

**Ontario Energy
Board**
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416-481-1967
Facsimile: 416-440-7656
Toll free: 1-888-632-6273

**Commission de l'énergie
de l'Ontario**
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416-481-1967
Télécopieur: 416-440-7656
Numéro sans frais: 1-888-632-6273



BY EMAIL

February 10, 2012

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: Innisfil Hydro Distribution Systems Limited
2012 IRM3 Distribution Rate Application
Board Staff Submission
Board File No. EB-2011-0176**

In accordance with the Notice of Application and Hearing, please find attached the Board Staff Submission in the above proceeding. Please forward the following to Innisfil Hydro Distribution Systems Limited and to all other registered parties to this proceeding.

In addition please remind Innisfil Hydro Distribution Systems Limited that its Reply Submission is due by February 24, 2012.

Yours truly,

Original signed by

Daniel Kim
Analyst, Applications & Regulatory Audit

Encl.



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2012 ELECTRICITY DISTRIBUTION RATES

Innisfil Hydro Distribution Systems Limited

EB-2011-0176

February 10, 2012

**Board Staff Submission
Innisfil Hydro Distribution Systems Limited
2012 IRM3 Rate Application
EB-2011-0176**

Introduction

Innisfil Hydro Distribution Systems Limited (“Innisfil Hydro”) filed an application (the “Application”) with the Ontario Energy Board (the “Board”), received on November 14, 2011, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that Innisfil Hydro charges for electricity distribution, to be effective May 1, 2012. The Application is based on the Board’s guidelines for 3rd Generation Incentive Regulation Mechanism.

In the interrogatory phase, Board Staff identified certain discrepancies in the data entered in the application model by Innisfil Hydro. In response to Board staff interrogatories which requested either confirmation that these discrepancies were errors or, an explanation supporting the validity of the original data filed with the application, Innisfil Hydro confirmed that they were errors and provided the corrected data. Board Staff will make the necessary corrections to Innisfil Hydro’s model at the time of the Board’s Decision and Order on the application.

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 Innisfil Hydro.

Board staff makes submissions on the following matters:

- Disposition of Group 1 Deferral and Variance Accounts as per the *Electricity Distributors’ Deferral and Variance Account Review Report* (the “EDDVAR Report”);
- Account 1521 – Special Purpose Charge (“SPC”);
- Lost Revenue Adjustment Mechanism (“LRAM”) and Shared Savings Mechanism (“SSM”) Claim; and
- Account 1562 – Deferred PILs.

DISPOSITION OF GROUP 1 DEFERRAL AND VARIANCE ACCOUNTS AS PER THE EDDVAR REPORT

Background

The EDDVAR Report provides that during the IRM plan term, a distributor's Group 1 audited account balances will be reviewed and disposed if the preset disposition threshold of \$0.001 per kWh (debit or credit) is exceeded.

The December 31, 2010 actual year end amount for Group 1 accounts with interest projected to April 30, 2012 is a credit balance of \$708,535. Credit balances are amounts refundable to customers. This amount results in a total claim of \$0.00309 per kWh, which exceeds the preset disposition threshold.

In its Manager's Summary, Innisfil Hydro requested a two-year period for the disposition of its Group 1 Deferral and Variance account balances due to the timing of its future Smart Meter True-up application and the disposition of Account 1562 (deferred PILs) which will assist with rate mitigation.

In response to Board staff interrogatory #15, Innisfil Hydro provided the total bill impacts by rate class when using: (i) a two year disposition period for Group 1 Accounts and Account 1562; and (ii) a one year disposition period for Group 1 Accounts and Account 1562. The total impact for the residential class is a reduction of 5.8% and 3.7% respectively. Innisfil Hydro also indicated that they have submitted their Smart Meter Cost Recovery application (EB-2011-0435) and filed a letter to the Board signifying their intention to file a cost of service application for 2013 rates. Innisfil Hydro reiterated that a two year disposition period will assist in "flattening" potential rate changes for its customers.

Submission

Board staff has reviewed Innisfil Hydro's Group 1 Deferral and Variance account balances and notes that the principal amounts to be disposed of as of December 31, 2010 reconcile with the amounts reported as part of the RRR. Board staff therefore submits that the amounts should be disposed of on a final basis.

Board staff notes that Innisfil Hydro's request for a two year disposition period is not consistent with the guidelines outlined in the EDDVAR Report with respect to the standard disposition period for Group 1 accounts (i.e. one year). However, Board staff notes that the Board has made previous decisions which deviate from the EDDVAR Report if it deems it in the public interest to do so. Board staff is of the view that the Board should strike a balance between reducing intergenerational inequities and mitigating rate volatility. Consequently, Board staff supports Innisfil Hydro's request to dispose of its Group 1 account balances over a two-year disposition period in order to reduce rate volatility for Innisfil Hydro's customers.

ACCOUNT 1521 – SPECIAL PURPOSE CHARGE (“SPC”)

Background

In its Manager's Summary, Innisfil Hydro did not request the disposition of Account 1521 since the recovery of the SPC was not completed as of December 31, 2010.

In response to Board staff interrogatory #9, Innisfil Hydro completed the table below and requested disposition of the credit balance of \$4,061 which is the principal balance of Account 1521 as of December 31, 2011 including carrying charges as of April 30, 2012.

Innisfil Hydro began charging the SPC on May 1, 2010 and ended the recovery of the SPC on December 2011.

SPC Assessment (Principal balance)	Amount recovered from customers in 2010	Carrying Charges for 2010	December 31, 2010 Year End Principal Balance	December 31, 2010 Year End Carrying Charges Balance	Amount recovered from customers in 2011	Carrying Charges for 2011	Forecasted December 31, 2011 Year End Principal Balance	Forecasted April 30, 2012 Carrying Charges Balance	Total for Disposition (Principal and Interest)
89,749.00	49,900.88	271.63	39,848.12	271.63	44,135.81	(24.54)	(4,287.69)	(20.89)	(4,061.49)

Submission

Board staff notes that the usual practice by the Board is to dispose of audited deferral and variance account balances. Board staff notes that the Board has approved the disposition of unaudited balances in Account 1521 in both the Horizon (EB-2011-0172) and Hydro One Brampton (EB-2011-0174) 2012 IRM proceedings.

Board staff has no concerns with the balances in Account 1521 presented by Innisfil

Hydro. Board staff submits that the Board should authorize the disposition of Account 1521 as of December 31, 2010, plus the amount recovered from customers in 2011, including carrying charges as of April 30, 2012. Board staff further submits that consistent with the disposition period for Group 1 Accounts, a disposition period of two years should be authorized

LRAM AND SSM CLAIM

Background

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

In its decision on Horizon's application (EB-2009-0192) for LRAM recovery, the Board also noted that distributors should use the most current input assumptions available at the time of the third party review when calculating a LRAM amount.

Innisfil Hydro requested to recover a total LRAM claim of \$180,250.03 over a one-year period. In response to Board staff interrogatories, Innisfil Hydro updated its LRAM claim using final 2010 OPA program results. Innisfil Hydro is now requesting approval of an updated LRAM claim of \$180,466.91. The lost revenues include the effect of CDM programs implemented from 2006 to 2010. Innisfil Hydro has requested approval of these savings persisting until December 31, 2011.

Submission

Persisting impacts of 2006-2009 programs and 2009 lost revenues

Innisfil Hydro has requested the recovery of an LRAM amount that includes lost revenues in 2009 for 2009 CDM programs and for the persisting impacts from 2006 to 2008 CDM programs in part of 2009 (May 2009 to December 2009). Innisfil Hydro has also requested recovery of the persisting lost revenues from programs delivered from 2006 to 2009 in 2010 and 2011.

Board staff notes that Innisfil Hydro's rates were last rebased in 2009.

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 time¹.

Board staff also notes that in its Decision and Order on Hydro One Brampton's 2012 IRM application (EB-2011-0174), the Board disallowed LRAM claims for the rebasing year as well as persistence of prior year programs in and beyond the test year on the basis that these savings should have been incorporated into the applicant's load forecast at the time of rebasing.

In cases in which it was clear in the application or settlement agreement that an adjustment for CDM was not being incorporated into the load forecast specifically because of an expectation that an LRAM application would address the issue, and if this approach was accepted by the Board, then Board staff would agree that an LRAM application is appropriate. Innisfil Hydro may want to highlight in its Reply Submission whether the issue of an LRAM application was addressed in their cost of service application.

In the absence of the above information, Board staff therefore does not support the recovery of the requested lost revenues in 2009 for 2009 CDM programs, persisting lost revenues from 2006 to 2008 CDM programs in 2009 or the persisting lost revenues from 2006, 2007, and 2009 CDM programs in 2010 and 2011 as these amounts should have been built into Innisfil Hydro's last approved load forecast.

2010 programs

Board staff notes that Innisfil Hydro has not collected the lost revenues associated with CDM programs delivered in 2010, a year where Innisfil Hydro was under IRM. Board staff supports the approval of the 2010 lost revenues, as these lost revenues took place during an IRM year and Innisfil Hydro did not have an opportunity to recover these

¹ Section 5.2: Calculation of LRAM, Guidelines for Electricity Distributor Conservation and Demand Management (EB-2008-0037)

amounts. Board staff notes that this is consistent with what the Board noted in its decisions on applications from Horizon (EB-2011-0172), Hydro One Brampton (EB-2011-0174), and Whitby Hydro (EB-2011-0206).

Board staff requests that Innisfil Hydro provide an updated LRAM amount that only includes lost revenues from 2010 CDM programs in the year 2010, including carrying charges, and the associated rate riders.

Board staff submits that it is premature to consider any lost revenues associated with CDM programs delivered in 2010 persisting in 2011.

ACCOUNT 1562 – DEFERRED PILs

Background

The PILs evidence filed by Innisfil Hydro in this proceeding includes tax returns, financial statements, Excel models from prior applications, calculations of amounts recovered from customers, SIMPIL² Excel worksheets and continuity schedules that show the principal and interest amounts in the Account 1562 deferred PILs balance. In its pre-filed evidence, Innisfil Hydro applied to refund to customers a credit balance of \$673,289, which includes a principal credit amount of \$593,071 and carrying charges of \$80,218.

On February 4, 2012, Innisfil Hydro updated its filed evidence and changed the amount to refund to its customers to \$154,070.

Submission

Excess Interest True-up Calculations

When the actual interest expense, as reflected in the financial statements and tax returns, exceeds the maximum deemed interest amount approved by the Board, the excess amount is subject to a claw-back penalty and is shown in the TAXCALC worksheet as an extra deduction in the true-up calculations. This has been a feature of the Board's methodology and was settled in the Combined PILs proceeding (EB-2008-0381) under Issue #13.

In its original application, Innisfil Hydro deducted the Board approved maximum deemed interest expense of \$730,894 from actual interest expense to calculate the excess amount subject to claw-back.

In response to Board staff interrogatories #13, Innisfil Hydro adjusted the interest true-up calculations to reflect the actual interest rate of 9.19%. Maximum interest of \$926,471 calculated using the weighted debt rate of 9.19%, and not the deemed interest rate of 7.25%, was deducted from actual interest expense to calculate excess interest that is subject to claw-back. Innisfil Hydro utilized the weighted debt rate for the excess interest true-up calculation in the SIMPIL models resulting in a lower excess interest amount as seen in the table below.

	2002	2003	2004	2005	Total
Excess interest using deemed rate					
Interest per financial statements	1,000,257	985,068	948,226	895,610	
Interest @ deemed rate of 7.25%	730,894	730,894	730,894	730,894	
Excess interest subject to claw-back	269,363	254,174	217,332	164,716	905,585
Excess interest using actual rate					
Interest per financial statements	1,000,257	985,068	948,226	895,610	
Interest @ weighted debt rate of 9.19%	926,471	926,471	926,471	926,471	
Excess interest subject to claw-back	73,786	58,597	21,755	-	154,138
Difference					\$ 751,447

Innisfil Hydro explained in its response to interrogatory #13 that:

Innisfil Hydro respectfully submits the interest true-up should be adjusted to reflect that the actual interest cost was prudently incurred as evidenced by the OEB approval of the debt rates within the 2006 and 2009 COS filings. In addition the calculation of rates from Oct 2001 to April 2006 is based on the calculation of MARR utilizing the deemed interest rate of 7.25% while Innisfil Hydro's debt was held by a 3rd party with rates ranging from 9.50% to 9.75%.

The excess interest calculated is mainly due to the 3rd party debenture debt incurred by Innisfil Hydro in March 1995 to purchase the Ontario

²Spreadsheet implementation model for payments-in-lieu of taxes

Hydro assets. The debt rates of 9.50% to 9.75% were the available market rates as evidence provided within Innisfil Hydro's 2006 EDR (EB-2005-0382). Within Innisfil Hydro's 2006 EDR decision a weighted debt rate of 9.19% was approval for incurring prudent debt interest costs. Innisfil Hydro further received approval within its 2009 COS (EB-2009-0233) decision for a long term debt rate of 7.28% confirming the prudence of the 3rd party debenture interest costs with other 3rd party debt costs.

Innisfil Hydro incurred and paid the excess interest costs of the 3rd party debentures not through the rates until May 2006 because the deemed interest rate of 7.25% was embedded in the rates from Oct 2001 to April 2006. Innisfil Hydro paid for the excess interest expense over what was within the rates from its allowed rate of return and should be allowed to retain the benefit from the tax deduction of the excess interest expense.

Also in response to Board staff interrogatory #13, Innisfil Hydro's reply was much like requesting that the Board vary a decision (RP-2000-0211/EB-2000-0452) that was issued on March 20, 2001. In that decision the Board stated the following:

The Board finds that Innisfil Hydro's election of a 9.88% Target Rate of Return on Common Equity, and its plan for mitigation of the impact of that election on customers, are in conformity with the Rate Handbook and the RP-2000-0069 Decision, and are acceptable.

The Board is satisfied that there are no significant deviations from the Rate Handbook.

The Board finds that the rates applied for are just and reasonable.

The interest rate approved by the Board within this application for the purposes of calculating the market adjusted revenue requirement (MARR) was 7.25%. Board staff submits that the time limit to ask the Board to vary this decision has elapsed. Innisfil Hydro has received the benefit of the 9.88% return on equity which was part of the Board's PBR1 framework when Innisfil Hydro filed its compliant application, as was the deemed interest rate of 7.25%.

The following is an excerpt from Innisfil Hydro's 2002 audited financial statements which shows that long term debt consists of debenture payable and note payable to the Town, and a floating rate term loan. The debt disclosure clearly shows that the note payable to the Town bears interest at 7.25% and that the floating rate loan is at prime rate less 0.5%.

Innisfil Hydro Distribution Systems Limited

Notes to the Financial Statements

December 31, 2002

9. Long term debt	2002	2001
Debenture payable to the Town	\$ 8,172,000	\$ 8,472,000
Note payable to the Town	2,107,444	2,107,444
Floating rate term loan	<u>996,000</u>	<u>600,000</u>
	11,275,444	11,179,444
Less: current portion	<u>330,000</u>	<u>300,000</u>
	<u>\$ 10,945,444</u>	<u>\$ 10,879,444</u>

The debenture is payable to the Town and bears interest at various rates ranging from 8.0% to 9.75%. Principal payments are due annually March 31 until 2015.

The note is payable to the Town. Payments are interest only at 7.25%. The note is callable with one year plus one day's notice.

The floating rate term loan matures March 31, 2004, is secured by a general security agreement conveying first fixed and floating charges over the property, assets, rights and interests of the Company, bearing interest at the prime rate of a Canadian chartered bank less ½ % per annum, payable monthly.

Principal payments due in each of the next five years are as follows:

2003	\$ 330,000
2004	1,063,000
2005	428,600
2006	469,600
2007	514,600

Although Innisfil Hydro submitted a revised PILs continuity schedule in its responses, the schedule did not include the revised true-up adjustments calculated in the updated SIMPIL models in response to interrogatories #12b) and #13i). Board staff estimates that Innisfil Hydro is proposing to reduce total interest claw-back by \$751,447 and is requesting to dispose of a revised final credit balance of approximately \$154,070.

Innisfil Hydro altered the calculation of excess true-up variance in the SIMPIL models and this is not consistent with the PILs methodology outlined in the Combined PILs proceeding. In the 2002 decision, the Board approved a deemed interest amount of \$730,894 (using the 7.25% deemed debt rate) for Innisfil Hydro which was contained in

rates and Board staff submits that this should be used as the threshold in calculating excess interest subject to claw-back.

Innisfil Hydro has disclosed interest expense in its financial statements as shown in the table above from the 2002 financial statements. Innisfil Hydro deducted the full interest expense in its tax returns. It did not reduce the interest expense deduction and pay more income tax PILs to the province. Innisfil Hydro paid the majority of the interest to its non-taxable municipal shareholder. Board staff is of the view that there are two sources of interest expense that must be compared in the excess interest true-up calculations; namely, deemed interest expense approved by the Board in the 2001 unbundling rate application and included in distribution rates, and actual interest expense as disclosed in the audited financial statements and deducted in the tax returns.

In its decision on Whitby's 2012 application (EB-2011-0206), the Board made the following findings:

In its submission Board staff noted that for 2003 and 2004, interest expense entered in the SIMPIL model does not match the interest expense reported in Whitby's audited financial statements and reflected in its tax returns. The Board-approved methodology requires the actual interest expense used in the tax returns as a tax deduction to be compared to the maximum deemed interest expense approved by the Board for inclusion in revenue requirement. The amount above the maximum deemed interest is subject to the claw-back penalty.

In Table 3 of Board staff's submission, Board staff noted that Whitby reduced its reported interest expense by \$500,000 in each of the 2003 and 2004 interest true-up calculations. Board staff submitted that Whitby should use the higher interest amounts that support its tax returns since this is consistent with approved methodology.

The Board finds that the reductions of reported interest expense by \$500,000 in each of the 2003 and 2004 interest true-up calculations are not consistent with the methodology identified in the Combined Proceeding as accepted by the Board and, therefore, should not be used

in the calculations of the claw back variance. The Board has excluded the reductions in reported interest expense and has calculated a revised credit balance of \$1,628,925.

In its decision on Hydro One Brampton's application (EB-2010-0132), the Board also made these findings:

The Board's interest expense clawback methodology effectively deprives the distributor of the tax benefits associated with incurring higher interest expense as a deduction in its tax returns. The threshold set by the Board was equivalent to the amount of interest expense to be included in rates once the distributor had reached full capitalization consistent with the deemed capital structure. Any interest expense in excess of this threshold became subject to the Board's excess interest clawback adjustment. HOBNI used the lower deemed interest expense in its application for 2002 PILs to be included in rates rather than the higher actual interest expense.

The Board's SIMPIL methodology created in the 2001-2002 rate periods did not identify causes of debt and related interest expense. The methodology compares the interest expense deducted in the preparation of the tax return for a given tax year with the deemed interest expense for the same tax year. The difference between the two sources is the excess interest expense subject to the clawback mechanism which results in a refund to customers.

The Board finds that the excess interest clawback adjustment should be applied in the SIMPIL reconciliations submitted by HOBNI. Consequently, HOBNI will include the excess interest tax deduction as a reconciling item that trues-up according to the established methodology in the SIMPIL worksheets.

Board staff submits that Innisfil Hydro is incorrect in its assumption of using actual weighted debt as a threshold to calculate excess interest subject to claw-back from 2001 to 2005. Board staff submits that the Board-approved maximum deemed interest of \$730,894 should be deducted from actual interest expense in determining the excess

interest true-up variances in the SIMPIL models and Innisfil Hydro should file revised SIMPIL models and the PILs continuity schedule consistent with the Board methodology.

Components of Interest Expense

Innisfil Hydro replied to Board staff's interrogatories and provided a table that discloses the components of its interest expense for the period 2001 to 2005.³

Long Term Interest Expense 2001 to 2005					
Type of Interest Expense	10-12/2001	2002	2003	2004	2005
Debenture debt - 9.25% to 9.75%	206,176	801,165	768,889	738,883	699,777
Shareholder debt - 7.25%	38,197	152,790	152,790	152,790	152,790
Customer deposits	215	7,688	2,278	17,680	10,744
Bank indebtedness - prime less 0.25%	-	38,614	45,093	38,873	32,299
Interest penalties	-	-	16,018	-	-
Interest Expense per audited f/s	244,588	1,000,257	985,068	948,226	895,610

Innisfil Hydro included interest on customer deposits and interest penalties in total interest expense subject to the claw-back penalty.

The Board decided in EB-2011-0174 that Hydro One Brampton's interest expense used to calculate the interest claw-back variance should not include interest on customer deposits.⁴ Board staff submits that interest on customer deposits should be deducted from total interest expense per the financial statements to be consistent with the Board's decision for Hydro One Brampton.

To the best of Board staff's knowledge, the Board has not yet decided if interest penalties should be included in interest expense for the SIMPIL claw-back variance calculations. The interest penalty related to a late payment charge to the Independent Market Operator in 2003. Board staff notes that the amount is relatively small in comparison to the total actual interest expense from 2001 to 2006; however, Board staff

³ Responses to Board Staff Interrogatories dated February 3, 2012/PDFpg17.

⁴ EB-2011-0174, December 22, 2011, pg9-10

generally views that interest from a late payment charge should be excluded from the calculation.

Board staff submits that Innisfil Hydro should change the amount of interest expense used in the 2001 to 2005 SIMPIL model interest claw-back penalty calculations to reflect Board staff's submissions, and update the PILs 1562 continuity schedule and balance to be refunded to customers. Board staff submits that Innisfil Hydro should file a schedule of revised interest expense identifying the components in a format similar to that above shown.

Board staff estimates a final credit balance of approximately \$671,287 to be refunded to customers after adjusting for the components of interest expense in the SIMPIL model (prior to adjusting for interest penalties) and correcting the excess interest true-up calculations.

All of which is respectfully submitted