Algoma Power Inc.
EB-2009-0278

Board Staff Submission on the Unsettled Issue:
Recovery of Extraordinary Event Costs

October 8, 2010

Introduction

Algoma Power Inc. ("Algoma Power")[1] is seeking the Board's approval to recover approximately $397,677 [2] in extraordinary event costs which Algoma Power indicates that it incurred to comply with Section 71 of the *Ontario Energy Board Act, 1998* ("Section 71").

As noted by Algoma Power: "Under Section 5(4) of Ontario Regulation 161/99, GLPL was exempt from Section 71 until December 31, 2008 and, as a result, was permitted to carry on the activities of transmission and distribution, together with generation, within the same corporation until such date."[3]

The claimed amount, as originally filed, of $410,695 (excluding interest) is comprised of costs incurred between November 2008 and December 2009 and relate to the following activities and elements. [4]

- Legal: $284,200 [5]
  - Representation in connection with discussions/applications made with the Ministry of Energy, Ontario Energy Board, IESO
- Consultants: $66,390
  - Outside consultants used primarily in the separation of engineering records
- Internal Costs: $56,440
  - Internal staff used primarily to assist in the separation of engineering records
- Administrative: $3,665
  - Registration fees with Ministry of Finance, IESO

Algoma Power argues that recovery is justified because the $397,677 meets the Board's criteria of causation, materiality, inability of management control and prudence.

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[1] Unless indicated otherwise, the name Algoma Power also refers to the predecessor companies.
[2] This is the revised amount, reflecting a $15,000 correction, shown in Undertaking J2.1. The original amount $412,749.
[3] Source : Exhibit 9-T2-S2 p.1 ln 14-15
[4] Source: Board Staff interrogatory No.43.
[5] The $15,000 revision noted in footnote 2 related to this activity. The revised number for Legal now totals $269,200.

With respect to the disposition of the amount, Algoma Power proposes to include the $397,677 in the total of deferral and variance account balances that would be disposed by way of rate riders (for all classes) over a 2.5 year period.

Discussion

In Board staff's view any consideration of the recoverability of extraordinary event costs must include an analysis through the four-part eligibility criteria. The criteria are as follows:

> In order for transition or extraordinary event costs to be considered for recovery in the Z factor, the costs must satisfy all four tests set out below:
>
> - Causation - the expense must be clearly outside of the base upon which rates were derived.
> - Materiality - the cost must have a significant influence on the operation of the electricity distribution utility, otherwise they should be expensed in the normal course and addressed through organizational productivity improvements.
> - Inability of Management to Control - to qualify for Z factor treatment, the cost must be attributable to some event outside of management's ability to control.
> - Prudence - the expense must have been prudently incurred. This means that the option selected must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

Materiality

Historically, recovery of extraordinary event costs is reserved for costs which have a significant influence on the operation of the utility[6]. The materiality test, for a utility of Algoma Power's size, is 0.5% of the utility's revenue requirement. This works out to be about $100,000 ($20M times .005).

[6] Source: 2000 Electricity Distribution Rate Handbook Revision 1 Chapter 5 section 5.5.1.1

Board staff notes that Algoma Power calculates the materiality threshold to be $71,000, being 0.25% of its average assets during 2009.[7] Using this approach, Board staff calculates the threshold to be $133,000.[8]

Inability of Management to Control

Board staff questions the basis of Algoma Power's assertion that the claimed costs are due to an event outside of management's control, being the statutory requirement of Sec. 71 of the *Ontario Energy Board Act*. Section 71 reads as follows:

> **Restriction on business activity**
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> **71.** (1) Subject to subsection 70 (9) and subsection (2) of this section, a transmitter or distributor shall not, except through one or more affiliates, carry on any business activity other than transmitting or distributing electricity. 2004, c. 23, Sched. B, s. 12.
>
> **Exception**
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> (2) Subject to section 80 and such rules as may be prescribed by the regulations, a transmitter or distributor may provide services in accordance with section 29.1 of the *Electricity Act, 1998* that would assist the Government of Ontario in achieving its goals in electricity conservation, including services related to,
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> (a) the promotion of electricity conservation and the efficient use of electricity;
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> (b) electricity load management; or
>
> (c) the promotion of cleaner energy sources, including alternative energy sources and renewable energy sources. 2004, c. 23, Sched. B, s. 12.
>
> **Exception**
>
> (3) Despite subsection (1), a distributor may own and operate,
>
> (a) a renewable energy generation facility that does not exceed 10 megawatts or such other capacity as may be prescribed by regulation and meets the criteria prescribed by regulation;
>
> (b) a generation facility that uses technology that produces power and thermal energy from a single source that meets the criteria prescribed by regulation; or
>
> (c) an energy storage facility that meets the criteria prescribed by regulation. 2009, c. 12, Sched. D, s. 11.

[7] Source: EB-2009-0278 oral hearing, Sept. 29, 2010, transcript p8 ln 23-24.
[8] Calculation: Net Fixed Assets Opening Balance of $45.4M plus Closing Balance of $62M, divided by 2, times .25% (assets amounts are found in Exhibit 2-T2-S1 p.10)

Algoma Power, through its legal counsel during VECC's cross examination of Mr. Lavoie, confirmed that impetus for the separation of distribution and transmission was section 71 of the Ontario Energy Board Act. An excerpt of the exchange is provided below. [9]

> MR. BUONAGURO: All right. I can leave that at that.
>
> I will just, I guess, summarize that we seem to have a different interpretation of section 71 of the Act, and at least part of what drove the company to do exactly what it did, i.e., not separating not only generation from the company, but separating the transmission and the distribution company was an interpretation of section 71, which required the separation of distribution and transmission.
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> I am not asking you if that legal interpretation is correct, but rather whether that particular interpretation existed and therefore drove your actions.
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> MR. TAYLOR: Sorry, are you asking if the impetus for the separation of distribution and transmission was section 71 of the Act?
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> MR. BUONAGURO: Yes.
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> MR. TAYLOR: The answer is yes.

Board staff does not interpret Section 71 to require the legal separation of transmission and distribution businesses. GLPL (the predecessor company which operated the transmission, distribution and generation businesses) was required to separate its generation business from transmission and distribution, but section 71 does not appear to prohibit the same corporate entity from carrying on both transmission and distribution businesses.
During the oral hearing, Mr. Buonaguro pointed out that Hydro One Networks Inc. acted as both a distributor and transmitter, apparently without running afoul of section 71. Algoma Power suggested that there were special provisions in the *Electricity Act* which allowed Hydro One Networks Inc. to carry on business

[9] Source : EB-2009-0278 transcript vol.1 (September 29, 2010) p. 24-25

as both a distributor and a transmitter. Although there are provisions of the *Electricity Act* dealing specifically with Hydro One Inc. (the parent company to Hydro One Networks Inc.) - for example, section 48 - Board staff is unable to find any provision of the *Electricity Act* which creates an exemption to section 71 for Hydro One Networks Inc. In other words, section 71 of the *Ontario Energy Board Act* appears to apply equally to Algoma power and Hydro One Networks Inc.

On this basis, in so far as the impetus for the claimed costs is Section 71 and to the extent that the claimed costs are related to activities to separate transmission and distribution, Board staff submits that the Applicant has not met this test.

Causation

Board staff questions the total amount Algoma Power is claiming for internal costs of $56,440, primarily related to the need to separate the distribution and transmission engineering records. Algoma Power has provided little certainty that all of the work activities that comprise the $56,440 result in incremental costs that are actually over and above what is expended in day-to-day operations, including provisions for overtime. Algoma Power, under cross examination by VECC, could only confirm that a portion of the costs were incremental, that there was some contracted back-filling of employees but however was unable to quantify the amounts which are incremental.[10]

Board staff submits that the amount of $56,440 should be reduced in that Algoma Power was able to confirm that only a portion of the costs were truly incremental. Board staff suggests that, given the apparent ambiguity, Algoma Power has not made its case for the full amount. Accordingly, Board staff submits that a 30% decrease would not be an unreasonable reduction.

Prudence

Board staff questions the prudence, from a cost perspective, of the corporate strategy undertaken by Algoma Power, or more appropriately Algoma Power's prior owners, to comply with the Section 71 statutory requirement.

[10] Source : EB-2009-0278 transcript vol.1 (September 29, 2010) p. 17-18

At market opening Great Lakes Power Limited (GLPL) was the owner/operator of generation, transmission and distribution business. GLPL, however, did not need to legally separate its generation business from its transmission and distribution businesses until December 31, 2008.

It appears to Board staff that the most cost efficient way, from a rate-payer perspective, to legally "separate" the businesses would have been to separate out the generation business from GLPL. This would leave GLPL with only the distribution and transmission businesses. There was no external statutory requirement for these two businesses to be separated. Of course, management could decide to sell one and keep the other. In this scenario, all the costs of splitting up the transmission and distribution businesses would be borne by the shareholders.

Allocation and Rate Design

If the Board decides to grant relief, staff submits that the approved costs should be allocated and recovered as proposed by Algoma Power. Algoma Power's proposal allocates the costs based on customer numbers and is recovered over 2.5 years by way of a volumetric rate rider from all classes.

Staff notes that any approved relief would be implemented commensurately with the Board's issuance of Algoma's 2010 rate order which the Board has already determined would be effective and implemented on December 1, 2010.

Conclusion

Board staff submits that the four part test for granting extraordinary events costs has not been met in this case. In Board staff's view, the appropriate materiality threshold is $100,000. Depending on the actual appropriate costs as determined by the Board, Algoma Power may pass this part of the test.
The costs, however, do not appear to have been outside of management's control. The stated reason for splitting the distribution and transmission businesses was to comply with section 71 of the Ontario Energy Board Act. As discussed above, Board staff does not believe section 71 requires the businesses to be split into separate corporations. It does not appear that all of the costs relate to the separation of the generation business. Algoma Power therefore fails this part of the test.

To the extent that the Board disagrees with this analysis, Board staff further submits that some of the costs are poorly documented and may not be incremental to Algoma Power's ordinary day to day costs. A reduction of 30% to internal costs would be appropriate.

The prudence portion of the test is tied to the management control portion of the test. To the extent that the Board agrees with staff's analysis regarding the applicability of section 71, then the obvious implication is that the expenditures were imprudent. If the Board agrees with Algoma Power and finds that the separation was necessary, however, then these expenses (subject to the proposed reductions described above) should be considered prudent.

All of which is respectfully submitted