ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

Essex Powerlines Corporation

EB-2009-0143

March 5, 2010

INTRODUCTION

Essex Powerlines Corporation ("Essex" or the "Applicant") is a licensed electricity distributor serving approximately 28,000 customers in the Amherstburg, LaSalle, Leamington and Tecumseh service areas located in southwestern Ontario. Essex filed its 2010 rebasing application (the "Application") on September 28, 2009. Essex requested approval of its proposed distribution rates and other charges effective May 1, 2010. The Application was based on a future test year cost of service methodology.

The Town of Amherstburg, Town of LaSalle, Municipality of Leamington, and Town of Tecumesh ("Representatives of the Streetlight Class"), the Vulnerable Energy Consumers' Coalition ("VECC"), the School Energy Coalition ("SEC"), and Energy Probe Research Foundation ("Energy Probe") were granted intervenor status. Two letters of comment were received.[1] The embedded distributor, Hydro One Networks Inc., was served Notice and a copy of the Application but did not participate in the proceeding.

Pursuant to Procedural Order No. 2, a Settlement Conference was convened on February 3, 2010. A partial but comprehensive settlement was reached between Essex and VECC, SEC and Energy Probe. The Representatives of the Streetlight Class did not participate in the Settlement Conference. This submission addresses the unsettled issues.

This submission reflects observations and concerns which arise from Board staff's review of the pre-filed evidence and interrogatory responses made by Essex with respect to the unsettled issues, and are intended to assist the Board in evaluating Essex's application and in setting just and reasonable rates.

OPERATIONS, MAINTENANCE AND ADMINISTRATION ("OM&A")

Background

In its original application[2], Essex requested an increase in OM&A costs of 13.8% from Essex's 2008 actuals. The proposed increase in 2010 is mainly driven by the replacement of the Operating Manager, a new position of Regulatory Manager and two

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[1] Response to Board staff Supplemental IR # 39.
[2] Exhibit 4/ Tab 1/ Schedule 1/ Page 1

additional non-union employees (Distribution Engineer and Special Customer Accounts Manager both dealing with FIT applications). In response to an Energy Probe interrogatory[3], Essex indicated that $108,000 of the increase in 2010 is attributed to the hiring of a Regulatory Manager. The inclusion of this cost in the 2010 Test Year was not settled by the Parties.

Board staff notes that effectively, Essex has included three new positions in this application. Although Board staff does not question the need of the Regulatory Manager position per se, staff does question the need for funding of three new positions in total. Given the fact that the parties settled on accepting two new positions of Distribution Engineer and Special Customer Accounts Manager, the Board may wish to consider that Essex could fund the third new position within the existing OM&A envelope for 2010.

Payments in Lieu of Taxes ("PILs")

Background

In its original application, Essex is requesting a PILs allowance of $730,483, composed of $710,078 for Income taxes and $20,405 for capital taxes.[4]

In response to interrogatories, Essex has made corrections to its PILs estimate for the following:

- the Combined 2010 tax rate[5];
- the Ontario Capital Tax by using the full $15 million exemption[6]; and
- the Capital Cost Allowance (CCA) classification.[7]

Discussion and Submission

Board staff notes that in Exhibit 4/ Tab 8/ Schedule 2/ Attachment 2, Essex provided its 2008 filed federal Tax Return and Ontario Tax Return. Schedule 23 of the Federal Tax return "allocating the business limit", indicates that management chose to allocate the full

[3] Response to EP interrogatory # 26
[4] Exhibit 4/ Tab 8/ Schedule 3/ Attachment 1, page 16.
[5] Responses to VECC IR # 20, Energy Probe IR # 39.
[6] Responses to Energy Probe IR # 38.
[7] Responses to Energy Probe IR # 41, 42.

business limit of $400,000 to Essex Power Services Corporation; and allocated zero to the regulated distributor, Essex. Based on the standalone principle, the regulated utility should be allocated 100% of the business limit. If the full $400,000 business limit was allocated to Essex, Box 410 on page 4 of the Federal Tax return would also reflect this $400,000 amount. This would allow the $400,000 to appear in the small business credit calculation (line 55 on page 4) in the Ontario Tax Return. Consequently it appears to staff that Essex is eligible for the small business credit, but management has chosen to provide the deduction to another company in the corporate group. The business limit for 2010 is $500,000. Essex may wish to comment on its allocation methodology used to calculate regulatory PILs in this application.

Board staff notes that other changes to Essex's revenue requirement are possible, due to the Board's decision on Essex's rate base, capital and operating expenditures. These changes also have a flow-through effect on the PILs allowance which should be recoverable in rates. Board staff submits that Essex should flow through applicable changes in operating and capital costs, and update the PILs allowance to determine the revenue requirement and rates resulting from the Board's Decision in its draft Rate Order filing.

Working Capital Allowance ("WCA")

Per the Partial Settlement Agreement no parties took issue with Essex's use of the 15% WCA formula for use in the current Application. Similarly, Board staff takes no issue with Essex's methodology for calculating the WCA in this Application. However, Board staff submits that Essex should update the WCA in determining the revenue requirement and associated distribution rates in preparing its draft Rate Order, to reflect any changes in controllable expenses as determined by the Board in its Decision, as well as to reflect the final load forecast and most current estimate of the RPP commodity price of $0.06215/kWh, from the Board RPP Report of October 15, 2009, as well as updates to reflect current uniform and retail transmission prices. Further, Board staff submits that Essex should provide sufficient detail and discussion to aid other parties in understanding the numbers provided and their derivation.

Essex has used the standard WCA derivation as 15% of the sum of the Cost of Power and controllable expenses. This methodology was inherited from the regulation of the electricity distribution sector by Ontario Hydro prior to restructuring and was documented in the 2000 Electricity Distribution Rate Handbook. The Board has generally accepted this approach for setting electricity distribution rates to date, although certain larger distributors have conducted lead-lag studies to provide alternative working capital requirements.

Board staff submits that it would be both timely and appropriate for Essex to support its WCA proposal at its next rebasing application with a lead-lag study considering the changes that will arise related to the conversion to TOU pricing. The Board has required larger distributors like Hydro One Networks Inc. and Toronto Hydro-Electric Systems Limited to undertake lead-lag studies in recent applications, and updated studies have resulted in reduced working capital requirements. Other distributors, like London Hydro Inc.[8], have been directed to conduct and file lead-lag studies for their next cost of service rebasing applications, while other distributors such as Kitchener-Wilmot, have agreed to conduct a study of their own for their next rebasing application.

Board staff is intending to conduct a generic Lead-lag study and issue the results by March 2012. In staff's view, the applicant has the option of either adopting the results flowing from Board staff's study or to perform its own study. In either case, Board staff submits that an updated lead-lag study should support Essex' next cost of service filing.

Cost of Capital

Background

The Board has revised and documented its approach to determine the cost of capital in the Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (the "Board Report"), issued December 11, 2009, under Board File No. EB-2009-0084. The Board Report is a guideline, but departures from the methodology in the Board Report are expected to be adequately supported. While the Board Report was issued subsequent to this Application, it states that the revised guidelines apply to applications for rates effective in 2010 or later and determined through a review of Cost of Service applications. Thus the Board Report supersedes the guidelines documented in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* issued December 20, 2006, and is applicable to Essex's application.

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[8] Decision with Reasons, Board File No. EB-2008-0235, August 21, 2009, page. 33-34.

In Exhibit 5 of its Application and response to Board staff interrogatories # 19, 21 & 50, Essex has proposed its test year Cost of Capital. This is summarized in the following table.

Table 1

Cost of Capital Parameter	**Essex's Proposal**
Capital Structure	60.0% debt (composed of 56.0% long-term debt and 4.0% short-term debt) and 40.0% equity
Short-Term Debt	1.33%
Long-Term Debt	5.56%, reflecting the new fixed term load agreement with TD Bank.
Return on Equity (ROE)	8.01%
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	6.37% as proposed, but subject to change as the short-term and long-term debt rates and ROE are updated per the Board Report at the time of the Board's Decision.

Discussion and Submission

Board staff submits that Essex's proposals for Cost of Capital, as amended through the interrogatory process, comply with the guidelines documented in the Board Report. Board staff also submits that the cost of capital parameters are to be updated in accordance with the Board's Cost of Capital guidelines based on data available at the time of the Board's decision.

REVENUE OFFSET

Background

Revenue offsets decrease the need for revenue from distribution rates. Essex provided a breakdown of its revenue offsets in Exhibit 3 / Tab 3/ Schedule 4/ Attachment 1, page 1 – Test Year Revenue Offsets. Essex is forecasting $679,883 in revenue offsets for 2010. In response to a VECC interrogatory[9], Essex made a correction by excluding the transformer allowance from the revenue offsets. The revenue offsets is adjusted to $601, 073.

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[9] Response to VECC interrogatory # 13

In response to an interrogatory posed by Energy Probe[10], Essex explained that the exclusion of account 4375 (Revenue from Non-utility operations) and account 4380 (Expenses of Non-utility operations) from the revenue offset is consistent with the Board's 2006 Electricity Distribution Rate model. Essex indicated that sheet 5-5 of the model did not include these accounts in the revenue offsets calculation.

In Exhibit 3/ Tab 3/ Schedule 1/ Attachment 2/ Page 1, Essex provided the revenue and expense account breakdowns for accounts 4375 and 4380 respectively. This is summarized in the following table.

Table 2

	2008 Actual	2009 Bridge year	2010 Test year
Account 4375	$1,899,074	$1,710,296	$1,787,240
Account 4380	($1,690,436)	($1,610,296)	($1,646,256)[11]
Net amount	$208,638	$100,000	$140,984

In response to VECC interrogatory #13 c) and Energy Probe interrogatory #68, Essex stated that there was a reduction of the net amount of approximately $100,000 for 2009 and 2010 to reflect the potential loss of the revenue generated from the billing service provided to the towns. Staff notes that this reduction is reflected in the net amount totals in the above table. Currently there is no contract between Essex and the towns for the billing service.

Discussion and Submission

In regards to the quantum of account 4375 and specifically the reduction of the net amount to reflect the potential loss of the billing service provided to the towns, the evidence indicates that Essex is anticipating the loss of this business, though currently Essex has not received confirmation from the towns to terminate the billing service. Given this uncertainty, and assuming the Board orders that the net impact of these two accounts be treated as a revenue offset, the Board may wish to consider allowing 50% of the revenues and costs associated with the billing service provided to the towns in the revenue offset calculation.

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[10] Response to EP interrogatory # 20 (a)
[11] Corrected as per response to EP IR #19 (b)

Should the Board accept this approach, staff notes that the net amount for the test year arising from non-utility operations that will offset the revenue requirement will increase to $191,000.

In terms of the treatment of account 4375 and account 4380, Board staff submits that Essex's approach of not treating these accounts as revenue offsets is inconsistent with the *2006 Electricity Distribution Rate Handbook* (Rate Handbook). Schedule 8-2 of the Rate Handbook details the "Revenues from Sources Other Than Board-Approved Rates and Charges". Row 4 of the schedule showed Account 4305 – 4398 recorded under Other Income / Deductions. This is one of the components used to offset the service revenue requirement as indicated in Schedule 8-1.

Board staff acknowledges that the 2006 Handbook and model are inconsistent for some situations with respect to the so-called "non-utility" revenues and expenses. The Handbook at Schedule 8-2 includes in the Revenue Offset all accounts 4305-4398, and does not make an exception for 4375 or 4380. Staff submits that this is the correct approach. Staff also notes however, that the computer model distributed by the Board in 2006 included the assumption at its initial stage that these two accounts did not record transactions of the regulated utility. In other words, the model assumed that any amounts being recorded in accounts 4375 and 4380 pertained to a non-regulated business that was not yet being recorded as a separate affiliate. The effect of this assumption is that accounts 4375 and 4380 were removed from any consideration in the later calculations, i.e. the calculation of the revenue offset. Staff submits that the computer model was incorrect for any distributor using these two accounts to record transactions pertaining to the regulated utility.

Deferral and Variance Accounts

Account 1588 – Global Adjustment sub-account

As noted in the partial Settlement Agreement, the parties have agreed to Essex's proposal to dispose of the December 31, 2008 balances in the deferral accounts together with carrying charges calculated to April 30, 2010, over four years. The Agreement allowed Board staff to make a submission on the appropriate disposition of the balance in the RSVA Account 1588 – Global Adjustment sub-account.

In response to Board staff supplemental IR # 47, the Global Adjustment sub-account contains a credit balance of $312,106, including interest to April 30, 2010 and the total deferral and variance accounts excluding the Global Adjustment sub-account contains a credit balance of $1,556,171.

Discussion and Submission

Board staff notes that the Board must decide whether the disposition of the balance of the Global Adjustment sub-account of Account 1588 should be subject to a separate rate rider, or, as proposed by Essex, be included in the single rate rider per class applicable to all customers in that class. Refunding the Global Adjustment sub-account balance solely to non-RPP customers more appropriately allocates over-collection from those customers that were overcharged in the first place. Board staff takes no issue with Essex's responses on the applicability and practicality of including MUSH sector customers from any specific Global Adjustment sub-account rate rider. However, Board staff requests that Essex, in its reply submission, confirm whether its billing system can implement a rate rider applicable solely to non-RPP customers, for collecting or refunding the balance of the Account 1588 Global Adjustment sub-account, as calculated in response to Board staff supplementary IR # 47. If the billing system cannot implement a separate rate rider, Essex may wish to explain why, and what actions need to be taken to upgrade the billing system in order to charge a separate rate rider.

If Essex's concerns are about the ability to implement a separate rate rider specific to non-RPP customers in a class with its existing billing system, one possible approach would be to defer disposition of the Account 1588 Global Adjustment sub-account for Essex for the purpose of setting 2010 distribution rates. In its next application for rates (2011, under 3rd Generation IRM), Essex could apply for disposition of the account balance. Presumably at that time, the upgraded billing system will be in place, and Essex could ensure that the upgraded billing system has the capability to handle several rate riders and also be able to handle sub-classes of customers such as non-RPP customers within each class. Board staff submits that Essex should address the practicality of this approach in its reply submission.

- All of which is respectfully submitted -