



***PUBLIC INTEREST ADVOCACY CENTRE  
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December 5, 2011

**VIA MAIL and E-MAIL**

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

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)  
Final Submissions: EB-2011-0335  
West Coast Huron Energy Inc. – Tornado Relief Rate Adder Application**

Please find enclosed the submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above noted proceeding.

Thank you.

Yours truly,

Michael Buonaguro  
Counsel for VECC

cc: West Coast Huron Energy Inc.

**ONTARIO ENERGY BOARD**

**IN THE MATTER OF the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15, Sch.B, as amended;**

**AND IN THE MATTER OF an Application by West Coast Huron Energy Inc. pursuant to section 78 of the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for electricity distribution to be effective October 1, 2011.**

**FINAL SUBMISSIONS**

**On Behalf of The**

**VULNERABLE ENERGY CONSUMERS COALITION (VECC)**

**December 5, 2011**

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**Vulnerable Energy Consumers Coalition (VECC)**  
**Final Argument**

**1 The Application**

- 1.1 West Coast Huron Energy Inc. ("West Coast Huron", "the Applicant," or "WCH") filed an application ("the Application") with the Ontario Energy Board ("the Board" or "the OEB") on September 8, 2011, under section 78 of the Ontario Energy Board Act, 1998 for an Order or Orders approving or fixing just and reasonable distribution rates effective October 1, 2011. The Application specifically proposed a Tornado Relief Funding Adder<sup>1</sup>. The proposed amount sought for relief was \$2,400,000<sup>2</sup> to be collected from West Coast Huron's rate payers over a sixty-three month period ending December 31, 2016.
- 1.2 In addition West Coast Huron requested that its current Tariff of Rates and Charges be declared interim effective October 1, 2011 pending the results of the Application. West Coast Huron further proposed to record all related costs incurred (net of recoveries from external parties as an offset) in USoA Account 1572 sub-ledger account "2011Tornado Relief Costs" with simple interest applied monthly to opening account balances using the Board's prescribed interest rates.
- 1.3 West Coast Huron anticipated that not all costs net of recoveries would be known and final by December 31, 2011 and that the spring of 2012 may be the earliest that this would be complete. West Coast Huron has proposed to bring final costs for Board review as a component of its 2013 rebasing application to be filed next year<sup>3</sup>.
- 1.4 The following sections set out VECC's final submissions regarding West Coast Huron's application.

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<sup>1</sup> Exhibit 1, Tab 1, Schedule 2, pages 1-2

<sup>2</sup> Subsequently revised to \$2,057,900 (VECC IR #4)

<sup>3</sup> Exhibit 1, Tab 1, Schedule 5, page 3

## **2 Nature of the Application**

- 2.1 On August 21, 2011 the Town of Goderich was subjected to a F3 tornado. West Coast Huron as the electricity distributor was impacted by this event incurring infrastructure (i.e., poles, wires and transformers) damage, loss of a distribution building and loss of revenue from impacted commercial and residential customers<sup>4</sup>.
- 2.2 West Coast Huron's rates were rebased in 2009 and the Utility is currently on 3<sup>rd</sup> Generation IRM. Under 3<sup>rd</sup> Generation IRM electricity distributors may apply for a Z-Factor Adjustment to rates to provide for unforeseen events outside of management's control<sup>5</sup>. Indeed, natural disasters such as tornados and severe storms are examples of the types of events typically cited as being eligible. However, West Coast Huron is not making a formal Z-Factor Adjustment Application at this time. The reason for this is that the recovery work is still ongoing and it does not have a full accounting of the associated costs<sup>6</sup>. Rather WCH's application is (in its words) "a new approach" which "has not been proposed for this purpose previously to the Board and has no precedence". In response to VECC's IRs, WCH states<sup>7</sup>:
- West Coast Huron believes its situation requires immediate financial attention and the mechanisms available for relief of this nature are currently not defined or available. It is West Coast Huron's belief that this proposal would protect the interest of all affected parties.*
- WCH proposes recovery of costs via a rate adder with a true up once actual costs are known and the actual revenue loss impact is also evident.*
- 2.3 Based on the foregoing, VECC understands that the purpose of applying for a "rate adder" at this time is to address the immediate financial implications (e.g. cash flow) associated with recovering from the tornado. VECC also understands that WCH proposes, as part of its 2013 rebasing Application, to make a formal Z-

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<sup>4</sup> Exhibit 1, Tab 1, Schedule 5, page 1

<sup>5</sup> Report of the Board on 3<sup>rd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors, July 2008 – pages 34-35

<sup>6</sup> VECC IR #1 a) and Board Staff IR #3.

<sup>7</sup> VECC IR #1 a)

Factor Adjustment Application, adjust the costs recorded in the proposed deferral account to reflect those found eligible for recovery by the Board and true-up any differences between eligible costs and rate adder revenues<sup>8</sup>.

2.4 Given the nature of the current Application, VECC submits that the Board needs to determine as part of this proceeding:

- Whether, in principle, costs incurred as a result of the F3 tornado would be eligible for a Z-Factor Adjustment.
- Whether a rate adder is warranted and justified at this point in time (i.e., prior to the filing of a formal Z-Factor Adjustment application) based on WCH's current circumstances.

If the response to these two propositions is affirmative, then there is a need to establish the level and duration of the rate adder. However, in doing so, VECC submits that the Board should not make any final determinations as to precisely what costs are to be ultimately recovered from customers. This decision should await WCH's formal application for a Z-Factor Adjustment, when all the costs are known and have been accounted for.

2.5 In VECC's view, that will be the point in time at which to assess and decide precisely what costs are eligible for recovery and for true-up (through the proposed deferral account) against any rate adder revenues. However, in order to establish a reasonable basis for the rate adder, VECC submits that the Board should make a "preliminary" determination as to the categories of costs that may be eligible and which, therefore, should form the basis for the rate rider.

### **3 Event Z-Factor Eligibility**

3.1 In response to VECC IR #1 b), WCH has addressed the Z-Factor Adjustment eligibility criteria as they apply to August 2011 tornado event. VECC submits that the event appears to meet the Causation and Prudence criteria. Furthermore, while (as indicated below) VECC has some issues with respect to the quantum of

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<sup>8</sup> Exhibit 1, Tab 1, Schedule 5, pages 2-3 and

costs WCH is claiming for purposes of determining the rate adder, it is clear that even if the questionable costs were excluded, the eligible costs will still exceed West Coast Huron's \$50,000 materiality limit.

- 3.2 Overall, VECC concludes that, from a preliminary review, West Coast Huron appears to have a justifiable case for its future Z-Factor Adjustment application.

#### **4 Need for a 2011 Rate Adder**

- 4.1 West Coast Huron's application states that while and after it is recovering from this disaster it is readily apparent that the utility's financial position is in dire strait and that there is an immediate need for readily available funds to cover unexpected expenses. It is for this reason that WCH is requesting the implementation of a Tornado Relief Rate Adder<sup>9</sup>.
- 4.2 To date, WCH has obtained a loan of \$500,000 from the Town, repayable when the proceeds for insurance on one of buildings leased from the town is received<sup>10</sup>. With this loan to offset some of the cash flow impact, WCH's bank balance has swung from a \$469,544 positive balance at the start of September 2011 to a \$431,562 shortfall projected for year-end 2011<sup>11</sup> – when the balance of the costs are expected to be accounted for. However, WCH has also received authorization to increase its line of credit from \$1 M to \$2 M<sup>12</sup>. Furthermore, WCH's balance sheet as of June 2011<sup>13</sup> indicates that the shareholder equity in the Company far exceeds the 40% deemed amount for rate setting purposes. As a result, it appears that West Coast Huron is able to financially manage the recovery and is not in the "dire financial straits" that it claims as a result of the tornado.
- 4.3 What appears to be of concern to WCH is the fact that it is planning to undertake a major capital program in the latter part of 2011 through 2012 which is estimated to cost \$2.8 M and which could use up the borrowing capability of the utility when

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<sup>9</sup> Exhibit 1, Tab 1, Schedule 5, page 1

<sup>10</sup> VECC IR #3 c) and AMPCO IR #4 g)

<sup>11</sup> AMPCO IR #2 a)- Schedule A

<sup>12</sup> VECC IR #5 a)

<sup>13</sup> AMPCO IR #2 a) - Schedule B

combined with the recovery spending<sup>14</sup>. However, it is also evident from the response to the SEC IR #4 that the actual costs of this program are unknown and that there is no solid evidence that WCH will be unable to borrow the funds required. Furthermore, there is no indication that WCH has given thought to reprioritizing its planned capital program spending in light of the spending required to respond to the tornado.

- 4.4 As WCH has acknowledged, this Application is unique and a departure from what is generally provided for in the Board's IRM Guidelines. As result, in VECC's view the onus is on WCH to clearly demonstrate need for deviation from standard practice (i.e., apply for a Z-Factor Adjustment once all costs have been incurred and accounted for). Based on the discussion in the preceding paragraphs, VECC submits that WCH has not presented a compelling case regarding its claim of "dire financial straits". As a result, VECC submits that there is no foundation for approving WCH's request for a rate adder at this time. Rather, WCH should be directed to file for a Z-Factor Adjustment as part of its 2013 rebasing Application (or before that if the required information can be assembled earlier).

## **5 Eligible Z-Factor Adjustment Costs**

- 5.1 In the previous section VECC has submitted that WCH has not justified its need for a tornado relief funding rate adder. However, in the event that the Board decides a funding adder is appropriate, this section addresses VECC's views as to the cost that should be provided for by such an adder.

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<sup>14</sup> SEC IR #4

5.2 In its Application, West Coast Huron has applied for a rate adder based on the following costs (as updated in its IR responses<sup>15</sup>):

**Revised estimate of loss recovery required**

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	<u>130,000</u>
Total estimated loss recovery	\$ 2,057,900

**Infrastructure Replacement**

5.3 The \$1.5 M represents a rounded estimate of the total costs that will be incurred. WCH's current best estimate of the total infrastructure replacement costs is \$1,440,339 (net of internal ineligible costs)<sup>16</sup>. However, a significant portion of this (\$948,747) are costs that, under WCH's normal accounting practices, would be capitalized<sup>17</sup>. WCH proposes to fully expense these costs<sup>18</sup> on the basis that capitalizing such costs would be contrary to the notion that Z-Factors are meant to address unforeseen temporary matters and capitalization would result in rate impacts over the entire useful life of these assets.

5.4 VECC disagrees with WCH's proposal to expense all of the costs that would normally be capitalized under its current policies. The fact that the assets will have a useful life beyond the proposed 63 month recovery period is precisely the reason why the related costs should be capitalized and included in rates for the extended period. Otherwise today's customers are clearly paying for benefits that will accrue to future customers. Also, VECC is concerned that WCH's approach will lead to discrepancies (and confusion) between WCH's audited asset base and its asset base as used for regulatory purposes.

5.5 In VECC's view the appropriate treatment of any eligible incremental capital costs would be to include the associated revenue requirement implications (up to point

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<sup>15</sup> VECC IR #4

<sup>16</sup> VECC IR #3 c)

<sup>17</sup> VECC IR #3 c) & e)

<sup>18</sup> VECC IR #3 c)



of rebasing in 2013) in the Z-Factor Adjustment calculations.

#### Interest Cost on Net Variance Balance

5.6 In its interrogatories, VECC requested<sup>19</sup> details regarding the determination of the \$198,400 in interest costs that form part of WCH's claim, including the calculations. However, no details were provided in the response. It is not clear to VECC how the \$198,400 was derived and whether or not the underlying calculations accounted for the future flow of rate adder revenues as well as the costs of restoration. VECC also takes issue with the 4% interest rate used in the calculation. VECC notes that the current interest rate prescribed by the Board for deferral/variance accounts is 1.47%<sup>20</sup>.

5.7 VECC submits that with out further details any allowance for interest on the net variance would have to be reduced significantly from the amount claimed by WCH for purposes of establishing the rate adder.

#### Net Book Value of Infrastructure Assets Destroyed

5.8 WCH states that it anticipates the write off of existing destroyed assets resulting in a loss on disposal equal to their net book value. For purposes of the Application this net book value is based on the estimated replacement cost present valued to the year of purchase using the consumer price index. The asset is then depreciated on a straight line basis over the useful life of the asset as per the company's current depreciation policy from the date of purchase to the year ended 2010<sup>21</sup>. In total, WCH is claiming \$229,500.

5.9 Again, despite requests during the IR process<sup>22</sup>, West Coast Huron has not provided any detailed calculations supporting the derivation of the \$229,500. Furthermore, WCH has not explained why it was unable to derive the remaining

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<sup>19</sup> VECC IR #4 a)  
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<http://www.ontarioenergyboard.ca/OEB/Industry/Rules+and+Requirements/Rules+Codes+Guidelines+and+Forms/Prescribed+Interest+Rates>

<sup>21</sup> Board Staff IR #3 b)

<sup>22</sup> VECC IR #4 a)

net book value directly from its accounting records or why the consumer price index was used in its calculations as opposed to other available indexes that more closely track the annual escalation in electricity distribution infrastructure costs (e.g. the Handy-Whitman index)<sup>23</sup>. Absent these explanations, it is VECC's view that the \$229,500 must be viewed with caution and may be subject to significant revision in any final true-up.

5.10 Furthermore, it is unclear to VECC precisely when WCH is planning on moving to modified IFRS and, as a result, whether there will be other mechanisms for recovery of write-offs such as that experienced due to the tornado.

5.11 Finally and most importantly, it must be noted that the current rates (rebased in 2009) include an allowance for depreciation and return related to the written off assets. If customers are to be charged for the write-off of the assets then the IRM-based rates applicable to customers for the balance of 2011 and all of the 2012 rate year would need to be adjusted to remove these costs. In VECC's view, the easier approach is to not adjust the rates (allowing for continued depreciation and return on these assets) and then remove them from rate base at the time of rebasing (i.e., 2013).

### Loss in Revenue

5.12 WCH is seeking recover of some \$130,000 in lost revenue due to interruptions and reduced operation experienced by customers as a result of the tornado<sup>24</sup>.

However, WCH acknowledges that the \$130,000 is just an estimate and that the actual lost revenue will only be revealed as the recovery process continues<sup>25</sup>.

5.13 VECC notes that in September 2009 Horizon Utilities Corporation filed an Application (EB-2009-0332) for a Z-Factor Adjustment to address a loss in large use customer revenue due to a change in the customer's operations. Similar to

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<sup>23</sup> Note – WCH's basis for establishing the remaining net book value not apparent until described in the interrogatory responses and, as a result, no follow-up has been possible.

<sup>24</sup> Board Staff IR #6

<sup>25</sup> VECC IR #4 a)

this case, the rationale for treatment as a Z-Factor was that the cause of the change in operations was beyond the control of the utility. In its subsequent decision the Board stated<sup>26</sup>:

*The Board is in agreement with the views of some intervenors that the Z-factor criteria were not intended to be used for the recovery of revenue losses.*

5.14 Based on this finding, VECC submits that it is highly questionable whether, as a part of any future formal Z-Factor Adjustment application WCH will be able to recover revenue losses arising from the event. As result, such losses should not be included in any preliminary estimate of the eligible amount used to determine a relied rate adder.

### Summary

5.15 As noted earlier, it is VECC's view that WCH has not made a prima facie case for the need for a tornado relief rate adder at this time based on cash flow and financial hardship considerations. However, if the Board determines that such a rate adder is appropriate it is VECC's views that it should be based on the following preliminary costs (subject to future true-up):

- Incremental OM&A                      \$491,592<sup>27</sup>
- Incremental Capital Costs        To Be Determined<sup>28</sup>
- Interest Costs                        \$73,000<sup>29</sup>

In VECC's view, the other cost elements proposed by WCH should not be included in the Z-Factor Adjustment estimate for the reasons discussed above.

## **6 Rate Adder Determination**

6.1 WCH proposes to allocate the costs to customer classes based on the 2010

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<sup>26</sup> EB-2009-0332 Decision, page 10

<sup>27</sup> VECC IR #3 e)

<sup>28</sup> Calculation to be based on the 2011 (partial) and 2012 (full) depreciation, return (interest & net income) and taxes associated with the incremental capital costs.

<sup>29</sup> Initially proposed value adjusted for lower interest rates - 1.47%/4% \* \$198,400

Distribution Revenues as reported to the Board via its RRR filing and to recover the amount from each class based on a fixed customer charge adder calculated using the 2010 customer count and a 63 month recovery period (i.e., ending December 31, 2016)<sup>30</sup>.

- 6.2 Should the Board decide to approve a rate adder at this time VECC has no objection to the proposed methodology for allocating the costs to customer classes. However, VECC does not agree with the proposal to base the adder for each class on a fixed customer charge. VECC notes that this approach is inconsistent with the approach adopted in Board Decision re Storm Damage Cost Recovery, EB-2007-0514/0595/0571/0551 (page 14) where the Board concluded:

*With respect to intra class allocations and billing determinants, the Board approves recovery of the approved amounts on the basis of the fixed/variable ratios that currently underpin each applicant's base distribution rates.*

- 6.3 VECC is also concerned that the use of fixed charge to recover the costs can result in significant bill impacts for low volume users relative to other users. Based on the revised Application (i.e., \$2,057,900), a 250 kWh / month Residential customer would see a total bill impact of 10.5% versus 4.4% for an 800 kWh / month customer. In comparison, the use of a fixed-variable rate adder approach results in total bill impacts of 7.5% and 4.8% respectively<sup>31</sup>.
- 6.4 Based on both past precedent and impact considerations VECC submits that, if the Board chooses to approve a rate adder at this time, the Board should approve recovery adders determined on the basis of the current fixed/variable split for each class.

## **7 Interim Rates**

- 7.1 West Coast Huron is requesting that its current rates be declared interim as of October 1, 2011<sup>32</sup>. WCH's application also proposed that the rate adder be effective October 1, 2011. However, in response to interrogatories, WCH has

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<sup>30</sup> Exhibit 1, Tab 1, Schedule 5, page 2

<sup>31</sup> WCH IR Responses, Exhibit 2, Tab 2

<sup>32</sup> Exhibit 1, Tab 1, Schedule 5, page 2

indicated that if the application is not approved early enough to make this possible on a going forward basis then the rate would be applicable for 63 months following the date of implementation (i.e., the effective date would not be set as of October 31, 2011)<sup>33</sup>. Based on this response VECC does not see any need for WCH's rates to be declared interim as of October 1, 2011.

## **8 Proposed “Tornado Relief Funding Adder” and “2011 Tornado Relief Costs” Accounts**

- 8.1 WCH is proposing two new USOA 1572 sub-ledger accounts. The first would record (with interest) the revenues received from the funding adder while the second would record the incremental costs incurred to restore the system net of any recoveries or contributions<sup>34</sup>.
- 8.2 As indicated previously, VECC does not support the implementation of a Tornado Relief Funding adder at this time (i.e. prior to approval of a formal Z-Factor Adjustment Application) and, as a result, does not see any need for the proposed “Tornado Relief Funding Adder” account. However, given the delay that will occur in developing the final accounting for the 2011 tornado relief costs VECC has no issue with the Board approving a “2011 Tornado Relief Costs” deferral account to be reviewed and cleared following the consideration of WCH’s future Z-Factor Adjustment Application for this event.

## **9 Recovery of Reasonably Incurred Costs**

- 9.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

All of which is respectfully submitted this 5<sup>th</sup> day of December 2011.

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<sup>33</sup> VECC IR #2 c)

<sup>34</sup> Exhibit 1, Tab 1, Schedule 5, page 2