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BY EMAIL ONLY

February 4, 2008

Ontario Energy Board
P.O. Box 2319
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2300 Yonge Street
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Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: North Bay Hydro Inc.
2008 Incentive Regulation Mechanism Rate Application
Board File Number EB-2007-0794**

Please find attached Board staff's submission for the above proceeding for distribution to the applicant and any intervenors.

Yours truly,

Original Signed By

Angela Pachon
Policy Advisor, Regulatory Policy Development

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

North Bay Hydro

EB-2007-0794

February 4, 2008

INTRODUCTION

North Bay Hydro (NBH) submitted an application on November 2, 2007, seeking approval for changes to the rates that NBH charges for electricity distribution, to be effective May 1, 2008. The application is based on the 2008 Incentive Regulation Mechanism and includes a request to recover storm costs.

The purpose of this document is to provide the Board with the submissions of Board Staff after its review of the evidence filed in the 2008 electricity distribution rates application by NBH. Board staff's submissions are informed by the Board's Report on 2nd Generation Incentive Regulation¹ (the "Report"), and the Board's Decision with Reasons dated July 31, 2007 in proceeding EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551 which dealt with rate adjustments to 2007 Distribution Rates to recover costs from severe storms in 2006.

This submission will focus exclusively on NBH's application for Z-Factor recovery. This submission will address the Z-factor application in three parts. First, Board Staff will comment on the lack of evidence and timing delays concerning this application. Second, Staff will review cost eligibility, i.e. the type of costs applied for, and whether in Staff's view these costs satisfy the eligibility criteria set out in the Board's Report. Third, Staff will comment on the accounting and recovery methodology proposed by NBH and whether the proposal is consistent with the recovery of similar type of costs approved in past claims.

THE APPLICATION

NBH was identified in the Board's letter dated April 4, 2007 as having self-nominated for rebasing in 2008. On October 3, 2007, the Board received a letter indicating that NBH was requesting to withdraw from the 2008 rebasing process and file a 2008 IRM rate application. NBH also indicated its intent to self-nominate for rebasing in 2009. In its Letter of Direction dated November 19, 2007, the Board indicated that it would process NBH's 2008 IRM application as

¹ December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors

requested, and that the Board accepted NBH's self-nomination for rebasing in 2009.

On November 2, 2007 NBH filed its 2008 IRM application. The application was based on the mechanism as per the Report. Also included, was a request for Z-Factor recovery for costs relating to a natural disaster which occurred on July 17, 2006. NBH stated that the storm knocked out distribution equipment and facilities resulting in a widespread power outage. Power was restored to approximately 95% of the city by July 20, 2006. Complete service was restored to urban areas by July 21, 2006 and on July 23, 2006 for rural areas. A number of secondary services that required repairs by electricians were restored during the week of July 24, 2006.

In response to staff's interrogatories, NBH explained that it did not seek recovery of storm costs incurred in 2006 as part of its 2007 IRM application, because NBH "became aware that this was an option that could be exercised with the combined proceeding on storm damage cost claims by Canadian Niagara Power Inc.(Fort Erie and Port Colborne), Peterborough Distribution Inc. and Lakeland Power Distribution Ltd. Decision with Reasons dated July 31, 2007."

NBH indicated that the total costs related to the 2006 storm were \$509,747.04. NBH however reduced this amount by \$80,547.43 to exclude "regular time costs for internal labour and overheads and for internal costs for vehicle and equipment". Hence NBH total claim is \$470,047.29. This amount includes \$163,882 (35%) for contracted services, \$133,922 (28%) for overtime hours, \$101,095 (22%) for materials, \$40,848 (9%) for accrued interest on incremental cost from December 2006 to the end of the proposed recovery period, \$19,948 (4%) for the overtime of trucks and \$10,352 (2%) for lodging, meals and travel expenses.

Discussion and Submission

Lack of evidence and timing delays

In page 34 of the Report, the Board stated that “for 2nd Generation IRM, the Board will limit reliance on Z-factors to well defined and well justified cases only (..)”.

With respect to supporting documentation, NBH submitted a detailed breakdown for the claim for contracted services from most of the contractors, lodging, meals and travel expenses. No breakdown was provided for the amount claimed on internal overtime hours, materials, “overtime” of trucks, and contracted services from most of surrounding electricity distributors. In addition, the calculation of accrued interest on incremental cost from December 2006 to the end of the proposed recovery period was not provided.

Parties are asked to comment on whether the Board should consider that this application is well justified given the lack of supporting documentation for a significant portion of the cost claims (about 65% of the total claim) of NBH.

Staff notes that the request to recover storm costs incurred in 2006 represents an out-of-period adjustment which could lead to inter-generational inequities. Staff also notes that as a result of this delay, customers have to pay greater interest because of the “unawareness” of NBH management.

This delay also raises a question about regulatory efficiency. Last year a combined proceeding on storm costs for four utilities was held. Regulatory efficiency would have been enhanced if NBH would have included this Z factor as part of its 2007 EDR application.

Eligibility Criteria

In the Report, the Board stated that Z-Factor amounts must satisfy the three eligibility criteria: causation, materiality and prudence².

² Board Report, Page 34 and Appendix C: Z Factors

Causation

The Report states that amounts claimed should be directly related to the Z-Factor event and must be clearly outside the base upon which rates are derived³.

In response to staff interrogatories, NBH reported that the amount embedded in the 2006 EDR rates as it related to storm costs is \$8,573.28. This represents about 2% of the total claim included in this application. With respect to the incremental nature of the expenses included in this storm costs claim, NBH stated that internal labour costs for regular hours were deemed to be non incremental labour and thus were excluded. In response to an interrogatory from Board Staff, NBH also explained that only overtime was included in the claim. Overtime is paid at double the normal hourly rate as per their Collective Agreement.

NBH also indicated that “normal payroll burden on overtime is 40%. Incremental payroll costs are incurred on paid overtime (i.e. Employer share of CPP and EI, EHT, WSIB, pension, benefits). There is an additional 5% overhead allocation related to Incremental Operations Supervision costs incurred and a 25% overhead allocation related to incremental Engineering costs. Paid supervision and engineering costs were over and above regular salary costs”.

NBH did not justify why there is a payroll burden on overtime. With respect to overheads, the NBH did not provide the rationale for the inclusion of an allocation of overhead.

NBH also included in its claim the overtime of trucks without further explanation. Additionally, NBH included an 8% overhead on the invoices for contracted services.

Parties are asked to comment on whether the Board should consider these costs as being incremental.

³ Board Report, page 34 and Appendix C: Z Factors

Materiality

The Report states that amounts claimed will be considered material and therefore eligible for potential recovery if they meet a certain materiality threshold. For expenses incurred, the total expenses on a per event basis must exceed 0.2% of total distribution expenses before taxes. Capital costs will be considered material if, on a per event basis, if they exceed 0.2% of net fixed assets⁴.

NBH calculated that its total claim represents 6.49% of the 2006 EDR total distribution expenses (\$7,245,392) thereby meeting the materiality threshold.

Staff notes that it is unclear from the evidence if capital expenditures are included in the total costs claim. For example, Appendix C mentions the inclusion of replacements costs of distribution transformers (approximately 21) as being costs directly related to the storm damages. However, Appendix B which summarizes the total cost claim does not include any costs in relation to distribution transformers. Also, in response to interrogatories NBH does not mention capital expenses in the list of costs that were deducted from the total costs attributable to the storm. NBH has not clarified whether capital expenditures are included in the claim. If the costs are included Board staff would find it difficult to determine if the materiality threshold has been exceeded.

Prudence

The Report states that amounts claimed must represent the most cost-effective option (not necessarily the least initial cost) for ratepayers. Consequently, the distributor will need to justify the reasonableness of the amounts relative to other options that the distributor may have had⁵.

In response to Staff's interrogatories, NBH explained that it does not have any prior arrangements with any other LDCs or non-LDCs to assist with the provision

⁴ Report, page 34 and Appendix C: Z Factors

⁵ Report, Appendix C: Z Factors, page V, VI

of emergency response services. When a storm hit, NBH calls on contractors that provide services to NBH on a regular basis or neighbouring LDCs.

Having prior agreements in place has permitted some utilities to establish caps on the charges that the other parties make in the event of an emergency. Since there is no detail of the invoices from other LDCs, staff cannot compare their hourly labour rate to the rate charged by other contractors.

As previously noted, NBH added an overhead of 8% to all the invoiced amounts for contracted services. NBH explains that overheads are included to cover the incremental costs incurred overseeing contracted services provided. Parties are asked to comment on the appropriateness of this approach considering that overseeing contractors is part of the normal duties of NBH staff.

ACCOUNTING AND RECOVERY METHOD

Background

In the December 9, 2004 Decision with Reasons on the Review and Recovery of Regulatory Assets, Phase 2 involving Hydro One, Toronto Hydro, London Hydro and Enersource Hydro, the Board established the principles and process to determine the reasonableness of regulatory asset amounts for the remaining distributors. As noted earlier, as part of the final review for remaining distributors involving year end 2004 balances, the Board approved the recovery of storm related costs for EnWin Utilities and Port Colborne recorded in account 1572, Extraordinary Event Costs. With respect to the recovery method, the Board approved 2004 customer numbers as the allocator in determining the class responsibility, and 2004 volumetric data as the billing determinant (kW or kWh as applicable).

In its Decision with Reasons on the combined storm damage proceeding (EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551), the Board found that the approved storm cost be allocated to the classes on the basis of distribution revenue. With respect to intra-classes allocations and billing determinants, the Board approved the recovery of storm costs on the basis of the fixed/variable

ratios currently underpinning each applicant's base distribution rates. The Board also opined that the use of two time specific rate riders (one reflecting a temporary fixed charge and one a temporary volumetric charge) would be more transparent, and has the advantage of not requiring another regulatory process to remove the riders. Finally, the Board accepted the recording of interest charges on deferral and variance accounts. No true up would occur for under or over recoveries.

NBH is proposing to allocate storm costs based on the number of customers (using 2006 EDR customer count). In addition, NBH is proposing that the recovery be solely through a monthly service charge rate rider over a two-year period. NBH indicated three reasons in support of this methodology:

- Storm costs were incurred for the entire service area, however the bulk of the service area relates to residential services. This allocator would result in a greater apportionment of costs to the residential class.
- Simplicity of application and predictable recovery period
- Mitigation and transparency to customers

In its Decision with Reasons on the combined storm cost proceeding (EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551), the Board found the method for applying interest charges used by Canadian Niagara Power to be reasonable. Moreover, the Board directed the utilities, for the purpose of implementation of the decision to "include all detailed calculations supporting the derivation of interest charges and rate riders".

NBH is seeking recovery of \$40,847.68 (8.7% of the total claim) of interest "from December 2006 over forecasted period of recovery".

Staff notes that although NBH included an interest charge, no evidence was provided about the method used to calculate the interest. Staff is also unclear on the rationale for accruing interest as of December 2006, while costs started to be incurred in July 2006.

Parties are asked to comment on whether the Board should allow interest recovery after May 1, 2007 given the delay of NBH in submitting this application for the recovery of 2006 storm costs.

NBH has proposed to recover its storm costs claims over a two-year period. Board Staff notes that the rate impacts including the proposed rate rider results would still result in a reduction of -0.4% of total bill for residential customers at 1,000 kWh and approximately -0.7% of total bill for a general service less than 50 kW customer at 2,000 kWh.

In its Decision with Reasons on the combined storm cost proceeding (EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551), the Board accepted that the approved cost claims be recovered as operating expenses and indicated that the Board would not order any portion of the approved claims to be capitalized. The Board also stated that the applicants should not capitalize any of the approved costs related to the damaged distribution facilities for rate base purpose nor should any approved costs be treated as distribution expense for purpose of determining a future revenue requirement.

In a response to an interrogatory from Staff, NBH stated that it intends to treat the cost claims in Appendix B as OM&A "with the exception of capitalized distribution transformers which will be adjusted out of the rate base in the 2009 EDR."

As previously noted, Staff is unclear about the treatment of capital expenses on the claim.

All of which is respectfully submitted