



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

Veridian Connections Inc.

EB-2007-0879

February 8, 2008

INTRODUCTION

On November 1, 2007, Veridian Connections Inc. (“VCI”) submitted an application based on the 2008 Incentive Regulation Mechanism (IRM) seeking approval for changes to the rates that Veridian charges for electricity distribution, to be effective May 1, 2008. Veridian also proposed to harmonize rates between its main service area and its Veridian Connections – Scugog area. The purpose of this document is to provide the Ontario Energy Board (the “Board”) with the submissions of Board staff after its review of the evidence submitted by Veridian.

RATE HARMONIZATION

Background

Veridian is comprised of three service areas with separate distribution rates: its main service area, Scugog and Gravenhurst. Its main service area is the result of the harmonization of several distributors that were acquired by VCI or merged with VCI. VCI’s most recent rate harmonization was approved in the RP-2005-0020/EB-2005-0422 proceeding, for implementation May 1, 2006, reducing four geographically-based rate schedules to one.

In its EB-2005-0256 application to acquire Scugog Hydro Energy Corporation (“Scugog Hydro”), VCI stated that it anticipated that rate harmonization would take place in 2007.

VCI is now proposing to harmonize its Scugog service area with its main service area effective May 1, 2008, while maintaining a separate rate schedule for its Gravenhurst service area. VCI calculated that, if its application is approved as filed, the total monthly bill impacts that would be experienced across rate classes would range from a 1.2% increase to a 35.8% decrease (see Table 1 below). These bill impacts exclude VCI’s proposed adjustments for retail transmission service rates.

**Table 1 — Total Monthly Bill Impacts
 (excluding Veridian's proposed retail transmission service rate adjustment)**

Rate Class	Typical kWh	Typical Demand	Main service Area		Scugog	
			\$	%	\$	%
Residential	1,000	-	0	0.4%	(1)	-0.4%
GS < 50 kW	2,000	-	2	0.4%	(1)	-0.1%
GS 50 to 2,999 kW	40,000	120	22	0.5%	N/A	N/A
GS 3,000 to 4,999 kW	1,200,000	4,000	1,546	1.2%	N/A	N/A
GS 50 to 4,999 kW	40,000	120	N/A	N/A	(111)	-2.4%
Large Use	2,800,000	6,000	3,227	1.1%	N/A	N/A
USL	1000	-	1	0.6%	(2)	-1.6%
Sentinel Lighting	200	1	(0)	-0.8%	(15)	-35.8%
Street Lighting - Scugog	30,000	100	N/A	N/A	(2,371)	-10.8%
Street Lighting - Main	200,000	700	(259)	-1.3%	N/A	N/A

Discussion and Submission

Timing

Board staff notes that in *Report of the Board on Rate-Making Associated with Distributor Consolidation*, the Board stated that:

“... the issue of rate harmonization in the context of a consolidation transaction is better examined at the time of rebasing, because this is when the consolidated entity will apply for its combined revenue requirement.”

Board staff also notes that in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*, the Board stated that:

“As noted previously, there are limited adjustments available to distributors. If these adjustments are insufficient for specific cost pressures (e.g., additional capital investment) or the distributor is in the tranche to be rebased, then the Board would expect these distributors to file a

comprehensive cost of service application and not to rely on the simplified filing requirements for the incentive mechanism.”

Staff notes that VCI is scheduled to be rate-rebased in 2010. While VCI finds that there is merit to rate-harmonizing at this time, it did not provide an explanation why it would be preferable to perform this rate-harmonization as part of the 2008 IRM process, instead of through a comprehensive cost of service application.

VCI did however assert that it would be appropriate to request rate-harmonization through the 2008 IRM process as “there is evidence that rate harmonization as an overall rate making principle is supported by the OEB.” In this regard, VCI refers to the Decision and Order in EB-2007-0074 in which the Board approved PowerStream Inc.’s (“PowerStream”) rate harmonization plan for implementation effective November 1, 2007. Board staff notes that, following issues raised by the intervention of the Town of Richmond Hill, PowerStream had been directed in the Board’s Decision and Order in RP-2005-0020/EB-2005-0409 to “bring forward a proposed harmonization plan to allow for the implementation of harmonized rates in 2007.” The Town of Richmond Hill highlighted the fact that the Share Purchase Agreement of Richmond Hill Hydro by PowerStream stipulated that:

“... the Purchasers covenant that after the Closing Date the distribution rates charged to distribution customers within the municipal boundaries of the Town of Richmond Hill will be harmonized with the distribution rates charged to the Purchasers’ customers subject to OEB requirements.”

In response to a staff interrogatory, VCI appears to have alluded to such a covenant by mentioning that the rate harmonization proposal “fulfills a provision of Veridian’s Scugog Hydro Purchase Agreement.” However, Board staff notes that the Township of Scugog has not intervened to request that such covenant, if any, be fulfilled at this time. Nonetheless, Board staff notes that the timing of VCI’s proposal is consistent with their anticipation, at the time of the purchase, on the undertaking of such a harmonization, as reflected in the Decision and Order in EB-2005-0256.

VCI stated that “the differing characteristics of customer density, topography and costs to service Veridian’s Gravenhurst service area do not, at this time, support harmonization of distribution rates with those of the balance of Veridian’s service areas.” Staff is unaware whether the Gravenhurst Hydro Purchase Agreement contained a covenant with regard to rate harmonization.

Methodology

To harmonize its rates, VCI performed the following three steps:

1. Combined the approved 2006 EDR revenue requirements of its main service area with Scugog, as adjusted for the new capital structure and payments in lieu of taxes, and harmonized the Retail Transmission Rates and loss factors to produce one set of new 2006 rates using the 2006 EDR model;
2. Applied the harmonized 2006 rates to the 2007 IRM model to produce the harmonized 2007 rates;
3. Applied the harmonized 2007 rates to the 2008 IRM model to generate the proposed rates.

Staff notes that this methodology is consistent with the harmonization proposal submitted by PowerStream, as approved in the EB-2007-0074 Board Decision and Order.

Revenue Requirement Impact

The application is not revenue neutral since VCI incorporated an adjustment to its combined revenue requirement for the Scugog and main service area to correct an alleged error in the 2006 EDR model. VCI proposes to increase the 2006 revenue requirement by \$103,136 (from \$ 41,413,510 to \$ 41,516,646) or about 0.25%. The main drivers for the change are:

<ul style="list-style-type: none"> • Correction of errors related to the Cost of Power in the Veridian’s approved 2006 EDR model • Changing Scugog’s Debt Equity ratio from 50/50 to 55/45 and its weighted debt rate from 6.25% to 7.11% • Resulting net income before PILs • PILs 	<p>\$3,527</p> <p>\$16,814</p> <p>-\$8,870</p> <p>\$91,665</p>
<p>Total</p>	<p>\$103,136</p>

Staff notes that VCI is not requesting any retroactive adjustments for the 2006 and 2007 rate years. The requested adjustment for the 2008 rate year would be prospective in nature.

The error related to the Cost of Power relates to the normalization of consumption per customer performed in the approved 2006 EDR model. The proposed correction to the normalization of the cost of power results in a \$44,310 increase in working capital allowance. This increase in working capital allowance in turns attracts an increase of \$3,527 in revenue requirement.

The \$91,665 increase in PILs relate mostly to the change in the treatment of Scugog Hydro’s non-capital loss carry-forward. While \$174,599 had been deemed to be used by Scugog Hydro to reduce 2006 taxable income (the Test Year) in its 2006 tax model, this amount is now being deemed to be used to reduce the combined income of Scugog and VCI’s main service area in 2005. Board staff notes that this treatment is similar to three recent applications approved by the Board (ENWIN Utilities Ltd. EB-2007-0522, Welland Hydro-Electric System Corp. EB-2007-0663, and PUC Distribution Inc. EB-2007-0723) where the Decisions stated that the request for an adjustment to current rates to reflect the reduction of the loss carry-forwards present in the 2006 rates is tax-related and is an anomaly. The request to rectify it does not constitute any deviation from the letter or the spirit of Z-factor adjustments permitted by the Board as

documented in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*.

While the \$91,665 increase in PILs relates mostly to the change in the treatment of Scugog Hydro's non-capital loss carry forward, as previously mentioned, VCI explains that the balance of the increase is due to applying the harmonized tax rate of 36.12% and the large corporation tax rate to Scugog.

RETAIL TRANSMISSION SERVICE RATES ADJUSTMENT

Background

In its letter dated October 29, 2007, the Board directed each distributor to propose an adjustment to their retail transmission rates (RTR) and disposition of the associated variance account balances in its 2008 Cost of Service or Incentive Rate Mechanism application, as applicable.

VCI is applying to adjust the harmonized RTR for its main service area and Scugog to reflect the change in wholesale transmission rates. VCI is proposing to reduce its RTR — Network Service Rate by 20.0% and its RTR — Line and Transformation Connection Service Rate by 20.0% for all its rate classes. VCI also proposes to dispose of the balances as at September 30, 2007, in variance accounts 1584 (a credit of \$1,404,790) and 1586 (a credit of \$8,330,270) for those two service areas, through rate riders over a one-year period.

VCI proposes no adjustment to its Gravenhurst service area RTR.

Discussion and Submission

To derive its proposed RTR adjustments for its main service area and Scugog, VCI determined their annual wholesale transmission network and connection costs based on

the Board rate order dated October 17, 2007 (EB-2007-0759) and readings for the January to July 2007 period. These adjusted wholesale transmission network and connection costs were subsequently compared to revenue generated through existing retail transmission rates for the same period to determine cost/revenue ratios for network and connection. The calculated cost/revenue ratios for network and connection were then applied to existing retail network and connection rates to derive the proposed adjustments to the RTR — Network Service Rate and RTR — Line and Transformation Connection Service Rate.

VCI's main service area and Scugog are partly embedded within Hydro One Networks Inc. ("Hydro One"), while Gravenhurst is fully embedded within Hydro One. Staff notes that, for the purpose of its RTR adjustment calculation, VCI has assumed Hydro One's rates will remain unchanged. VCI notes that Hydro One "has not yet obtained Board approval for updates to the retail transmission rates used to assess costs to embedded distributors. Accordingly, it is premature to consider updates to retail transmission rates for Veridian's service territory in Gravenhurst at this time." Parties are asked to comment on whether the Board should consider to further adjust VCI's proposed RTR by assuming that the wholesale transmission charges payable to Hydro One would change by the same percentage as the wholesale transmission charges payable to the IESO.

VCI is proposing to dispose the unaudited September 30, 2007 balances in variance accounts 1584 and 1586 of its main service area and Scugog. Usual practice for disposing of variance and deferral accounts in the electricity sector is to use the most up-to-date audited balances, as supported by audited financial statements, plus forecasted carrying charges on those balances up to the start of the new rate year. The disposition of deferral and variance account balances is also generally dealt with in aggregate rather than clearing discrete accounts.

Parties are asked to comment on whether the Board should consider whether the disposition of deferral and variance account balances should be dealt with in aggregate

since some accounts may contain debit balances while others have credit balances. Disposing of all deferral and variance accounts at the same time would minimize fluctuations in amounts refunded to or collected from customers through deferral and variance account disposition.

Given that one of the intents of the Incentive Regulation Mechanism was to provide a streamlined process for setting rates, parties are asked to comment on whether the Board should consider waiting for the review of the disposition of all deferral and variance accounts until such time as VCI applies for its distribution rates to be rebased, which is scheduled to occur in 2010.

All of which is respectfully submitted.