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BY EMAIL

January 13, 2010

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319, 27th Floor
2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Chatham-Kent Hydro Inc.
2011 IRM3 Distribution Rate Application
Board Staff Submission
Board File No. EB-2010-0074

In accordance with the Notice of Application and Written Hearing, please find attached the Board Staff Submission in the above proceeding. Please forward the following to Chatham-Kent Hydro Inc. and to all other registered parties to this proceeding.

In addition please remind Chatham-Kent Hydro Inc. that its Reply Submission is due by February 3rd, 2011.

Yours truly,

Original Signed By

Kelli Dobson
Analyst, Applications & Regulatory Audit

Encl.

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2011 ELECTRICITY DISTRIBUTION RATES

Chatham-Kent Hydro Inc.

EB-2010-0074

January 13, 2011

Board Staff Submission
Chatham-Kent Hydro Inc.
2011 IRM3 Rate Application
EB-2010-0074

Introduction

Chatham-Kent Hydro Inc. ("CKH") filed an application (the "Application") with the Ontario Energy Board (the "Board") on Sept 17th, 2010, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that CKH charges for electricity distribution, to be effective May 1, 2011. The Application is based on the 2011 3rd 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 CKH.

In the interrogatory phase, Board staff identified certain discrepancies in the data entered in the application model by CKH. In response to Board staff interrogatories which requested either a confirmation that these discrepancies were errors or, an explanation supporting the validity of the original data filed with the application, CKH confirmed that they were errors and provided the corrected data. Board Staff will make the necessary corrections to CKH's model at the time of the Board's decision on the application.

Staff has no concerns with the data supporting the updated Retail Transmission Service Rates ("RTSRs") proposed by CKH. Pursuant to Guideline G-2008-0001, updated on July 8, 2010, Board staff notes that the Board will update the applicable data at the time of this Decision based on any available updated Uniform Transmission Rates.

Staff notes that CKH's variance and deferral account balances as of December 31, 2009 did not meet the threshold for disposition and so CKH has not requested disposition at this time.

In response to interrogatory 6 from Board staff, CKH provided a revised version of Sheet F1.1 Z-Factor tax changes. The Taxable Capital entry for 2010 was revised to $56,287,699 and the Regulatory Taxable Income entry for 2010 was revised to $2,459,986 to reflect the Revenue Requirement Work form corresponding to the Board's Decision in EB-2009-0261 (CKH's 2010 cost of service application). Board staff notes that the use of the revised data is consistent with the Board's instructions for the 2011 IRM3 model issued on August 20, 2010.

Board staff will make the necessary corrections to CKH's models at the time of the Board's decision on this application.

Board staff makes submissions on the following matters:

- Revenue-to-Cost ratios; and
- Smart Meter Adder;

Revenue-to-Cost Ratios

Board staff observes that intervenors have posed several interrogatories regarding the adjustments made by CKH to the R/C ratios and whether the proposals in this application comply with the Settlement Agreement between CKH and intervenors in the EB-2009-0261 application. Board staff makes no submission on the matter of whether there is a resultant shortfall or whether CKH's adjustments to address any shortfall is compliant with the Settlement Agreement in the EB-2009-0261 case. Board staff was not a signatory to the agreement. Board staff's submission is limited to commenting on whether CKH's adjustments are appropriate for ratemaking purposes going forward.

CKH rebased its distribution rates effective May 1, 2010, through a Cost of Service ("CoS") rate application last year. The Board dealt with the application under File No. EB-2009-0261.

CKH is also a distributor that was specifically named in regulation and authorized to deploy smart meters beginning in 2006. CKH has been active in smart meter deployment since then. Further, CKH has had costs for installed smart meters reviewed and funding adders and disposition rate riders reviewed and approved in several applications.[1]

Since 2005, when smart meters arose as an issue, the Board has developed and evolved its policies and practices regarding how smart meter costs will be treated for

1 CKH has had its costs for smart meters reviewed in the following cases: EB-2007-0063 (the combined smart meter proceeding, involving all distributors named in regulation at that time), EB-2007-0881, (CKH's 2008 IRM application), EB-2008-0150 (a separate application re: smart meter cost disposition) and CKH's 2010 EDR Cost of Service application under EB-2009-0261.

rate setting purposes. This started with the approval of a funding adder as "seed money" included in distribution rates in 2006. The Board has documented its evolved policies and practices in *Guideline G-2008-0002: Smart Meter Funding and Cost Recovery* (the "Guideline"), issued October 22, 2008.

In last year's 2009 CoS application, CKH sought to have its costs approved on a final basis for smart meters deployed to December 31, 2008. The Guideline contemplates that disposition of smart meter costs would occur through either a CoS application or through a stand-alone application. Review as part of a CoS application is generally preferable, as it allows approved costs to be incorporated into rate base at current net book value (i.e. initial cost less accumulated depreciation), and also allows costs to be allocated to applicable classes of metered customers. Disposing of smart meter costs in a CoS application thus avoids the calculation of a Smart Meter Incremental Revenue Requirement ("SMIRR") rate rider, as the costs are directly incorporated into the rate base like other distribution assets (e.g. poles, wires, transformers, etc.).

CKH's 2010 CoS application was subject to a Settlement Agreement, with the exception of certain issues. The Board accepted the Settlement Agreement in its Decision on Partial Settlement and Procedural Order No. 5, issued March 11, 2010. However, it was only at the stage of CKH's draft Rate Order ("DRO") that it came to light that CKH had not included the costs for installed smart meters into its rate base, and instead calculated a SMIRR rate rider of $0.17 per month per metered customer to recover the approved amounts. Having a separate rate rider is not the preferred approach, as it would remain in effect until the next rebasing, scheduled for 2014 for CKH. As mentioned above, the preferred approach in a CoS application is to incorporate the approved smart meter assets into rate base and to allocate them. Through the DRO process, CKH incorporated the $0.17 as an increment to the monthly service charge for metered customers[2] rather than showing it as a separate rate rider for up to four years. This is a proxy method for incorporating into rate base[3], but Board staff views the approach as reasonable.

2 CKH notes this as Note 1 to the Revenue-to-Cost Ratio Table on page 4 of the Manager's Summary.
3 The approach is based on a premise that the sum of the base distribution rate for non-smart meter assets plus the rate corresponding to the incremental revenue requirement of the smart meters being incorporated into rate base and associated operating expenses will equate to the rate to recover the revenue requirement associated if the smart meters were added into rate base directly. The derivation of the Smart Meter Incremental Revenue Requirement rate rider is based on the same premise. While there are some approximations in this approach, Board staff views the approach as reasonable.

However, this treatment has an unintended consequence of altering the Revenue-to-Cost (“R/C”) ratios. In the response to Board staff IR # 1 and similar interrogatories posed by intervenors, CKH recalculated the R/C ratios without the adjustment for the incremental smart meter revenue requirement of $0.17 per month per metered customers, along with the adjustment for Standby rates. Based on that analysis, Board staff submits that the adjustments for the smart meter amount and the Standby Class to the R/C ratios in 2011 and 2012 appear to be consistent with the Settlement Agreement from CKH’s previous CoS case as a starting point for further adjustments to class-specific R/C ratios to move them all within the bands.

Staff also submits that CKH’s approach of adjusting the Monthly Service Charge of metered customers to include the $0.17 charge corresponding to the incremental revenue requirement for smart meters installed to December 31, 2008 is appropriate for rate setting purposes. However, if the Board was to find that this is not an appropriate adjustment in light of the Settlement Agreement, staff would not be opposed to maintaining a SMIRR rate rider for CKH’s IRM period, and until the effective date of its next Cost of Service rate order.

Smart Meters

Board staff makes submissions on the following issues with respect to smart meters:

- Proposed Smart Meter Funding Adder;
- Stranded Meter Costs; and
- Costs for Residential Smart Meters installed in 2011.

Proposed Smart Meter Funding Adder

Discussion

CKH has proposed a smart meter funding adder of $0.96 per month applicable to all metered customers. In response to Board staff IR # 2 a), CKH confirmed that this funding adder is intended to recover the incremental revenue requirement for the period 2009 to 2011 inclusive, related to 318 GS < 50 kW and 197 GS > 50 kW customers for which smart meters have been installed in 2009 and 2010. The derivation is shown in the smart meter model. There is no prudence review of these costs in this application; such review will occur in a subsequent application for disposition of smart meter costs.

Submission

In general, it appears that CKH has complied with the Guideline in completing the Smart Meter Model, subject to corrections that CKH and Board staff have noted.

Board staff has observed that the Smart Meter Model used by CKH and certain other distributors has a further error in that the deemed short-term debt capitalization is not taken into account in determining the incremental revenue requirement. CKH rebased for 2010 distribution rates and has had the deemed short-term debt capitalization reflected in its revenue requirement since that time. There is also an issue where the model as originally issued, references the wrong cells for the 2011 net income and amortization expense for purposes of calculating the grossed-up tax/PILs expense. A corrected version of CKH's smart meter model to more properly reflect short-term debt capitalization is attached to this submission; the corrections implemented by Board staff are formulaic in nature. This would result in a slight increase to the Smart Meter Funding Adder to $1.14 per month per metered customer, which Board staff submits is the proper funding adder for 2011.

Stranded Meter Costs

Discussion

In response to Board staff IR # 3, CKH has documented its treatment of costs associated with stranded meters – those meters replaced by smart meters. CKH notes that the costs associated with stranded meters installed no later than December 31, 2006 have been moved to account 1555, while stranded meters installed after 2006 remain in rate base.

Submission

CKH's treatment of stranded meters, and particularly of the different treatment of stranded meters installed before 2007 and post-2006, is not clear. However, Board staff observes that the accounting and treatment of stranded meters does not factor into the proposed smart meter funding adder in this application. As such, Board staff takes no issue at this time. However, when CKH files its next smart meter prudence application for its remaining costs, it should take note of any Board decisions on future applications where the Board makes findings on the treatment of stranded meters.

Costs for Residential Smart Meters Installed in 2011

Discussion

In the Smart Meter model filed in the application and upon which the proposed funding adder of $0.96 per month per metered customer is based, Board staff has observed that CKH has forecasted no residential smart meter installations in 2011. The data in the model show 28,568 residential smart meters installed from 2006 to 2010 inclusive.

However, in response to Board staff IR # 2 b), CKH stated:

> CKH intends to fund smart meter additions in 2011 via the smart meter adder described in (a) above. CKH anticipates seeking Board approval for smart meter recovery post deployment, at such time as CKH is certain that all smart meter deployment costs are known (including MDM/R costs and stranded meter costs). CKH does not assume that before the next Cost of Service application, base distribution rates for residential customers will fully recover capital-related and operating costs of smart meters, subject to inflation less productivity gains.

Submission

The above issue has no impact on the proposed funding adder but Board staff wishes to comment in order to provide some clarity on this matter.

Board staff is uncertain how the proposed smart meter funding adder will fund any new residential smart meter additions in 2011 if there are no residential smart meters forecasted, as shown in the model.

Board staff has some concerns with CKH's approach and assumptions. There is a long history to Smart Meter funding and cost recovery, beginning with the generic issues hearing RP-2005-0020/EB-2005-0529 as part of the 2006 EDR process. This was the genesis of the smart meter funding adder and the deferral/variance ("D/V") account approach to tracking funding adder revenues and capital and operating costs for installed meters, as the regulations and technology became established. The Board's regulatory and rate-setting treatment has evolved, as evidenced by the Guideline and the Board's decisions in applications since 2007.
While the funding adder and D/V account treatment was necessary to allow for smart meter investment without affecting other utility operations (at least from a financing

perspective), and managing rate impacts on customers, at some point smart meters should be treated like other distribution capital assets – poles, wires, transformers, buildings, vehicles, and tools.

Board staff submits that CKH has basically reached this stage with respect to smart meters for residential customers. Capital costs for smart meters installed to the end of 2008 have been reflected in rate base and revenue requirement, and hence in distribution rates. It appears that CKH's smart meter program for residential smart meters has been completed by the end of 2010, and that it may be reasonable for any costs incurred in 2011 to be part of normal operations covered by the IRM mechanism. Therefore, Board staff question the need for further tracking of residential smart meter costs in 2011 and beyond for future disposition.

Board staff observes that CKH's response to Board staff IR # 2 b) does not factor into the proposed smart meter funding adder in this application, but this matter should be reviewed upon a subsequent application for disposition.

All of which is respectfully submitted.