Ontario Energy Board
EB-2007-0713

Hydro Ottawa Limited
2008 Electricity Distribution Rates

Argument-in-Chief
(Issues 4.2 and 8.4)

Introduction

1. Hydro Ottawa Limited ("Hydro Ottawa") filed the Settlement Proposal in this proceeding on January 23, 2008. The Settlement Proposal indicated that Hydro Ottawa and the other parties to it achieved a complete settlement of 28 issues, an incomplete settlement of one issue (4.2), a partial settlement of one issue (3.4), and no settlement of one issue (8.4).[1]

2. Issue 4.2 and Issue 8.4 are now, in effect, two parts of a single issue: the use of a deferral account (4.2) as a mechanism to recover the revenue deficiency arising in the first four months of the Test Year (8.4). Hydro Ottawa and the other parties agreed that these two issues should be addressed by means of argument alone and, moreover, they advised the Board that they preferred written argument.[2]

3. The Board conducted a settlement hearing on January 24, 2008 in which the Board accepted the Settlement Proposal subject to the following:

   - the clarification of paragraph (c) in the description of the complete settlement of Issue 4.1;[3] and

   - the correction of three clerical errors in the Settlement Proposal identified by counsel for Hydro Ottawa.[4]

4. Hydro Ottawa revised the Settlement Proposal accordingly and filed the revised version on January 25, 2008. Hydro Ottawa also filed another version that indicated each revision of the original Settlement Proposal.[5]

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[1] The Board's Issues List set out 32 issues. The Board disposed of the 32nd issue – Issue 9.2 – in its Decision on Request for Interim Rates dated January 10, 2008: "[t]he Board denies Hydro Ottawa's request that its existing distribution rates be declared interim effective January 1, 2008" (p. 5).
[2] Hydro Ottawa and the others also agreed that Issue 3.4 – capitalization process – should be addressed in an oral hearing of Hydro Ottawa's evidence on this issue. The Board conducted its oral hearing yesterday and provided a schedule for written argument.
[3] See the settlement hearing transcript at pp. 42 and 45.
[4] *Id.* at pp. 3 and 45.
[5] The revised Settlement Proposal was marked as Exh. N1.1 during the Board's oral hearing of Issue 3.4 yesterday; see p. 2 of the transcript.

5. The Board also approved, at the settlement hearing, the use of written argument for Issues 4.2 and 8.4. The Board established the following schedule in this regard:

- February 5, 2008 – today – for Hydro Ottawa's argument-in-chief;
- February 8, 2008 for the argument of each intervenor; and
- February 12, 2008 for Hydro Ottawa's reply argument.[6]

Revenue Deficiency

6. Hydro Ottawa proposes to recover a revenue deficiency that arises by virtue of the four-month difference between the Test Year and the 2008 rate year. The as-filed revenue deficiency was $3.5 million; the derivation of it is provided in Exhibit I1-3-2. The amount of the revenue deficiency, however, would be adjusted to reflect the cost consequences of the Settlement Proposal, including the update of the rate of return on equity ("ROE") in accordance with the complete settlement of Issue 5.1, and the Board's decision on Issue 3.4.

7. The Test Year is calendar 2008 and, as a result, Hydro Ottawa's as-filed revenue requirement is derived from cost forecasts for calendar 2008. The amount of the as-filed revenue requirement, however, would be adjusted as described in paragraph 6. The 2008 rates would be designed accordingly; that is, they would be designed to recover Hydro Ottawa's adjusted revenue requirement during calendar 2008.

8. Hydro Ottawa would not recover those costs, however, because its 2008 rates will not be effective during the entire Test Year but, rather, only for the final eight months of it. Hydro Ottawa's revenue requirement for the Test Year is a proxy, in effect, for the 2008 rate year – May 1, 2008 through April 30, 2009 – without testing the validity of the proxy.

9. Hydro Ottawa's proposal gave rise to Issue 8.4:

> 8.4 Is it appropriate that Hydro Ottawa implement a mechanism to recover revenues not recovered in the January to April 2008 "Deficiency Period"?

10. The reference to "mechanism" in Issue 8.4 was, at the time of the Board's Procedural Order No. 2, a reference to either of two mechanisms. Hydro Ottawa's preferred mechanism was a combination of interim rates and rate riders and, in the alternative, a deferral account (although the alternative relief is perhaps better described as a variance account).

11. The Board's "Decision on Request for Interim Rates" dated January 10, 2008 eliminated Hydro Ottawa's preferred mechanism: "[t]he Board denies Hydro Ottawa's request that its existing distribution rates be declared interim effective January 1, 2008" (p. 5). Hydro Ottawa's alternative mechanism was one of the matters that gave rise to Issue 4.2:

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[6] See the settlement hearing transcript at pp. 43-45.

4.2 Are the proposed new variance and deferral accounts for the test year appropriate?

Issue 8.4

12. "The other parties did not agree that there would be a revenue deficiency and, even if there is one, they did not agree that Hydro Ottawa should recover it."[7] Issue 8.4 is accordingly the starting point.

13. The Board must answer "yes" or "no" to the question that is posed by this issue. Hydro Ottawa urges the Board to answer "yes" because the revenue deficiency would be real, rather than notional, for the reasons explained in paragraph 16 below. If the Board's answer is "no," however, there would be no need for a deferral (or a variance) account.

14. Exhibit I1-3-2 explains how, and why, Hydro Ottawa calculated a revenue deficiency of $3.5 million for the first four months of the Test Year (i.e., the "Deficiency Period" that is referred to in Issue 8.4). Hydro Ottawa's rate revenue during this period, using its existing rates, will fall short of matching its as-filed revenue requirement cost forecasts by $3.5 million.

15. Hydro Ottawa's revenue deficiency arises because the Board's rate year is not aligned with the test year that Hydro Ottawa and other electricity distributors must use:

> This is a permanent deficiency since it represents the difference between the revenue collected during the four-month period in 2008, based on 2007 rates, and the cost-based revenue requirement for the same period of the Test Year. The primary driver for this deficiency is the timing difference; that is, using 2007 rates during a period when those rates do not reflect the cost-based, revenue requirement for the period.[8]

16. Hydro Ottawa's revenue deficiency in 2008 (i.e., its financial year) would be real, rather than notional, based on its experience in 2002 and 2006:

> Hydro Ottawa's actual distribution revenue for 2002 was only $84.2[M], a shortfall of $2.9 million. Hydro Ottawa's net income for 2002 was negative as a result of regulatory assets, but even with net income normalized to remove the effect of regulatory assets, the net income would have been well short of the approved regulated net income (i.e., return on equity) of $10M. Hydro Ottawa's net income for 2003 was only $1.2M indicating that this deficiency was not simply being shifted from one year to the next.

[7] See Settlement Proposal (Exh. N1.1) at page 18, Issue 4.2, middle paragraph of the description of the incomplete settlement. This statement was recorded here, rather than later on page 23 in the description of Issue 8.4, to provide a context for their position on a deferral (or a variance) account for the recovery of the revenue deficiency.
[8] Hydro Ottawa's response to Board Staff Interrogatory #57 in part c) at p. 5.

> For 2006, Hydro Ottawa's approved revenue requirement was $122.4M with a regulatory net income of $18.2M. Hydro Ottawa's actual distribution revenue for 2006 was only $113.9M. The normalized net income for 2006, with the effects of the regulatory asset recovery removed, was only $16.7M, indicating a shortfall. Hydro Ottawa's estimated net income for 2007 is only $15.1M indicating once again that the deficiency is not simply a shift from one year to the next.[9]

17. Hydro Ottawa's actual revenue deficiencies in 2002 and 2006 clearly indicate that, at rebasing time, a revenue deficiency is a likely outcome. "It was this deficiency, and expectation of revenue deficiencies in each year that rates are rebased, that prompted Hydro Ottawa to address this situation for 2008."[10]

18. The Board's use of a test year and a rate year that are not aligned, for rate-making purposes at rebasing time, is accordingly more likely than not to give rise to a revenue deficiency for Hydro Ottawa and other similarly-situated distributors. The consequential effect on Hydro Ottawa and those other distributors would not be fair or reasonable because, quite simply, their opportunity to earn their Board-approved ROE would be materially diminished if not eliminated altogether.

19. Hydro Ottawa is seeking to ultimately recover its cost-based revenue requirement, as adjusted, for calendar 2008 (i.e., the Test Year) via a combination of rates and a deferral (or a variance) account.[11] This combination would comply not only with the just and reasonable standard, but also with the fair return standard, provided Hydro Ottawa has a fair opportunity to earn its Board-approved ROE.[12]

Issue 4.2

20. "The other parties do not agree that Hydro Ottawa should have a deferral account for this purpose;" that is, recovering the revenue deficiency.[13] The Board's decision on Issue 8.4 will provide, nevertheless, the answer to the question posed by Issue 4.2 *vis-à-vis* a deferral (or a variance) account for the revenue deficiency.

21. If the Board answers "yes" to the question posed by Issue 8.4, then the Board's answer here must also be "yes." There is no other mechanism that is now available to Hydro Ottawa for this purpose.

22. If the Board answers "no" to the question posed by Issue 8.4, however, the Board's answer here must also be "no." There would be no need for a deferral (or a variance) account.

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[9] *Id.* in part h) at pp. 7-8 (footnotes omitted). The $15.1M amount was based on a June 2007 estimate.
[10] Hydro Ottawa's response to VECC Interrogatory #5 in part c) at p. 2. The reference to "this deficiency" is a reference to the revenue deficiency in 2006.
[11] Para. 6 above explains the word "adjusted."
[12] Both are legal standards when the rate-making process involves a utility's cost-based revenue requirement.
[13] See the Settlement Proposal (Exh. N1.1) at page 23, Issue 8.4, last paragraph in the description of no settlement. This statement was recorded here, rather than earlier on page 18 in the description of Issue 4.2, to reflect their position that Hydro Ottawa should not recover a revenue deficiency via a deferral (or a variance) account.

Conclusion

23. The revenue deficiency is real, not notional, and the Board should allow Hydro Ottawa to recover it. It follows that the Board should allow Hydro Ottawa to do so by means of a deferral (or a variance) account.

24. This Argument-in-Chief is respectfully made to the Board on February 5, 2008 by Fraser Milner Casgrain LLP, through Jerry H. Farrell, as counsel for Hydro Ottawa in this proceeding.