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BY EMAIL

January 21, 2011

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

Dear Ms. Walli:

Re: Veridian Connections Inc.
2011 IRM3 Distribution Rate Application
Board Staff Submission
Board File No. EB-2010-0117

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 Veridian Connections Inc. and to all other registered parties to this proceeding.

In addition please remind Veridian Connections Inc. that its Reply Submission is due by February 11, 2011.

Yours truly,

Original signed by

Lawrie Gluck
Analyst, Applications & Regulatory Audit

Encl.

ONTARIO ENERGY BOARD

BOARD STAFF SUBMISSION

2011 ELECTRICITY DISTRIBUTION RATES

VERIDIAN CONNECTIONS INC.

EB-2010-0117

January 21, 2011

Introduction

Veridian Connections Inc. ("Veridian") filed an application (the "Application") with the Ontario Energy Board (the "Board"), received on October 5, 2010, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that Veridian 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 Veridian.

In the interrogatory phase, Board staff identified certain discrepancies in the data entered in the application model by Veridian. 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, Veridian confirmed that they were errors and provided the corrected data. Board staff will make the necessary corrections to Veridian's models at the time of the Board's decision on the application.

Board staff makes submissions on the following matters:

- Adjustments to the Revenue-to-Cost Ratios;
- Z-Factor Cost Recovery – PCB Testing; and
- Deferral and Variance Account Disposition.

Adjustments to the Revenue-to-Cost Ratios

Background

In its 2010 cost of service application (EB-2009-0140), Veridian proposed adjustments to revenue-to-cost ratios for 2011 for selected classes in both the Main and Gravenhurst Tariff Zones.

In this application, for the Main Tariff Zone, Veridian has proposed to adjust the revenue-to-cost ratio for the Sentinel Lighting rate class from the current level of 56.53% to the target minimum range of 70%. The offsetting revenue adjustment has been allocated to the GS < 50 kW rate class, which is the only rate class where the revenue-to-cost ratio is currently over 100%.

For the Gravenhurst Tariff Zone, Veridian has proposed the following revenue-to-cost ratios adjustments:

a) Residential-Suburban - 61.68% to 69.45%;
b) GS < 50 kW – 141.45% to 133.48%; and
c) Sentinel Lighting – 30.02% to 43.32%.

The offsetting revenue adjustment has been allocated to the GS > 50 kW rate class. Although the ratio for this class is within the Board's target range, Veridian indicated that it is currently the highest among the classes.

In interrogatory #7, Board staff asked Veridian to explain why no revenue offsets were included in the 2011 IRM3 Revenue Cost Ratio Adjustment Workform. Veridian noted that no revenue offset information has been included because there is no relevant source for this information. Veridian also explained the manner in which this issue was addressed in its 2010 Cost of Service application.
The Vulnerable Energy Consumers Coalition ("VECC") asked in interrogatory # 1b that Veridian provide a revised 2011 IRM3 Revenue Cost Ratio Adjustment Workform which allocates the revenue offsets between its Main and Gravenhurst Tariff Zones on the basis of the 2010 Board-approved distribution revenue requirement. Veridian complied with this request in its interrogatory response.

Submission

Board staff submits that the revenue-to-cost ratio adjustments proposed by Veridian for both its Main and Gravenhurst Tariff Zones are consistent with the evidence that supported the Settlement Agreement in Veridian's 2010 cost of service application, and are appropriate as they move the revenue-to-cost ratios closer to (or within) the Board prescribed ranges as set out in the Board's November 28, 2007 "Report on Application of Cost Allocation for Electricity Distributors".

Board staff submits that revenue offset information should be included in the 2011 IRM3 Revenue Cost Ratio Adjustment Workform. Board staff requests that Veridian propose a methodology for including the 2010 revenue offset amount of $4,463,100 in the 2011 IRM3 Revenue Cost Ratio Adjustment Workform.

Z-Factor Cost Recovery – PCB Testing

Background

Veridian has requested the recovery of $314,927 previously recorded in Account 1572 – Extraordinary Event Costs. This amount is for costs incurred by Veridian in 2009 related to the testing of non-pole top transformers required for compliance with Environment Canada's PCB Regulation which became effective September 5, 2008.

Veridian has applied for cost recovery of the above amount as a Z-factor claim in accordance with Section 2.2 of "Chapter 3 of the Filing Requirements for Transmission and Distribution Applications," dated July 9, 2010 (the "Filing Requirements"). Veridian indicated that it provided notice to the Board, in accordance with Filing Requirements (dated July 22, 2009) of its intention to record its 2009 PCB testing costs in account 1572 and would seek approval for the recovery of these amounts in a future rate application.

Board staff notes that Section 2.2.1 of the Filing Guidelines sets out the following Z-Factor Amount Eligibility Criteria:

a) **Causation** – Amounts must be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.
b) **Materiality** – The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor.
c) **Prudence** – The amount must have been prudently incurred. This means that the distributor's decision to incur the amount must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

In regards to causation, Veridian noted that its 2009 distribution rates were established on cost of service levels which did not include the legislated, non-discretionary costs of PCB testing required for compliance with the Environment Canada legislation.

With respect to materiality, Veridian noted that the Board's Z-factor materiality threshold is set at 0.5% of Distribution Revenue Requirement for a distributor with a revenue requirement greater than $10 million and less than or equal to $200 million. Veridian noted that its approved 2010 Distribution Revenue Requirement is $46,284,010 and the resulting Z-factor threshold amount is $231,420. Therefore, Veridian stated that its PCB testing costs are clearly in excess of the Board's materiality threshold.

Veridian stated that in order to meet the deadlines of the relevant legislation it would be necessary to contract outside services to complete the PCB testing work. Veridian noted that the costs it incurred were prudent as it initiated a competitive Request for Proposal process to identify the least-cost bidder and awarded the contract on that basis (with a maximum award contract in place). Veridian also noted that it prudently managed its service contract and as a result, the total contracted costs were below the maximum contract price.

Veridian has proposed to recover its Z-factor claim through a one-year Distribution Volumetric Rate Rider, which would expire on April 30, 2012. Veridian also proposed to allocate the costs to the customer rate classes within each Tariff Zone on the basis of the 2009 reported metered kWh.

In interrogatory #15, Board staff requested that Veridian provide the rationale for using metered kWh to allocate the Z-factor costs to Veridian's customer rate classes. Veridian stated that it has proposed to use metered kWh as the allocator because the July 31, 2009 "Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative" (the "EDDVAR Report") states that the default allocator for Account 1572 – Extraordinary Event Costs includes metered kWh. Board staff also asked whether Veridian considered allocating the Z-factor costs on the same basis as transformer costs and whether Veridian would consider this approach to be appropriate. Veridian stated that it viewed this as an acceptable approach for allocating the recovery of Z-factor costs.

Submission

Board staff submits that Veridian's claim for Z-factor recovery of its PCB testing costs is in accordance with the Z-factor eligibility criteria. In Board staff's view, Veridian has demonstrated that the PCB testing costs were material, prudently incurred, were clearly not discretionary since mandated by the federal government, and outside the base upon which rates were derived. Therefore, Board staff supports Veridian's request for Z-factor recovery of $314,927.

Board staff further submits that in order to better reflect cost causality principles, the allocation of the Z-factor recovery should be based on the rate class responsible for transformer costs. .

Deferral and Variance Account Disposition

Background

For purposes of 2011 IRM applications, the EDDVAR Report requires a distributor to determine the total value of its December 31, 2009 Group 1 Deferral and Variance account balance and determine whether the balance exceeds the preset disposition threshold of $0.001 per kWh using the 2009 annual kWh consumption reported to the Board. When the preset disposition threshold is exceeded, a distributor is required to file a proposal for the disposition of Group 1 account balances (including carrying charges) and include the associated rate riders in its 2011 IRM Rate Generator for the disposition of the balances in these accounts. The onus is on the distributor to justify why any account balance in excess of the threshold should not be cleared.

Veridian noted that the Board approved, in its 2010 Cost of Service application, the calculation and establishment of two separate rate riders for Group 1 account balances. The Board approved the establishment of a delivery component rate rider for recovery of Group 1 account balances (excluding the recovery of Account 1588 – RSVA – Power – Global Adjustment Sub-account) and a separate electricity component rate rider for the recovery of the Global Adjustment Sub-account.

On the basis that the Board has accepted that the recovery of the Global Adjustment sub-account should be independent of the other Group 1 account balances, Veridian stated that to apply the materiality threshold test to the total of all Group 1 account balances is not appropriate. Veridian proposed that the materiality threshold test be applied separately to the amounts proposed for disposition by separate rate riders.

Veridian noted that using the Board's threshold test (which calculates the threshold for the total Group 1 Account balance including the Global Adjustment Sub-account) for its

Main Tariff Zone results in a value of $0.000275 per kWh (which is below the threshold). This result is due to the large debit balance in the Global Adjustment Sub-account which largely offsets the balances in the remainder of the Group 1 accounts.

Veridian proposed to utilize a separate threshold test for each of:

a) Group 1 accounts (excluding the Global Adjustment Sub-account),
b) The Global Adjustment Sub-account only.

Veridian's proposed methodology results in threshold test values for the Main Tariff Zone of a credit of $0.0044 per kWh for the Group 1 Accounts (excluding the Global Adjustment Sub-Account) and a debit value of $0.0047 per kWh for the Global Adjustment Sub-account. For the Gravenhurst Tariff Zone, the result of Veridian's proposed threshold testing methodology is a credit of $0.0044 per kWh for the Group 1 Accounts (excluding the Global Adjustment Sub-Account) and a debit value of $0.0029 per kWh for the Global Adjustment Sub-account.

Veridian requested that the Board review and approve the disposition of the December 31, 2009 balances of Group 1 Deferral and Variance account balances, including interest as of April 30, 2011 for both its Main and Gravenhurst Tariff Zones. In the Main Tariff Zone, the total balance of the Group 1 accounts (excluding the Global Adjustment Sub-account) is a credit of $10,555,886 and the balance of the Global Adjustment Sub-account is a debit of $11,209,683. In the Gravenhurst Tariff Zone, the total balance of the Group 1 accounts (excluding the Global Adjustment Sub-account) is a credit of $400,493 and the balance of the Global Adjustment Sub-account is a debit of $265,001. Debit balances are amounts recoverable from customers while credit balances are amounts to be refunded to customers.

Veridian proposed to dispose of all its Group 1 account balances over a two-year period.

Submission

Board staff notes that the threshold testing methodology proposed by Veridian is not consistent with the EDDVAR Report. In the EDDVAR Report, the Board established a preset disposition threshold of $0.001 per kWh during the IRM plan term for all Group 1 accounts combined. On that basis, the preset disposition threshold was not exceeded for either the Main or Gravenhurst Tariff Zones. The Board also stated in the EDDVAR Report that during the IRM plan term: "this disposition threshold level should enhance the distributor's ability to manage its cash flow."[1] Board staff further notes that even when the Group 1 account balances for both the Main and Gravenhurst Tariff Zones are combined the disposition threshold is not exceeded, which suggests that no material cash flow considerations exist for the corporation.

Board staff also submits that the fact that the Board approved a separate rate rider applicable to non-RPP customers to dispose of the global adjustment sub-account balance is not relevant to the establishment of a disposition threshold. In Board staff's view, the approval of a separate rate rider is a cost allocation and rate design issue, and is not germane to the establishment of a disposition threshold methodology. Board staff further notes that no intergenerational inequities issues were raised by Veridian.

Veridian stated that its proposed threshold test method would mitigate the accumulation of larger account balances to be recovered or refunded to ratepayers. Board staff notes that the record is unclear on that point since no bill impacts by rate class were presented for non-RPP customers. Board staff is finally of the view that an IRM application is not an appropriate forum to address deviations from existing Board Policy.

Board staff therefore submits that disposition is not warranted at this time.

All of which is respectfully submitted.

[1] EDDVAR Report Page 10