2011 IRM3 Electricity Distribution Rates
EnWin Utilities Ltd. ("EnWin")
Responses to VECC Interrogatories
EB-2010-0079

Revenue to Cost Ratio Adjustments

VECC IR#1

Reference: Revenue Cost Ratio Adjustment Workform, Sheet C1.3

a) The purpose of the adjustment is to remove the transformer ownership allowance (TOA) discount from the rates where appropriate. However, the results shown yield higher (not lower) volumetric distribution rates for the various GS and Large User classes. This appears to be due to the TOA discount being input as a "negative value". Please review and revise as necessary.

Response
On Sheet C1.3, the "Transformer Allowance (A)" is a calculated amount based on *ENWIN*'s entries for "Transformer Allowance kW's (B)" which are positive numbers and for "Transformer Allowance Rate (E)" which are negative numbers per *ENWIN*'s approved Tariff of Rates and Charges.

On Sheet C1.6, those calculated amounts from C1.3 are applied as negative amounts under "Re-based Transformer Allowance (D)". The effect, as shown in "Revenue Requirement from Rates (E=C+D)", is to decrease the Revenue Requirement from $50,384,514 to $48,974,788.

Stretch Factor Methodology

VECC IR#2

Reference: Manager's Summary, pages 5-6

a) Please explain how the Productivity Factor is "based on forecasted opportunities".

b) Please explain how the Stretch Factor is based on "historical performance".

c) The submissions made under part (1), appear to suggest that the Stretch Factor should not apply to any electricity distributor who has been rebased in 2008, 2009 or 2010. Is this ENWIN's view? If not, please explain.

Response

a) The July 14, 2008 *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* states: "The Board has determined that X-factors for individual distributors will consist of an empirically derived industry productivity trend (productivity factor) and stretch factor" (p. 19).

As discussed by the Board in the July 14, 2008 report as well as the September 17, 2008 *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, the Productivity Factor uses trend data as a proxy for the level of total factor productivity (TFP) that should be expected from Ontario's Electricity Distributors over the course of the post-rebasing rate cycle. The Productivity Factor forecasts the opportunities for LDCs to find efficiencies each IRM year.

In other words, *ENWIN* interprets the Board to be saying, "While inflation will put upward pressure on rates, the Board believes that this LDC's overall costs shouldn't increase as much as inflation because, based on TFP trend data, this LDC will be able to find 0.72% in efficiencies in this coming year. Accordingly, based on this forecasted opportunity to find savings, the Board will hold back rates by 0.72%."

b) The Stretch Factors, by contrast, are not based on forward-looking trends. They are described by the Board in its September 17, 2008 Report: "Stretch factors are an integral part of the IR formula, and are not dependent on future performance by the utility" (p. 20).

The Stretch Factor is dependent upon historical levels of OM&A (originally 2004-2006 in EB-2006-0268 and updated each year with the 3 most recent historical years). For this Application, if the Board applies the Stretch Factor and does so using the methodology from the July 14, 2008 Report, then the Board will set a Stretch Factor based on *ENWIN*'s 2007-2009 OM&A expenses relative to those of other LDCs. To the extent that *ENWIN* performed its OM&A-classified work during that historical period at cost-levels that were lower than the OM&A-classified cost-levels of comparator LDCs, then *ENWIN*'s performance may be rewarded in 2011 rates by way of a lesser Stretch Factor.

c) The application of Stretch Factors for LDCs (including but not exclusive to those that rebased in 2008-2010) requires careful consideration by the Board. As stated in the September 17 Report:

> "The Board notes that all of the participants in the consultation agreed that the setting of stretch factors is a matter that calls for the exercise of judgment. As such, there are no hard and fast principles to guide the Board's determination of an appropriate value. The Board also notes that each of the participants urged the Board to take a conservative approach with respect to the stretch factor values in light of the fact that the Board's experience with benchmarking is in its early stages.
> …
> The Board recognizes that the risk of misclassification cannot be ruled out" (p. 20).

The argument raised by *ENWIN* under part 1 is that the current methodology does address these considerations raised in its Reports. It is not *ENWIN*'s position that there is no role for benchmarking or Stretch Factors as part of rate regulation, rather, that the current methodology is not an appropriate way to do it.

ENWIN had its rates rebased in 2009. It is *ENWIN*'s performance in and beyond 2009 that should be the subject of any benchmarking and application of a Stretch Factor.

ENWIN's position is that rebased rates are the most accurate picture of what rates ought to be because the Board has had full regard for the circumstances of the LDC and its ratepayers. It sets a clean slate.

For practical reasons, not every LDC can or should get rebased rates every year. So, where rebased rates are changed following a rebasing through a tool such as IRM, the methodology should only look back as far as the rebasing. During the period after its 2009 COS, the LDC may be subject to scrutiny for its activities, including OM&A costs, from 2009 onward. The same principle should apply for 2008 COS, 2010 COS, etc.

ENWIN's position on how it should be benchmarked are the focus of parts 2-4 and are further addressed in response to VECC IR#3 and 4.

VECC IR#3

Reference: Manager's Summary, pages 6-7

a) Provide a schedule that sets out ENWIN's actual 2009 overall return on rate base.

b) Please a schedule that sets out ENWIN's actual average cost of long-term debt for 2009.

c) Based on the results from parts (a) and (b) and ENWIN's deemed capital structure please provide a schedule that set out ENWIN's actual ROE for 2009 that is comparable to its approved ROE.

d) Please provide an updated version of Table 1 that reports 2010 usage up to the most recent month-end currently available (e.g. November 2010). Please also include 2009 in the Table and along with total kWhs for each year.

Response

a) *ENWIN*'s actual 2009 overall return on rate base was $12,402,555 on a 2009 Cost of Service approved rate base of $199,803,078.

By comparison, the approved 2009 Cost of Service rates were projected to provide a return on rate base of $14,078,754.

b) *ENWIN*'s actual 2009 average cost of long-term debt was $3,600,190.

By comparison, the approved 2009 Cost of Service rates were projected to support $7,570,768 in long-term debt and $106,295 in short-term debt.

c) *ENWIN*'s actual 2009 return on equity was $8,857,441 on a 2009 Cost of Service approved rate base of $199,803,078.

By comparison, the approved 2009 Cost of Service rates were projected to support a return on equity of $6,401,691.

d) Below please find the charts updated with the most recent available reliable billed data.

	2008 (kWh)		2009 (kWh)		2010 (kWh)	Change	
Rate Class	**Jan-Oct**	**Total Year**	**Jan-Oct**	**Total Year**	**Jan-Oct**	**2008 to 2010**	**2009 to 2010**
Residential	533,666,783	639,839,347	504,148,825	604,624,554	547,221,313	2.5%	8.5%
GS < 50 kW	196,228,199	234,975,292	184,500,409	220,940,816	187,464,651	(4.5%)	1.6%

	2008 (kW)		2009 (kW)		2010 (kW)	Change	
Rate Class	Jan-Oct	Total Year	Jan-Oct	Total Year	Jan-Oct	2008 to 2010	2009 to 2010
GS > 50 kW	2,190,610	2,591,380	2,033,205	2,411,400	2,027,522	(7.4%)	(0.3%)
Intermediate	116,299	136,365	109,270	130,057	108,631	(6.6%)	(0.6%)
LU - Regular	569,726	676,823	466,262	550,085	489,238	(14.1%)	4.9%
LU - 3TS	631,299	751,966	620,312	739,223	608,602	(3.6%)	(1.9%)
LU - FA	99,546	113,540	79,861	95,070	87,468	(12.1%)	9.5%

VECC IR#4

Reference: Manager's Summary, pages 8-9

a) With respect to the second last paragraph on page 8, is it ENWIN's contention that distributor's still on 2GIRM (i.e. those that have not rebased using a forward test year) will over-invest or under-invest as opposed to following good utility practice?

b) What evidence does ENWIN have the distributors who have not been subject to "rebasing" are over or under investing? Furthermore, does ENWIN have information to suggest whether the propensity of these distributors is to either over invest or under invest?

c) Please explain more fully how over/under investing will skew the rankings which are based primarily on OM&A.

d) Does ENWIN's argument in part (4) apply to all distributors who have been re-based? Is it ENWIN's position that none of these distributors should be subject to a "stretch factor".

e) In which cohort (I, II or III) was ENWIN placed for 2009 and for 2010?

Response

a) No. In the paragraph cited, *ENWIN* stated that "some distributors **could conceivably** continue to over-invest or under-invest…" (emphasis added). *ENWIN*'s statement is based on the theory that rebasing through the intensive Cost of Service methodology provides the Board, ratepayer groups and others with the opportunity to engage in a heightened level of scrutiny of investments. To the extent that a LDC has never filed a Cost of Service rate application, it has never been subject to that scrutiny. Accordingly, that LDC's approach to investing in its distribution system remains unchecked and **could conceivably** be an approach whereby more or less investment is taking place than the Board would otherwise find prudent.

b) Per the response in (a), *ENWIN*'s did not state that distributors are over or under investing.

ENWIN disagrees with the premise of VECC's question that distributors have a propensity to either over invest or under invest.

Cash flows enable the LDC to make investments in the distribution system through capital and OM&A activities. These cash flows are dependent on rates. If rates are insufficient there will be under investment.

As an example, some rates are rebased annually (e.g. EB-2007-0680, EB-2009-0139, EB-2007-0681, EB-2009-0096) with the expressed recognition and justification that the circumstances warrant the need for incremental investment. Presumably, if those applications had not been brought and the Board had not rebased the rates, then there would have been under investment.

The potential for over investment is addressed in (a).

c) *ENWIN* has used the term "investment" to encompass both capital and OM&A activities. Investing too little in OM&A would elevate a LDC in the benchmarking.

To help illustrate the differing levels of investment in the industry, *ENWIN* has attached a FAQ for ESQR released by the Board on December 23, 2010. It appears to be the case that the questions are from actual LDCs. Of note are questions 6 and 7, which suggest that at least 1 LDC has not made the investments in capital or administrative staff to accurately track telephone accessibility. Also of note is question 12, which suggests that at least 1 LDC has not made the investments in capital or O&M staff to track when field crews arrive on the sites of emergencies.

The implication of the above examples are not only that regulatory reporting may not be accurate, but that some LDCs may have no idea that excessive numbers of customers are having great difficulty contacting the LDC or that some LDCs may have no idea of if or when a crew arrives at the site of an emergency. These examples demonstrate that there may be under investment in OM&A at some LDCs. Because the current benchmarking methodology and Stretch Factors have no regard for service levels, if a LDC does not have its service levels checked and found prudent by the OEB, then it could conceivably do very well in the benchmarking and receive a low Stretch Factor at the expense of an under funded distribution system.

d) *ENWIN*'s position is that until all LDCs have their performance, costs and rates scrutinized through Cost of Service, there is an ongoing unfairness to all LDCs and all ratepayers in the province. *ENWIN* has expressed its concern that this is an industry-wide issue, but, recognizing that this is an isolated proceeding with an isolated purpose, *ENWIN* proposes that the Board start addressing the issue by not applying the Stretch Factor to *ENWIN* for 2011 rate-setting purposes. It is incumbent on any LDC that wishes to not have the Stretch Factor applied against it to raise the issue in its application until such time as the issue may be addressed on a generic basis.

e) In 2009, *ENWIN* was not subject to benchmarking results by virtue of having had its rates set on a Cost of Service basis. In 2010, *ENWIN* was placed in group III.