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Ontario Energy Board
P.O. Box 2319
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Attention: Ms. Kirsten Walli, Board Secretary

Re: Niagara Peninsula Energy Inc.
2011 Electricity Distribution Cost of Service Rate Application
Board File Number: EB-2010-0138
Argument-in-Chief

Dear Ms. Walli:

In accordance with the Board's Decision on Partial Settlement and Procedural Order No. 3, please find enclosed NPEI's argument-in-chief on the two unsettled issues.

If further information is required, please contact Suzanne Wilson, Vice-President Finance at 905-353-6004 or Suzanne.Wilson@npei.ca.

Yours truly,

S Wilson

Suzanne Wilson
VP Finance

**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 Niagara Peninsula Energy Inc. to the Ontario Energy Board for an Order or Orders approving or fixing just and reasonable rates and other service charges for the distribution of electricity as of May 1, 2011.

**ARGUMENT-IN-CHIEF**

**Filed: May 18, 2011**

## INTRODUCTION

Niagara Peninsula Energy Inc. (“NPEI” or “Applicant”) filed an application with the Ontario Energy Board (“Board”) seeking approval for changes to the rates it charges for electricity distribution, to be effective May 1, 2011. Following the usual Board processes, as a result of a settlement conference the Parties filed a Proposed Settlement Agreement (“Agreement”), dated May 4, 2011. All issues were settled, except two. The unsettled issues are the cost of long term debt, and the effective date of the new distribution rates. The Parties explicitly requested that the Board consider and accept the Agreement as a package, with the exception of one issue which is severable. That severable issue is related to an increase in the Monthly Variable Retail Service Charge.

By a decision and procedural order dated May 16, 2011, the Board accepted the Agreement as filed on May 4, 2011 except for the increase in the Monthly Variable Retail Service Charge. The Board made a decision on this item without requiring the Parties to make submissions. On the matter of the two unsettled issues, the Board agreed to the Parties’ request that these issues be dealt by way of written submissions and set the timelines for such submissions. The deadline for Argument-In-Chief was set as May 18, 2011.

This Argument-in-Chief therefore deals with the two outstanding issues, affiliate debt rate and effective date for the distribution rates.

**AFFILIATE DEBT**

**The Issue**

NPEI is requesting to continue to include in its revenue requirement for the 2011 year a long-term cost of debt that is based on a fixed rate of 7.25% associated with two long-term Promissory Notes (the "Notes") entered into with two affiliates. The Notes are at Exhibit 5, Index, pages 13 and 14. The first is in the amount of $22,000,000 with the City of Niagara Falls. The second is in the amount of $3,605,090 with the Niagara Falls Hydro Holding Corporation. Both Notes have a maturity date of April 1, 2020. Only interest is paid for both Notes.

The written evidence on this issue is found at Exhibit 5, as well as in responses to interrogatories Board Staff 15, Energy Probe 29 and SEC 16, 17, and 19.

**Submission**

*The 2006 Handbook (Electricity Distribution Rate Handbook)*

In the Board’s 2006 Electricity Distribution Rate Handbook, dated May 11, 2005, issued for purposes of setting 2006 rates for all electricity distributors, the Board stated:

> “To preclude any opportunity for a distributor to obtain debt from an affiliated firm at higher than a market-based rate, the deemed debt rate would be used as an upper boundary for debt placed with an affiliated entity; if the actual debt rate for the debt instrument is lower than the deemed debt rate, the actual rate should be used.”

In the case of NPEI’s 2006 rate rebasing proceeding, the Board approved NPEI’s actual debt rate of 7.25%, which is reflected in NPEI’s current rates.

*The 2006 Report (Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors)*

In the Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, dated December 20, 2006, at page 12 the Board stated:

> "Long-term debt is a major component of a distributor's capital structure. As noted previously, for ratemaking purposes the term of the debt should be assumed to be compatible with the life of the asset. With electricity distributors, the asset life can extend beyond 30 years. Typically, debt is incurred at the time when assets are put in service and the cost of that debt at the prevailing market prices. This means that a distributor may be holding long-term debt at rates that differ according to when the debt was incurred. This is often called "embedded debt.""

Clearly, the Board acknowledged that long-term debt instruments are appropriate and that the rates may differ according to when they were issued. This in fact is a long-standing and widely-accepted regulatory principle and practice in setting rates.

In the 2006 Report the Board also made a distinction between new and existing affiliate debt. Specifically, the Board stated:

> "The Board has determined that for embedded debt the rate approved in prior Board decisions shall be maintained for the life of each active instrument, unless a new rate is negotiated, in which case it will be treated as new debt."

> "For new affiliate debt, the Board has determined that the allowed rate will be the lower of the contracted rate and the deemed long-term rate …"

For NPEI and its affiliates, this was confirmation that as long as the existing affiliate debt remained, it would be considered "embedded debt" and that the 7.25% would apply going forward if it was not renegotiated in the interim period, which was not.

*The 2009 Report (Report of the Board on the Cost of Capital for Ontario's Regulated Utilities)*

In the Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, dated December 11, 2009 ("the 2009 Report"), at page 52 the Board states:

> "The Board wishes to reiterate that the onus is on the distributor that is making an application for rates to document the actual amount and cost of embedded long-term debt and, in a forward test year, forecast the amount and cost of new long-term debt to be obtained during the test year to support the reasonableness of the respective debt rates and terms."

As noted elsewhere, "embedded debt" refers to long-term debt at rates in accordance to when the debt was incurred. NPEI's debt with its affiliates is "embedded debt' and the actual amount and the fixed debt rate of 7.25% are documented in the evidence.

At page 53 of the 2009 Report, the Board states:

> **"The Board will primarily rely on the embedded or actual cost for existing long-term debt instruments."**

This statement by the Board, which was bolded for emphasis by the Board, is absolutely clear. The existence of embedded debt at existing rates is to be primarily relied on by the Board in setting distribution rates. NPEI's affiliate debt is embedded, and carries a fixed rate of 7.25%.

Starting at page 53 of the 2009 Report, the Board sets out certain circumstances where the Board's deemed long-term debt rate (5.32% for 2011) will act as a proxy or ceiling for what would be considered to be a market-based rate by the Board.

The first stated circumstance is:

> "For affiliate debt (i.e. debt held by an affiliated party as defined by the *Ontario Business Corporations Act,* 1990) with a fixed rate, the deemed long-term debt rate <u>at the time of issuance</u> will be used as a ceiling on the rate allowed for that debt." [emphasis in the original]

Again, the Board's own emphasis makes the point of the importance of the date of issuance very clear. As the 7.25% fixed rate is the rate at the time the of issuance of the affiliate debt some ten years ago, the ceiling is the 7.25% fixed rate, not the Board's deemed rate for 2011 of 5.32%.

The facts in this case are that there is debt owed to two affiliated entities, which debt dates back some 10 years ago, and it carries a fixed rate of 7.25%. This is "embedded debt". It is also a fact that NPEI's affiliate debt and the fixed debt rate of 7.25% have been approved by the Board in 2006 in NPEI's last rebasing proceeding, pursuant to the Board's 2006 Rate Handbook.

There have been no changes to either of the Notes or their terms since the time the Board approved the affiliate debt and the debt rate of 7.25%. What has been introduced since that time is the Board's further thinking on the affiliate debt matter through the 2006 Report and subsequently the 2009 Guidelines.

In the 2006 Report the Board acknowledged that long-term debt instruments are appropriate and acknowledged that the rates may differ according to when they were issued. In NPEI's view, the evolved thinking in the 2006 Report was around new affiliated debt or renegotiated affiliated debt. These did not apply to NPEI. In fact, the 2006 Report provided renewed confirmation that as long as NPEI's existing affiliate debt remained, and not renegotiated, it would be considered "embedded debt" and that the 7.25% would apply going forward. The Notes and their terms have not changed.

In the 2009 Report the Board emphasized that it "will primarily rely on the embedded or actual cost for existing long-term debt instruments". As the Notes are long-term (to 2020) and are fixed at 7.25%, NPEI submits that this surely means that the 7.25% debt rate is the rate that should apply. It is NPEI's submission that any consideration in the 2009 Report that may appear to suggest otherwise cannot hold, or is secondary to the prime consideration the Board itself emphasized it will rely on.

NPEI has been paying the 7.25% rate, previously approved by the Board, and has paid this rate for the current fiscal/test year, that is since January 1, 2011.

For all of the above, NPEI submits that its request for the continuation of the 7.25% rate in the 2001 test year revenue requirement is reasonable and that the Board again so find.

## EFFECTIVE DATE

### The Issue and Proposal

In its application, NPEI requested an effective date of May 1, 2011 for its new rates. By Interim Rate Order dated April 28, 2011 the Board declared NPEI's current rates interim as of May 1, 2011. Therefore there are no legal impediments for the Board to make the final rates effective May 1, 2011.

### Submission

Below NPEI sets out the reasons why it was not feasible or even possible to have filed its application earlier than when it did. At the core, it is the fact that NPEI had to file a cost of service application for the first time as an amalgamated utility after the January 1, 2008 merger between Niagara Falls Hydro and Peninsula West Utilities.

Due to the merger, NPEI had to complete many models three times covering information from 2005. NPEI had to:

- Build three versions of most of the Excel models: individual models for Pen West and Niagara Falls up to December 2007, and then a combined NPEI model from 2005 to 2011.
- Compile historical billing data from two separate legacy systems, which was only available in hard copy.
- Contend with a lack of adequate records and documents for the historical Pen West information. In addition, many of the personnel who would have had knowledge of the lacking data have since left the company.

Below are examples of specific activities that had to be undertaken to accommodate the 2011 filing for the merged utility. In all cases they reflect additional complications and effort to bring the 2011 filing in a manner that would satisfy the Board's filing requirements and at the same time anticipate and pre-empt the kinds of questions parties may have, so that the later stages of the proceeding would be as efficient as possible and of as much assistance to the parties and the Board.

***Exhibit 2***

- Detailed data on Pen West's historical capital projects was difficult to obtain as personnel that existed at Pen West were no longer with NPEI.
- The Fixed Asset continuity schedules for the years 2005 to 2007 were first constructed separately for Niagara Falls and Pen West and were then added together in the NPEI model.

***Exhibit 3***

- Historically, Niagara Falls and Pen West used different general ledger accounts to record the same transactions relating to Other Revenues (for example, pole rentals and scrap sales). Therefore, to allow for a relevant variance analysis, we first presented the data as it was originally recorded, and then restated it on a consistent basis.

- Customer counts and billed kW/kWh had to be compiled from three billing systems: the old Niagara Falls and Pen West systems, and the current NPEI Harris system.
- The weather normalization excel models were done three times. Once for Pen West 2005-2007, one for Niagara Falls 2005-2007 and one combined file from 2005 to 2011. Heating degree and cooling degree days were researched twice due to Pen West and Niagara Falls using different weather stations.

***Exhibit 4***

- Historically, Niagara Falls and Pen West used different general ledger accounts to record similar OM&A expenses. Therefore, to allow for a relevant variance analysis, NPEI first presented the data as it was originally recorded, and then restated it on a consistent basis.
- Depreciation calculations were doubled due to the maintaining of the Pen West depreciation schedules.
- Locating payroll information and FTE tracking from 2005 to 2007 was time consuming. Also several schedules were done three times for the same reasons noted above.

***Exhibit 6***

- Three revenue requirement files needed to be created.
- The calculation of the revenue deficiency is based on the 2011 Revenue Requirement less the Test Year Forecast at Existing Rates. In NPEI's case, this calculation was complicated by the fact that we have two sets of existing rates.

***Exhibit 7***

- NPEI was not in possession of the original Pen West cost allocation informational filing, nor the underlying load profile. NPEI had to search out to obtain this information from Board Staff and the consultant who completed the Pen West cost allocation study.
- NPEI's 2011 load profile had to be constructed by first adding together the original load profiles for Niagara Falls and Pen West, and then scaling to the 2011 updated total load.

***Exhibit 8***

- Currently, NPEI has separate sets of approved rates for Pen West and Niagara Falls customers. The 2011 filing included a proposal to harmonize rates. As a result, additional information needed to be presented in this Exhibit, for example two sets of bill impact tables.
- Two Revenue Requirement Work Forms needed to be completed for the two service areas for bill impacts.

***Exhibit 9***

- The preparation of the Regulatory Asset Continuity Schedule in this Exhibit required that the former Niagara Falls and Peninsula West pre-merger transactions be added together up until December 2007, and then continue with the NPEI data from January 1, 2008 forward.

As noted, the above are only examples but do reveal, NPEI submits, the depth and breadth of the unique challenges NPEI had to face and overcome in preparing and completing the 2011 application. It is not that NPEI was unmindful or unfocussed; it was very mindful and very much focused. It was the difficulty of the tasks in gathering and analyzing the disparate data from two separate utilities, understanding it and presenting it in a manner that would present the minimum of difficulty for the intervenors and the Board. NPEI believes that it has accomplished that goal. NPEI believes that its filing was of high quality. It is the impression of NPEI that the number and nature of interrogatories by parties were not unusual. The fact that a settlement was reached so quickly is, at least partly, a testament to the completeness and quality of the filing.

NPEI is not a large utility. There are only a small number of employees that could have participated or assisted in the application preparation process. Bringing outside help would not have speeded up the process as the information and knowledge that had to be gathered, understood, analyzed and presented was to a very large degree esoteric to the employees of NPEI. Hiring third-party help not only would not have advanced the preparation of the filing in any meaningful way but it would also be costly, the costs of which would have been recoverable from ratepayers. For similar reasons, NPEI prepared its own load forecast and cost allocation, areas in which utilities of the size of NPEI typically rely on consultants. It would be unfair for NPEI to now be penalized for attempting to present as complete and as high quality application as possible under the unique challenges presented by the merger and with the minimum of costs for ratepayers.

As the Board knows, the speed upon which an application proceeds once filed depends on the applicant's capacity to meeting the Board's deadlines for the subsequent steps as well as the Board's capacity to accommodate scheduling for these events in a suitable time frame. In this case, NPEI has met all the deadlines set by the Board, with the one exception of the responses to the Energy Probe interrogatories, which were filed one business day late. Responses to the interrogatories of Board Staff, SEC and VECC were filed two business days early. NPEI has not caused any delay in that respect. Unluckily, it appears that the Board's scheduling did not allow for an earlier date for commencing the Settlement Conference. There was a period of about three weeks between the two events. It is NPEI's take that three weeks is an unusually lengthy period. In many other cases the Board's schedule allowed the Settlement Conference to immediately follow the Technical Conference or otherwise in a considerable shorter period than three weeks. To be abundantly clear, this is not intended as a criticism of the Board; it is only to note that despite the Board's unquestionable commitment in scheduling to avoid unnecessary delays, there could be situations where the regulatory calendar could lead to undesirable delays. This appears to have been one of these situations.

The filing of the application was three months late from the date stipulated by the Board. In the end however, and on the assumption that the Board accepts the proposed settlement agreement, the retroactivity period will be modest and the impacts will be minimal. As a point of reference, a one month retroactivity would translate to an impact of only 23 cents on a typical residential customer's monthly bill at 800 kWh, reflecting the proposed 7.25% cost of affiliate debt.

*Effective Date and Implementation Date Considerations*

All of NPEI's customers are billed on a monthly basis. The GS>50 kW rate class is billed on a calendar month basis, on the 16th day of the month following the consumption month. This is so because of the 15 day waiting period to obtain the final pricing information from the IESO. For the residential and GS<50 kW rate classes there are different billing cycles reflecting different meter reading schedules. The Streetlight class is billed similar to the GS >50 kW rate class. The majority of the Sentinel and USL rate classes are similar to the residential and GS<50 kW billing schedules. If NPEI were to receive a final rate order for June 16th implementation of the new rates, NPEI would be prepared to forego billing of the higher rates for the residential, GS<50 kW, Sentinel and USL classes for May consumption that will be billed prior to June 16th. Therefore, if NPEI were to receive a rate order for commencing its new rates on June 16th with an effective date of May 1, then there would not be a need for a rate rider.

Considering that there is only one outstanding issue that may potentially cause changes to the revenue requirement, NPEI wishes to advise the Board that NPEI will be prepared to submit a Draft Rate Order within two days of the Board's decision on the outstanding issues. The Applicant anticipates that the Parties would require a minimum amount of time to review the Draft Rate Order, since there would be only one adjustment and it would be mechanistic in nature and within the models that have already been filed.

Should that scenario not be possible, NPEI proposes that the foregone revenue associated with the period from an effective date of May 1, 2011 to the implementation date be recovered through a volumetric rate rider to be in effect until April 30, 2012, to coincide with NPEI's next rate adjustment under the Board's current IRM process.

For all of the above, NPEI submits that the appropriate effective date for the new rates is May 1, 2011 and that the Board should so find. The new rates with a May 1st effective date can be implemented on June 16th without a need for a rate rider. Should the issuance of a final rate order not be possible by June 16th, NPEI requests that the foregone revenue be recovered through a rate rider as described above.