EB-2007-0753

IN THE MATTER OF the Ontario Energy Board Act 1998, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an Application by Norfolk Power Distribution Inc. for an Order or Orders approving or fixing just and reasonable rates and other charges for the distribution of electricity commencing May 1, 2008.

SUBMISSIONS OF THE SCHOOL ENERGY COALITION

These are the submissions of the School Energy Coalition ("SEC") in connection with the application by Norfolk Power Distribution Inc. ("NPDI" or the "Applicant") for an order approving just and reasonable rates for the distribution of electricity effective May 1, 2008.

<u>Introduction</u>

The Applicant seeks a total revenue requirement for the test year of $12,800,352 [Exhibit 1/1/8, pg. 1]. This represents a revenue deficiency for 2008 of $1,916,396 [Exhibit 1/1/9]. Of the $1.9 million revenue deficiency, $654,159 is due to smart meters [SEC IR#8].

The revenue deficiency represents distribution rate increases for NPDI's major customer groups in the amount of 26% for residential, 32% for GS<50kW, and 26% for GS>50kW.

Even on a total bill perspective, the rate impacts for GS<50kW customers in particular is quite high, 5.1% [Exhibit 1/1/6, pg. 2]

In SEC's submission, even excluding smart meters, the revenue requirement increase NPDI seeks in this application is extremely large and warrants careful scrutiny. As is discussed in greater detail below, however, the Applicant has failed to adequately explain large spending increases, particularly in OM&A.

<u>Operating Expenses</u>

NPDI's OM&A expenditures increase by $1,146,872 between 2006 and 2008, an increase of 30% [from $3,797,656 to $4,943,872] in two years.

Of the total increase, $362,000 is due to smart meters, and a further $124,902 is due to increases in compensation costs. [Board Staff submissions, pg. 6[1]]

That leaves a further $659,314 in increased expenditures in other areas. Most of these increases occur in 2007.

SEC is unclear, however, as to how the increase in other areas has been calculated. As shown below, SEC is able to make submissions on some of the spending increases. However, for a number of other areas where NPDI shows substantial spending increases, primarily in 2007 over 2006, NDPI has not provided an adequate explanation for the increases, with the result that there is insufficient information on the record to be able to comment.

Regulatory Expenses

NDPI has budgeted $95,000 and $95,855 in regulatory expenses for 2007 and 2008 respectively (Ex 4/2/1/pg5). This represents OEB annual fee and cost assessments in the range of $66,000 to $67,000 and other non-OEB costs of $29,000 each year [Board Staff IR#23].

Reasonable ongoing costs (i.e. OEB fees likely in the range of $25,000 - $26,000) should be recovered in 2008 and beyond (2009 & 2010 non-rebasing years). One-time costs- i.e. 2007 cost allocation fees of $16,457, system programming changes (amount not provided, see Board Staff IR#23 b) should only be recovered in the year in which the expense is incurred. NDPI has recorded these one-time costs in 2007. NDPI's 2008 regulatory costs, however, will likely be much lower than the 2007 level.

NDPI claims that it does not expect to continue to incur these costs over the next two years under 3rd GIRM mechanism. SEC believes that NDPI should, in its reply submission, identify all one-time cost components in 2007 & 2008 separately and include only one-third of the 2008 one-time costs in 2008 rate year to prevent an over-recovery of the operating expenses in non-rebasing years.

Bad Debt Expense

It appears that NDPI has adopted a direct write-off method to record its bad debt expense rather than the allowance method. As explained by NDPI, delinquent accounts as at December 31, 2006 are generated at year-end 2007 and the amount is then written-off to bad debt expense for 2007 (not 2006) [Board Staff IR#23].

Under the direct write-off method, bad debts are considered expenses in the period in which they are written off. This method is not considered acceptable under GAAP unless

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[1] Equals difference between total compensation costs charged to OM&A in 2008, $1,655,963, and 2006, $1,531,061.

the amounts are immaterial.

The proper treatment should be the allowance method, which seeks to estimate the amount of uncollectible receivables and establish a contra valuation account for the amount estimated to be uncollectible. The annual charge to bad debt expense should be determined based on either annual sales or the year-end receivables balance.

NDPI should be urged to revisit its accounting treatment for bad debt provision and its collection policy to manage doubtful accounts.

Accordingly, SEC submits that the amount of $121,080 in bad debt expense for 2008 is not justified. It is also not an appropriate base upon which to project 2009 & 2010 bad debt expense under the incentive regulation mechanism. SEC submits that bad debt expense for 2008 be frozen at the 2006 level of $63,170.

Other Accounts Increase Substantially with Inadequate Explanation

A number of other accounts show significant spending increases in the 2006 to 2008 period. These include, among others, accounts 5315 (Customer Billing), 5010 (Load Dispatching), 5114 (Mait. of Dist. Equipment), and Trouble Calls. Most of the spending increases in these areas occurred in 2007.

As a result, NPDI's total controllable OM&A increases by 20% from 2006 to 2007. A further 8.8% increase follows in 2008 over 2007, due mostly to smart meters expenditures.

Unfortunately, SEC is not able to determine, based on the evidence on the record, whether the (non-smart meter) increases in 2007 OM&A expenditures are justified. In interrogatory #23(b), Board Staff asked that cost drivers be accompanied by a "detailed explanation and …any additional information Norfolk Power believes is required." All that was provided was a table listing each account and a brief, rather cryptic, description of the increase.

Recommendation- OM&A

In view of the above, SEC recommends that NPDI's OM&A be reduced by $300,000. SEC believes that is a reasonable reduction given some of the issues discussed above and given the fact that NPDI has not adequately explained various spending increases in 2007.

Moreover, the reduction would still result in an increase, exclusive of smart meters OM&A, of over 6% *per year* from 2006 to 2008.[2] SEC believes that is a generous annual increase given NPDI's identified cost pressures.

Including smart meters, the resulting OM&A of $4,643,872 is still 22% above the 2006 level, which is still an extremely large increase for consumers to absorb in a short period.

With respect to smart meters, although SEC has no submissions with respect to the quantum of smart meter expenditures, SEC believes smart meter expenditures (capital, OM&A, and amortization) should not be part of revenue requirement. In SEC's submission, they should continue to be recorded in the appropriate deferral account and recovered through a rate adder.

Rate Base

2008 Test Year Rate Base

The ending balance of gross asset account #1815 includes a deposit or a "down-payment" for a second 115KV transformer to be installed at the Bloomsburg TS [Ex 2/T2/S3/pg4; SEC IOR#2e, 2g] in the amount of $120,000.

SEC believes that the fund set aside for future installation of the capital asset should be treated as a reclassification of current asset rather than an addition to the gross asset in the test year to prevent an overstatement of the utility rate base. In SEC IR#2(e) and Board Staff IR#6, NPDI clarified that the project won't be in service in 2008 and agreed that this amount should be removed from the rate base. SEC is satisfied with that position.

Asset Performance and Asset Management Plan

NDPI confirmed it does not have an asset management plan [Board Staff IR#6] and that there are no reliability data to support renewal projects [Board Staff IR#8]. Pole testing and some field survey were performed to determine the spending for distribution system renewal requests [VECC IR#9]. Capital expenditures were prioritized by importance, age and reliability standards [Board Staff IR#6].

SEC believes that an asset management plan is necessary to address reliability and asset condition problems, and that the asset condition for major distribution asset classes should continue to be quantified and monitored through the use of asset health indices.

Capital Expenditures

[2] 2006 actual OM&A of $3,797,656 increased by 6% per year in each of 2007 and 2008 results in a 2008 OM&A of $4,267,046. Adding $362,000 for 2008 smart meter expenditures equals $4,629042, or about $314,825 (SEC's recommended reduction is $300,000) less than the as-filed 2008 OM&A of $4,943,872.

Smart meters comprise the bulk of the increase in NPDI's capital expenditure budget in 2008. Capital expenditures for 2008, including smart meters, are $10.19 million, an 81% increase over 2007 ($5.62 million). However, excluding smart meters, 2008 capital expenditures total $5.94 million, a 6.5% over 2007 ($5.57 million) [Board Staff IR#2]

SEC has no submissions on the level of NPDI's smart meter or other capital spending for 2008.

However, as stated above, SEC believes smart meter spending should not form part of base revenue requirement but rather should continue to receive deferral account treatment (specifically, accounts 1555 and 1556) and be recovered through a rate adder. NPDI has not received approval to commence smart meter spending. Actual spending could vary considerably from the forecast amount. (In fact, included in NPDI's forecast of smart meter capital expenditures is $185,063 for "contingency at 5%"- see VECC IR#10(f)).

Cost of Capital

SEC echoes Board Staff's concerns as to the calculation of the cost rate of NPDI's long-term debt.

Load Forecast

No submissions.

Deferral and Variance Accounts

New deferral account for future capital projects

NPDI is requesting a new deferral account to track future capital project investments in non-rebasing years in the event that the 3rd Generation Incentive Regulation Mechanism ("3GIRM") is not completed in time to address the capital project expenditures.

In SEC's submission, the treatment of revenues in the 3GIRM period is a matter for the panel deciding the 3GIRM process. NPDI 's application is premature as it preempts the 3GIRM process, where the Board will be able to develop a approach to this issue that is consistent across all distributors.

In addition, NPDI said in response to Board Staff IR#38(h) that it intends to "record any under-forecast or over-forecast of 2008 capital costs in this deferral account." SEC submits that there is no justification at all, and contrary to regulatory principles, to allow a utility to have deferral account treatment against its own forecasting errors.

Account 1572- Extraordinary Event Losses

SEC shares Board Staff's concerns that NPDI has not demonstrated that the costs claimed ($207,739, resulting from two storms causing damage in the amount of $161,763 and $37,971 respectively) are incremental to the normal risk for this type of event that is already imputed into NPDI's rates. In SEC's submission, given the incomplete information and the large distribution rate impacts stemming from this application generally, these costs should be denied.

Cost Allocation

NPDI proposes little movement with respect to the revenue to cost ratio of Streetlighting class, despite the fact that the Streetlighting customer is an affiliate of NPDI and despite the fact that Streelighting's proposed new revenue to cost ratio (54.3%) remains well-below the Board's guideline.

In SEC's submission, NPDI is providing a service to an affiliate at a cost well below the actual cost of providing the service. Unless there is an exemption by the Board, it is SEC's submission that NPDI is not entitled to charge an affiliate for any service at less than cost. Therefore, it is submitted that the rules relating to affiliate transactions should be applied, and the Streetlighting rates should be set at 100% of cost.

Rate Design

No submissions.

PILS

SEC believes the change in federal corporate income tax should be reflected in NPDI's PILS allowance. In response to VECC IR#24(a), NPDI states that the Application should not be updated to reflect new federal corporate tax for 2008 since the result would be a change of $18,081 which NPDI says is "below the materiality threshold set by the OEB of 1% of Distribution Expenses." SEC does not believe the quantum of the impact bears any bearing on whether the evidence should be updated or not.

Costs

SEC participated responsibly in this proceeding and respectfully submits that it be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted this 25th day of March, 2008.

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