro 2000 Inc. and any intervenors in this proceeding.

Hydro 2000 Inc. reply to submissions is due February 23, 2010.

Yours truly,

Original Signed By

Martin Benum
Advisor, Applications and Regulatory Audit

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

Hydro 2000 Inc.

EB-2009-0229

February 2, 2010

Board Staff Submission
Hydro 2000 Inc.
2010 IRM3 Rate Application
EB-2009-0229

Introduction

Hydro 2000 Inc. (“Hydro 2000”) filed an application with the Ontario Energy Board (the “Board”), received on October 26, 2009, under section 78 of the Ontario Energy Board Act, 1998, seeking approval for changes to the distribution rates that Hydro 2000 charges for electricity distribution, to be effective May 1, 2010. The application is based on the 2010 3rd Generation Incentive Regulation Mechanism.

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 Hydro 2000.

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 Revenue to Cost Ratios;
- 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.

Hydro 2000 Specific Background

Annual Disposition

Hydro 2000 has requested the dispostion of its Group 1 account balance over a one year period. Board staff interrogatory # 6a requested that Hydro 2000 complete and submit an updated version 4 of the Deferral Variance Account Workform. Hydro 2000 has complied with this request.

Global Adjustment

In response to Board staff interrogatory # 2a, Hydro 2000 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, Hydro 2000 confirmed that it made adjustments subsequent to its initial application 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, Hydro 2000 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. Hydro 2000 however noted that timing could be an issue due to customer migration away from the non-RPP customer group and into the non-RPP customer group.

In response to Board staff interrogatories # 3b, Hydro 2000 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. Hydro 2000 however indicated there would be a challenge in keeping track of all the customers enrolling and de-enrolling with retailers, which at this point is an automated process.

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, Hydro 2000 indicated that the rate rider should not apply to RPP customers, but should include customers in the MUSH sector. Hydro 2000 further indicated the rate rider should be applied to all the customers in the MUSH sector because the majority of the MUSH sector benefited from multiple units and only paid the first Tier cost of power. All customers in the MUSH sector have been transferred from MUSH to HOEP (Hourly Ontario Energy Pricing) customers at November 1, 2009 and the rate rider will apply to all of them in subsequent years. Hydro 2000 expressed the view that that it may not be practical to implement complex billing changes that would apply to a single year.

Hydro 2000 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 global adjustment sub-account is a debit of $98,415. The balance in the 1588 global adjustment sub-account is a debit of $50. Hydro 2000 has included interest, using the Board's prescribed interest rates, on these account balances up to April 30, 2010. Debit balances are amounts recoverable from customers.

Submission

As a matter of principle, Board staff would suggest 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. This approach would be more reflective of cost causality since it was that group of customers that were undercharged by the distributor in the first place.

Hydro 2000 however reported a negligible debit balance of $50 in the global adjustment sub-account. From a practical standpoint, Board staff suggests that the Board may wish to consider to recover the allocated global adjustment sub-account balance from all customers in each class. This approach would also 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. Board staff hence agrees with Hydro 2000's proposal.

In order to reduce inter-generational inequities, Board staff submits that the disposition period for all Group 1 accounts should not exceed one year. This is also consistent with Hydro 2000's proposal.

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 RSVA power 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 RSVA power 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 Hydro 2000's RRR filings. Board staff has reviewed the balances and notes that the changes result in material differences. Board staff notes that Hydro 2000 stated in response to staff's interrogatory # 6d that Hydro 2000 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. Board staff suggests that the Board consider approving the proposed deferral and variance account balance disposition rate riders on a final basis.

Were the Board to have any concerns about these adjustments, Board staff proposes that the Board might consider declaring the rate riders interim until the revised balances can be brought forward in a future application and supported by a third party audit.

ADJUSTMENTS TO THE REVENUE TO COST RATIOS

Background

The Board's Decision (EB-2007-0704) for Hydro 2000's 2008 cost of service rate application prescribed a phase-in period to adjust revenue to cost ratios. The 2010 Supplemental Filing Module included schedules for Hydro 2000 to complete to address this matter. The process adjusts base distribution rates before the application of the price cap adjustment.

Submission

Board staff submits that Hydro 2000 has complied with the filing requirements of the 2010 Supplemental Filing Module. Board staff takes no issue with Hydro 2000's revenue to cost ratio adjustments.

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.

Hydro 2000 Specific Background

Hydro 2000 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 Hydro 2000, 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 Hydro 2000 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.

Hydro 2000 Specific Background

In response to Board staff interrogatory # 7a which asked if Hydro 2000 agrees that a deferral account should be established to capture the reductions in OM&A and capital expenditures, Hydro 2000 stated that:

> "Hydro 2000 agrees to capture in a variance account the PST for the reductions in OM&A and capital expenditures. The actual PST included in the OM&A and capital expenditures is very minimal. Hydro 2000 estimates for the PST variance is less than $2,000.00 for 2010.
>
> Hydro 2000 would recommend waiting until the next Cost of Service before taking any actions. Hydro 2000 revenues and recovery of rates rider have been impaired by the lost of load encountered by the natural gas availability since 2008. If the Board want to address all expenses in the IRM model than the Boards should have a mechanism to address the lost revenues or over revenues bases on previous year actual load versus Cost of service load estimate."

Submission

Board staff notes that many distributors' comments on the administrative burden and costs of sales tax harmonization are at odds with the provincial and Federal governments' pronouncements regarding the stimulative and competitive results of harmonization. Because the costs and savings are not clear at this point, Board staff submits that tracking of these is warranted at this point to quantify, per government pronouncements, that the potential savings for corporations like Hydro 2000 could be significant. Accordingly, Board staff submits that the Board may wish to consider establishing a deferral account to record the amounts, after July 1, 2010 and until Hydro

2000'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 Hydro 2000's next cost of service application is determined by the Board or until the Board provides guidance on this matter, whichever occurs first.

Hydro 2000 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