Board Staff Submission
Whitby Hydro Electric Corporation
2012 IRM3 Rate Application
EB-2011-0206

Introduction

Whitby Electric Corporation ("Whitby") filed an application (the "Application") with the Ontario Energy Board (the "Board") on Sept 30, 2011, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that Whitby charges for electricity distribution, to be effective January 1, 2012. The Application is based on the 2012 3rd Generation Incentive Regulation Mechanism.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by Whitby.

In the interrogatory phase, Board staff identified certain discrepancies in the data entered in the application model by Whitby. In response to Board staff interrogatories which requested either a confirmation that these discrepancies were errors or an explanation supporting the validity of the original data filed with the application, Whitby confirmed certain errors as described below and provided the necessary corrections. Whitby also provided explanations for certain discrepancies as requested by Board staff interrogatories.

Board staff makes detailed submissions on the following matters;

- Shared Tax Savings
- Account 1562 – Payment-in-Lieu of Taxes ("PILs")
- Account 1521 – Special Purpose Charge ("SPC")
- Smart Meter Funding Adder ("SMFA")
- Lost Revenue Adjustment Mechanism ("LRAM")

Shared Tax Savings

Background

According to *Chapter 3 of the Filing Requirements for Transmission and Distribution Applications* ("Filing Requirements") if a rate rider calculation results in a figure that has more than four decimal places it should be considered negligible and therefore recorded in account 1595 to be disposed at a later date.

The Shared Tax Savings model in Whitby's application resulted in a volumetric rate rider of -$0.0001 for the General Service Less Than 50kW customer class. Whitby considered the rate rider to be negligible and requested the Z-Factor Tax Change claim owing to General Service Less Than 50kW class to be recorded in 1595 for future disposal.

Submission

Pursuant to the Filing Requirements, Board staff notes that a rate rider of -$0.0001 is not considered to be negligible and therefore is not to be recorded in account 1595. Board staff submits that the Tax Savings volumetric rate rider of -$0.0001 for rate class General Service Less Than 50kW should not be considered negligible and should be implemented effective with rates on January 1, 2012.

Account 1562 - PILs

Cost Allocation

Background

The allocation of the disposition of account 1562 across rate classes is determined by the allocation of distribution revenues as approved by the Board in an electricity distributor's most recent Cost of Service application. The IRM 3 Rate Generator requires this information to be entered to calculate the Deferral/Variance Account rate riders.

Originally, Board staff was unable to reconcile the allocation of distribution revenue entered by Whitby in the Rate Generator model. Whitby confirmed that the figures entered in the model could not be reconciled with the distribution revenue established in the EB-2009-0274 Cost of Service rate application proceeding. In place of distribution revenue from EB-2009-0274, Whitby entered actual PILs revenue collected by customer class.

Whitby has proposed to use actual PILs revenue collected by customer class to allocate the balance of account 1562. Whitby is of the view that account 1562 balances should follow the same proportions as those from which the PILs were collected.

Submission

In the Combined PILs Proceeding, EB-2008-0381, a complete settlement was reached to allocate the final balance in account 1562 across customer classes on the basis of a distributor's distribution revenue established in its previous Cost of Service application. Board staff notes that the Rate Generator model incorporates this allocation methodology and that the majority of distributors have been using distribution revenue as established by their last Cost of Service application to allocate the balance of account 1562. Board staff submits that the distribution revenue as established in EB-2009-0274 should be used to allocate the balance of 1562 across customer classes.

Quantum: Rates used to calculate PILs recoveries from customers

Background

In 2001, the Board approved a regulatory PILs tax proxy approach for rate applications coupled with a true-up mechanism filed under the Reporting and Record-keeping Requirements ("RRR") to account for changes in tax legislation and rules, and to true-up between certain proxy amounts used to set rates and the actual amounts. The variances resulting from the true-up were tracked in account 1562 for the period 2001 through April 30, 2006.

On December 18, 2009 the Board issued a decision in the Combined Proceeding and provided its views on how it will review the evidence related to account 1562 deferred PILs.

> The parties may well differ in their interpretations of the methodology but the Board will decide those questions on the basis of the facts and the underlying documents. The Board will not enter into an enquiry as to what the methodology should have been but rather, will determine, where necessary, what the methodology was and what the appropriate application of the methodology should have been.[1]

Whitby filed its evidence for a review of the balance in account 1562. Part of the evidence includes worksheets that show how the Applicant determined the PILs recoveries from customers during the period October 1, 2001 through April 30, 2006.

The 2002 application rate adjustment model ("RAM") provided two sheets that calculated the rate slivers associated with the 2001 and 2002 PILs proxy amounts approved by the Board for recovery from customers. These rate slivers had both fixed customer charge and volumetric charge elements. In order to correctly determine the amounts recovered from customers, the Applicant must multiply the rate slivers by the appropriate billing determinants.

In the 2004 application instructions, Applicants were directed to remove the 2001 PILs proxy from rates. The 2002 PILs proxy remained in rates. The Board changed the rate recovery allocation to 100% based on the variable or volumetric charge. The Board ordered Whitby's changed rates to be effective on March 1, 2004 and to be implemented on April 1, 2004.

For the period January 1, 2004 to March 31, 2004 Whitby billed its customers the 2002 approved rates which included both the 2001 and 2002 PILs proxies. The new rates which came into force on April 1, 2004 contained the 2002 PILs proxy and rate recovery was based on the volumetric rate component.

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1 EB-2008-0381Combined Proceeding, Account 1562 Deferred Payments in Lieu of Taxes (PILs), pg. 7.

Submission

In reviewing the PILs recovery calculations, Board staff was unable to verify the rate slivers used for 2002 and 2004 in Whitby's Excel worksheets with the corresponding rate slivers in the Board-approved 2002 and 2004 RAMs.

The first table shows the fixed charge for the General Service Less Than 50 kW rate class used in Whitby's PILs recovery worksheet compared to the corresponding rate from the 2002 application for the March 1, 2002 to July 31, 2002 period. Whitby received another Board Order for rates effective August 1, 2002.

The second table shows the volumetric rates for all rate classes used in Whitby's PILs recovery worksheet compared to the rates from the 2004 application for the April 1, 2004 to March 31, 2005 period.

Table 1: March 1, 2002 to July 31, 2002 period

	Whitby PILs Recovery Worksheet	**Approved 2002 RAM**
Rate Class	**Fixed Charge**	**Fixed Charge**
Residential		
GS<50 kW	$ 2.53058	$ 2.982
GS>50 kW		
USL		
Sentinel Light		
Street Light		

Table 2: April 1, 2004 to March 31, 2005 period

	Whitby PILs Recovery Worksheet	**Approved 2004 RAM**	
Rate Class	**Volumetric Rate**	**Volumetric Rate**	
Residential	$ 0.001122	$ 0.004212	kWh
GS<50 kW	$ 0.002221	$ 0.002895	kWh
GS>50 kW	$ 0.423939	$ 0.534510	kW
USL	$ 0.003259	$ 0.006149	kWh
Sentinel Light	- $ 0.918113	$ 3.255704	kW
Street Light	$ 0.251143	$ 1.187129	kW

Board staff submits that Whitby should reconcile the rate slivers for 2002 to 2004 and if discrepancies are verified, re-file corrected PILs recovery worksheets, PILs continuity schedule, and EDDVAR continuity schedule.

Interest expense used in the true-up calculations

Background

Actual interest expense, as reflected in the tax returns, that exceeds the maximum deemed interest amount is subject to a claw-back. This has been a feature of the Board's methodology and was settled in the combined proceeding[2] under Issue #13.

One adjustment to interest expense in the true-up calculations includes the addition of capitalized interest. The Board also accepted in the combined proceeding the settlement of Issue #4 regarding exclusion of regulatory assets. In EB-2010-0132 the Board directed Hydro One Brampton to remove the impacts of regulatory assets from the calculation of the balance in account 1562.[3]

> In the Combined Proceeding, the settlement agreement approved by the Board excluded both recoveries and deductions from the determination of the balance in PILs account 1562. The Board approves the same approach for HOBNI.

In the table below, for 2003 and 2004, interest expense as reported on the SIMPIL model does not match interest expense from the financial statements that support the tax returns.

Table 3: Interest Expense Analysis

	2001	**2002**	**2003**	**2004**	**2005**
Interest Expense from Financial Statements ($)					
Promissory Note	216,122	2,000,000	2,500,000	2,500,000	2,000,000
Customer Deposits	6,499	20,095	32,892	36,313	32,643
Prudential Requirements IESO & Other	-	45,572	33,015	32,391	36,529
	222,621	**2,065,667**	**2,565,907**	**2,568,704**	**2,069,172**
Interest Portion of True-Up from Revised SIMPIL model ($)					
Interest deducted on SIMPIL "MoF" filing	**222,621**	**2,065,667**	**2,065,907**	**2,068,704**	**2,069,172**
	-	-			-

In interrogatories, Board staff asked for Whitby's views on which types of interest income and interest expense should be included in the excess interest true-up calculations. Whitby's response was:

> "According to Board direction, Whitby Hydro has submitted the 1562 disposition using Halton Hills models which use the interest expense reported on their audited financial statements. This interest expense would include prudential requirements, customer deposit interest and other miscellaneous interest expenses. Whitby Hydro

2 EB-2008-0381, decision dated June 24, 2011
3 EB-2010-0132, page 50, paragraph 2.

> believes these amounts should be excluded from the calculation as the intent of the PILs model was to model long term debt interest."

Board staff submits that in the combined proceeding, Halton Hills made adjustments to interest expense used in the true-up calculations. However, the intervenors and the utility settled for a lower claw-back penalty amount because of facts unique to Halton Hills.

Submission

Board staff submits that Whitby should use the higher interest amounts that support the tax returns as shown in the upper portion of Table 3 since this is consistent with the approved methodology.

Should the Board agree with Whitby that interest related to customer deposits and prudential requirements should be excluded, Board staff submits that the higher interest expense from the upper portion in Table 3 for the Promissory Note should be used to calculate the claw-back penalty.

Account 1521 – SPC

Background

On April 9, 2010, the Board issued a letter and invoice to all licensed electricity distributors outlining the amount of each distributor's SPC assessment and the associated SPC.

On April 23, 2010, the Board issued a letter to all licensed electricity distributors authorizing Account 1521, Special Purpose Charge Assessment Variance Account. Any difference between the amount remitted to the Ministry of Finance for the SPC assessment and the amount recovered from customers was to be recorded in "Sub-account 2010 SPC Assessment Variance" of Account 1521.

The letter also indicated, in accordance with section 8 of the SPC regulation, that electricity distributors are required to apply to the Board no later than April 15, 2012 for an order authorizing them to clear any debit or credit balance in the "Sub-account 2010 SPC Variance". The Board expected that requests for disposition in "Sub-account 2010 SPC Variance" and "Sub-account 2010 SPC Assessment Carrying Charges" would be addressed as part of the proceedings for the 2012 rate year, except in cases where this approach would result in non-compliance with the timeline set out in section 8 of the SPC Regulation. In addition, the letter indicated in accordance with section 9 of the SPC Regulation, recovery of the SPC assessment is to be spread over a one-year period.

Whitby is requesting the disposal of a credit balance of $8,646.15 in account 1521. The disposal of 1521 is consistent with the Filing Requirements and the letters issued by the Board on account 1521.

Whitby is requesting to continue the use of account 1521 past January 1, 2012 in order to address adjustments that may occur in the future due to the possibility of further billing adjustments. Whitby is proposing to include account 1521 as a Group 1 account and be reviewed and disposed as a Group 1 account on an annual basis as outlined in the EDDVAR Report.

Submission

Whitby stated that it does not anticipate that the future adjustments to account 1521 will be significant in value. In Board staff's view the credit balance of $8,646.15 in 1521 is a relatively small balance which indicates that future adjustments would likely be immaterial.

Board staff submits that after disposal of this balance, the account should be considered to be closed to future adjustments. Account 1521 should not be included in Group 1 accounts in future applications as per Whitby's request due to the immaterial nature of the likely adjustments and to maintain consistency across distributors in the treatment of account 1521. Board staff submits that the disposal of the balance in account 1521 stated in this proceeding should be declared final.

Smart Meter Funding Adder ("SMFA")

Background

Whitby has proposed to continue its existing SMFA for the 2012 rate year. Its current SMFA is $2.13/month applicable to all metered customers. This amount was approved in Whitby's 2010 Cost of Service application, considered under Board File No. EB-2009-0274. However, due to timing, the rates approved in that application were approved effective January 1, 2011, and Whitby did not apply for an adjustment to rates under the 3rd Generation Incentive Regulation mechanism for 2011.

Whitby has proposed to continue the SMFA at the current approved amount for two reasons:

- First, Whitby notes that it does not have a sunset date on the SMFA on its existing Board-approved tariff of rates and charges.
- Second, Whitby has documented that it still has significant costs for smart meters in 2011, which are unaudited.

With respect to the first point, in many decisions with respect to 2011 distribution rates applications, the Board signaled that, with the deployment of smart meters complete, or nearing completion for most distributors, it was timely for the utilities to seek approval and disposition of smart meter costs. As a typical example, in its decision for Festival Hydro Inc's 2011 EDR application, the Board stated:

> Since the deployment of smart meters on a province-wide basis is now nearing completion, the Board expects distributors to file for a final prudence review at the earliest possible opportunity following the availability of audited costs. For those distributors that are scheduled to file a cost of service application for 2012 distribution rates, the Board expects that they will apply for the disposition of smart meter costs and subsequent inclusion in rate base. For those distributors that are scheduled to remain on IRM, the Board expects these distributors to file an application with the Board seeking final approval for smart meter related costs. In the interim, the Board will approve the requested SMFA of $1.52 per metered customer per month from May 1, 2011 to April 30, 2012. This SMFA adder will be reflected in the Tariff of Rates and Charges, and will cease on April 30, 2012. Festival Hydro's variance accounts for smart meter program implementation costs, previously authorized by the Board, shall be continued.[4]

Similar wording was contained in the Board's decisions for many rate applications in 2011. As Whitby's last Board-approved rates were for 2010 EDR, this concept of the completion of smart meter deployment and the sunset date of the SMFA was not included in the Board's decision.

Whitby also notes that a significant amount of its smart meter costs occur in 2011 and are currently unaudited. In Appendix M of its application, Whitby has documented that unaudited 2011 costs account for about 25% of its total smart meter costs. This greatly exceeds the 10% threshold for unaudited actuals and forecasted costs that the Board expects to see in prudence review applications.[5]

In the response to Board staff interrogatory # 7 b), Whitby notes that the majority of 2011 costs are for smart meter installations for General Service Less Than 50 kW customers, and that there are also $440K for costs for billing system changes for

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4 Decision and Order [EB-2010-0083], April 21, 2011, page 5

5 On September 13, 2011, the Board sent by e-mail to all electricity distributors a revised Excel spreadsheet Smart Meter Model Version 2.0. The model includes a Notes page that indicates that:

> When applying for the recovery of smart meter costs, a distributor should ensure that historical cost information has been audited including the smart meter-related deferral account balances up to the distributor's last Audited Financial Statements. A distributor may also include historical costs that are not audited and estimated costs, corresponding to a stub period or to a forecast for the test rate year. The Board expects that the majority (i.e. 90% or more) of costs for which the distributor is seeking recovery will be audited. In all cases, the Board expects that the distributor will document and explain any differences between unaudited or forecasted amounts and audited costs.

TOU rates and related requirements. Board staff notes that the billing system changes for TOU rates and related requirements may be, in large part "beyond minimum functionality", and thus will be examined at the time of disposition.

In response to Board staff interrogatory # 7 c), Whitby states that the model that it has used would support an SMFA of $2.69/month for the deferred revenue requirement up to December 31, 2012. Whitby filed a working Excel version of the model in that response.

Submission

Board staff makes no submissions with respect to whether the SMFA should be continued or not. It appears to staff that Whitby may be in a position to file for a final prudence review with at least 90% of its costs audited, in the second half of 2012 and possibly in time for rate implementation by January 1, 2013. In the event the Board is inclined to approve the continuation of the SMFA for 2012, Board staff makes the following observations relating to the level of the SMFA proposed by Whitby.

Board staff has reviewed the model filed by Whitby and notes that the utility has used its own Smart Meter model, not that issued by the Board on September 13, 2011. Board staff's review indicates that Whitby is using a methodology different than that accepted by the Board in some recent decisions. Board staff acknowledges that Whitby's model appears to correctly calculate simple interest on the opening balance of OM&A and depreciation/amortization expenses for account 1556. However, in addition to calculating the deferred revenue requirement for in-service smart meter assets, starting in 2009, Board staff observes that interest is calculated on the net book value of capital assets less SMFA revenues for the whole period..

In Board staff's submission, this approach is contrary to the accepted methodology, and is incorrect in concept. The revenue requirement appears to be calculated correctly. However, Whitby's methodology effectively compensates the utility with a weighted average cost of capital ("WACC") of 8.0% in 2009 and 2010 and 7.0% in 2011 and 2012, while also allowing for carrying charges at the prescribed interest rates for D/V accounts (currently 1.47%) on the net book value of the same capital assets.

Board staff submits that this interpretation and application of the smart meter cost recovery methodology is inconsistent with FAQ # 8 of the August 2008 Accounting Procedures Handbook FAQs, also documented in Appendix C of *Guideline G-2008-0002: Smart Meter Funding and Cost Recovery*, issued October 22, 2008. The example provided therein does not incorporate the interest on the capital investments in Account 1555 in the net deferred revenue requirement. The example in FAQ # 8 is considered to be illustrative and not precedent setting or implying of Board approval of smart meter cost recovery.

Whitby's methodology is the basis for their calculation of the SMFA. Allowing for the WACC and carrying charge on net capital assets will overestimate the net deferred revenue requirement. As the Board made clear in many 2011 EDR decisions, the intention of the SMFA is not to be fully compensatory, but to provide some funding and to smooth rate increases and mitigate rate shock for when smart meters are fully reflected in rate base and revenue requirement.

Board staff submits that Whitby's current approach is inconsistent with Board policy and practice and risks over-collecting the deferred revenue requirement. Should the Board determine that Whitby's SMFA should continue until December 31, 2012, Board staff submits that a slightly reduced SMFA may be appropriate to reduce the risk of over-collection. Without detailed calculations on the record, Board staff suggests that a revised SMFA of $1.50/month per metered customer would be reasonable; Board staff also suggests that the Board confirm a sunset date for any continued SMFA of December 31, 2012.

Finally, Whitby should be directed to file a stand-alone application for disposition of its Smart Meter costs for implementation by January 1, 2013.

LRAM

Background

Whitby originally sought a total amount for LRAM recovery of $510,763, including carrying costs. The lost revenues cover the period 2009 to 2011 inclusive. Whitby updated its LRAM claim to $472,604, including carrying costs, due to the original LRAM claim using 2009 program results as a best representative estimate for 2010 program year results. The adjusted LRAM claim of $472,604 is based on final 2010 OPA program results. Whitby did not file a claim for Shared Savings Mechanism ("SSM"). In response to Board staff Interrogatory 8(a), Whitby noted it does not intend to file a claim for SSM in the future.

Submission

The Board's *Guidelines for Electricity Distributor Conservation and Demand Management* (the "Guidelines") issued on March 28, 2008 outlines the information that is required when filing an application for LRAM.

Board staff submits that Whitby's application for LRAM recovery is consistent with the Board's Guidelines and the Board's Decision on Horizon's application (EB-2009-0192) for LRAM recovery, to the extent that the Board noted that distributors should use the most current input assumptions available at the time of the third party review when calculating LRAM.

Updated LRAM Amount

Board staff notes that the updated LRAM claim of $472,604 includes the final OPA verified results of the 2010 OPA programs. To the extent that it impacts the 2009 and 2010 years, Board staff submits that using the updated 2010 verified results is appropriate and consistent with the method accepted by the Board in past applications.

LRAM Recovery for 2009 and 2010

Board staff supports the requested 2009 and 2010 LRAM amounts that result from past programs that have savings persisting into 2009 and 2010 and new programs implemented in 2009 and 2010. As indicated in response to interrogatory #3(f) from VECC, the LRAM claim without including 2011 lost revenues was calculated by Whitby to be $265,377, plus carrying costs. Board staff notes that Whitby has not recovered these lost revenues in past applications.

LRAM Recovery for 2011

Staff notes that Whitby last rebased with an updated load forecast effective January 1, 2011. The intent of the LRAM in the electricity sector is to maintain revenue neutrality for CDM activities implemented by distributors during the IRM term since their rates do not reflect incremental CDM activities. It is Board staff's view that the expectation in the electricity sector has been that future LRAM claims pertaining to the test year (including true-ups to previous rebasing forecasts) would be unnecessary once a distributor rebases and accordingly updates its load forecast. This approach results in rate certainty for base rates.

Board staff notes that the CDM Guidelines state the following with respect to LRAM claims.

> Lost revenues are only accruable until new rates (based on a new revenue requirement and load forecast) are set by the Board, as the savings would be assumed to be incorporated in the load forecast at that time[6].

In its most recent test year application, Whitby had the opportunity to reflect CDM savings on a forecast basis for all programs planned to be deployed up to and including the test year, and intervenors had the opportunity to challenge that forecast. In response to Board staff interrogatory #9, Whitby provided its rationale for why it did not include CDM adjustments in the forecast. Whitby stated that in the testing of the regression model

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6 Section 5.2: Calculation of LRAM, Guidelines for Electricity Distributor Conservation and Demand Management (EB-2008-0037)

CDM was not considered to be a statistically significant variable and therefore it was dropped from the forecasting model. Therefore, there were no quantifiable persisting impacts included in the load forecast. Whitby also noted that data associated with 2009 and 2010 CDM programs would not have been available to include in the load forecast.

Board staff is of the view that there are other methods to adjust a forecast for CDM initiatives that Whitby could have explored including the use of reasonable proxies for CDM effects for new programs deployed in the years leading up to and including the test year.

In this particular case, parties settled on the final forecast which the Board approved. There is no evidence to indicate that in approving the Whitby settlement agreement, including the load forecast, the Board also acknowledged (or tacitly approved) that a true-up for CDM activities would take place related to the subject test year. In fact, a plain reading of the CDM guidelines suggests that once a new load forecast is approved, it is to be considered final in all respects. The same would hold true in Board staff’s view if a CDM adjustment was included in the forecast but was not achieved.

While a true up of all unforecasted CDM activities would be consistent with the revenue neutrality principle of the LRAM concept, it is staff’s view that the over riding regulatory principle at play here is rate certainty. Final rates means no retroactive adjustments related to the period in which rates were declared final. This is a key regulatory principle which the Board has, with very few exceptions, always upheld. To the extent that actual savings were not reflected in the final approved forecast should be, in Board staff’s view, absorbed by the applicant.
Board staff submits that the appropriate LRAM amount for the Board to approve is $265,377, plus carrying costs.