January 21, 2011

BY EMAIL & COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2010-0139
Norfolk Power Distribution Inc. – 2011 Cost of Service Application
Energy Probe – Submission on the Preliminary Issue

Pursuant to the Decision and Procedural Order No. 1, issued December 16, 2010, attached please find the Submissions of Energy Probe Research Foundation (Energy Probe) in respect of the Preliminary Issue in the EB-2010-0139 proceeding for the consideration of the Board.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

Original signed by

David S. MacIntosh
Case Manager

cc: Jody McEachran, Norfolk Power (By email)
James Sidlofsky, Borden Ladner Gervais LLP (By email)
Randy Aiken, Aiken & Associates (By email)
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EB-2010-0139

Ontario Energy Board

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

AND IN THE MATTER OF an application by Norfolk Power Distribution Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2011.

SUBMISSIONS OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")
ON PRELIMINARY ISSUE

January 21, 2011

A – INTRODUCTION

The Ontario Energy Board (the "Board") issued Decision & Procedural Order No. 1 on December 16, 2010 in relation to the cost of service rebasing application of Norfolk Power Distribution Inc. ("NPDI"). This procedural order noted that in a letter sent to distributors dated April 20, 2010 (the "Letter"), the Board indicated that a distributor filing a cost of service application, if it was not on the list attached to the Letter, must demonstrate that it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period, and as such, is applying for early rebasing.

The Letter further indicated that the Board may determine, as a preliminary matter or issue, whether the application is justified, and if not justified, that it may disallow some or all of the costs associated with the preparation and hearing of the application.

In Procedural Order No. 1, the Board determined that it would consider the preliminary issue in advance of further procedural steps with respect to the current application.

Board Staff and intervenors filed interrogatories on the preliminary issue with NPDI on December 23, 2010. NPDI responded to these interrogatories on January 11, 2011.

This is the submission of the Energy Probe Research Foundation ("Energy Probe") on the preliminary issue.

B - REPORTS OF THE BOARD ON 3RD GENERATION INCENTIVE REGULATION FOR ONTATRIO'S ELECTRICITY DISTRIBUTORS

The July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors ("Report") was the result of consultations that:

> *"considered all of the necessary elements of an IR mechanism framework including the form and term of the plan, the inflation and productivity factors, the potential for earnings sharing, and the treatment of unforeseen events. The consultations also included a focus on specific issues associated with capital investment to support infrastructure maintenance and development, lost revenue due to changes in electricity consumption and distributor diversity."* (page 2)

The elements of the plan, as set out in the Report of the Board that are relevant to the current application by NPDI include the term of the plan, off-ramps and the stretch factor included in the X-factor,

With regards to the term of the IR plan, the Board determined that the plan term for the 3rd Generation IR would be fixed at three years (i.e. rebasing year plus three years). The Board further stated that:

> *"The rates of the distributor are not expected to be subject to rebasing before the end of the plan term other than through an eligible off-ramp."* (page 7)

The Board`s policy with respect to off-ramps is that the 3rd Generation IR plan would include a trigger mechanism with an annual ROE dead band of +/- 300 basis points. In particular, when a distributor performs outside of this earnings dead band, a regulatory review may be initiated.

In particular, the Board determined that a distributor would be required to make a report to the Board no later than 60 days after the company's receipt of its annual audited financial statements in the event that the distributor falls short of or exceeds its ROE by 300 basis points. This report would be reviewed to determine if further action by the Board would be warranted. Any such review could result in modifications to the IR plan, a termination of the IR plan, or the continuation of the IR plan. The Board indicated that this was to be an early warning mechanism rather than necessarily terminating the IR plan.

C - JUSTIFICATION FOR A COST OF SERVICE REBASING APPLICATION

NPDI filed a letter with the Board dated February 19, 2010 indicating to the Board of its intention to file a cost of service application in August 2010 for new rates effective May 1, 2011. A copy of this letter is attached as Appendix A to Energy Probe Interrogatory #5 (b). The letter indicates that the reason for this early rebasing was the result of the recent completion of phase two of NPDI's transformer station and other major capital projects. It was NPDI's wish to begin recovery of these asset investments and their associated expenses through rates "as soon as reasonable".

Three days later, in their Reply Submission in EB-2009-0238 (an IRM application for May 1, 2010 rates), NPDI noted that it had recently notified the Board of its intention to submit a cost of service application later in 2010 for rates effective May 1, 2011 (EB-2009-0238 Final Submission dated Feb. 22, 2010).

Energy Probe notes that the Board has made it clear, both in the Report and in the April 20^{th} Letter, that it expected a distributor to stay in IRM unless there are legitimate reasons to do otherwise. Energy Probe further notes the Board's expectation that a justification must be provided for a 2011 cost of service application by a distributor.

The threshold issue in this case, as stated in the April 20^{th} Letter, is whether NPDI has justified in its cost of service application and through further examination of evidence "why an early rebasing is required notwithstanding that the "off ramp" conditions have not been met". Distributors were also instructed to "clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period".

It is the submission of Energy Probe that NPDI has failed to justify the need for a 2011 cost of service methodology application for rates and the early termination, by 12 months, of the IRM plan.

D - FAILURE TO JUSTIFY

Energy Probe submits that NPDI has failed to justify its need to set rates under a cost of service application for the 2011 test year and terminate the IRM plan 12 months early.

In its letter to the Board dated May 31, 2010 related to the cost of service early rebasing application, NPDI stated that:

> *"it wishes to confirm that based on changes to its rate base and distribution revenue since it last rebased in 2008, it will meet the criteria for an "off-ramp" provision, earning less than its approved ROE, by more than 300 bps for the year 2011. On this basis NPDI wishes to confirm its intent to file a Cost of Service application in August 2010 for new rates effective May 1, 2011".*

As shown in part (d) below, NPDI will not trigger an off-ramp in 2011. As such, the early cost of service rebasing should be denied as the reason for the application in the May 31, 2010 letter is not valid.

NPDI has now presented four reasons for the early cost of service rebasing application that are summarized in the response to Board Staff Interrogatory #2. These reasons are rate stabilization, prior Board Decision, rate application efficiency, and financial need. None of these factors, in the view of Energy Probe, justify the early rebasing application.

Energy Probe submits that the early rebasing application by NPDI should be denied by the Board based on the following submissions.

a) Rate Stabilization

In the response to Board Staff Interrogatory #2, NPDI indicates that one of the reasons for the early rebasing application is that there will be a significant reduction in Retail Transmission Connection Rates charged to customers as the result of the completion of the transformer station in 2010.

NPDI discusses this is more detail at the bottom of page 3 in Exhibit 1, Tab 2, Schedule 1. NPDI submitted that as its customers are now benefiting from the completed station both through reliability and reduced transmission rates, it is reasonable and appropriate that it should also be able to recover costs related to the same asset through distribution rates commencing in 2011. At page 4 of the evidence, NPDI recognized that it could use the incremental capital module to address the increased capital spending under IRM, but indicates that this would have made the IRM application "complex". Energy Probe comments on this complexity in a later section.

As indicated in the response to Energy Probe Interrogatory #3, NPDI would qualify for the use of the capital module under IRM for 2011 rates. Moreover, NPDI could have used the capital module for 2010 rates since it qualified for its use then, when the transformer station was put into service.

Energy Probe submits that any reduction in transmission costs in 2011 resulting from the completion of the transformer station is not a justification for an early rebasing application. Any reduction in transmission costs incurred in 2011 will be captured in a variance account to be disposed of in the future.

NPDI also discusses the impact of the increase in the rebate to customers as a result of the approved methodology from the EB-2009-0238 proceeding to dispose of the balances in deferral and variance accounts to customers. The rebate to customers will end in May 2012. NPDI asserts that if the cost of service application does not proceed until 2012, the removal of the 2011 rate riders and an increase in distribution rates from the cost of service application will result in rate volatility at that time.

Energy Probe submits that there is no evidence to suggest that rate volatility in excess of that which may require rate mitigation measures will occur if the cost of service application proceeds for 2012 rates as scheduled. NPDI has provided no evidence to support this conclusion. There is no evidence to suggest that the deferral and variance rate rider included in 2012 rates will be positive or negative (except of course that NPDI is expecting a credit to customers related to transmission costs). In any event, the 2012 cost of service proceeding would deal with any rate mitigation measures that might be necessary based on the evidence in that proceeding, not on conjecture on the part of NPDI in this proceeding.

b) Prior Board Decision

NPDI submits that the Board acknowledged NPDI's statement that it would be submitting a cost of service application for 2011 rates in the EB-2009-0238 IRM Decision. Energy Probe does not believe that this acknowledgement should in any way affect the Board's policy for rebasing.

First, and most important, NPDI's appears to believe that the Board accepted NPDI's intent to file a cost of service application in the EB-2009-0238 Decision. Energy Probe respectfully disagrees.

The issue in the EB-2009-0238 proceeding was with the timing of the disposition of the deferral and variance account balances. There was no issue related to the appropriateness of rebasing a year earlier than scheduled. This can be seen in the response provided to Energy Probe Interrogatory #7 (b). In that response, NPDI only indicated its intention to file a 2011 cost of service application in its reply submission. Importantly, NPDI did not explicitly explain that this would be an early rebasing application in that reply submission.

The Board would not, and indeed should not, give its approval for this early rebasing which was not an issue in the proceeding, and was not raised by the applicant until its reply submissions. Even if it is assumed that the Board did approve an early rebasing application from NPDI, it would be reasonable to assume that this approval was under the presumption that such an application could be justified. This justification is the subject of the current proceeding. The approval, based on appropriate justification, cannot be justification in and of itself.

While the Board did acknowledge NPDI's intention to file a 2011 cost of service application it did not approve the filing of such an application. It simply approved the timing of the disposition of deferral and variance account balances.

Energy Probe further notes that NPDI did not provide any rationale for the early rebasing other than rate volatility. Energy Probe has provided its submissions on this issue in the preceding section.

The Board policy with respect to rebasing is clear. Absent the triggering of the off-ramp, any distributor applying to rebase early must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period. NPDI did not do this in the EB-2009-0238 proceeding. It has not done this in this proceeding. If the Board were to accept a simple statement in the reply submission of an IRM application that a distributor was going to rebase in the following year (with or without explicitly identifying that this would be an early rebasing) as justification for an early rebasing, it would be effectively eliminating the applicability of its stated policy with respect to the off-ramp.

<u>c) Rate Application Efficiency</u>

NPDI has submitted 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 filing an IRM in 2011, along with applications for LRAM/SSM, retail transmission rates, smart meters and an incremental capital module.

Energy Probe notes that NPDI has indicated that the LRAM/SSM and smart meter components of the IRM filing for 2011 are not mandatory components of the IRM (Energy Probe Interrogatory #4). The retail transmission rates adjustment is a mandatory part of the IRM application, but only to the extent that it reflects approved changes to the Uniform Transmission Rates. NPDI proposes that it would adjust the kW forecast to reflect the completion of the transformer station that will reduce costs. However, Energy Probe submits that this is not necessary as part of the IRM application. As noted above, any variance in transmission costs would be tracked in the variance account.

In other words, the 2011 IRM application would be a standard application, with the addition of the incremental capital module. This is no different than what any distributor would be required to file if it wanted to reflect the increase in rate base associated with a significant new asset such as a transformer station.

Energy Probe, therefore, does not believe there is any regulatory efficiency to be gained by filing a cost of service application for 2011 followed by a 2012 IRM filing as compared to the reverse of the above. In fact the opposite is true for 2011.

The Board's policy with respect to IRM includes a term component of four years: the rebasing year followed by three years of IRM applications. This term was set by the Board, at least in part, to provide regulatory efficiencies. By shortening the term, NPDI has created regulatory inefficiencies.

This rationale for an early rebasing has no impact on NPDI's ability to adequately manage its resources or financial needs. As a result, Energy Probe submits that there is no justification based on regulatory efficiency for an early rebasing application.

d) Financial Need

In its evidence at page 2 of Exhibit 1, Tab 2, Schedule 1, NPDI indicates that based on current rates, it was forecasting a return on equity in 2011 of 5.61%, which was 296 basis points below the approved 2008 deemed return on equity of 8.57% included in NPDI rates and 424 basis points below the 9.85% deemed return on equity approved by the Board for 2010 rebasing applications.

First, with regards to the Board approved 2010 return on equity, Energy Probe submits that this comparison is irrelevant. The Board was clear on the desire of a utility to apply the Board's current return on equity policy in the EB-2010-0133 Decision for Hydro Ottawa dated October 27, 2010. At page 11 of that Decision, the Board concluded that "*a cost of service application provides an opportunity to implement the Board's policies in* *these areas; but the policies themselves are not a reason to advance a cost of service application early."*

Second, with regards to the triggering, or near triggering of the off-ramp, Energy Probe submits that the evidence is clear. NPDI did not trigger an off-ramp based on its 2009 results. As shown in the response to Board Staff Interrogatory #1 (c), the adjusted return on deemed equity for regulatory purposes was 8.22%.

Similarly, no triggering of the off-ramp is projected based on the 2010 bridge year forecast, or the actual results for 2010. As shown in the Board Staff interrogatory response, NPDI was forecasting a 2010 return on deemed equity of 6.44%. Further, as noted in the response to part (e) of the Board Staff interrogatory, NPDI completed a forecast for 2010 in November 2010 using financial statements as of September 30, 2010 that results in a return on equity forecast of 6.73%. Both the original forecast (6.44%) and the updated forecast (6.73%) are well within the 300 basis points range around the Board approved return on equity embedded in rates of 8.57%.

With respect to the forecasted return on equity for 2011, Energy Probe submits that the 5.61% noted on page 2 of Exhibit 1, Tab 2, Schedule 1, is misleading and should be ignored by the Board. This is because NPDI has included in this calculation a proposal to include smart meters in rate base (Board Staff Interrogatory #1 (b)) and to include smart meter related expenses in OM&A.

As shown in the response to the Board Staff interrogatory, excluding the smart meters from the 2011 revenue requirement results in a return on deemed equity in 2011 of 7.06%. This is well within the Board's 300 basis point range around the approved return on equity. In fact, it is only a difference of 151 basis points, or approximately half of the Board's 300 basis points.

Energy Probe notes that on pages 10-11 of the EB-2010-0133 Decision, the Board noted that the forecasted 2011 return on equity was 6.52% and that *"the return does not approach the off-ramp of 300 basis points as measured against the Board approved return on equity of 8.57% included in 2008 rates"*. The Board went on to find that, from a financial perspective, Hydro Ottawa had not justified the need to terminate the IRM plan.

NPDI has confirmed that it was able to obtain long term debt financing in 2009 and 2010 from third parties and that it did not pay any premium over market rates for this debt (Energy Probe Interrogatory #6).

Energy Probe submits that based on the evidence in this proceeding that from a financial perspective, NPDI has not provided any justification for the need to terminate the IRM plan 12 months early.

E – SUMMARY

In the April 20, 2010 letter related to the Early Rebasing Applications, the Board indicated that a distributor "*that seeks to have its rates rebased in advance of the 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".*

The Board went on to state that *"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".*

Energy Probe submits that NPDI has not justified why an early rebasing is required. Nor has NPDI demonstrated that it cannot adequately manage its resources and financial needs during the 12 months remaining in its IRM plan.

Energy Probe respectfully submits that the Board should find that there is no justification or need for NPDI to terminate the 3rd Generation IRM plan in advance of its scheduled rebasing application for the 2012 test year.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

January 21, 2011

Randy Aiken

Consultant to Energy Probe