EB-2010-0074

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 Chatham-Kent Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2011.

REPLY SUBMISSION OF CHATHAM-KENT HYDRO INC.

FILED FEBRUARY 14, 2011

INTRODUCTION:

1. Chatham-Kent Hydro Inc. ("CKH") owns and operates the electricity distribution system in its licensed service area which consists of twelve non-contiguous areas dispersed over 2,400 km^2 in The Municipality of Chatham-Kent, serving approximately 32,100 customers. CKH's service area is 76.9 km^2. CKH has service areas that are directly connected to Hydro One Networks Inc.'s transmission system as well as many areas that are embedded in Hydro One Networks Inc.'s distribution system.

2. CKH's 2010 forward test year cost of service distribution rate application (EB-2009-0261) was, for the most part, settled by way of a Settlement Agreement filed with and approved by the Board (the "2010 Settlement Agreement"). A small number of outstanding issues were addressed in written submissions. The 2010 Settlement Agreement included a section on cost allocation, in which the parties to that proceeding [CKH, School Energy Coalition ("SEC"), Vulnerable Energy Consumers Coalition ("VECC") and Energy Probe Research Foundation ("Energy Probe")] agreed that CKH's proposed cost allocation was appropriate,[1] and that "the revenue-to-cost ratios for customer classes (all classes except Residential and General Service < 50 kW) that are outside of the Board's guidelines would be moved to the range over a three year period. The Parties agreed that the migration to the lower or upper band, as applicable, will be done by moving half-way to the applicable boundary in 2010, and then the rest of the way in equal increments in 2011 and 2012 (see Appendix L)."[2] Appendix L to the 2010 Settlement Agreement set out CKH's 2010 Test Year Updated Revenue-to-Cost Ratios.

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[1] See Issue 7.1 of the 2010 Settlement Agreement, at page 21 of 73. The 2010 Settlement Agreement was appended to Procedural Order No. 5 in the 2010 Application, and is available at: <http://www.rds.oeb.gov.on.ca/webdrawer/webdrawer.dll/webdrawer/rec/180113/view/Dec_PO5_CKHydro_Settlement_20100311.PDF.>

[2] See Issue 7.2 and Appendix L of the 2010 Settlement Agreement. The text related to Issue 7.2, and the table comprising Appendix L, were reproduced by CKH in response to Schools Interrogatory 1 – Exhibit 2.1 in CKH's combined responses to Board staff and intervenor Interrogatories.

3. CKH filed its 2011 IRM3 application (the "Application") with the Ontario Energy Board (the "Board") on September 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 3rd Generation Incentive Regulation Mechanism, and for the most part represents a mechanistic adjustment to CKH's electricity distribution rates in keeping with the IRM process. As part of this Application, CKH proposed certain adjustments to its revenue-to-cost ratios. CKH submitted that the proposed ratios were consistent with the 2010 Settlement Agreement and maintained revenue neutrality. Two parties requested intervenor status due to concerns with CKH's treatment of the revenue-to-cost ratios and were granted intervenor status at the outset of the process: School Energy Coalition ("SEC") and Vulnerable Energy Consumers Coalition ("VECC"). During the week of January 31, 2011, Energy Probe requested and was granted intervenor status. CKH filed responses to all interrogatories on November 26th, 2010. The evidence in this proceeding (referred to here as the "Evidence") consists of the Application and CKH's responses to the interrogatories.

4. Board Staff, SEC and VECC have filed submissions in this proceeding. The SEC and VECC submissions pertain to CKH's proposed revenue-to-cost ratios. SEC and VECC express concerns that the revenue-to-cost ratios proposed by CKH for 2011 are not consistent with the 2010 Settlement Agreement, and that the range of 85%-115% used by CKH for its Intermediate customer class, shown in Appendix L attached to the 2010 Settlement Agreement, is incorrect. In its submission, SEC has also alleged that CKH has breached the terms of the 2010 Settlement Agreement and requested that the Board sanction CKH with respect to the manner in which CKH addressed its revisions to the 2010 revenue-to-cost ratios in this Application.

5. On January 21, 2011, the Board issued a letter advising that the allegations being made by SEC with respect to a breach of the 2010 Settlement Agreement were a serious matter, and that the Board would await CKH's reply submission, following which it would consider whether further procedural steps will be required to resolve the matter before issuing a decision on CKH's 2011 IRM application.

6. On Tuesday, February 1, 2011, CKH convened a confidential, without prejudice conference call with the intervenors' counsel and consultants, and invited Energy Probe's consultant to participate, as Energy Probe had been an intervenor in the 2010 cost of service. The purpose of the conference call was to attempt to determine whether it would be possible to resolve all or any of the matters raised by the intervenors relating to the revenue-to-cost ratios proposed in the Application. Following the

conference call, Energy Probe requested intervenor status, with CKH's consent, and the Board granted Energy Probe's request. Accordingly, the Parties to the current Application now correspond to those in the 2010 cost of service application. The Parties have treated their discussions as confidential, without prejudice settlement discussions and have acted in accordance with the Board's *Settlement Conference Guidelines* (the "Guidelines"), notwithstanding that the process for this proceeding does not include a settlement conference. The parties have agreed that the Guidelines shall be deemed to apply to such discussions, as if the discussions had constituted a Board-ordered settlement conference.

7. There are six outstanding matters in relation to this Application that would require a reply from CKH:

   - Smart Meter Adder/Deferral Disposition;
   - The SEC allegations with respect to the propriety of CKH's actions;
   - Monthly Service Charge – $0.17 Adjustment for SMIRR;
   - The range of revenue-to-cost ratios applicable to the Intermediate Class;
   - Standby Revenues; and
   - Revenue-to-Cost Ratios for 2011.

8. The first of these relates to a question from Board staff with respect to the timing of a CKH request for final disposition of its residential smart meter-related account balances, and the intervenors made no submissions on this matter. The second is a matter that CKH must address with the Board, and it is doing so below. CKH is pleased to advise that the remaining four matters have been addressed in the Settlement Agreement that is being filed concurrently with this reply submission. Accordingly, this reply submission deals only with the following two matters:

   - Smart Meter Adder/Deferral Disposition; and
   - The SEC allegations with respect to the 2010 Settlement Agreement.

9. Should the Board have questions or require further information with respect to the matters addressed in the Settlement Agreement, CKH requests that it have an opportunity to respond to them.

SMART METER ADDER/DEFERRAL DISPOSITION

10. Board Staff have suggested that CKH has essentially reached the stage at which Smart Meters should be treated like other distribution capital assets, and have questioned the need for further tracking of residential smart meter costs in 2011 and beyond for future disposition.

11. CKH submits that although it completed residential Smart Meter installation in 2010, it is currently in the process of installing General Service Smart Meters through 2011 and remains committed to ensuring that all customers are billed on a Time of Use basis by June 2011.

12. However, CKH is not yet in a position to submit final Smart Meter costs for residential meters. As indicated in its interrogatory responses, CKH has yet to receive any MDM/R costs and has also yet to finalize stranded meter values[3]. Outstanding MDM/R costs include charges yet to be received from the IESO. Outstanding stranded meter costs would be reduced for future sales proceeds on the remaining value of meters taken out of service.

13. Smart Meters represent a new technology and a new learning process for distributors. This process involves significant troubleshooting as well as meter retrofitting. CKH continues to experience unanticipated retrofitting requirements on previously installed residential meters.

14. CKH believes that it is prudent to wait to ensure all costs have been captured for both residential and general service Smart Meters prior to making its application to the Board for final disposition of the smart meter-related balances. At that time, following the Board's prudence review and approval of the disposition, it will be reasonable to treat CKH's Smart Meter assets in a manner similar to its other distribution assets. CKH notes that in its 2008 cost of service rate application, it applied for and received approval of the disposition of its Smart Meter-related balances to December 31, 2008. CKH's proposed approach, in which only one more disposition application will be made, is consistent with the Board's Smart Meter Guidelines (G-2008-0002), which contemplate only two disposition applications. At page 12, the Board states:

> The Board expects that a distributor will normally file for inclusion of smart meter costs into ongoing operations and rate base when it files for a cost of service rate adjustment. When applying for recovery of smart meter costs, a distributor should ensure that all cost information has been audited, including the smart meter related deferral account balances.
>
> The Board also expects that only two applications will need to be made for the recovery of smart meter costs. The first is when the distributor achieves at least 50% penetration of smart

[3] CKH Response to Board Staff Interrogatories, Exhibit B1.2, at pages 3 and 4

meters within its service area. The second is when the distributor installs 100% of the meters.

15. CKH also believes that by applying only once more for disposition of its Smart Meter-related balances, and by requesting simultaneous disposition of residential and general service Smart Meters by way of a single application, the overall regulatory burden will be reduced.

16. Finally, it is the understanding of CKH that typically, the Board's expectation is that audited costs will be used in applications for final disposition of Smart Meter-related balances. CKH anticipates filing its application for Smart Meter cost disposition in the second quarter of 2012. By this time, its Smart Meters will be fully deployed and the related costs known to the extent possible, and 2009 through 2011 audited financial information will be available for both residential and general service Smart Meter-related costs (as noted in paragraph 14 above, CKH's Smart Meter-related balances to December 31, 2008 were disposed of in its 2010 cost of service distribution rate application).

ALLEGATIONS WITH RESPECT TO CKH'S CONDUCT IN THIS PROCEEDING

17. There were serious concerns raised around the revenue-to-cost ratios proposed by CKH in the Application. In particular, SEC has requested that the Board sanction CKH for what SEC views as a unilateral attempt to modify the terms of the 2010 Settlement Agreement.

18. As noted above, the parties to the 2010 Settlement Agreement agreed that the migration to the lower or upper band, as applicable, will be done by moving half-way to the applicable boundary in 2010, and then the rest of the way in equal increments in 2011 and 2012.

19. In its Interrogatory No. 3(b), VECC asked that CKH explain the rationale for any discrepancies between the ratios as calculated per the Settlement Agreement and those proposed in the current Application. CKH explained its rationale in its response, reproduced here for the Board's reference:

> "b) The Settlement Agreement indicated that migration to the lower or upper band, as applicable, would be done in two stages of equal increments in 2011 and 2012. However, CKH found that when the Settlement Agreement is applied literally, the distribution revenue adjustment does not balance. This occurs because the dollar impact of migrating the high-side Intermediate class (down to the upper band) exceeds the dollar impact of migrating the low-side outlier rate classes (up to the lower band). The consequence of this scenario would be a $442,321 distribution revenue shortfall in 2011 and an $884,642 distribution revenue in 2012 and thereafter (see Attachment 2 of this response).
>
> Another approach CKH considered was to balance the Attachment 2 scenario by upwardly adjusting the two rate classes (Residential class and GS<50 kW class) currently within the Board ranges. However, this scenario results in the Residential class being taken above a 100% revenue-to-cost ratio (from 94.7% currently to 104.3% by 2012). The alternative of raising the GS<50 kW class further above its current 106.6% ratio did not appear to be equitable and the GS<50 kW class

> was not adjusted under this scenario (see Attachment 3 of this response).
>
> CKH further considered balancing the Attachment 3 scenario by upwardly adjusting the low-side outlier rate classes to a common unified ratio above the lower band in order to be distribution revenue neutral. However, this scenario results in revenue-to-cost ratios above 100% for these rate classes (see Attachment 4 of this response). This also did not appear equitable.
>
> After conducting the above scenarios as part of the 2011 IRM preparation, CKH reached the following tenets, which were used to create the proposed revenue-to-cost ratios:
>
> i. Revenue-to-cost ratio adjustments should be kept as distribution revenue neutral;
>
> ii. No rate class with a ratio currently below 100% should be adjusted to above 100%;
>
> iii. The Intermediate with Self Generation / Standby rate class should not be increased significantly because the class represents a single customer;
>
> iv. To facilitate (i)-(iii) above, the residential rate class needs to increase within the Board band range, while remaining at or below 100%, to ensure that distribution revenue remains neutral
>
> CKH believes the proposed revenue-to-cost ratios are equitable and consistent with the intent of the Settlement Agreement."

20. It is of critical importance to CKH that the Board, its staff and the parties to this proceeding understand that at no time has it intended to contravene the terms of the 2010 Settlement Agreement. CKH recognized that the strict application of the ratios in the 2010 Settlement Agreement created a significant revenue shortfall. CKH submits that its focus was on acting reasonably and in good faith to propose an equitable solution, consistent with the intent of the 2010 Settlement Agreement, for all rate classes, and this included the maintenance of revenue neutrality in adjustments to CKH's revenue-to-cost ratios. CKH notes that the IRM3 Model promotes revenue neutrality in that it attempts to maintain the total revenue requirement across customer classes when revenue-to-cost ratios are adjusted. The model alerts users to "out of balance" positions when this does not occur. CKH also notes that the use of the 85% - 115% revenue to cost ratio range in the current Application for its Intermediate class was consistent with the range shown in the agreed-upon and Board-approved 2010 Settlement Agreement, and it referred to this range consistently in its Interrogatory responses in this proceeding.

21. Although they did not agree with the approach to adjustments to revenue-to-cost ratios as proposed by CKH, both VECC and SEC agree with maintaining revenue neutrality. At paragraph 2.5 of its final submission, VECC states:

> "2.5 As noted in paragraph 2.3 the generally higher proposed (versus Settlement) revenue to cost ratios for those classes with ratios below 100% are meant to address the overall revenue shortfalls that would occur in 2011 and 2012 based on a literal interpretation of the Settlement Agreement[10]. VECC agrees that a literal interpretation of the Settlement Agreement (I.e., no revenue to cost ratio adjustments other than those specified in the Agreement) would be inappropriate – since it would lead to a revenue deficiency for

Chatham-Kent."

At paragraph 15 of its final submission, SEC states:

> "15. Of course, as will be clear from our submissions below, the solution that would have been agreed would not have been the one proposed by the Applicant, which is clearly incorrect. However, we would expect that a reasonable result would have been agreed, to ensure that the changes in revenue to cost ratios were revenue neutral (which was not agreed in the Settlement Agreement, but was expected by the parties to it), and that all parties got a result that was reasonably close to what was expected when they entered into the Agreement."

22. It is the view of SEC and VECC that CKH should have approached the parties to the Settlement Agreement prior to filing the Application and discussed the proposed course of action and sought concurrence.[4] It is not the maintenance of revenue neutrality that is at issue, but rather, it is CKH's lack of consultation in attempting to do so.

23. CKH understands the importance of settlement agreements and the Board's settlement process. That process allowed for the resolution of issues related to CKH's 2010 cost of service application while avoiding the need for further submissions (except on a limited number of issues) and/or a hearing. CKH also agrees that it is important that parties be able to rely on those agreements and assume that they will be honoured for the periods that they cover. As noted previously, though, CKH believed that it approached the concept of distribution revenue neutrality in good faith and in a manner consistent with the Settlement Agreement. CKH did not intend to take any actions that would be construed as contravening the 2010 Settlement Agreement or the Board's regulatory processes.

24. Having considered the submissions of the intervenors further, CKH agrees that in the circumstances of this Application, it would have been more appropriate for CKH to have raised earlier with the parties to the 2010 cost of service application the need to address the revenue shortfall resulting from the strict application of the ratios in the 2010 Settlement Agreement. CKH regrets not having done so, but reiterates that at no time did it intend to act in a way that would be construed as contravening the terms of the 2010 Settlement Agreement. CKH notes that the Settlement Proposal in this proceeding addresses this on a prospective basis. The concluding paragraphs of the Settlement Proposal being filed concurrently with this submission provide:

> "The Parties acknowledge that the Board is currently undertaking a Review of Electricity Distribution Cost Allocation Policy (Board File No. EB-2010-0219, referred to as the "Cost Allocation Review"), and that this consultation may result in changes to the Board's approved

[4] For example, see paragraph 2.7 of the VECC final submission and paragraph 14 of the SEC final submission.

> ranges of revenue-to-cost ratios. The Parties agree that in the event that the Board revises its approved ranges, whether in the context of the Cost Allocation Review or otherwise, CKH may apply to the Board for permission to make further adjustments to its revenue-to-cost ratios to bring all outlying classes to the upper or lower end of the Board's new ranges, as applicable, and that proposal may include further adjustments to the revenue-to-cost ratios of its other customer classes in order to maintain revenue neutrality, all subject to Board approval. On any such application, all parties to this Agreement shall be free to take any positions they choose with respect to the CKH proposal, including but not limited to the presentation of counter-proposals, or of other changes to rates, revenue requirement or otherwise that they believe should be implemented as a consequence of the CKH proposals. Any of those positions need not, with respect to any prospective year, be consistent with the provisions of this Settlement Proposal.
>
> CKH agrees that if it intends to make such adjustments to its revenue-to-cost ratios during the period prior to its next rebased cost of service distribution rate application, it will discuss such further adjustments with SEC, VECC and Energy Probe prior to any such adjustments or any application to the Board for approval thereof."

25. CKH submits that it did attempt to act throughout this process in good faith and with integrity and respect for the regulatory process and stakeholders. CKH suggests that this can be seen in at least two ways. First, this can be seen in CKH's handling of its LRAM claim in this Application, in which CKH corrected in the Application an error that, if left unaddressed, would have resulted in a significant over-recovery from its customers. At page 5 of the Manager's Summary, CKH explained the LRAM issue as follows:

> **"8. Lost Revenue Adjustment Mechanism (LRAM) Recovery/Shared Savings Mechanism (SSM) Recovery Rate Rider**
>
> In EB-2009-0261, an LRAM / SSM recovery of $427,184 was approved for recovery beginning May 1, 2011. However, during the EB-2009-0261 application process, it was noted that LRAM / SSM had been included in CKH's deferral accounts. As such, it was agreed that these amounts would be removed from the regulatory asset recovery. However, CKH inadvertently left these amounts in the deferral balance approved in the May 1, 2010 rates. Therefore, CKH has not included the $427,184 LRAM / SSM recovery for the periods 2006 to 2008 herein.
>
> CKH intends to file for 2009 and 2010 LRAM / SSM recoveries in a future rate application."

26. Second, CKH convened the confidential settlement discussions that have led to the resolution of all outstanding rate-related matters in this proceeding (including the use of the Board's 80% - 180% revenue-to-cost ratio range for CKH's Intermediate class rather than the 85% - 115% set out in the Board-approved 2010 Settlement Agreement), and CKH has committed to advance consultation with the intervenors with respect to proposed revenue-to-cost ratio adjustments in the circumstances set out in the concluding two paragraphs of the Settlement Proposal. CKH has learned from the circumstances surrounding the current Application, and has worked cooperatively with the parties to avoid similar events on a going forward basis.

27. Finally, CKH acknowledges that SEC has requested that the Board sanction and/or admonish CKH for its conduct in this matter. CKH respectfully submits that such a step is not necessary. CKH hopes it is clear to the Board that it has attempted to act in good faith in this matter; that it understands the importance of adhering to Board-approved settlement agreements; and that it regrets the manner in which this Application has proceeded. CKH respectfully submits that no further measures are warranted.

CONCLUSION

28. CKH respectfully requests that the Board approve its 2011 rate adjustment application in the manner agreed to by the parties in the Settlement Proposal submitted by the parties concurrently with this reply submission.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 14TH DAY OF FEBRUARY, 2011.

BORDEN LADNER GERVAIS
Per:

Original signed by James C. Sidlofsky
James C. Sidlofsky

Counsel to Chatham-Kent Hydro Inc.

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