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**BY EMAIL**

December 5, 2011

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street, Suite 2700  
Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: West Coast Huron Energy Inc.  
Tornado Relief Rate Adder Application  
Board File Number EB-2011-0335**

Pursuant to Procedural Order No. 2, issued November 18, 2011, please find attached the Board Staff submission on West Coast Huron's funding adder application to recovery costs caused by an F3 Tornado, filed September 8, 2011.

Please forward the attached to West Coast Huron Energy Inc. and parties to this proceeding.

Yours truly,

*Original Signed By*

Birgit Armstrong  
Advisor, Applications & Regulatory Audit



# **ONTARIO ENERGY BOARD**

## **BOARD STAFF SUBMISSION**

**TORNADO RELIEF RATE ADDER APPLICATION**  
**West Coast Huron Energy Inc.**

**EB-2011-0335**

**December 5, 2011**

**Board Staff Submission  
West Coast Huron Energy Inc.  
TORNADO RELIEF RATE ADDER APPLICATION  
EB-2011-0335**

***Introduction***

West Coast Huron Energy Inc. ("WCH") filed an application with the Ontario Energy Board (the "Board"), received on September 8, 2011, under section 78 of the *Ontario Energy Board Act, 1998, c. 15 (Schedule B)* seeking approval to recover the costs caused by an F3 Tornado that occurred on August 21, 2011. WCH requested that the estimated costs associated with the storm damage be recovered over a 63 month period effective October 1, 2011 by means of a rate adder. In its application, WCH indicated that not all costs, net of recoveries from third parties, will be known and final by December 31, 2011. WCH further indicated that the earliest that this could be completed would be in the spring of 2012. WCH proposed to bring final costs for the Board's review as part of its 2013 cost of service application.

In Procedural Order No. 1, the Board declared WCH's current Tariff of Rates and Charges interim effective November 1, 2011.

This submission reflects observations and concerns which arise from Board staff's review of the pre-filed evidence and interrogatory responses made by WCH. The submission is intended to assist the Board in evaluating WCH's application and in setting just and reasonable rates.

***The Application***

WCH originally requested tornado relief in the amount of \$2.4 million inclusive of a 4% interest charge, to be recovered by means of a rate adder over a 63 month period ending December 31, 2016. The total claim is comprised of estimated infrastructure loss of \$1.5 million, net of insurance claims, and \$0.5 million in lost revenue. In response to Board staff interrogatory #6, WCH revised its estimated claim to \$2.1 million.

WCH proposed to allocate the estimated tornado damage costs on the basis of 2010 distribution revenues and to recover the allocated amounts by rate class by means of a fixed rate adder.

WCH also proposed to record all related recovery from the rate adder in USoA Account 1572 sub-ledger account "2011 Tornado Relief Funding Adder", and to record all related costs incurred net of recoveries from external parties as an offset to the above in USoA Account 1572 sub-ledger account "2011 Tornado Relief Costs" with simple interest applied monthly to opening account balances.

In its application WCH stated that it anticipates that not all costs net of third party recoveries will be known by December 31, 2011. WCH estimated that the earliest that all costs would be known may be the spring of 2012. WCH proposed to bring final costs for Board review as a component of WCH's 2013 cost of service application expected to be filed by May 1, 2012.

Board staff's comments are focused on three areas related to this application. First, Board staff will comment on whether all of the proposed estimated cost elements should be included in the calculation of the rate adder. Board staff will also comment on whether WCH's proposed recovery period of 63 months is suitable and whether the proposed cost allocation methodology is appropriate.

### ***Estimated Storm Damage Costs***

In response to Board staff interrogatory #6, WCH revised its original claim to the following amount:

| <b>Revised estimate of loss recovery required</b>       |                     |
|---|---------------------|
| Infrastructure replacement                              | \$ 1,500,000        |
| Interest cost on net variance balance (63 months at 4%) | 198,400             |
| Net book value of infrastructure assets destroyed       | 229,500             |
| Loss in revenue   | 130,000             |
| Total estimated loss recovery                           | <u>\$ 2,057,900</u> |

## ***Evaluation Criteria***

On July 14, 2008, the Board issued the *Report of the Board on 3<sup>rd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors (the "Report")*. In the Report, the Board set out its approach for dealing with the costs of unforeseen events that are outside of management's control. The Board determined that in order for amounts to be considered for recovery by way of a Z-factor, the amounts must satisfy all three eligibility criteria of causation, materiality and prudence.

In response to VECC interrogatory #1, WCH indicated that its application is not a Z-factor application since a typical Z-factor application would be made after all expenses have been recorded, vetted for incremental impact, and audited. However, WCH stated that the amount claimed satisfies the three eligibility criteria established by the Board in the *Report*.

## ***Discussion and Submission***

Board staff agrees with WCH that its application is not a Z-factor claim per se since the total amount is based on a combination of actual and estimated values. However, Board staff, informed by the criteria established by the Board in the Report, is of the view that causation, materiality, and reasonableness of the cost should be examined as part of this application. Board staff also agrees that the prudence of final actual costs incurred should be tested as part of WCH's 2013 cost of service application.

Board staff notes that the approval of a rate adder does not constitute a finding as to the prudence of the costs incurred. A rate adder is by definition a tool designed to provide advance funding on an interim basis for certain investments or expenses as prescribed by the Board and to mitigate or smooth the anticipated rate impact when recovery of these costs are approved by the Board. Since the approval of a rate adder does not constitute regulatory approval of any costs actually incurred, the prudence of such costs is examined, and the costs are approved in whole or in part, at the time that the distributor brings the matter forward for regulatory review.

Board staff submits that WCH has demonstrated that the criteria of causation and materiality have been met. With respect to the reasonableness of the costs claimed, Board staff has two concerns, as set out below. Firstly, the claim includes the net book

value of infrastructure assets destroyed which is not appropriate in Board staff's view. Secondly, Board staff is of the view that lost revenue should not be included in the calculation of the rate adder.

### ***Net Book Value of Infrastructure Assets Destroyed***

In response to Board staff interrogatory #3(b), WCH stated that the company anticipated to write off destroyed assets, resulting in a loss on disposal equal to their net book value. WCH stated that the net book value of these assets amounts to \$229,500.

### ***Discussion and Submission***

Board staff notes that the subject assets are currently included in WCH's rate base and therefore the return on and of these assets are being recovered in current rates. In order to avoid the potential risk of double counting, Board staff is of the view that the return on and of these assets should continue to be recovered through base rates until WCH files its 2013 cost of service application. Board staff therefore submits that the write-off of these assets and their subsequent removal from WCH's rate base should be considered during WCH's next cost of service application. Accordingly, the net book value of these assets should not be used in deriving the rate adder.

### ***Lost Revenue***

In response to Board staff interrogatory #6, WCH submitted that the revised revenue loss of \$130,000 is still based on assumptions regarding its customer base. WCH further stated that the actual loss will be revealed as the recovery process continues and would be part of a true-up process once all costs are known.

### ***Discussion and Submission***

Board staff notes that in the 2007 Combined Proceeding on Storm Damage Cost Claims (the "Combined Proceeding")<sup>1</sup>, the Board approved the recovery of similar storm related costs for Canadian Niagara Power Inc. – Fort Erie, Canadian Niagara Power Inc. – Port Colborne, Peterborough Distribution Inc. and Lakeland Power Distribution Ltd. Board

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<sup>1</sup> Decision with Reasons: EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551 ("Combined Proceeding")

staff also notes that costs brought forward by the above-mentioned distributors during the Combined Proceeding did not include lost revenue due to load loss.

Board staff also notes that in its 2012 IRM application (EB-2011-0203), WCH applied for an incremental capital module. WCH indicated that Sifto, a large customer, informed WCH in May of 2011 of its plan to significantly increase demand. WCH stated that Sifto has purchased two Continuous Miners with an expected in-service date of July 2012 and that each miner will be drawing an additional 1.5 MW of continuous load.

Board staff submits that WCH's estimate of \$130,000 in lost revenue is still based on imprecise assumptions<sup>2</sup>. Board staff further submits that under a price cap, the revenue associated with the forecasted increased demand of Sifto would accrue solely to the benefit of WCH's shareholder during the remaining IR plan term, and may outweigh the actual lost revenue due to the storm. Board staff also notes that lost revenue has not generally been considered by the Board as being eligible for recovery under a Z-factor treatment. For those reasons, Board staff submits that the cost of \$130,000 should be excluded from the calculation of the rate adder.

### ***Recovery Period***

In its application, WCH proposed to recover the costs of the F3 tornado storm over a 63 month period beginning October 1, 2011. In response to VECC interrogatory #2, WCH revised the effective date to December 1, 2011 and indicated its intent to prospectively recover the amount approved by the Board over a 63 month period. As previously mentioned, WCH also stated its intent to bring final costs for the Board's review in its 2013 cost of service application which is expected to be filed by May 1, 2012 for rates effective January 1, 2013.

### ***Discussion and Submission***

Board staff submits that a sunset date of 63 months is not appropriate as funding adders are intended to provide advanced funding until such time as costs can be reviewed for prudence. As such, Board staff submits that a rate adder should be in place until WCH's next rebasing application. A final prudence review should be done as part of WCH's 2013 cost of service application to allow the Board to make a final determination on actual tornado storm damage costs.

Board staff therefore submits that the Board should approve a rate adder that would be in place until such time that WCH's 2013 rates come into effect.

Board staff notes that WCH has included a carrying charge of \$198,400 (63 months at 4%) in its total estimated costs. Board staff submits that if the Board approves the approach advocated by Board staff, the carrying charges should be revised to exclude the cost elements proposed by Board staff (i.e. \$229,500 + \$130,000) and reflect a rate adder that would be in place for approximately 12 months instead of 63 months. Board staff also submits that the most recent Board-approved short term interest rate should be used in the derivation of the carrying charges.

### ***Rate Adder Calculation***

In response to SEC interrogatory #2, WCH stated that a cash flow of approximately \$38,000 per month would support the additional costs of a line of credit needed to pay for the costs incurred resulting from the tornado storm.

### ***Discussion and Submission***

Board staff notes that the evidence makes no reference to the terms and conditions of the line of credit and the underlying financial obligations of WCH. Based on the exclusions suggested by Board staff (i.e. \$229,500 + \$130,000 and revised carrying charges), a monthly cash flow of approximately \$25,000 per month would result from the rate adder. Board staff proposes that the rate adder be set to recover this monthly amount. Board staff invites WCH to make a reply submission as to its current cash flow position and details on the terms and conditions of the credit line used to finance storm damage costs.

### ***Allocation and Recovery of Storm Damage Costs***

WCH proposed to allocate the estimated tornado damage costs on the basis of 2010 distribution revenues and to recover the allocated amounts by rate class by means of a fixed rate adder.

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<sup>2</sup> Response to Board staff interrogatory #6.



### ***Discussion and Submission***

In the Combined Proceeding, with respect to the allocation and recovery of storm damage costs, the Board determined that the approved cost would be allocated to the various customer rate classes on the basis of distribution revenue. The Board noted that storm damage is a general distribution system problem and that in the ordinary course of electricity distribution rate-setting the Board allocates distribution costs between classes on the basis of distribution revenue. The Board noted that this ensures that the burden on each class of customers is not unreasonable. With respect to intra class allocation and billing determinants, the Board approved the recovery of the amounts on the basis of the fixed/variable ratios that currently underpin each applicant's base distribution rates.

Board staff notes that the Board also previously approved an allocation based on customer count in other storm damage costs proceedings<sup>3</sup> and recovery through either fixed or variable charges.

Board staff submits that WCH's proposed cost allocation methodology is consistent with the methodology approved by the Board in the Combined Proceeding. However, Board staff notes that the evidence filed does not provide sufficient information to infer the respective rate classes' responsibilities for storm damage costs. Board staff further notes that an allocation based on distribution revenues would place a significant burden on the Large User rate class (\$3,929 per month based on the methodology proposed by WCH). Board staff invites WCH to comment in its reply submission on the appropriateness of this outcome on the Large User rate class from a cost causality perspective and whether the customer in that rate class is aware of this potential outcome. Board staff also invites WCH to comment on the appropriateness of using customer count/number of connections as the allocator for storm damage costs. Board staff submits that the cost allocation study to be filed as part of WCH's 2013 cost of service application would inform the Board about an appropriate cost allocation methodology when this application for a prudence review will be made.

All of which is respectfully submitted

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<sup>3</sup> In RP-2005-0020/EB-2005-0359, RP-2005-0020/EB-2006-0011, EB-2007-0794.