SHIBLEY RIGHTON LLP
Barristers and Solicitors

Jay Shepherd
Direct Line (416) 214-5224
Direct Fax (416) 214-5424
jay.shepherd@shibleyrighton.com

TORONTO OFFICE:
250 University Avenue, Suite 700, Toronto, Ontario, M5H 3E5
Main 416 214-5200 Toll free 1-877-214-5200
Facsimile 416 214-5400

WINDSOR OFFICE:
2510 Ouellette Avenue, Windsor, Ontario, N8X 1L4
Main 519 969-9844 Toll free 1-866-522-7988
Facsimile 519 969-8045

www.shibleyrighton.com

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**BY EMAIL and RESS**

November 13, 2009
Our File No. 2090688

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

**Attn: Kirsten Walli, Board Secretary**

Dear Ms. Walli:

**Re: EB-2009-0193 – Enersource 2010 Rates**

We are counsel for the School Energy Coalition. In accordance with the Board's Notice of Application dated July 21, 2009, this letter constitutes the SEC's written submissions with respect to the Enersource rate application. These submissions deal with only a single issue: the change in the effective date of the rate change from May 1, 2010 to January 1, 2010.

**Summary**

1. ***Fairness.*** This is an unusual application from an intervenor's point of view, since the request to change the rate year is, on its face, a request to correct an inherent unfairness in the regulatory practices applicable to electricity distributors. While electricity distributors are nominally given the opportunity to earn a fair return, in fact in a period of inflation and/or rising distribution costs, the four month lag between Test Year and rate year builds in structural underearning. All other things being equal, this should be corrected. We note that the Applicant has, in this case, taken a reasonable approach of trying to adjust for the immediate impacts, and thus is sensitive to the interests of ratepayers on this issue, which further suggests that, if there is an injustice, it should be corrected.

2. ***Return on Equity.*** The effect of the lag is that the Board-approved return on equity is, as a practical matter, reflective of a slightly lower return. On the one hand, the Board-approved return is understood by most to meet the "fair return standard". On the other hand, it must be assumed that the Board, in establishing the return for electricity distributors, determined that the current Board-approved return did in fact meet the fair return standard, after taking into account the lag. Any repeal of the built in lag would, subject to other considerations, constitute an increase in return on equity to a level above that required to meet the fair return standard.

3. ***Calculation of Real Impact.*** The immediate impact of removing the lag on rates and revenue collected is different depending on whether it is done during a COS or an IRM year. The Board has to consider whether downstream impacts in a future COS year should be considered, and if so whether the appropriate time to implement any change in the lag has to be during a COS application.

4. ***Process.*** The lag rule is one that applies to all distributors in the province. This is an application for rates from an individual utility. If the Board is to consider the request to remove the lag, it must be clear whether it is doing so because this distributor is different from other distributors, or because the rule is no longer appropriate in general. If the latter case, it is questionable whether changing the rule in an individual IRM rate case is the appropriate way of considering the policy ramifications and ensuring that all affected parties have notice and the right to be heard. It is also self-evident that a ruling in favour of the Applicant in this case would likely result in 80 more applications of this sort.

5. ***Precedent.*** The Board establishes rules applicable to all cases of a certain type, for reasons of regulatory efficiency and fairness. If the Board grants the Applicant's request in this case, it is effectively declaring open season by regulated entities on any of the Board's policies and rules that they don't like. It is only the current high onus of demonstrating the inappropriateness of a policy or rule in an individual case that acts as a barrier to many utility applications opposing the existing rules.

6. ***Consistency with Other Board Processes.*** The Board is currently considering the return on equity for electricity distributors, among others. Granting this Application would result in an increase in the ROE for this distributor and, if it is applicable to other distributors, a general increase in ROE. The Board should consider whether such a change should be done in the context of an ROE review, or through the back door in a single IRM rate application that does not directly consider the appropriate ROE.

7. ***Consistency with Other Board Processes – Idem.*** The Board has a project to review electricity rate design. Fundamental changes in rate design will have indirect impacts on revenue, risk, and ROE. The Board may wish to consider whether rate design should be dealt with before changing the timing of rate changes.

8. ***Ratepayer Impact.*** Ratepayers have been hit with quite a number of increases in distribution rates over the last few years that do not relate to increased or improved service or actual

increases in costs. To add another one at this time, especially when the GEGEA cost increases are pending, may not be the optimum timing.

9. ***Distributor Convenience/Public Markets.*** While the Applicant has suggested that removing the lag is necessary to end "complicated" explanations of their results in the public markets, the evidence does not appear to support that claim. Therefore, we do not consider this a relevant aspect of the issue. The financial markets appear to understand fully how the regulatory process works, because of the expertise of utility specialists in those markets, and none of the evidence suggests that this is a source of confusion or difficulty.

**Overall Recommendation**

10. In our submission, this Board panel should not grant the relief requested by the Applicant - i.e. a removal of the lag – unless it is satisfied that the Applicant's circumstances are fundamentally different from those of other electricity distributors. The evidence makes clear that this is not the case.

11. Instead, this Board panel should refer the issue back to the Board as a whole, with the recommendation that it be reviewed by the Board in the context of the ROE and other policy issues being considered by the Board.

12. In the alternative, if the Board elects to make a change for this distributor at this time, in our view the rate increase for 2010 should be zero, reflecting the evidence that the impact over time of the change is greater than the impact in an IRM year.

**Return on Equity**

13. It would appear to us that, in a period of rising costs (and therefore underlying revenue requirements) for distributors, it is undisputed that charging rates for a calendar year that reflect for a third of the year the lower costs of the previous year will produce a lower ROE than if the rates for the whole year are based on the costs for that year.

14. We estimate that, in an IRM year in which the allowed price cap increase is 1%, and assuming IRM is working perfectly in all other respects, the impact on ROE available to be earned is a reduction of 3 basis points. That is, if the Board-approved ROE is 8.01%, the lag results in a "real" Board-approved ROE of 7.98%.

15. Further, we estimate that, in a COS year in which rate base increases by 6%, the impact on ROE available to be earned is a reduction of 16 basis points. That is, if the Board-approved ROE is 8.01%, the lag results in a "real" Board-approved ROE of 7.85%.

16. It also appears clear to us that the impact of the lag is greater on utilities with faster growing rate base, for example because of population growth or catchup spending to renew infrastructure. Enersource is one of many LDCs that many fit in that category.

17. It is not a given that, with a Board-approved ROE of 8.01%, a “real” Board-approved ROE of 7.85% falls below the fair return standard. It is more likely, in our submission, that the 7.85% represents the fair return standard, and the 8.01% represents an amount above the fair return standard. Indeed, the financing flexibility component of the current ROE would cover this rate year lag impact multiple times.

18. Further, the Board has been applying the same approach to LDC ROE for some years, and it is not a reasonable assumption that the Board never understood the impact on ROE of the rate year lag. While we understand that many utilities have argued that the ROE for the last 5 or 10 years has not met the standard, the Board has in fact rejected that argument numerous times in that period.

19. More important, from the point of view of this Application, no evidence has been filed on which this Board panel can make a decision on the effective ROE for the Applicant in the Test Year that would meet the fair return standard. The Board has a policy in place on ROE, which applies to all LDCs despite the rate year lag that also applies to all of them. If the Applicant argues that its effective ROE will be below the fair return standard because of the regulatory lag, then it has the onus to lead evidence showing that to be the case. It has not done so. There is no evidence on the record dealing with the appropriate ROE for this Applicant in the Test Year.

20. In our submission, the essence of this Application is that the ROE for the Applicant is too low due to the rate year lag, and should be adjusted upwards. The Board is not in a position to reach that conclusion based on the current record.

**Process Issues**

21. In our view, the biggest concern with granting the relief sought in this Application is the generic nature of the issue being raised. This has two components. First, in considering the issue in this Application alone, the Board lacks proper context in which to assess the appropriate policy response. Second, the issue is fundamentally related to other issues under active consideration by the Board, and should not be determined in isolation from those issues.

22. ***Special Circumstances.*** Enersource has suggested that this is not as much a generic issue as an issue particular to their situation. They have a public issuance of bonds, and their participation in the public markets makes this rate year lag an unnecessary complication, they say.

23. The Applicant was asked about their particular problem of explaining this to the financial community in Tab I, Exhibit 6.1. As is readily apparent from the answers to that interrogatory, there is no material impact on their disclosure to the public. In fact, the MDMA excerpt included at Attachment A reads very much like an MDMA of Enbridge, which does not have a rate year lag. The only places where the May 1$^{st}$ date is referenced are

those identifying the date of a price increase. Companies have price increases all the time, and it is rare that those increases will consistently take place on the first day of a fiscal period. This Applicant is not in a different position.

24. Further, in our view the Applicant is underestimating the sophistication of the financial community when it comes to considering utility returns. If indeed there were confusion in this regard, we would expect, for example, the ratings reports on electricity distributors to make mention of the rate year lag, and specifically calculate the ROE impact of that lag. To the best of our knowledge, none of the rated utilities in Ontario have any reference in the rating reports to rate year lag. Unless the Applicant is proposing that the rating agencies have missed this point, it would appear clear that it is not a serious issue.

25. We also note that, in all of the rampant debate over the last two years about ROE, to the best of our knowledge no-one has done the simple calculation of the difference between Board-approved ROE and the effective Board-approved ROE after taking the lag into account. If this is a concern for the financial community, we would have expected to have seen the calculation in the myriads of material on ROE the Board has seen in that period.

26. The fact is that the Applicant has not provided any credible evidence that this is a source of confusion. The true problem with the rate year lag is that it makes it slightly harder for a utility to earn its Board-approved ROE in a given fiscal period. This is a legitimate problem. The confusion alleged in the financial markets is not.

27. ***Generic Process Issues.*** Once it is accepted that this is a generic issue, the Board must be concerned with the most appropriate and most efficient way of considering that issue. The Applicant has proposed that it be reviewed in the context of a single IRM application. We believe that is not appropriate, and a proper consideration of this issue can only take place in the context of a generic proceeding (whether hearing or policy process).

28. There are several reasons why it is essential that this issue be considered on a broader basis than a single IRM application, including the following:

(a) The essence of the problem is an effective ROE that is lower than the Board approved ROE. Consideration of any change in the current policy should take into account whether the existing Board approved ROE already adjusts for this impact, and whether there are other changes to ROE that affect this component. In addition, the existing ROE consultation considers related issues, and any resolution of rate year lag should be considered in conjunction with that general review of ROE policies.

(b) The impact of the rate year lag varies from LDC to LDC based on cost increases and increases in billing determinants, and it also varies as between COS and IRM periods. A revised policy should take those differences into account.

(c) Hydro One is seeking to change its rate year to January 1, 2010, in part to give lead time for all other distributors to update their Low Voltage Charges in time for a May 1, 2010. This could not be achieved if other LDCs also have rates adjusted as of January 1st.

(d) Any review by the Board of rate year lag will be impacted by fundamental changes to rate design, such as those that have recently been proposed.

(e) There are many stakeholders potentially affected by a change in rate year lag that did not have notice of this proceeding, and did not have any reasonable expectation that a change in a longstanding policy could be implemented in a single IRM application. Not only other LDCs, but also other ratepayer groups, other intervenors (such as environmental groups or utility unions), and many others could seek to have an opportunity to be heard on any proposed changes to this policy.

(f) As we note below, the interaction between the IRM rules and rate year lag has not been fully considered in this Application. Getting IRM adjustments right when a full year is not passing between rate-setting, but a full year is passing between Test Years, is a non-trivial activity and there is insufficient evidence in this proceeding to consider that fully.

(g) Even if the Board makes its decision in this Application specific to this Application, we would expect a flood of applications from other LDCs for adjustment of their rate year to match their Test Year. This is not an efficient way for the Board to deal with this.

29. For all of these reasons, in our submission it would not be good regulatory practice to consider and resolve the substance of this issue in a single IRM application.

**The Enbridge Example**

30. We note, although it is not a main part of our submissions, that the Applicant argues for an existing precedent, i.e. the change in fiscal year end for Enbridge. In our submission, this is entirely a red herring. In considering the Enbridge request, the Board did not make any determination as to whether the change in fiscal year was appropriate, because the Board concluded that decision was entirely up to the utility. The Board was only concerned with whether that change would result in any changes in rates that had to be addressed.

31. In this case, the Applicant is not changing its fiscal year end. It has an existing year end, which it is retaining, and a Board policy that its rates will be recovered over a different period than the fiscal period. What the Applicant is seeking is not Board reflection of the results of a decision within the Applicant's control, but rather a change to, or exception from, an existing Board policy with no change in underlying circumstances.

**Calculation of the Impact**

32. The Applicant has proposed (see Tab I, Ex. 5.5) that an adjustment be made for the acceleration of the rate change by reducing the PCI by a third to reflect the four months of acceleration. While this has the attraction of simplicity, in our view it fails to consider several important aspects that need to be addressed in establishing a proper adjustment.

33. The first aspect not considered is the difference in impact between COS and IRM years, based on the size of the rate adjustment being sought.

34. In Tab I, Ex. 5.1 SEC calculated the impact over multiple years, including a COS year, and asked the Applicant to confirm or dispute the calculations. The Applicant refused to review those calculations, on grounds that, in our view, are clearly extraneous. In our submission, a fair read of the response is that the Applicant's refusal could only be because the calculations are correct.

35. The calculations in I/5.1 are not evidence presented by SEC, but are mathematical calculations to demonstrate a principle. The Applicant has had an opportunity to demonstrate that the math is incorrect, and has been unable to do so. This is not surprising. The math is quite straightforward.

36. What this demonstrates is that the overall incremental rate increase arising out of the removal of rate year lag is significantly greater than the amount proposed by the Applicant, and it varies depending on the amount of the general rate adjustment sought in the Application. In our submission, the Applicant's adjustment proposal does not take this into account.

37. The second aspect of this is the treatment of the productivity factor and the stretch factor, both of which are proposed to be reduced by one third as part of the reduction in the PCI (Tab I, Ex. 5.5). This calculation is incorrect.

38. The productivity factor is based on an assumption that, over a twelve month period, a typical utility should be able to reduce costs by a given amount due to empirical cost differentials observed in past one year time intervals. No change is being proposed to the Test Year, and therefore the productivity factor should in fact be based on a twelve month period. The fact that rates are being collected earlier does not affect whether the utility, in the period January 1, 2009 to January 1, 2010, should be able to achieve a certain level of efficiencies on average.

39. The same is true of the stretch factor. Utilities are asked to generate, through good management, additional productivity gains over each twelve month period. Like the productivity factor, it is based on a one year period, from January to January, and that has not changed.

40. Without taking this matters into consideration, in our view the adjustment will be incorrect.

41. The third aspect is the effect of increasing load, which provides further additional revenue to the Applicant over time that is not reflected in their impact analyses. We asked the Applicant to provide a model setting out how increasing load will affect their revenues (Tab I, Ex. 5.2), but they declined to do so. In our submission this impact must be addressed if the adjustment is to be correct.

42. There are numerous other aspects of this calculation that need to be addressed if the adjustment is to be right, including:

    (a) It is not clear why the GDP figure should be a twelve month figure, rather than the nine month actual figure, or indeed some other figure.

    (b) The stretch factor is calculated based on a comparison between utilities, which will not be available in time for a January 1, 2010 rate adjustment.

    (c) The Shared Savings Tax Rider is not designed to be recovered in this manner, and has to be adjusted to accommodate the revised rate year timing. It is not clear that the approach proposed by the Applicant is a suitable resolution.

    (d) The Applicant's adjustment is dependent upon the assumption that billing determinants for each class are constant for all months of the year. This is clearly not the case, yet the adjustment does not take monthly revenue differentials into account. If the billing determinants of the utility for the months of January through April exceed for any class one third of the annual total for that class, the additional revenue to the utility has been understated, and the proposed adjustment is less than it should be.

43. We are not suggesting that the Applicant failed to include considerations they knew should have been included. Rather, it is our submission that the issue is simply more complex than the simple resolution proposed by the Applicant, and the Board should have evidence and analysis of those complexities before accepting the proposed adjustment as if it fairly compensates for the removal of the rate year lag.

**<u>Conclusion</u>**

44. Based on the analysis above, we conclude that this Application does not demonstrate that the Applicant has special circumstances sufficient to warrant an exception to the Board's longstanding policy on rate year lag for electricity distributors, and therefore on the grounds proposed by the Applicant, this Application for an exception should be denied.

45. However, there is a general issue implicit in the Applicant's concerns, i.e. the underlying difference between Board-approved ROE and effective Board-approved ROE after taking into account the rate year lag. That is a real issue, and one on which the Applicant may have a legitimate case. On this more general issue proper evidence has not been led, and proper notice and discussion has not taken place, so the Board is not in a position to grant the relief sought in this Application on generic grounds either.

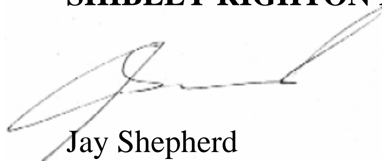
46. Instead, in our submission this Board panel should recommend to the Board as a whole that the issue of rate year lag be considered in a generic process, so that all aspects can be dealt with and due consideration can be given to related policy issues.

47. In the alternative, if the Board does decide to grant the relief sought, in our submission the amount of the adjustment proposed by the Applicant, one-third of the PCI, is too small. For the reasons set forth above, we believe that it should be substantially greater, and in all the circumstances a zero rate increase would more closely approximate the fair adjustment that would be calculated if evidence had been led and reviewed on all the components of the calculation.

48. The School Energy Coalition submits that it has participated responsibly in this proceeding with a view to assisting the Board, and requests that the Board order payment of 100% of its reasonably incurred costs for that participation.

All of which is respectfully submitted.

Yours very truly,
**SHIBLEY RIGHTON LLP**



Jay Shepherd

cc: Wayne McNally, SEC (email)
Bob Williams, SEC (email)
Interested parties (email)