

**Ontario Energy
Board**
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

**Commission de l'énergie
de l'Ontario**
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



BY E-MAIL

January 21, 2011

Board Secretary
Ontario Energy Board
2300 Yonge Street
Toronto ON M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: Board Staff Submission
Norfolk Power Distribution Inc.
2011 Electricity Distribution Rate Application – Early Rebasing Issue
Board File Number EB-2010-0139**

Please find the attached Board staff submission in the above proceeding. Please forward the following to Norfolk Power Distribution Inc. and all other parties to this proceeding.

Sincerely,

Original Signed By

Martin Davies
Project Advisor, Applications & Regulatory Audit

Attachment



ONTARIO ENERGY BOARD

STAFF SUBMISSION

**2011 Cost of Service Application – Early
Rebasing Issue**

Norfolk Power Distribution Inc.

EB-2010-0139

January 21, 2011

INTRODUCTION

Norfolk Power Distribution Inc. (“Norfolk” or “the Applicant”) filed an application with the Ontario Energy Board (the “Board”), received on October 29, 2010 under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the rates that Norfolk charges for electricity distribution, to be effective May 1, 2011. The Board assigned the application File Number EB-2010-0139.

The Board issued a Notice of Application and Hearing dated November 10, 2010. Energy Probe Research Foundation (“Energy Probe”), Vulnerable Energy Consumers Coalition (“VECC”), School Energy Coalition (“SEC”) and HVAC Coalition (“HVAC”) were accepted as intervenors by the Board.

On December 16, 2010, the Board issued Decision & Procedural Order No. 1, in which it determined that it would consider Norfolk’s application for early rebasing for 2011 distribution rates (the “Preliminary Issue”) in advance of further procedural steps. In this context, the Board allowed an initial round of interrogatories by intervenors and Board staff to obtain additional information specifically related to the Preliminary Issue and Norfolk’s evidence on the Preliminary Issue followed by submissions and reply submissions. Board staff, Energy Probe and VECC all asked interrogatories on the Preliminary Issue. Norfolk filed its responses to these interrogatories on January 11, 2011.

This submission reflects observations and concerns which arise from Board staff’s review of Norfolk’s evidence on the Preliminary Issue as well as its responses to the related interrogatories.

EARLY REBASING ISSUE

In a letter sent to distributors on April 20, 2010 (the “Early Rebasing Letter”), the Board stated that:

A distributor, including the four distributors referred to above, that seeks to have its rates rebased in advance of its next regularly scheduled cost of service proceeding must justify, in its cost of service application, why an early rebasing is required notwithstanding that the “off ramp” conditions have not been met. Specifically, the distributor must clearly

demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period. Distributors are advised that the panel of the Board hearing the application may consider it appropriate to determine, as a preliminary issue, whether the application for rebasing is justified or whether the application as framed should be dismissed.

Distributors are also advised that the Board may, where an application for early rebasing does not appear to have been justified, disallow some or all of the regulatory costs associated with the preparation and hearing of that application, including the Board's costs and intervenor costs. In other words, the Board may order that some or all of those costs be borne by the shareholder.

Staff notes that Norfolk rebased its distribution rates in 2008 and would normally come in for rebasing in 2012 under the 3rd Generation Incentive Regulation Mechanism plan. In its application, and specifically at Exhibit 1/Tab2/Schedule 1/pp. 2-4, Norfolk provided its reasons and support for filing an application for an early rebasing of rates for 2011. These reasons were summarized by Norfolk in its response to a Board staff interrogatory¹ as follows:

1. Rate Stabilization
2. Prior Board Decision
3. Rate Application Efficiency
4. Financial Need

In this submission, staff will review each of the reasons offered by Norfolk for its early rebasing application and provide its views as to whether or not Norfolk has adequately justified its request.

1. Rate Stabilization

Norfolk stated that there were two aspects to the rate stabilization issue.

The first of these is that with the completion of its transformer station in 2010, Norfolk's transformation charges have declined which will result in a significant reduction in Retail Transmission Connection Rates charged to customers. Norfolk stated that in its cost of

¹ Norfolk Power Distribution Inc. EB-2010-0139, Interrogatory responses to Ontario Energy Board Staff on the Preliminary Issue, Delivered January 11, 2011 (Board staff interrogatory responses), #2

service application, it is trying to implement those savings for its customers now, whereas in a simple mechanistic IRM application, adjustments to the Retail Transmission Service Rates would be based simply on Board approved revisions to the Uniform Transmission Rates. Norfolk added that reduced load information resulting in reduced transmission service costs would not be updated and that as a result of the current cost of service application, its customers would be benefitting from the completed station both through increased reliability and reduced transmission costs, while also paying reasonable and appropriate costs related to the new station through distribution rates commencing in 2011.

Staff notes that the Board's approach to adjusting RTS rates is not limited to adjusting for any change to the Uniform Transmission Rates. The Board's methodology also takes into account a distributor's most recent historical cost and revenue patterns. Nevertheless, while the Board's preference has indeed been to maintain a mechanistic approach to adjusting RTS rates in an IRM application, it is always open to a distributor to propose a more wholesale adjustment to its RTS rates given its unique circumstances. Similar to the approach the Board used for the disposition period of Norfolk's deferral and variance account balances in the 2010 IRM application (which will be discussed below), the Board has in the past been flexible in allowing applicants to deviate from the filing requirements and guidelines in order to better address unique and discrete issues.

The second aspect of the rate stabilization issue cited by Norfolk is that in its 2010 IRM application (EB-2009-0238), it had proposed to delay disposition of 75% of the relevant Group 1 account balances until 2011. Norfolk stated that the rationale behind this request was to avoid rate volatility due to decreased rates in 2010 arising from a full disposition of Group 1 accounts in that year followed in 2011 by both the removal of the disposition rate rider, plus increased distribution rates from the planned cost of service application. Norfolk further stated that if its cost of service application does not proceed until 2012, rate volatility will occur at that time, with the removal of the 2011 rate riders and an increase in distribution rates from the cost of service application, thereby nullifying the rationale for the Board approved two year disposition of Group 1 accounts. This aspect will be further discussed in the subsequent section of this submission.

Staff would note that while some rate stabilization may occur as a result of the earlier filing of the cost of service application, this comes at the expense of customers paying

the higher rates arising from such an application one year earlier. Staff further notes that rate stabilization is not a criterion justifying an earlier cost of service application in the Early Rebasing Letter, or one that has previously been accepted by the Board.

2. Prior Board Decision

The second justification cited by Norfolk is the Board's Decision on its 2010 IRM application, specifically, the paragraphs referenced below²:

Norfolk's (sic) requested the disposition of its Group 1 account balance over a four year period. Board staff submitted that a disposition period no longer than one year would be appropriate for all Group 1 account (sic) since these balances have been accumulating over the last four year period and to delay any immediate action would not be in the interest of all parties. In its reply submission, Norfolk stated that refunding the Group 1 account balance over one year would have a significant impact on its cash flow. Norfolk also expressed concerns about rate volatility. Norfolk stated that it intends to file a 2011 cost of service application and anticipates upward pressure on rates due to rate base increase and approval to recover stranded meter costs. Norfolk submitted that if the Board were to disapprove a four year disposition period, the Board may wish to consider approving a two year disposition plan where 25% of the Group 1 account balances would be refunded in 2010 and the remaining amount in 2011.

The Board accepts in principle Board staff's rationale for a disposition period of one year and adopts it subject to any compelling evidence that the disposition period should be lengthened. The Board finds that Norfolk's rationale for proposing to extend the disposition period is reasonable but is of the view that a four year disposition period is too long. The Board will accept Norfolk's alternative proposal to dispose 25% of the Group 1 account balances in 2010 and the remaining 75% in 2011. The Board will reflect these findings in Norfolk's draft Rate Order.

Norfolk expressed the view that the Board's Decision, which incorporated the setting aside of the accepted principle of a one-year disposition period due to rate fluctuations arising from the early 2011 cost of service application, represented an acceptance by the Board that it would be making the cost of service application. Norfolk expressed the belief that the setting of 2011 rates as it had requested was done by the Board to help mitigate the increase in rates coming from its intended cost of service application. Furthermore, Norfolk stated that given the Board had set aside its accepted principle

² EB-2009-0238 Norfolk Power Distribution Inc., Decision and Order, pp. 13-14

and adjusted the rates based on Norfolk's stated intention to file the cost of service application, it believed that it now had an obligation to file the cost of service application.

Norfolk added that it was for this reason that it did not believe that the Hydro Ottawa Decision, in which the Board had rejected Hydro Ottawa's early rebasing application, was applicable to its circumstances. Instead, Norfolk stated that it was in a similar position in this regard to Horizon Utilities Corporation whose early rebasing application had been allowed to proceed by the Board. Norfolk cited, in support of its position, the finding from that Decision reproduced below³:

However, the Board finds that it was reasonable for Horizon to believe that the Board would accept a cost of service application from Horizon at this time. Therefore, the Board finds that the considerations in the April 20th letter and the Hydro Ottawa decision do not apply to this application.

Staff would agree with Norfolk that there are some similarities between these aspects of the Horizon and Norfolk applications in that both preceding Board Decisions had referred to impending cost of service applications by the applicant in question. However, in the case of Horizon Utilities, it had earlier filed an application for Z-factor treatment of load loss that had been denied by the Board.⁴ In denying that application, the Board sought to provide guidance to distributors confronted with large customer revenue losses, stating that⁵:

In making these findings, the Board is mindful of the need to provide guidance to distributors as to the appropriate approach to take when confronted with such revenue losses. The Board notes the importance of assessing the actions taken by a distributor to deal with customer load loss in the context of their overall impact on the utility, including the overall financial impacts on the utility. The Board believes that the most appropriate approach for a distributor to take under such circumstances is to file a cost of service application. A distributor could also bring forward a request for special treatment of such losses within the context of the overall cost of service application.

³ EB-2010-0131 Horizon Utilities Corporation, Decision on the Preliminary Issue of early Rebasing and Procedural Order No. 4, p. 6

⁴ EB-2009-0332 Horizon Utilities Corporation, Application to the Ontario Energy Board for a Z-Factor-Related Rate Rider, September 3, 2009

⁵ EB-2009-0332 Horizon Utilities Corporation, Decision, March 24, 2010, p.16

Board staff would note that Norfolk's early rebasing application is, unlike Horizon's, not based on the need to deal with a pressing load loss, or similar, issue. Staff would therefore submit that it does not meet the stated criterion in the Early Rebasing Letter "that the distributor must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period."

3. Rate Application Efficiency

Norfolk stated that it would be more efficient to proceed with a cost of service application at this time, followed by a simpler IRM application in 2012 rather than file an IRM application in 2011, along with applications for CDM-related costs through the Lost Revenue Adjustment Mechanism ("LRAM"), Retail Transmission Rates, Smart Meters and an Incremental Capital Module ("ICM"); to be followed with a full cost of service application in 2012. Norfolk noted that previous ICM applications have resulted in oral hearings and expressed the view that it is likely that an oral hearing would have been required had it filed an ICM application for 2011. Norfolk expressed the belief that it would be more cost effective and efficient to deal with all of these applications now through a cost of service application, followed by a simple IRM application in 2012, rather than to address these matters as part of an IRM application, or separate applications, in addition to the IRM application in 2011, followed by a cost of service application in 2012.

Board staff would acknowledge that some efficiencies may be achieved under these circumstances. However, it is likely that if the IRM application had been filed in 2011 and dealt with all of the referenced issues, there would have been cost savings and efficiencies related to the potentially less complicated 2012 cost of service application that would have arisen compared to the 2011 cost of service application presently before the Board. Staff also notes that it would be difficult to quantify the magnitude of the efficiencies that would be achieved and their significance since other presently unanticipated issues may have arisen before the 2012 cost of service application was filed. Furthermore, possible rate application efficiencies are also not a criterion that has been established by the Board to justify early rebasing applications.

Staff also notes that a typical IRM application includes rate adjustments for matters such as LRAM, deferral and variance account disposition, changes to smart meter

funding adders and the re-setting of RTS rates. In addition, two applications that have been filed for 2011 rates include an ICM (Oakville Hydro – EB-2010-0104 and Guelph Hydro - EB-2010-0130). While both applications are in the submission stages, neither has involved an oral hearing.

4. Financial Need

Norfolk stated that on May 31, 2010 it had submitted a letter to the Board confirming its intention to file a cost of service application for May 2011 rates. Norfolk stated in that letter that it expected to earn less than the approved ROE by more than 300 basis points for the year 2011. However, Norfolk noted that, between the time of the letter and the submission of the application, revisions to expected expenditures in 2011 reduced this amount to 296 basis points.

Norfolk further noted that it anticipated significant capital expenditures to replace aging assets and that other LDCs have indicated the need to finance future capital spending requirements. Norfolk stated that since its last cost of service application, its rate base has increased 21% and this increase is not being recovered in current rates. Norfolk added that while the dollar values may appear small compared to other LDCs, based on Norfolk's size, the capital spending requirements are just as great.

Board staff notes that Norfolk's presently approved ROE is 8.57%. This would mean that the application of the 300 basis points off-ramp would imply that Norfolk's ROE would need to be at a level of 5.57% or lower to meet this criterion. In response to a Board staff interrogatory,⁶ Norfolk stated that its 2009 and 2010 ROEs were 8.22% and 6.44% respectively. Furthermore, Norfolk's most current updated forecast for 2010 is 6.73%. Staff notes, in addition, that in response to an Energy Probe interrogatory⁷ Norfolk provided a 2009 actual ROE return based on its deemed capital structure of 10.02%, which is well above the 8.57% threshold referenced above.

Staff notes that Norfolk's results for 2009, the most recent year for which full actual figures are available, demonstrate that its ROE is substantially above the 5.57% threshold ROE. The most recent forecast for the 2010 Bridge year is 6.73%, which is more than 100 basis points above this threshold. Norfolk's forecast for 2011 at 5.61% is

⁶ Board staff interrogatory 1

⁷ Energy Probe Research Foundation interrogatory 2b

also slightly above the threshold. Board staff would therefore submit that Norfolk has not demonstrated that the Board's off-ramp criteria related to financial need has been met.

OPTIONS

1. Hear the Application

Norfolk has stated that hearing the cost of service application this year would be the most efficient approach for the Board to take and that any IRM application for 2011 would be a relatively complex application. Furthermore, Norfolk has noted that the 2012 cost of service application would normally be filed only seven months from now.

In Staff's view, these factors would constitute potential justification for the Board to hear the present cost of service application.

2. Dismiss the Application

Board staff notes that Norfolk does not satisfy the 300 basis point threshold to apply for early rebasing as stipulated in the Board's Early Rebasing Letter and that it has not provided a reason as to why there would be any serious implications for the financial well-being of the utility justifying re-examination of Norfolk's cost of service at this time. Furthermore, Norfolk has not demonstrated why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period in the absence of a cost of service application.

Should the Board dismiss the application, Norfolk would presumably re-apply in its usual turn for a cost of service review for 2012 electricity distribution rates. This would normally result in a refiling in August 2011, seven months from the date of this submission. In the interim period, it would open for Norfolk to file an IRM application for 2011 rates. Such an application could be processed in three to four months, and a decision and rate order issued not long after the May 1 effective date for 2011 rates. With a cost of service application filing planned for August 2011, it would be open to Norfolk to decide how complex it wished to make its 2011 IRM application.

- All of which is respectfully submitted –