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

AND IN THE MATTER OF an application by Milton Hydro Distribution Inc. for an Order or Orders approving and fixing just and reasonable distribution rates and other charges effective May 1, 2006**;**

AND IN THE MATTER OF a Notice of Motion by Milton Hydro Distribution Inc. seeking an Order Varying the Decision and Order of the Board in RP-2005-0020 / EB-2005-0391;

AND IN THE MATTER OF Rules 42, 44.01 and 45.01 of the Board's *Rules of Practice and Procedure*.

REPLY ARGUMENT OF MILTON HYDRO DISTRIBUTION INC. ("MILTON HYDRO")

1. **Late Filing of the Motion**

Board staff submissions on the issues do not object to the late filing of the motion. They note that the Board has recently heard matters in several instances where motions were filed outside the 20-day period, and exercised its discretion in favour of the utility.

School Energy Coalition

School Energy Coalition ("Schools") objected to the late filing on the grounds that:

- the matter has been before the Board several times;
- the time between the Board's decision in the matter in April 2006 and the filing of the motion was too long; and
- consideration of the motion at this time would undermine the public's confidence in the regulatory system.

In reply, Milton Hydro suggests:

- The fact that the matter has been considered by the Board on two occasions (the second time was there was no Board decision since the request was outside the Filing Guidelines) is not relevant to the issue of whether the Board should entertain a "late motion". There are specific Board Rules which deal with timing, and they should be determinative of the matter.

- The Board has never designated a particular late period as too long for consideration, nor do the Rules. The time involved, 7 months after the decision to remove the request for review from Milton Hydro's 2007 rates submission, is less than one-half the time permitted Toronto Hydro in EB-2006-0145 et al.

- The notion that consideration of a late motion in these circumstances to review a previous Board decision would undermine public confidence in the regulatory system is not relevant to the issue of accepting a late application. If it goes to anything, it goes to the merits, and even then is a far-fetched and bizarre proposal.

- Finally, Milton Hydro believes that Rule 2.01 is important in these circumstances. As the Board knows, Rule 2.01 requires the Board to liberally construe the Rules in the public interest to secure the most <u>just</u>, expeditious and efficient determination on the merits (*our emphasis*). It would be unfair to Milton Hydro for the Board, given the complex procedural history of the case, including the role played by Board staff, to deny Milton Hydro an opportunity to seek relief due to a late filing.

2. The Threshold Question

Board Staff Comments (pars. 18-20)

Board staff took no issue with the first two allegations, namely, that the Board erred in finding the amounts being sought were out of period and that there is a high onus on Milton Hydro to recover the out of period costs. Given that the Board staff raised objections to each of Milton

Hydro's remaining four submissions, Milton Hydro assumes that Board staff did not oppose the submissions and in fact was sympathetic to them.

This is understandable as the costs claimed were not out of period, in that Milton Hydro claimed them at the first practical opportunity (Submission, p. 1, Thorne Affidavit, pp. 1-2). Milton Hydro's customer did not declare bankruptcy until April 30, 2002. In its 2002 rates case, filed on February 11, 2002, Milton Hydro raised the matter of the impending losses with the Board, and that it would need to recover some amounts in rates after the pending bankruptcy. It advised the Board that once its claims were crystallized, cash payouts made, and the remaining losses audited, it would apply to the Board for recovery of those losses, likely in its 2003 rates case. That was the earliest it could do so, given the fact that the amount was not yet clear. Neither the Board staff nor the Board objected to that approach. The manager's summary in the 2002 rates case made it clear that the amount was material, an order of magnitude larger than the bad debt allowance.

The usual meaning of "out of period" is that costs must be recovered in the rates of the year in which the costs were incurred. In this case, the fact that the losses would be incurred was confirmed on the last day of the period, and, even then, the amount was not certain until cash payouts and audits had occurred. It was impossible for Milton Hydro to recover the losses during the 2001 rates year, or the 2002 rates year. The earliest opportunity was 2003. However, by then the rate freeze was in place. The Thorne Affidavit outlines the remainder of the procedural history, including the advice provided by Board staff.

3. **Retroactive Ratemaking**

Given that the costs were not truly out of period, the recovery of them in the later year cannot constitute retroactive ratemaking. Costs are simply being recovered at the first practical opportunity. That they are being recovered a few years later than they were incurred is unusual but not unprecedented (see, for example, discussion of stranded costs in Submission on the Motion, at p. 2).

Board staff quotes the Board and the Courts selectively to the effect that retroactive ratemaking is not permitted. The comment quoted from the ATCO decision was dicta, as the case was decided on different grounds. Milton Hydro agrees, but reiterates its point that the Board's allowance of Milton Hydro's claim does not constitute retroactive ratemaking.

Board staff then comments that Milton Hydro did not take advantage of the tools of interim rates and deferral accounts to manage the losses, without specifying exactly how Milton Hydro should have done that.

Milton Hydro suggests interim rates are typically used in cost-of-service rate making with a forward test year when the applicant utility is concerned that the rate case will not be completed and a Board order issued until after the beginning of the new rate year. The applicant requests the Board to declare the rates then in effect (and which the applicant seeks to change) interim, so that the new rates can be effective the first day of the new rates year. That is not the circumstance here. There was no advantage to make the existing 2001 rates "interim" since the Board would put the new rates in effect on time and the magnitude of the loss would not be known until after it was audited and payouts to creditors completed in 2002.

As for deferral accounts, the Board is reluctant to approve new deferral accounts at any time, in particular between rates cases. Such accounts are normally approved as part of an annual rate case where the utility contemplates incurring costs in some area in the test year but is unable to forecast them with any accuracy. Milton Hydro had no inkling of the financial difficulty of its client, CPI, at the time it filed its 2001 rates.

Moreover, during the relevant period, 2001 - 2003, the Ontario utilities, including Milton Hydro, were under a performance-based ratemaking regime. Milton Hydro's losses clearly qualified as z-factors under the Distribution Rates Handbook 2000 Version (the "DRH 2000") then in effect (see Milton Hydro's Submissions on the Motion to Review, p. 24, and Thorne Affidavit, p. 9)

Financial Hardship, Financial Needs Test (paragraphs 21-27)

Board staff appears to have misunderstood Milton Hydro's argument with respect to the relevance of the financial circumstances of the utility to ratemaking.

Milton Hydro's argument on this point (preliminary issues submission, paragraph (iii) at p. 7) was that under normal circumstances the Board should not take the financial status of the utility into account. The Board should not deny a utility recovery of an otherwise valid claim on the grounds that the utility is not in dire financial straits, or, as the Board puts it, "in making this finding, the Board has concluded that failure to recover the requested amount will not cause unmanageable financial hardship." The Board clearly relied on the fact that Milton Hydro was a healthy, growing utility, as a reason for denying relief. That is not acceptable, or, legal, ratemaking.

It would be another matter if the utility were on the verge of bankruptcy and made a claim for recovery of costs, for which pro and con ratemaking considerations applied. The Board could in these circumstances use its discretion and statutory mandate to facilitate the maintenance of a financially visible electricity industry to rule in favour of the utility based on its dire need for cash. The two situations are very different, and different legal ratemaking principles apply.

Board staff also misunderstood the relevance of the materiality of the amounts claimed (par. 23). The amounts claimed, in total, are clearly material amounts. Based on the materiality criterion in the Board's 2006 Rate Filing Guidelines, they are orders of magnitude larger than other materiality thresholds (see Thorne Affidavit, pp. 5 and 7).

Ongoing Losses Versus One Time Loss (par. 23)

The losses in respect of which Milton Hydro claims relief are twofold – the bankruptcy induced loss and the restructuring induced losses for 2004 and 2005. Milton Hydro agrees with Board staff on that point. However, Milton Hydro's point is that the Board seemingly confused the matter in its decision when it suggested that because there was no ongoing loss of revenue arising from the restructuring beyond the incurred losses in 2004 and 2005, in that the rates from

May 1, 2006 onward reflected the reduced revenue, the actual losses in 2004 and 2005 rate years were not recoverable. The two matters are unrelated because the losses were already material. The loss of revenue in these two years plus interest amounted to $427,151.00. The amount was material, according to the Board's own definitions, as noted above (see Thorne Affidavit, p. 7). It was also material in the sense that it was a sufficient size to constitute a z-factor under the price cap regime then in effect (see below). The loss for 2004 alone amounted to 1.5% of Milton Hydro's cost of service. That amount is material in any common sense interpretation of the terms. Again, Milton Hydro's point was that the fact that there was no further revenue deficiency once 2006 rates were set did not mean the losses were not material, which is what Board staff suggests in the third line of page 7 of their submission. More important, it was apparently one of the reasons the Board denied Milton Hydro's application.

Role of Board Staff

Board staff does not address the significant role played by Board staff in the procedural history of this case. At several key points in the process Board staff advised Milton Hydro to follow a particular course of action, or failed to advise it of options available to it. These circumstances are detailed in the Thorne Affidavit, but are summarised here for convenience.

- Milton Hydro first raised the issue of its intention to claim a bankruptcy related loss, once it verified the amount, in its 2002 rates application. Neither Board staff nor the Board raised any issue with this proposed procedure at that time and did not suggest any comment about the need for interim rates or a deferral account.

- When Milton Hydro next raised the issue as part of its January 23, 2004 filing of its 2004 rates submission, Board staff advised it to defer the claim until the 2005 rates submission, and Milton Hydro complied and submitted a revised 2004 rates application on March 11, 2004, without claiming the losses. However, when Milton Hydro included the claim for both bankruptcy and restructuring induced losses in its 2005 rates submission, the Board decided that the Board's filing guidelines for the 2005 rate case did not permit such a filing. So having followed the Board staff advice

in 2004, Milton Hydro lost out in 2005. As noted above, in its 2005 decision, the Board, noting that "the process did not contemplate such adjustments", invited Milton Hydro to apply for "other specific changes to rates" in a separate application. Milton Hydro filed such a separate application on October 18, 2005 to recover the losses. It filed its 2006 rates application in August, 2005. The guidelines for the 2006 rates application did not include any provision for extraordinary event losses, and the Board collapsed Milton Hydro's independent submission into its rate case.

When Milton Hydro included a request for the Board to review its 2006 rates decision in its 2006 rates case filed on January 27, 2007, Board staff suggested Milton Hydro remove the review request for the rates case and make it the subject of a separate application to review. Milton Hydro did this and prepared the application immediately following the conclusion of the smart meter case, in September 2007.

Given the fact that these losses occurred in the very early days of the Board's regulation of the Ontario electricity distributors, it was reasonable for Milton Hydro to rely on Board staff's advice, and to expect that Board staff would explain the options available to it each step of the way.

Inconsistent Findings (par. 25)

Board staff argues that the Oakville Hydro decision and the Milton Hydro cases involved significantly different circumstances and did not involve inconsistent findings in similar cases. Board staff is not correct on this point. Oakville Hydro sought to recover in its rates commencing May 1, 2005 (2006 rates year) lost revenues that arose in the previous period, as a result of fundamental restructuring of a large industrial customer from a manufacturing mode to a service mode. The change in consumption occurred on January 1, 2005 (mid-way through the 2004 rates year) and the loss was incurred over the period January 05 to April 30. Oakville Hydro included the claim for extra revenue in its 2006 rates submission. There is no significant difference between the two cases. In each case the utility incurred a material loss through no fault of its owners. In each case the utility sought to include the amount of the loss in rates in a

subsequent period. Oakville Hydro did manage to request that the loss be recompensed in the immediately succeeding rate year but it was able to do that because it could fairly easily calculate the amount of the loss, and, more important, it was not dissuaded from doing so by legislation, Board filing guidelines, and Board staff advice.

Change of Circumstance

Milton Hydro suggests that the Board staff comments on the change of circumstance proposed by Milton Hydro, namely, the issuance of the Board staff discussion paper *Electricity Distributors and the Management of Customer Commodity Payment Risk* and the launching of a proceeding (EB-2007-0635) therewith is not a change in circumstance contemplated by the Rules is an opinion unsubstantiated by any decision of the Board, or by the Board's Rules of Practice. The Board's Rules state that one of the grounds on which the correctness of a Board decision can be questioned in a motion to review is simply a "change in circumstances". Change in circumstances, as a ground, is separate from, and in addition to, other grounds, including "error in fact" or "new facts that have arisen" (Rule 44.01). From this Milton Hydro concludes that the circumstances being referred to include changes in the regulatory context from those that existed at the time the case was heard.

The Board's Notice of Hearing and Procedural Order No. 1 qualifies the words, "change in circumstances" only to the extent that they must have occurred after the decision for which the review is being sought, have been brought to the attention of the Board promptly after it occurred, and was material, in the sense that its consideration by the review panel could reasonably lead the panel to review the initial decision.

Milton Hydro reiterates that the commencement of the proceeding (EB-2007-0635) is a relevant and substantial change in circumstances, at least in relation to the commodity portion (85%) of the bankruptcy induced loss. Indeed, the introductory paragraphs of the document cited above make mention of the Milton Hydro decision as illustrative of the problem that exists. The Board is now fully aware of the problems created by the current security deposit regime, and the limitations on alternative means to manage default risk.

Effect of 2006 Rates Decision being Superseded by the 2007 Decision (paras. 31 and 32)

The fact that a particular rate order for which review is being sought has been replaced by a subsequent rate order is not determinative of the motion to review. The Board's Rules place no such restriction on Motions to Review. Rule 44.01 speaks of review of an order or decision. The substance of the process Milton Hydro has launched is to seek recovery of the losses it incurred in rates. In fact, Milton Hydro is not seeking to change the 2006 rate order or the 2007 rate order, but to apply a rate rider to the 2008 rates to recover the agreed losses during that 12-month period. Recovery by rate rider is the form by which the recovery is proposed to be made. The substantive issue is whether Milton Hydro should be able to recover these costs, which were denied in the April 2006 decision. It is that decision that Milton Hydro seeks to have reviewed. In this context the Board staff's comment in paragraph 32 is confusing. If Board staff have specific alternative routes to recovery in mind they should disclose them. The point here is to obtain a just result and Board staff should not be creating artificial procedural hurdles to impede a just result.

Performance-Based Ratemaking

Finally, Milton Hydro notes that Board staff does not address Milton Hydro's argument that during the period under consideration, the period when the losses were incurred, the utilities were under a price cap regime, governed by the DRH 2000. Milton Hydro's losses were extraordinary event costs that qualified as z-factors according to DRH 2000 (Milton Hydro's Submission on the Motion, p. 6), especially VECC's concurrence with this approach. The Board erred in not allowing the losses as "notional z-factors" and making the appropriate adjustment to 2006 rates.

Schools Comments:

(a) Its "Related Procedural Question"

Schools suggests that Milton Hydro has "had its day in Court" and for that reason should not ask for a review of the decision. In fact, Milton Hydro has had only one decision by the Board on

the merits of its case, in April 2006. On the other hand, it has struggled to get its case before the Board for several years.

(b) The Threshold Question

Milton Hydro disputes Schools' contention that there is no likelihood of demonstrating that the losses were out of period for the reasons provided above, namely, that Milton Hydro applied for the losses as soon as it could. But even if the losses were deemed to be out of period, Milton Hydro would argue that they should be recovered in rates for the reason cited by Mr. Thorne, in his affidavit, that they are material, beyond the control of the utility, and beyond a reasonable level of business loss.

Fairness

Finally, the case raises a basic issue of the fairness and integrity of the ratemaking process. The applicant, an innovative small to medium sized utility, operating in the early years of a dramatically new regulatory regime, incurs substantial losses through no fault of its own, follows to the letter the advice, and directives of the Board and Board staff on how to proceed to recoup its loss in rates, and, when it finally gets heard on the matter some 5 years later, is told by the Board that the costs it seeks are out of period, and, moreover, rather unceremoniously that "the applicant's request would have been out of period even if their application in 2002, or subsequent application because of the Minister's leave, had been considered by the Board" (*our emphasis)*. This is not principled ratemaking.

Conclusion

The principal error the Board has made is to mischaracterize the claim for relief as a claim for out of period costs. Put simply, costs are not out of period if the utility makes a good faith attempt to recover those costs as soon as possible, but is dissuaded from doing so by government legislation, Board procedural decisions, or Board staff advice and directions. As noted in the Thorne Affidavit and the Submission, Milton Hydro's client did not declare bankruptcy until the

last day of the 2001 rates year. There was not time to do anything in the rates years in which a loss was first recognized (2001) or in which the amount of the loss was crystallized (2002).

Once the claim had been mischaracterized in this way, the Board took the next step and categorized the claim as one that, if allowed, would result in retroactive ratemaking. If the costs were not out of period, there can be no retroactive ratemaking. This error was identifiable on the record, the amount of money involved was clearly material, and, had the Board made a correct decision the 2006 rates would have permitted the recovery of the earlier losses.

All of which is respectfully submitted this 5th day of December, 2007.

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