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BY E-MAIL

July 13, 2011

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

Dear Ms. Walli:

Re: Board Staff Submission
Niagara West Transformation Corporation
Board File No. EB-2010-0345

Attached please find Board staff's submission with respect to the above proceeding. Please notify Niagara West and all intervenors in this proceeding.

Yours truly,

Original signed by

Edik Zwarenstein
Project Advisor

Enclosure:

Ontario

EB-2010-0345

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 West Transformation Corporation for an Order or Orders pursuant to section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15, Schedule B, for Approval of 2011 Revenue Requirement and Change to the Uniform Electricity Transmission Connection Rate.

BOARD STAFF SUBMISSION

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NIAGARA WEST TRANSFORMATION CORPORATION

EB-2010-0345

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1. Introduction

Niagara West Transformation Corporation ("NWTC" or the "Applicant") filed an application dated November 9, 2010 (the "Application") with the Ontario Energy Board (the "Board") under section 78 of the *Ontario Energy Board Act, 1998*, 1998 S.O.c.15, (Schedule B) seeking an Order of the Board approving changes to its 2011 transmission revenue requirement, and approving inclusion in, and an update to the provincial uniform transmission rate ("UTR") that is charged for electricity transmission transformation, to be effective March 1, 2011.

As originally filed, the Application sought to have NWTC integrated into the provincial uniform transmission rate (but only the electricity transmission transformation rate portion). However, NWTC has since modified its proposal and now requests revenue requirement recovery through a rate charged directly to the distributors it serves, effective March 1, 2011[1].

In its submission NWTC is seeking approval of a transmission revenue requirement of $838,672 for 2011, based on a 2011 forecast load of 432,175 kW. The revenue deficiency amounts to $190,410.

This submission reflects observations and concerns arising from Board staff's review of the evidence, and is intended to assist the Board in evaluating NWTC's application and setting just and reasonable rates. Additionally, this submission reflects a concern in regard to the operation and management of the utility and its proper standing in the current regulatory environment. Therefore Board staff focuses on the calculation of revenue requirements, as well as on the duties and responsibilities of a licensed transmitter.

1.1 Procedural Record

The Board issued a Notice of Application and Written Hearing on December 6, 2010.

On January 12, 2011, the Board issued Procedural Order No.1, granting intervenor status to Hydro One Networks Inc. ("Hydro One") and the Independent

[1] Page 4 of 66/ll. 4-5

Electricity System Operator (the “IESO”), and provided a schedule for interrogatories.

On February 24, 2011, Hydro One filed a letter with the Board indicating that some interrogatories were incompletely answered, and other interrogatory responses raised even further questions, and it therefore requested an opportunity to clarify and follow-up on some of the responses provided by NWTC.

As mentioned earlier, in responding to IRs, NWTC retracted its request to be included in the UTR.

On April 6, 2011, the Board issued Procedural Order No. 2 that scheduled a Technical Conference for April 26, which, at the request of NWTC, was later moved to, and held on, May 11 by way of Procedural Order No.3.

On May 25, 2011the Board issued Procedural Order No. 4 providing for submissions by the Applicant, Board staff and intervenors, and a reply submission.

On May 25, 2011, newly appointed NWTC counsel Mr. H. Reginald Watson filed a request for an extension of the date of submissions. The Board issued on June 7, 2011 Procedural Order No. 5 amending the schedule for Applicant and intervenor submissions. On July 4, 2011 NWTC filed its submission (“Argument in Chief”).

1.2 The Legislative Framework

The application was filed under section 78 of the *Ontario Energy Board Act, 1998*, 1998 S.O.c.15, (Schedule B), which states in part that:

> **78. (1)** No transmitter shall charge for the transmission of electricity except in accordance with an order of the Board, which is not bound by the terms of any contract. 2000, c. 26, Sched. D, s. 2 (7).
>
> **78. (3)** The Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity or such other activity as may be prescribed and for the retailing of electricity in order to meet a distributor’s obligations under section 29 of the Electricity Act, 1998. 2009, c. 12, Sched. D, s. 12 (1).
>
> **78. (3.0.5)** The Board may, in approving or fixing just and reasonable rates or in exercising the power set out in clause 70 (2) (e), adopt methods that provide,

> (a) incentives to a transmitter or a distributor in relation to the siting, design and construction of an expansion, reinforcement or other upgrade to the transmitter's transmission system or the distributor's distribution system; or
>
> (b) for the recovery of costs incurred or to be incurred by a transmitter or distributor in relation to the activities referred to in clause (a). 2009, c. 12, Sched. D, s. 12 (2).
>
> **78. (7)** Upon an application for an order approving or fixing rates, the Board may, if it is not satisfied that the rates applied for are just and reasonable, fix such other rates as it finds to be just and reasonable. 1998, c. 15, Sched. B, s. 78 (7).

1.3 NWTC Background

NWTC is a small transmitter located in the Niagara region. Its assets are a single transmission station, consisting of two transformers and associated works. NWTC provides transmission services to two distribution utilities: Niagara Peninsula Energy Inc. ("NPEI") and Grimsby Power. Unlike most transmitters, NWTC does not currently recover its revenue requirement through the UTRs. Instead, it has its own "stand alone" rate that it charges directly to the utilities to which it provides service. Currently, that rate is $1.50/kW. NWTC's rate – both the amount and its stand alone nature – was originally determined by the Minister of Energy in 2003 (and formalized through a Board order RP-2004-0139/ EB 2004-0219 in 2004), as at that time a "rate freeze" was in effect and rates could only be set or altered with the Minister's approval.

2. Load Forecast and Revenue Requirement

The two key elements in setting an appropriate rate in a cost of service proceeding are the load forecast and the revenue requirement.

2.1 2011 Load Forecast

NWTC's original evidence included a 2011 forecast[2] of 432,175 kW with high level explanation that stated in part that:

> *"….The proposed 2011 load forecast reflects the average of the actual years 2007 to 2009. The 2010 budget reflects a 1% growth rate over 2009 actual. Currently, the 2010 actual year to date (i.e., January to August) results are tracking about 6% over the same period for 2009. However, the Minister of Energy and Infrastructure issued a directive, dated March 31, 2010, to the Board with regards to electricity*

[2] NWTC's pre-filed evidence, November 9, 2010/page 16 and Table 4

> *conservation and demand management ("CDM") targets to be met by licensed electricity distributors. ….<u>As a result, NWTC believes the expected actual 2010 level of usage is not sustainable in 2011 since Grimsby Power Inc. and Niagara Peninsula Energy Inc. will need to begin implementing additional CDM programs to achieve the required CDM targets. NWTC submits it is reasonable to base the load forecast of for the 2011 test year based on the average actual usage from 2007 to 2009</u>."[underlining added for emphasis]*

Board staff requested in an interrogatory, that NWTC recalculate its 2011 load forecast based on a bottom up approach. The bottom up approach proposed recalculates the 2011 load forecast without CDM, then subtracts the CDM targets for the 2011. This approach is transparent and more accurate than the NWTC original approach of trading off the high load-level of the year 2010 (by excluding the 2010 load and only averaging the loads of 2007-2009) for not including the 2011 effects of the CDM on that forecast. NWTC response to that interrogatory agreed[3] with the proposed approach which produced a 2011 load forecast of 435,343 kW which is slightly higher than the 2011 NWTC forecast of 432,175 kW as noted above.

NWTC agreed with the Board staff approach and responded to Question d) of Interrogatory 23, as follows:

> *"The 2010 actual load provided by NWTC to GPI and NPEI was 444,847 kW. <u>NWTC would agree with Board Staff that a more reasonable forecast for 2011 would include the results of 2010</u>. The 2011 forecast of 435,343 kW shown in 22b appears reasonable to NWTC considering when the 2010 actual results are reduced by 7,884 kW for CDM savings the resulting value is just slightly higher than 435,343".[underlining added for emphasis]*

Board staff notes that NWTC's Argument-in-Chief[4] ignored the fact that NWTC had agreed that there was a more reasonable forecast than the 2011 forecast set out in the Application. This is clear in light of the noted NWTC's response to Board staff interrogatory number 23, Question d., where it agreed that the 2011 forecast of 435,343 kW was more reasonable.

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[3] NWTC Response to Board staff Interrogatories, February 8, 2011/pages 41-44/Interrogatory 23, Questions a., b., c., d

[4] NWTC's Argument-In-Chief, July 1, 2011, paragraph 22, (e)

Board staff submits that the 2011 load forecast should be 435,343 kW for the purpose of establishing the 2011 transformation rates for NWTC.

2.2 Revenue Requirement and Revenue Deficiency (Pre-filed Evidence)

NWTC's pre-filed evidence[5] requested, on a forward test year (2011) cost of service transmission rate basis, approval to charge rates effective March 1, 2011 to recover a revenue requirement of $841,192.

The table below, extracted from the Applicant's pre-filed evidence[6] depicts the 2011 revenue requirement of $841,192 and its key components, the revenue offset of $2,520, the revenue requirement at existing rates, and the resulting revenue deficiency of $190,410.

Table 1: 2011 Revenue Requirement and Revenue Deficiency [7]

O&A Expenses	$210,900
Amortization Expenses	$180,794
Regulated Return On Capital	$449,498
PILs	$0
Service Revenue Requirement	$841,192
Revenue Offset	($2,520)
Base Revenue Requirement	$838,672
Revenue @ Existing Rates	$648,262
Revenue Deficiency	$190,410

Board staff found no issues with amortization expenses of $180,794. However Board staff suggests changes may be warranted in the operating and administration amount of $210,900 and in the cost of capital, including the return on equity and the regulated return on capital.

[5] NWTC's pre-filed evidence, November 9, 2010/page 6/lines 4-5
[6] NWTC's pre-filed evidence, November 9, 2010/page 12 Table 1

2.2.1. 2011 Operating and Administration Expenses of $210,900

A summary Table 6 in the pre-filed evidence[7] identified the various components of the 2011 administrative expenses, totaling $131,081 and various components of the operating expenses totaling $79,819 resulting in a 2011 total of $210,900.

The following three 2011 expense components were questioned during the discovery phase and in Board staff's view may be either inappropriately high or inadequately supported or explained by the record.

2011 Insurance Expense - $60,000

In responding to Board staff Interrogatory #10[8], Question b), the Applicant indicated that information is not available to determine what the impact of the fire that occurred in 2008[9] had on the significant increase in the insurance premiums that increased from the $28,752 in 2009 (actual) to $58,500 in 2010 (budget) and to $60,000 in 2011(forecast). NWTC further responded to Question c) of the same interrogatory by indicating that it did not investigate an alternative insurance provider following the fire since there are few insurers and that MEARIE (the insurer) had provided good service in the past, and was very supportive of NWTC through the fire claim. In the Technical Conference the Applicant said in regard to the fire[10], that "the insurance industry told us that that was not the reason for the charges going up" and later clarified that this information was contained in a letter from MEARIE.

Board staff believes that an increase of more than 100% in the insurance premium is questionable irrespective of quality service received from the insurer. The onus lies with the applicant to demonstrate the reasonableness of its proposed expenses, and the evidence supporting the increase in insurance costs is thin.

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[7] NWTC's pre-filed evidence, November 9, 2010/page 18 Table 6
[8] NWTC Response to Board staff Interrogatories, February 8, 2011/pages 18-21/Interrogatory 10, Question b.
[9] NWTC's pre-filed evidence, November 9, 2010/page 20/lines 15-16
[10] Technical Conference Transcript page 29

2011 Regular Maintenance (Rondar) $25,917

Board staff explored the regular maintenance program during the discovery phase and received NWTC's responses to two interrogatories (5 and 12)[11], and notes that while the Rondar contract appears to be comprehensive, its cost variability from year to year is too high for rate stability. For instance NWTC's response to the noted Board staff interrogatory explains the reasons for the increase from 2010 where the maintenance cost was $3,787 to the 2011 maintenance cost of $25,917 by stating in part that:

> *"Year two of the maintenance/testing program was in 2010 and was mainly a visual inspection at a value of $3,787. Year three of the program occurs in 2011 and covers considerable more work at a value of $25,917."*

While a direct line between the nature of the utility's structure and its apparent vulnerability to volatility cannot be proven, Board staff is of the view that due to lack of scale, and lack of asset diversity, NWTC is exposed to not only inability to negotiate cost effective services, but also to large cost variability year over year e.g. maintenance costs that vary more than 600%, with commensurate potential volatility to rate levels.

2011 Monitoring (Hydro One) $27,262

Board staff inquired about the monitoring cost performed by Hydro One during the discovery phase and received NWTC's response[12], which in Board staff's view did not provide adequate answers. In response to Question b) to the noted interrogatory, NWTC indicated that the increase in the monitoring cost from 2007 of $12,000 to the $26,932 in 2008 is for monitoring and switching services that are based on actual costs from Hydro One, and in response to Question c) NWTC indicated that there is no formal Agreement between the two parties.

[11] NWTC Response to Board staff Interrogatories, February 8, 2011/pages 9-10/Interrogatory 5, Question b. & pages 23-24/Interrogatory 12, Questions a., b., c., d.

[12] NWTC Response to Board staff Interrogatories, February 8, 2011/pages 25-26/Interrogatory 13, Questions a., b., c., d.

During the Technical Conference, exchanges[13] took place between the Board Counsel and NWTC's witness in regard to the monitoring services by Hydro One, which revealed their lack of basic information of that essential service. The following is a summary of that exchange:

(1) the NWTC witness confirmed that there is no formal contract to govern the service;

(2) the NWTC witnesses indicated that they have no idea as to the reasons for the increase in the monitoring cost from 2007 of $12,000 to the $26,932 in 2008, and continued at the high level in 2011 at $27,262;

(3) The NWTC witnesses also indicated they have no document to list the services provided.

Board staff believes that lack of expertise and attention to details by NWTC's officers is cause for concern. A sudden jump in Monitoring Service costs of more than 200% should lead to at least an enquiry from NWTC regarding the reasons for this increase. While Board staff is unable to recommend an alternate figure, the issue goes towards a critique of the operation.

2.2.2. <u>Cost of Capital</u>

Board staff acknowledges that NWTC in its response to Board staff interrogatories 16, 17, 18[14], indicated agreement with various clarifications including the basis for updating its Cost of Capital ("COC"). For a March 1, 2011 effective date, application of the methodology as determined in the Board's Cost of Capital Report[15] would use data from November 2010, three months prior to March 1, 2011. Board staff notes that the Board approved rates effective March 1, 2011 for Ontario Power Generation Inc. in a decision earlier this year, with the ROE of 9.43% as discussed in Appendix H of that Decision issued on March 10, 2011 (EB-2010-0008). Board staff has calculated that the deemed

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[13] Technical Conference, May 11, 2011/pages 33-34
[14] NWTC Response to Board staff Interrogatories, February 8, 2011/pages 30-34/Interrogatories 16, 17,and 18.
[15] Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (the "Cost of Capital Report"), (EB-2009 -0084), issued December 11, 2009.

long-term debt rate would be 5.02% and the deemed short-term debt rate would be 2.48% for a March 1, 2011 effective date.

Board staff has no issue with the capital structure, the proposed short term debt rate, the long term debt rate, and the return on equity (“ROE”) as it was applied for and clarified in the noted responses to Board staff interrogatories 16, 17, and 18.

Although the calculation of the appropriate cost of capital appears to be essentially correct, Board staff notes that NWTC is proposing to forego full recovery of this amount in order to allow for a rate of $1.77/kW (which matches the current UTR rate). This issue is discussed in further detail in section 2.3 below.

2.3 Proposed Rate

As discussed above, NWTC is seeking to continue its existing stand alone rate (albeit at a different level), whereby its revenue requirement does not form part of the UTR, and charge its rate directly to Grimsby Power and NPEI. The rate that NWTC proposes to charge is $1.77/kW, which matches the current UTR rate – in other words, Grimsby Power and NPEI would be paying essentially the same amount they would pay if NWTC entered the UTR.

2.3.1 Revenue Requirement versus Proposed Rate

NWTC’s proposed base revenue requirement ($838,672) divided by the proposed load forecast (435,343kW) produces a rate of $1.93/kW. If the Board approves the proposed rate of $1.77/kW (and assuming the load forecast is correct), NWTC will recover only $770,557 of its total base revenue requirement representing a deficiency of $68,115. NWTC was asked about this deficiency in the Technical Conference, and confirmed at the Technical Conference that it was prepared to accept a lower ROE than it would be entitled to under the Board’s Cost of Capital Report. NWTC indicated that it preferred that its rate match the

UTR so that its customers (i.e. NPEI and Grimsby Power) not receive a different price signal.[16] What NWTC has done is in effect to "reverse engineer" the requested revenue requirement to match a rate of $1.77/kW. The total cost of capital as detailed in the application is $449,498, so presumably NWTC is prepared to accept a revised amount of $381,383 (i.e. $449,498 less $68,115).

Board staff is not opposed in principle to a utility choosing to forego a portion of its ROE as a temporary rate mitigation exercise (or possibly for some other reason). The Cost of Capital Report recognizes that utilities may seek the Board's permission to charge something other than the amount that is derived by applying the standard formula. There are in fact at least two utilities whose approved rates reflect less than full recovery of the allowed ROE: Fort Frances Power Corporation and Thunder Bay Electricity Distribution Inc.

The preparedness of NWTC to accept a lower ROE is highly unusual, with only Fort Frances Hydro and Thunder Bay Hydro doing so, in the first case due to a long term historical relationship with a mill related energy supplier and in the latter due to a conscious municipal policy to mitigate rates.

Absent unusual circumstances, however, Board staff urges caution in allowing a utility to earn less than its allowed ROE over a lengthy period of time. The cost of capital (including the ROE) is an actual cost for utilities. Absent full recovery of this amount, utilities may experience difficulties in servicing existing debt costs and attracting capital to invest in their facilities. There may also be a temptation to reduce other OM&A expenses to increase ROE. An inability to service debt or attract capital does not appear to be an issue for NWTC (at least over the near term); however if its proposal is approved the situation should continue to be monitored.

If the Board is disinclined to allow NWTC to recover less than its full revenue requirement, it can approve a rate of $1.93/kW, assuming that it also approves the other expense components of the revenue requirements discussed above.

[16] Technical conference transcript, pp. 21-22.

2.3.2 Stand Alone Rate vs. UTR Participation

NWTC's proposal for a "stand alone" rate is unusual. All other transmission utilities are included in the UTR. Indeed, NWTC's application originally sought to have its revenue requirement recovered through the UTR.

NWTC's revenue requirement is not currently part of the UTR, and it is now requesting that this status quo be maintained with a higher rate than the current \$1.50/kW (i.e. \$1.77/kW). Although this arrangement is unusual, Board staff has no specific objection to this approach. Should the Board choose to do so, however, it would have the power to reject NWTC's proposal for a stand alone rate and instead bring its revenue requirement into the UTR pursuant to section 78(7) of the Act.

It would appear from the Applicant's submission (paragraph 20) that there is an assumption that the "stand alone" arrangement would maintain the same rate as in the UTR rate, including changes precipitated by other transmitters and approved by the Board. Board staff submits that this is an incorrect assumption, and the Applicant should recognize that in future it will need to apply to the Board, supported by full evidence on costs and load, for any change to the rate that the Board grants NWTC in this proceeding.

In the light of numerous current applications from generators to seek transmitter licences there may be larger implications to permitting participation of small transmitters in the UTR process, in that they do not fulfill all the functions of licenced transmitters and might distort the validity of the UTR formula weighting for transformation, line and network charges. This is a broader question than Board staff is able to deal with in the current proceeding, but which may warrant some consideration as one factor in deciding if the Applicant should be required to participate in the UTR framework.

3. Other Issues

3.1 Requirements of Electricity Transmission License

NWTC holds an Electricity Transmission License (the "License") approved by the Board. The License contains certain rights, duties and responsibilities to which NWTC must adhere. For example, NWTC is required to follow all of the provisions of the Transmission System Code ("TSC").

Through the discovery process, some parties have questioned whether or not NWTC is fully compliant with the TSC. Section 6.1.3 of the TSC requires, for example, that transmitters have Board-approved connection procedures for processing requests to connect to their transmission systems or to modify existing connections. It appears that NWTC does not have such policies, nor has it sought an exemption from the TSC for this requirement.[17] It also appears that it is not in a position to connect any generators, which is a requirement of section 6.13 of the TSC.

The current case, of course, is a rates case. The chief task of the Board will be to establish the appropriate revenue requirement and set a just and reasonable rate. This is not an inspection under Part VII of the Act, nor is it a compliance proceeding under Part VII.1 of the Act. Board staff submits that the current proceeding is not the appropriate forum to address issues of potential non-compliance with the license or the TSC. If the evidentiary record in this proceeding leads the Board to believe that another process should be initiated to deal with these types of concerns, then another process can be initiated.

Of course it is possible that matters relating to compliance with NWTC's License could have impacts on the proposed revenue requirement. Ensuring compliance with all applicable regulatory instruments is a responsibility of all utilities, and there are certainly costs associated with that exercise. Reasonable costs for this are appropriately part of the revenue requirement, and to the extent a party

[17] Hydro One Networks Inc. IR No. 11; Technical conference transcript, pp. 64-67.

argues that NWTC needs more money to enable it to be compliant with applicable regulatory instruments, the Board can of course consider this and make whatever findings it deems appropriate.

3.2 Future Expenses

Without passing any judgment on whether or not NWTC is in compliance with the TSC (and therefore its License), Board staff notes that it is possible that NWTC may be required to incur additional expenses in the near to medium term future with respect to TSC compliance. Clearly some parties are concerned that NWTC needs to take additional activity to become TSC compliant. If the Board chooses to examine this issue further through a separate process, there would be additional costs for NWTC – regulatory costs at a minimum, and also possibly additional costs relating to any orders requiring actions to become compliant with the TSC.

It is difficult to speculate with any level of precision on what the quantum of these costs might be. However, given that NWTC is already proposing to recover less than its full revenue requirement, Board staff submits that the Board should continue to monitor NWTC through its routine mechanisms (for example the audit process) to ensure that it is recovering revenues sufficient to maintain safe and efficient operation. If it appears that revenues are not sufficient to match costs, the Board may have to re-set NWTC's rates – either on NWTC's application or on the Board's own motion.

The Applicant may, in its reply submission, wish to address the possibility that the Board accepts the Applicant's willingness to receive a lower Return on Equity and in addition disallows some proportion of the critiqued O&A expenses. For example, if the Board were to disallow <u>all</u> of the increased costs for insurance and Hydro One monitoring, the rate that would result would be of the order of $1.66/kW.

In its response to Board staff IR 27 b), NWTC indicated that it did not consider the possibility of transferring its assets to one or both of its customer utilities, but it did indicate that the LDCs have right of first refusal if the holding company chose to divest of NWTC assets. The Applicant further stated[18] that there was a proposal that one the LDCs it supplies purchase the whole transformation operation. Board staff observes that transmission assets can in fact be deemed as distribution assets pursuant to section 84 of the Act, so it would be possible for a distributor to operate these assets with the Board's permission. Were such an arrangement undertaken by NWTC it might provide additional possibilities for economic operation, improved market power, less volatility in costs, a larger pool of expertise and more efficient operation of the utility.

3.3 Administration and Operation

As described in more detail in the revenue requirement section above, Board staff has some potential concerns regarding certain practices at NWTC. NWTC is a small utility and cannot be expected to have as many staff as a larger transmitter, but it still must meet all of the responsibilities required of all transmitters. Ratepayers are entitled to certain assurances that a utility is appropriately managing costs. Board staff notes that for two of the larger cost increases (insurance and Hydro One monitoring fees), the utility appears to have made little if any enquiry of the service provider to explain these increases. Ratepayers ultimately must bear these costs, and it is incumbent upon a utility to be able to explain why any costs are increasing.

All of which is respectfully submitted.

[18] Technical Conference Transcript page 56