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BY EMAIL and RESS

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Our File No. 2090913

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2009-0423 – Years Ends of Electricity Distributors

We are counsel for the School Energy Coalition. On January 21, 2010 the Board issued a letter (the "Proposal") asking for input from stakeholders on a proposal to align the rate years of electricity distributors with their test years. The effect would be that rates would be collected over the same period as the costs and revenues on which the rates are based.

These are the submissions of the School Energy Coalition on the Proposal. We start below with a general analysis of the issues, and then answer the seven questions posed by the Board in the Proposal.

On November 13, 2009 we provided detailed submissions in EB-2009-0193, the Enersource 2010 IRM rate case, on many of the same issues raised by the Proposal. Rather than duplicate those submissions, we have attached them to this letter as supplementary submissions. Where our views have evolved since that time, we note the changes in our positions in the main body of these submissions, below.

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General Submissions

School Energy Coalition has been of the view for some time that the current four month lag between test year and rate year (i.e. rate recovery period) is, or can be, unfair to distributors. Although conceptually one can understand that the utility is given the ability to collect revenues to cover all costs and return, and the time shift is a minor one, in fact the utility's public financial results will always, in a period of rising costs, be depressed by that shift. We have estimated in the Enersource case that the time shift reduces true ROE by 3 basis points in an IRM year, and 16 basis points in a COS year (assuming a 6% rate increase). With the new, much higher levels of ROE, those impacts would be higher, probably closer to 3 basis points and 21 basis points for IRM and COS years respectively.

Further, on a practical level the time shift plays havoc with budgeting. We already saw, in the Sudbury 2009 COS rate case (EB-2008-0230) evidence of management having to seek approval from their Board of Directors for a different budget than the one in their application to the Board. While that is not really appropriate behaviour in the regulatory context (i.e. the regulatory budget should be what the utility actually expects to spend in the test year), it is understandable given the time shift. A responsible Board of Directors would be more willing, in our view, to approve a budget for actual spending in a period based on the actual revenues expected during that period, not the notional revenues based on a regulatory construct. For an LDC in Ontario, the actual revenues in their statutory fiscal period are comprised of four months at last year's rates, and eight months at new rates. It is not surprising that a Board of Directors, and management reporting to them, would treat that actual revenue stream as the money available to be spent in the calendar year, and budget accordingly.

The problem with that, of course, is that the actual budget would then have to be lower than the budget presented to this Board. But, the Board requires that applicants seek approval for a calendar year budget, and saying you will spend $X in the calendar year to the Board when you know you will only spend $X-$Y in that same calendar year is concerning, to say the least. If the system essentially requires distributors to do that, it is flawed.

Another practical issue has been raised with respect to LDCs that access the public financial markets. For those distributors, it is suggested that the mismatch between test year and rate year confuses the markets and creates complications. We have seen no evidence of that, and believe that in fact the capital markets understand and adjust for the time shift.

Given that, in our view, the time shift is unfair to the distributors, there appear to us to be the following substantive questions raised:

1. ***Return on Equity.*** Does the Board's existing ROE formula, when it is applied to electricity distributors, already account for the ROE impact of the time shift? That is, is it the net actual ROE allowed, after taking the time shift into account, that has met and continues to meet the "fair return standard"? Or, is it the nominal ROE, 8.01% last year, and 9.75% or more this year, that meets the "fair return standard"? This involves determining whether the Board implicitly or explicitly took misalignment into account in setting the LDC ROE, or whether the formula has sufficient adders (for example, the 50 basis points added at the end) that they already compensate for the time shift.

On this point, there does not appear to be any direct evidence. We have reviewed past consultations and decisions with respect to ROE, and this matter does not appear to have been discussed directly. Therefore, in our view the assessment comes down to two indirect sources of analysis. First, the Board has known that there was a time shift, and believed that it was allowing a fair return despite the misalignment. This suggests that the actual net ROE meets the fair return standard. Second, the Board generally applies the same ROE to other utilities, such as the gas distributors, that do not have a time shift issue. This suggests that it is the nominal allowed ROE that meets the fair return.

On balance, we believe that the current allowed ROE already takes the time shift into account. Therefore, if a utility seeks to align test year and rate year, it should have its ROE adjusted downward. The fair reduction, in our submission, is the average of the COS and IRM impacts, or a net of 12 basis points reduction.

We therefore propose that the Board establish a reduction of 12 basis points in ROE for a distributor that opts to align its test year and rate year.

2. ***Transitional Year Adjustment.*** Enersource proposed, in their application, a reduction in their rate increase for the transitional year to insulate ratepayers from the impact of the change. We note that the adjustment, as proposed by Enersource, would only carry over until there is a COS application, when the artificial rate reduction would be adjusted back upward as rates are set on the basis of costs for an aligned test year.

   However, in our view of the situation a transitional year adjustment is not required in any case. Either the current system already adjusts for this time shift in the ROE, or it does not. If it does, then the correct response to removing the time shift is to fix the ROE, as we have proposed above. If the current system does not account for the time shift, then requiring a distributor to take a lower rate increase in the transitional year simply continues the existing unfairness until their next COS year.

   On this point, our views have changed from those set out in our attached Enersource submissions. We see this component of the issue as simpler today. If the ROE today is fair, then it will be too high after alignment of years. An adjustment to ROE is required. If the ROE today is too low due to the mismatch, then fixing the mismatch gets the ROE right. No further adjustment, to ROE or anything else, is required.

3. ***Practical Issues.*** The current regulatory calendar for electricity distributors is driven to a large extent by the COS timing. In order to have rates in place by May 1st, the Board has to issue a decision no later than March. By working backward, and considering the numbers of LDCs that will be applying in any given year for COS rates, it becomes clear that the target for filing a COS application needs to be in August. This includes one or two weeks of "dead time" due to the Christmas break.

   If the rates are to be in place by January 1st, this would imply a process that starts at least four months earlier, i.e. COS applications filed in late April. However, this does not account for the inevitable time dilation that takes place during the summer, when utility, intervenor, and Board personnel are on vacation. This is more than the one or two weeks slippage at Christmas. We would therefore assume that, for rates to be in place January 1st, a utility would need to file a COS application no later than March 31st with a complete and straightforward application, one that includes nothing so unusual or controversial that it will require additional time.

The difficulty with this process is that utilities would then have to file their budgets for the test year at a time when they have little or no actual information for the bridge year. This is not unheard-of. Gas distributors for years did applications of this type, updating their bridge year information during the proceeding with (typically) “6+6”, or in some cases even “8+4”, bridge year data. Parties managed to handle this changing data, although it is true that in those cases we were dealing with utilities that had extensive experience with the regulatory process, and lots of regulatory resources in-house. This may be more difficult with electricity distributors who are still fairly new to the regulatory process. It also may be a challenge for their Boards of Directors, who would have to approve capital and operating budgets about a year in advance.

This year – 2010 - may be particularly problematic. Not only will the practical filing deadline come up quite soon, making it unlikely that most utilities will be able to file by March 31st this year. As well, one collateral impact of the Cost of Capital Report may be that 40 or more utilities will file for 2011 rates on a COS basis. The combination of up to double the normal number of applications, coupled with a significant acceleration of the deadlines (on short notice), may make meeting the January 1st date for new rates impossible for many of this year’s applicants.

We see two possible solutions to this.

First, if the Board accepts our submissions on ROE adjustment, above, then those who seek the alignment will also have a slightly lower ROE. Some will elect not to pursue the alignment in those circumstances, which would alleviate the pressure on the regulatory calendar.

Second, if some applications are late this year relative to the new, earlier deadlines, the Board could as a matter of policy decide that their new rates would not recover the incremental revenues for the period from January 1st until the new rates are actually in place. For example, if a utility files in June, and as a result new rates are March 1st, those new rates would be based on a calendar test year, and a calendar rate year. However, the revenue shortfall in January and February would not be recovered. For many utilities, this would still be an improvement on the current situation, and it is temporary, since for every subsequent year rates and test are calendar.

However, we also note that, if the Board accepts our view with respect to timing of any change, then 2011 COS applications filed in 2010 can use the existing schedule. See our comments on this point, below.

4. ***COS vs. IRM.*** In our view, utilities should be required to apply if they want a change to align test and rate year. This will allow those for whom it doesn't matter to stay with the mismatch, thus spreading the regulatory calendar out just a bit.

   It was our original view that this kind of change should take place only in a COS year, since it is only in COS that there is actually a test year on which costs and rates are analyzed. Part of that view was rooted in the likelihood that the ratepayer impact would be higher in a COS year. If the ratepayer impact is to be adjusted through an initial rate reduction, as Enersource originally proposed, then from the point of view of ratepayers it is preferable to have the change as part of COS, when the adjustment is a full adjustment (compared to the understated adjustment in an IRM year).

   We have changed that view, now considering that the adjustment is one of ROE, not rates by themselves. If that is the case, the same adjustment should apply to all distributors whose years are aligned, and it is a permanent one. If that is true, then the question of timing is one of ratepayer impact. Implementing alignment in a COS year accelerates a bigger increase than in an IRM year.

   Our conclusion is as follows. Any electricity distributor should be allowed to apply for alignment of test year and rate year, and that application should be in a COS application. However, it should only be implemented in the next IRM year after that COS application. In a typical case, this would mean that a COS application for 2011 rates can be filed in August 2010, with rates effective May 1, 2011. That application would use the calendar 2011 test year, and the rate year with the four month delay, just as it does today. If that application also seeks alignment, there would be one further change. The applicant's IRM application for 2012 would be for rates effective January 1, 2012. In effect, the 2011 COS rates would be in effect for only eight months, before being increased again (on a full year basis) as part of IRM.

   We note that this would also solve the practical problem of the many COS applications in 2010 for 2011 rates, and would reduce the impact on ratepayers at the time that the alignment occurs. An additional benefit is that the impact of alignment would not be piled on top of the many other electricity bill increases already expected to happen in 2010 and 2011.

The Board's Questions

In light of the above, we answer the Board's seven questions as follows:

1. ***Benefits.*** As noted above, the benefits of alignment are:

   a) Rectification of an anomaly in the ratesetting process that is unfair to utilities; and

   b) Simplifying and aligning the budgetary process for utilities.

2. ***Ratepayer Impacts.*** The number of annual bill changes for an electricity customer are not generally a problem. The fact that gas bills change four times a year means that

three times for electricity would be fine. Changing the RPP to a quarterly adjustment on a calendar year basis, as with gas, would assist in this, resulting in electricity bill changes at the same times of the year as gas bill changes.

The primary ratepayer impact is an accelerated increase in rates, which is essentially permanent because it happens in every subsequent year. As we note in the attached material, that impact depends on the size of the rate increase, but over the long term is substantial.

As we also discuss above, the primary impact on ratepayers is that rates implicitly would include a higher ROE than is currently the case. This is a problem that must be dealt with before alignment can be done fairly.

3. ***Automatic or by Application?*** Alignment should only be on application, primarily because some distributors will not wish to incur the costs associated with this change (for example, a slightly reduced ROE). In our view, the application should be made in a COS application, but the actual alignment of rates should take place in the immediately following IRM year, to reduce the immediate impact of the change on ratepayers.

   Some comparisons between distributors may be less straightforward for a short period while alignment is taking place, perhaps a couple of years. Those problems do not seem to us to be serious ones, and once most distributors are again on the same regulatory timing, they would largely disappear.

4. ***Transition under Cost of Service.*** The change to rates being collected over the same period as the test year is not complicated, since the Board already has experience with rates on this basis for gas distributors. The main adjustments, aside from ratepayer impacts, will be in the budgeting and approval process internally at LDCs. Particularly difficult will be the preparation of budgets a year in advance, without data on the intervening year.

5. ***Transition under IRM.*** The impacts are much less in an IRM year, because the rate increase is typically lower, and because there is in fact no "test year" for which costs have to be reviewed. Sooner or later, the same budgeting issues will arise for every utility, but by implementing the change in an IRM year the transition may be easier to digest for both ratepayers and utilities.

6. ***Filing Requirements.*** As noted in earlier questions and in our general analysis, the COS process is different if it has to be completed by the end of the bridge year. At the time the application is filed, there is historical year data, including audited financials, but essentially no actuals for the bridge year (hence the name). Typically this means that updates including some actuals for the bridge year (a "6+6", probably) will be required during the process. This is not a problem for the Board or most experienced parties, who have dealt with this in the context of gas, but for the electricity distributors it may take some getting used to.

7. ***Other Issues.*** We have noted above practical issues with respect to the Board's regulatory calendar, and the particular problem of 2010, but we have also suggested some solutions to those issues.

Conclusion

We appreciate the opportunity to provide our input into this issue. We believe that it should be addressed by the Board, and if it is brought in using a "gentle" approach, as we have suggested above, the misalignment can be rectified for the benefit of the distributors, while still limiting the immediate impacts on ratepayers. The latter is particularly important given the many other rate increases (Cost of Capital, HST, GEGEA, etc.) ratepayers will be facing in 2010 and 2011.

We believe that we have participated responsibly in this process with a view to assisting the Board in an efficient and constructive manner. We therefore ask that the Board order payment of our reasonably incurred costs of our participation.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.

Jay Shepherd

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