



EB-2010-0159

IN THE MATTER OF the *Ontario Energy Board Act 1998*,
S.O.1998, c.15, (Schedule B);

AND IN THE MATTER OF an Application by Canadian
Niagara Power Inc., requesting approval to establish a
deferral account to record certain preliminary costs.

BEFORE: Ken Quesnelle
Presiding Member

Paula Conboy
Member

DECISION WITH REASONS

August 18, 2010

THE APPLICATION

Canadian Niagara Power Inc. (the “Applicant” or “CNPI”) filed an application with the Ontario Energy Board, (the “Board”) dated April 9, 2010 requesting Board approval to establish a deferral account. The purpose of the account would be to record costs associated with the preliminary work and the making of an application by CNPI for leave to construct certain transmission facilities with the intent to seek disposition of the account balance through a prudence review in a future cost of service rate setting proceeding. The leave to construct application was ultimately denied by the Board. CNPI owns and operates distribution and transmission systems in Ontario. This application is in respect to CNPI’s transmission business.

The Board assigned File No. EB-2010-0159 to this application.

BACKGROUND

On July 16, 2009, CNPI filed an application (EB-2009-0283) under section 92 of the *Energy Board Act 1998* (the “Act”) for an order of the Board granting leave to construct transmission facilities in the Niagara Falls / Fort Erie area to reinforce its existing 115 kilovolt transmission system (the “Project”). On March 29, 2010, the Board issued a decision in which it denied CNPI’s leave to construct application. Consequently, CNPI will not be proceeding with the Project. In its April 9, 2010 application letter, CNPI advised that it had made what it considered to be a substantial investment in preliminary costs for the Project amounting to approximately \$1.5 million (the “Preliminary Costs”).

CNPI has requested that it be permitted to establish a deferral account to record its Preliminary Costs for the Board’s consideration in a future proceeding. Depending on the outcome of that future proceeding, CNPI could then be granted approval to recover the Preliminary Costs from Ontario ratepayers through the Uniform Transmission Rates.

THE PROCEEDING

- The Board issued a Notice of Application and Hearing (the “Notice”) on April 28, 2010. The Notice and the application were served by the Applicant and posted on the Applicant’s website, as directed by the Board.
- Energy Probe Research Foundation (“Energy Probe”) applied for and was granted intervenor status.
- The Board proceeded with this case by way of a written hearing.

- Board staff and Energy Probe filed interrogatories on June 4 and 7, 2010, respectively.
- CNPI filed responses to the interrogatories on June 15, 2010.
- CNPI filed its closing submission on June 22, 2010.
- Board staff and Energy Probe filed submissions on July 5, 2010.
- CNPI filed its reply submission on July 9, 2010.

EVIDENCE

Details and Timing of Spending

Based on the prefiled evidence, CNPI made what it considered to be a substantial investment in preliminary work (the “Preliminary Costs”) associated with the leave to construct application (EB-2009-0283). Below is a summary of the Preliminary Costs that CNPI has proposed to be included in a new deferral account.

System Impact Studies:	\$250,000
Engineering, Environmental and Financial Studies:	\$665,000
Accumulated interest during work in progress:	\$209,000
Representation costs and internal costs related to the impact studies and the Application:	\$376,000
Total	\$1,500,000

Based on CNPI’s evidence, the expenditures were made in the timeframe from late 2003 until the completion of the record in the EB-2009-0283 proceeding in early 2010.

CNPI began preliminary evaluation of the Project in December 2003. Throughout 2004 and 2005, CNPI invested modestly to evaluate the Project. In December 2005, CNPI began more formal work with payments being made to the Independent Electricity System Operator (“IESO”), the New York Independent System Operator (“NYISO”) and Hydro One Networks Inc. for feasibility, system and customer impact studies, respectively.

Work related to the system impact studies, preliminary engineering, land ownership reviews and application preparation continued until the submission of the application on July 16, 2009.

Further costs were incurred during the application review process to respond to the various interrogatories posed by Board staff and intervenors.

Timing of the Application and Rationale

This application for the deferral account was filed with the Board on April 9, 2010, about 11 days after the Board's decision on the leave to construct application.

CNPI submitted that it did not request a deferral account prior to its decision to proceed with the leave to construct application for the following reasons:

- CNPI had a reasonable expectation, based on results of system impact studies and "the positive response from IESO staff", that the leave to construct application would be approved and consequently the subject development costs would have been capitalized with the other development and construction costs related to the project. Until capitalization, CNPI recorded the preliminary costs in Account 2055 "Construction Work in Progress".
- CNPI indicated that it is not certain about the appropriateness of keeping the Preliminary Costs in the 2055 Construction Work in Progress account since that account contemplates the completion of the work. Therefore, CNPI sought approval to record its Preliminary Costs in a new deferral account.
- CNPI submitted that, if it is the Board's preference that the Preliminary Costs remain in Account 2055 for potential disposition at CNPI's next transmission cost of service rate application, CNPI would not object.
- CNPI submitted that it had not considered using one of the deferral accounts included in the Uniform System of Accounts since, given the Board decision in the leave to construct application, "it would be prudent to seek the Board's leave prior to establishing a balance in such a deferral account".
- CNPI submitted that it should have the opportunity, at its next transmission cost of service rate application, to establish that the Preliminary Costs were prudent.
- CNPI makes reference, in its submission, to the Board's Notice of Proposal to Amend a Code (EB-2008-0003), which states that "a transmitter that has been designated by the Board to undertake development activities in relation to an enabler facility will be permitted to recover all of the prudently incurred costs associated with those activities, even if the enabler facility does not proceed to

construction". CNPI also makes reference to Board staff's discussion paper regarding transmission project development planning (EB-2010-0059) where CNPI states that the same concept is proposed by Board staff.

Position of the Parties

Energy Probe, in its interrogatories, questioned whether CNPI's request to establish a deferral account to record Preliminary Costs meets the Board's criteria for the establishment of such an account (causation, materiality, management inability to control and prudence). In its responses, CNPI submitted that the above noted criteria apply to distributors who are applying to recover Z-factor costs (extraordinary, unpredictable and unmanageable costs) and do not apply to this application because CNPI is not applying to recover Z-factor costs. However, CNPI went on to explain that its proposal does meet the criteria.

Board staff, in its interrogatories and submission, raised the issue of retroactivity regarding the timing of when the Preliminary Costs were incurred as compared to when these costs were proposed to be recorded in the deferral account. Board staff submitted that the Board is not authorized to set rates retroactively. Any expenses that a utility wishes to recover from its ratepayers must either be in its Board approved rates tariff, or recorded in an authorized deferral or variance account until such time as the disposition of the account balance in rates is approved. In most cases, a deferral account should be approved before the expenses in question are recorded in the account. If this were not the case, then any distributor or transmitter could seek after the fact approval for out of period expenses simply by requesting a deferral account after the expenses were incurred. This would amount to retroactive ratemaking.

CNPI submitted that the future recovery of the Preliminary Costs would not constitute retroactive ratemaking since development, engineering and construction costs are recorded in Account 2055 and "simply because the project will not be completed does not mean that the recovery of CNPI's Preliminary Costs would amount to retroactive ratemaking".

BOARD FINDINGS

Timing of Expenditures and Application

In the Board's view, the main issue in this case is whether CNPI's proposal is appropriate and reasonable in terms of the timing of the spending in relation to the

approval sought to establish the proposed deferral account. Regulatory policy, practices, and tenets of cost of service rate making that make up the regulatory compact must be considered in this case.

One of the main tenets of cost of service rate making is the matching of future revenues with anticipated future costs. A company files an application for rates that will recover a revenue requirement for its anticipated costs over a future test period. The anticipated costs of service are typically illustrated through a presentation of anticipated activities related to the ongoing operation of the company's assets as well as capital replacements and expansion plans. Ratepayers are afforded the opportunity to provide comments that are informed by the company's total spending plan. The Board then issues its final decision setting rates in accordance with what it considers to be just and reasonable. The company is then required to manage its costs within the envelope of its incoming revenue between these rebasing periods. Ratepayers should have confidence in the rates they will be charged in the intervals between rebasing milestones.

The Board notes that CNPI has not filed a rate application since 2001 and therefore its revenue requirement underpinning the approved rates has remained constant at \$4,612,443 since that time. CNPI is expected to work within its revenue envelope until such time as the company files an application for, and the Board approves a new transmission rate based on a newly substantiated revenue requirement. If, in between rate cases, there are anticipated expenses or capital costs that the company can not afford, it should come to the Board on a prospective basis and seek relief. This includes and in the particular circumstances of this application, the possibility that current expenses may arise due to situations where development costs for capital works can't be capitalized because the projects may never come into use.

The Board notes that the anticipated cost of the project in question was in excess of \$30M. CNPI's rate base as of the year 2000 from its filing in 2001 was approximately \$22M. Irrespective of the dated information on CNPI's rate base, the Board considers that the size of the project relative to CNPI's existing system to be very substantial and that the sheer size of the project should have driven CNPI to consider these matters more carefully.

The manner in which the company seeks relief can either be in the form of a cost of service application or, if there is sufficient uncertainty in the amount of the future expenses or capital costs, the applicant can seek a deferral or variance account prior to

incurring the costs for future disposition. The merits of the cost drivers and the probability of the assets coming into use would be tested at that time.

The Board is not convinced that there is anything particular to CNPI's situation that would compel the Board to deviate from a well established tenet of rate making. If CNPI foresaw expenses that it could not afford within its current revenue envelope it should have applied to the Board prior to incurring the expenses to have the merits of its new revenue requirement tested.

CNPI referenced the Board's Notice of Proposal to Amend a Code (EB-2008-0003) as well as to Board staff's discussion paper regarding transmission project development planning (EB-2010-0059) in support of its application. CNPI submitted that establishing a deferral account for its Preliminary Costs would be akin to a transmitter that has been designated by the Board to undertake development activities in relation to an enabler facility being permitted to recover all of the prudently incurred costs associated with those activities, even if the enabler facility does not proceed to construction. CNPI referenced the Board staff discussion paper as proposing the same concept. The Board considers this line of reasoning to be flawed. There has been no proceeding involving CNPI akin to the Board's anticipated "designation" process in which the merits of the development activity would have been examined in advance. It would be on the basis of the Board's conclusions on those merits that costs would be recoverable in the event that the project did not come to fruition.

Criteria for Establishing a Deferral Account

There were substantial interrogatories and submissions from Energy Probe and CNPI on whether or not the four criteria mentioned above apply to this case. In the Board's view, deferral accounts are for the current period or future costs. This includes Z-factor costs which are recorded in a deferral account (1572 - Extraordinary Event Costs) provided that they ultimately meet the criteria mentioned above. The Board accepts CNPI's position that the Preliminary Costs are not Z-factor costs. In addition, there is no other provision for establishing a deferral account for expenditures that have already been made in relation to costs incurred in a prior year.

CONCLUSION

Based on the above evidence and findings, the Board denies CNPI's application requesting Board approval to establish a deferral account to record Preliminary Costs

associated with the transmission facilities that were the subject of the leave to construct application EB-2009-0283.

Cost Awards

Energy Probe may submit cost claims by **August 30, 2010**, in accordance with the Board's Practice Direction on Cost Awards.

CNPI will have until **September 13, 2010** to object to any aspect of the costs claimed.

Energy Probe will have until **September 20, 2010** to respond as to why their cost claim should be allowed. Copies of its submissions must be filed with the Board and served on CNPI.

DATED at Toronto, August 18, 2010

ONTARIO ENERGY BOARD

Original signed by

Ken Quesnelle
Presiding Member

Original signed by

Paula Conboy
Member