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Ontario

BY EMAIL

March 15, 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 Kenora Hydro Electric Corporation Ltd.
2010 Electricity Distribution Rates Application
Board File Number EB-2009-0200

Please see attached Board staff's submission for the above proceeding. Please forward the attached to Kenora Hydro Electric Corporation Ltd. and any intervenors in this proceeding.

Kenora Hydro Electric Corporation Ltd.'s reply to submissions is due April 6, 2010.

Yours truly,

Original Signed By

Martin Benum
Advisor, Applications and Regulatory Audit

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

Kenora Hydro Electric Corporation Ltd.

EB-2009-0200

March 15, 2010

Board Staff Submission
Kenora Hydro Electric Corporation Ltd.
2010 IRM2 Rate Application
EB-2009-0200

Introduction

Kenora Hydro Electric Corporation Ltd. ("Kenora Hydro") filed an application with the Ontario Energy Board (the "Board"), received on November 26, 2009, under section 78 of the Ontario Energy Board Act, 1998, seeking approval for changes to the distribution rates that Kenora Hydro charges for electricity distribution, to be effective May 1, 2010. The application is based on the 2010 2nd 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 Kenora Hydro.

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 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.

Kenora Hydro Specific Background

Annual Disposition

In response to Board staff interrogatory #1a, Kenora Hydro indicated that the preset disposition threshold was exceeded for its Group 1 account balance. This was based on "an informal calculation of the impact of the disposition of the "Group One" RSVA accounts as at December 31, 2008. The RSVA balances as Dec31, 2008 of $(315,432) plus estimated carrying charges to Dec 31, 2009 of $(184,988) for a total disposal of $(500,420) were tested in the rate model. A claim per kWh of (.004532) /kWh resulted."

In response to Board staff interrogatory #1e Kenora Hydro indicated that "unless directed by the OEB, Kenora Hydro does not wish to apply for the disposition of the balances at this time."

In response to Board staff interrogatory #1i, Kenora Hydro noted that:

"Rate stability has been indicated as a desired outcome of any rate filing. Kenora Hydro is in the process of developing the Cost of Service application for new rates effective May 1, 2011. Kenora Hydro has undergone a significant re-design and refurbishment of our aged substation over the past 3 years. This has resulted in unprecedented capital expenditures for this small utility. It is anticipated that through the 2010 Cost of Capital rate model, the revenue requirement will result in a rate increase significant enough to warrant rate mitigation, limited to a 10% customer rate increase year one, with an additional, likely similar rate increase in the following year.

In addition to the extensive capital expenditures incurred over the past few years, the smart meter program has also resulted in significant expenditures to date, increasing the total variance accounts to a point that the net amount payable to customers that has accrued in the RSVA accounts is completely offset (and has now moved the variances to a recoverable position) by the smart meter outlays. With the potential recovery of the smart meter expenditures, it would not be logical to reduce rates for May 1, 2010, then to have customers face potentially significant rate increases in the near term to recover the outlays for the substantial capital expenditures that have occurred in the past few years, as well as face an additional increase in rates due to the recovery of actual smart meter outlays. The benefit that each customer will receive from a disposition of the RSVA accounts in the May 2010 will cause confusion among customers, as new rates will take effect in the spring of 2011 based on the updated actual revenue requirement.

Therefore, it is the position of management of Kenora Hydro that a rate decrease, no matter how slight, in May 2010 will create customer confusion, and will not promote rate stability in our small customer base. It is recommended in this rate model that there be no disposal of the RSVA balances for May 1, 2010."

Submission

Board staff submits that the Board might consider ordering Kenora Hydro to dispose of its December 31, 2008 Group 1 account balances. Were the Board to elect to do so, Board staff suggests that the Board bifurcate this issue such that distribution rates could be implemented effective May 1, 2010. Alternatively, Board staff suggests that the Board may wish to defer to 2011 the disposition of Kenora Hydro's Group 1 account balances on the ground that the distributor provided adequate justification of why any account balance in excess of the threshold should not be cleared.

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 charges 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.

Kenora Hydro Specific Background

Kenora Hydro has applied for an adjustment to its RTSR rates that is based on a comparison of RTS revenue under existing rates and adjusted wholesale transmission costs. Kenora Hydro is requesting an increase of 10% for its Network Service Rate. Kenora Hydro does not incur or charge Line and Transformation Connection Service charges. In Board staff's view, Kenora Hydro has provided a reasonable analysis and explanation as part of its original application

Submission

Board staff has reviewed the evidence provided by the applicant and submits that the proposal by Kenora Hydro may no longer be reasonable, based on the January 1, 2010 level of the UTRs. Board staff asks Kenora Hydro to clarify if it wishes to continue with the as filed calculated RTSR adjustments, submit a revised calculation or reflect the January 1, 2010 UTR adjustments.

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.

Kenora Hydro Specific Background

In response to Board staff interrogatory # 4a which asked if Kenora Hydro agrees that a deferral account should be established to capture the reductions in OM&A and capital expenditures, Kenora Hydro stated that “on direction of the OEB, Kenora Hydro would establish a variance account to capture identifiable OM&A reductions.”

Submission

Board staff submits that the Board may wish to consider establishing a deferral account to record the amounts, after July 1, 2010 and until Kenora Hydro'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 Kenora Hydro's next cost of service application is determined by the Board or until the Board provides guidance on this matter, whichever occurs first.

Kenora Hydro 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