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Ontario

BY EMAIL

February 3, 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 PUC Distribution Inc.
2010 Electricity Distribution Rates Application
Board File Number EB-2009-0247

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

PUC Distribution Inc. reply to submissions is due February 24, 2010.

Yours truly,

Original Signed by

Martin Benum
Advisor, Applications and Regulatory Audit

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

PUC Distribution Inc.

EB-2009-0247

February 3, 2010

Board Staff Submission
PUC Distribution Inc.
2010 IRM3 Rate Application
EB-2009-0247

Introduction

PUC Distribution Inc. ("PUC") filed an application 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 PUC 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 PUC.

Board staff makes submissions on the following matters:

- Potential Tax Sharing Rate Rider;
- Disposition of Deferral and Variance Accounts as per the Electricity Distributors' Deferral and Variance Account Review Report (the "EDDVAR Report");
- Treatment of Smart Meter Funding Adder;
- 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").

POTENTIAL TAX SHARING RATE RIDER

General Background

The Supplemental Report of the Board on 3rd generation incentive regulation issued on September 17, 2008 determined that a 50/50 sharing of the impact of currently known legislated tax changes, as applied to the tax level reflected in the Board-approved base rates for a distributor, is appropriate. The calculated annual tax changes over the plan term are to be allocated to customer rate classes on the basis of the Board-approved base-year distribution revenue. These amounts will be collected from or refunded to customers each year of the plan term, over a 12-month period, through an explicit volumetric rate rider derived using annualized consumption by customer class underlying the Board-approved base rates.

PUC Specific Background

Using the Boards Supplemental Filing module PUC's Tax Sharing amount is a refund of $14,333. This amount when unitized using PUC's volumetric billing determinants results in energy-based kWh rate riders less than four decimal places and demand-based kW rate riders less than two decimal places.

Submission

Board staff notes that as a result of having kWh Tax Sharing rate adders of $(0.0000) when rounded to the fourth decimal place and kW Tax Sharing rate adders of $(0.00) when rounded to the second decimal place, the refund amount of $14,333 will not be returned to ratepayers, which defeats the intent of tax sharing process. Board staff submits that the Board may wish to consider directing PUC to record the Tax Sharing refund amount of $14,333 in the variance account 1595 for disposition in a future rate application.

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.

PUC Specific Background

Annual Disposition

PUC has requested the disposition of its Group 1 account balance. Board staff interrogatory # 5 requested that PUC complete and submit an updated version 4 of the Deferral Variance Account Workform. PUC has complied with this request.

Global Adjustment

In response to Board staff interrogatory # 1a, PUC 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 #1b, PUC confirmed that it had not 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 #5d, PUC advised:

> “PUC has complied with and applied correctly the Boards accounting policy and procedures except for one exception. Upon further review PUC discovered the carrying charges for account 1588 – Power Variance, 1584 Network Variance and 1580 Wholesale Market Variance had inadvertently been reversed for 2007 and 2008. “

In response to Board staff interrogatory #2a, PUC 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 #2b, PUC stated that it did not 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. PUC however indicated:

> "At this time PUC's billing system would not be capable of billing Non-RPP customers a separate rate rider. PUC's billing system could be modified to include a separate non-RPP rate rider but further analysis of the alternatives would need to be completed by PUC. "

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 #4d, PUC indicated that the rate rider should not apply to RPP customers, and should exclude customers in the MUSH sector who had remained on RPP until November 2009. PUC further indicated:

> "PUC proposes that this issue is generic to the industry and that a stakeholder consultation may be required to fully address this issue. PUC's billing system would require some modification to exclude customers in the MUSH sector if a separate rate rider were to apply for the disposition of the 1588- Global adjustment sub-account. PUC would need to further analyze different billing methods in the current billing system but the IR process does not provide sufficient time to fully consider the alternatives. "

PUC 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 credit of $2,138,877. The balance in the 1588 global adjustment sub-account is a debit of $595,004. PUC 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.

PUC did not address any 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. PUC has selected a 1-year disposition period in its Deferral Variance Account Workform V4.

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. Board staff however notes that PUC's current billing system would not be capable to effect such a change. 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. Board staff hence agrees with PUC'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 PUC'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 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 PUC's RRR filings. Board staff has reviewed the balances and notes that the changes do result in material differences. Board staff notes that PUC stated in response to staff's interrogatory #5d that PUC has complied with the Board's accounting policies and procedures. However PUC disclosed that accounting errors were discovered in reviewing balances and cautioned the Board that these balances were un-audited. 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.

TREATMENT OF SMART METER FUNDING ADDER

Background

PUC has a current Board-approved smart meter funding adder of $1.00 per month per metered customer. In its application, PUC is requesting an increase in its rate adder to $1.68 per month per metered customer. PUC is authorized for smart meter deployment under the amended Regulation pursuant to and in compliance with the London Hydro RFP process. In its application, PUC filed supporting documentation in accordance with section 1.4 of the Smart Meter Guideline.

PUC is not seeking approval for capital and operating costs incurred to date or in 2010 in this application, but will track actual costs, and revenues received from the funding adder, in the established deferral accounts for review and disposition in a subsequent application.

Submission

Board staff submits that PUC has complied with the policies and filing requirements of the Smart Meter Guideline. Actual smart meter expenditures will be subject to review when PUC makes application for disposition of the account balances in a subsequent proceeding. Hence, Board staff takes no issue with PUC's proposal to increase its smart meter funding adder to $1.68 per month per metered customer.

ADJUSTMENTS TO THE REVENUE TO COST RATIOS

Background

The Board's Decision (EB-2008-0208) for PUC's 2009 cost of service rate application prescribed a phase-in period to adjust revenue to cost ratios. The 2010 Supplemental Filing Module included schedules for PUC 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 PUC has complied with the filing requirements of the 2010 Supplemental Filing Module. Board staff takes no issue with PUC'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.

PUC Specific Background

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

Submission

Board staff notes that very few distributors, including PUC, 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.

Board staff has reviewed the evidence provided by the applicant and submits that the proposal by PUC may no longer be reasonable, based on the January 1, 2010 level of the UTRs. Board staff submits that PUC's proposed network service 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.

PUC Specific Background

In response to Board staff interrogatory # 4a which asked if PUC agrees that a deferral account should be established to capture the reductions in OM&A and capital expenditures, PUC stated:

> “At this time PUC would not agree to capture in a variance account the reduction in OM&A and capital expenditures as a result of PST and GST being harmonized. The harmonization of sales taxes are said to reduce a utility’s OM&A costs and capital expenditures in the long term. However, in the short term, during the IRM period a utility’s OM&A costs and capital expenditures are not likely to decrease. Prices may not go down at all. Further, growth/reduction in capital expenditures is not incorporated into rates during the IRM period unless such growth/reduction exceeds the materiality threshold limit set by the OEB. There are numerous other elements of a utilities cost (other than PST) embedded into distribution rates such as property taxes, employment insurance rates, Canada pension plan rates, etc. and increases/decreases to all

components of rates should be considered simultaneously. In addition, there would be an increased exposure to bad debts as accounts receivable increase. Addressing only the commodity tax component of rates during the IRM period amounts to “a single-issue rate adjustment” and on that basis it should be rejected.

Furthermore, establishing a variance account during the IRM period to track reductions in OM&A and capital expenditures imposes an enormous administrative burden on a utility.

PUC proposes that the issue is generic to the industry and a stakeholder consultation is required to ensure implications of this tax change are fully addressed. In the meantime, the distributors revenue requirements should be established based on the current tax regime. Due to the nature of the short IRM period (1 year), sufficient time is not available to fully consider the issue of impacts through harmonization of sales taxes in order to put forth practical alternatives to a variance account being proposed by Board staff. “

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

PUC 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