



EB-2011-0173

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 Hydro
Hawkesbury Inc. for an order or orders approving or
fixing just and reasonable distribution rates and other
charges, to be effective May 1, 2012.

BEFORE: Karen Taylor
Presiding Member

Paula Conboy
Member

DECISION AND ORDER
(Originally issued April 19, 2012, corrected on April 20, 2012)

Introduction

Hydro Hawkesbury Inc. ("HHI"), a licensed distributor of electricity, filed an application with the Ontario Energy Board (the "Board") on November 15, 2011 under section 78 of the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that HHI charges for electricity distribution, to be effective May 1, 2012.

HHI is one of 77 electricity distributors in Ontario regulated by the Board. The *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "IR Report"), issued on July 14, 2008, establishes a three year plan term for 3rd generation incentive regulation mechanism ("IRM") (i.e., rebasing plus three years). In its October 27, 2010 letter regarding the development of a Renewed Regulatory Framework for Electricity ("RRFE"), the Board announced that it was extending the IRM

plan until such time as the RRFE policy initiatives have been substantially completed. As part of the plan, HHI is one of the electricity distributors that will have its rates adjusted for 2012 on the basis of the IRM process, which provides for a mechanistic and formulaic adjustment to distribution rates and charges between cost of service applications.

To streamline the process for the approval of distribution rates and charges for distributors, the Board issued its IR Report, its *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on September 17, 2008 (the "Supplemental Report"), and its *Addendum to the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on January 28, 2009 (collectively the "Reports"). Among other things, the Reports contain the relevant guidelines for 2012 rate adjustments for distributors applying for distribution rate adjustments pursuant to the IRM process. On June 22, 2011, the Board issued an update to Chapter 3 of the Board's *Filing Requirements for Transmission and Distribution Applications* (the "Filing Requirements"), which outlines the application filing requirements for IRM applications based on the policies in the Reports.

Notice of HHI's rate application was given through newspaper publication in HHI's service area advising interested parties where the rate application could be viewed and advising how they could intervene in the proceeding or comment on the application. No letters of comment were received. The Notice of Application indicated that intervenors would be eligible for cost awards with respect to HHI's proposal for the lost revenue adjustment mechanism ("LRAM") and recovery of the costs of replacing two transformer stations. The Vulnerable Energy Consumers Coalition ("VECC") and School Energy Coalition ("SEC") applied and were granted intervenor status in this proceeding. The Board granted VECC and SEC eligibility for cost awards in regards to HHI's request for LRAM recovery and recovery of the costs of replacing two transformer stations. Board staff also participated in the proceeding. The Board proceeded by way of a written hearing.

While the Board has considered the entire record in this proceeding, it has made reference only to such evidence as is necessary to provide context to its findings. The following issues are addressed in this Decision and Order:

- Price Cap Index Adjustment;
- Rural or Remote Electricity Rate Protection Charge;

- Use of Actual versus Forecasted Load Data
- Shared Tax Savings Adjustments;
- Retail Transmission Service Rates;
- Review and Disposition of Group 1 Deferral and Variance Account Balances;
- Review and Disposition of Account 1521: Special Purpose Charge;
- Review and Disposition of Lost Revenue Adjustment Mechanism;
- Review and Disposition of Account 1562: Deferred Payments In Lieu of Taxes; and
- Incremental Capital Module (“ICM”).

Price Cap Index Adjustment

As outlined in the Reports, distribution rates under the 3rd Generation IRM are to be adjusted by a price escalator, less a productivity factor (X-factor) of 0.72% and a stretch factor.

On March 13, 2012, the Board announced a price escalator of 2.0% for those distributors under IRM that have a rate year commencing May 1, 2012.

The stretch factors are assigned to distributors based on the results of two benchmarking evaluations to divide the Ontario industry into three efficiency cohorts. In its letter to Licensed Electricity Distributors dated December 1, 2011 the Board assigned HHI to efficiency cohort 1 and a cohort specific stretch factor of 0.2%.

On that basis, the resulting price cap index adjustment is 1.08%. The price cap index adjustment applies to distribution rates (fixed and variable charges) uniformly across customer classes that are not eligible for Rural or Remote Electricity Rate Protection.

The price cap index adjustment will not apply to the following components of delivery rates:

- Rate Riders;
- Rate Adders;
- Low Voltage Service Charges;
- Retail Transmission Service Rates;
- Wholesale Market Service Rate;

- Rural or Remote Rate Protection Charge;
- Standard Supply Service – Administrative Charge;
- Transformation and Primary Metering Allowances;
- Loss Factors;
- Specific Service Charges;
- MicroFIT Service Charges; and
- Retail Service Charges.

Rural or Remote Electricity Rate Protection Charge

On December 21, 2011, the Board issued a Decision with Reasons and Rate Order (EB-2011-0405) establishing the Rural or Remote Electricity Rate Protection (“RRRP”) benefit and charge for 2012. The Board amended the RRRP charge to be collected by the Independent Electricity System Operator from the current \$0.0013 per kWh to \$0.0011 per kWh effective May 1, 2012. The draft Tariff of Rates and Charges flowing from this Decision and Order will reflect the new RRRP charge.

Use of Actual versus Forecasted Load Data

In its 2012 IRM application HHI sought Board approval to use actual kWh as of December 31, 2010 instead of the load forecast approved as part of its 2010 cost of service application to derive the rate riders for: (i) the shared tax savings; (ii) LRAM recovery; and (iii) ICM and Z-factor. The rationale provided by HHI is that in its cost of service application, the kWhs came from a Cost Allocation Study following the loss of its only large user. HHI felt that the cost of service data is less representative than the 2010 actual data.

In its submission VECC noted that *Chapter 3 of the Filing Requirements for Transmission and Distribution Application* issued June 22, 2011 states:

“The IRM application process is intended to streamline the processing of a large volume of rate adjustment applications, and is therefore mechanistic in nature. For this reason, the Board has determined that the IRM process is not the appropriate venue by which a distributor should seek relief on issues which are substantially unique to an individual distributor or more complicated and potentially contentious.”¹

¹ Chapter 3 of the *Filing Requirements for Transmission and Distribution Application*, Section 4.0, p. 24

On that basis, VECC submitted that it does not support HHI's proposal to use 2010 actuals. VECC considered changes to revenue forecasts to be an exclusion from IRM applications and any changes should be addressed in HHI's next cost of service application rather than in this 2012 IRM application.

Similarly, SEC submitted that adjusting the load forecast within the IRM term is inappropriate. SEC noted that during a cost of service hearing, the load forecast is approved by the Board after being rigorously tested by Board staff and intervenors. SEC argued that since rate payers do not benefit from an adjustment when the actual load is higher than what was approved by the Board, utilities in turn should not receive an adjustment when the actual load is less than approved. Variations in load from forecast to actual are one of the risks for which the utility is compensated through a Return on Equity ("ROE").

SEC noted that the Applicant is seeking to use its 2010 actual kWh and not the 2011 actual numbers, which would be more reflective of its expected 2012 load. SEC noted that a detailed load forecast for the 2010 test year was reviewed by the parties and established by the Board as a final basis for rates. Absent compelling factors to the contrary, that should be the basis on which rates are set until the next rebasing.

Board staff made no submission on the load forecast issue.

In its reply submission, HHI maintained that in times of economic uncertainty, especially in a smaller municipality, using 2010 actual data is a better reflection of the actual economical conditions since they reflect costs which have occurred and can be reliably measured. HHI stated that it was not its objective to increase its revenues, but to present an accurate picture of its current load.

HHI submitted that while it made its best effort to predict the impact of the loss of the large user on future years in its 2010 approved load forecast, the 2010 actuals were much lower than anticipated. In the same manner in which a utility must update its interest rates and its cost of capital to reflect the most up-to-date information, HHI felt that the 2010 actuals versus forecast would reflect the most up-to-date information available. Therefore, HHI requested approval to utilize actual kWh data as of December 31, 2010.

The Board agrees with the submissions of intervenors that Hydro Hawkesbury's proposal to use actual kWh data as of December 31, 2010 for the purpose of calculating the rate riders for the ICM, shared tax savings and LRAM is inconsistent with the IRM framework. In particular, the Board is of the view that given the limited opportunity for discovery in an IRM application, it is more appropriate to use the 2010 load forecast and the associated kWh data approved by the Board in Hydro Hawkesbury's 2010 cost of service rate application for the purpose of calculating the rate riders for the ICM, shared tax savings, and LRAM.

Shared Tax Savings Adjustments

In its Supplemental Report, the Board determined that a 50/50 sharing of the impact of currently known legislated tax changes, as applied to the tax level reflected in the Board-approved base rates for a distributor, is appropriate.

The calculated annual tax reduction over the IRM plan term will be allocated to customer rate classes on the basis of the Board-approved base-year distribution revenue. These amounts will be refunded to customers each year of the plan term, over a 12-month period, through a volumetric rate rider using annualized consumption by customer class underlying the Board-approved base rates.

HHI's application identified a total tax savings of \$1,375 resulting in a shared amount of \$687 to be refunded to rate payers.

The Board approves a shared tax savings of \$687 to be refunded to customers over a one year period from May 1, 2012 to April 30, 2013.

Retail Transmission Service Rates

Electricity distributors are charged the Ontario Uniform Transmission Rates ("UTRs") at the wholesale level and subsequently pass these charges on to their distribution customers through the Retail Transmission Service Rates ("RTSRs"). Variance accounts are used to capture timing differences and differences in the rate that a distributor pays for wholesale transmission service compared to the retail rate that the distributor is authorized to charge when billing its customers (i.e. variance Accounts 1584 and 1586).

On June 22, 2011 the Board issued revision 3.0 of the *Guideline G-2008-0001 - Electricity Distribution Retail Transmission Service Rates* (the “RTSR Guideline”). The RTSR Guideline outlines the information that the Board requires electricity distributors to file to adjust their RTSRs for 2012. The RTSR Guideline requires electricity distributors to adjust their RTSRs based on a comparison of historical transmission costs adjusted for the new UTR levels and the revenues generated under existing RTSRs. The objective of resetting the rates is to minimize the prospective balances in Accounts 1584 and 1586. In order to assist electricity distributors in the calculation of the distributors’ specific RTSRs, Board staff provided a filing module.

On December 20, 2011 the Board issued its Rate Order for Hydro One Transmission (EB-2011-0268) which adjusted the UTRs effective January 1, 2012, as shown in the following table:

2012 Uniform Transmission Rates

Network Service Rate	\$3.57 per kW
<u>Connection Service Rates</u>	
Line Connection Service Rate	\$0.80 per kW
Transformation Connection Service Rate	\$1.86 per kW

The Board finds that these 2012 UTRs are to be incorporated into the filing module.

Review and Disposition of Group 1 Deferral and Variance Account Balances

The *Report of the Board on Electricity Distributors’ Deferral and Variance Account Review Report Initiative* (the “EDDVAR Report”) provides that, during the IRM plan term, the distributor’s Group 1 account balances will be reviewed and disposed if the preset disposition threshold of \$0.001 per kWh (debit or credit) is exceeded. The onus is on the distributor to justify why any account balance in excess of the threshold should not be disposed.

HHI’s 2010 actual year-end total balance for Group 1 Accounts including interest projected to April 30, 2012 is a debit of \$164,300. This amount results in a total debit claim of \$0.00108 per kWh, which exceeds the preset disposition threshold. HHI proposed to dispose of this debit amount over a one-year period.

In its submission, Board staff noted that the principal amounts to be disposed as of December 31, 2010 reconcile with the amounts reported as part of the *Reporting and Record-keeping Requirements* ("RRR") with the exception of Account 1588 Power excluding Global Adjustment and Account 1588 Power – Sub-Account – Global Adjustment, which show a difference of \$505,329 between the reported amounts and the balance sought for disposition. In response to Board staff interrogatory #15 regarding the reasons for these differences, HHI stated that as part of the RRR it reported the balances as of December 31, 2010 recorded in its accounting books at that time. Furthermore, HHI stated that the corrections as per the Board's Decision EB-2010-0090 were made in its general ledgers in September 2011 in Account 1588 Power excluding Global Adjustment and Account 1588 Power - Sub-Account - Global Adjustment.

Board staff noted that it appears that HHI's RRR balances as of December 31, 2010 were reported using the figures that HHI had on its general ledgers at that time. The evidence provided by HHI indicates that HHI has made the required corrections in its general ledgers to correct the errors noted in the Board's Decision EB-2010-0090. Board staff submitted that the variances between the 2010 RRR balances and the amounts sought for disposition as of December 31, 2010 are due to a timing difference. Therefore, Board staff expressed no concerns with the December 31, 2010 Group 1 account balances sought for disposition in this proceeding.

Board staff further submitted that HHI's proposal for a one-year disposition period is in accordance with the EDDVAR Report.

The Board notes that the EDDVAR disposition threshold of \$0.001/kWh has been exceeded. The Board approves, on a final basis, the disposition of a debit of \$164,300, representing principal as at December 31, 2010 and interest to April 30, 2012, over a one year period, from May 1, 2012 to April 30, 2013.

The table below identifies the principal and interest amounts approved for disposition for Group 1 Accounts.

Account Name	Account Number	Principal Balance A	Interest Balance B	Total Claim C = A + B
LV Variance Account	1550	\$31,225	\$986	\$32,211
RSVA - Wholesale Market Service Charge	1580	-\$204,029	-\$4,713	-\$208,742
RSVA - Retail Transmission Network Charge	1584	\$58,508	\$1,277	\$59,785
RSVA - Retail Transmission Connection Charge	1586	-\$32,156	-\$2,952	-\$35,108
RSVA - Power (excluding Global Adjustment)	1588	\$281,183	\$16,024	\$297,207
RSVA - Power – Global Adjustment Sub-Account	1588	\$53,797	\$10,029	\$43,768
Recovery of Regulatory Asset Balances	1590	-	\$158	\$76
Disposition and Recovery of Regulatory Balances (2008)	1595		-\$24,897	- \$24,897
Disposition and Recovery of Regulatory Balances (2009)	1595			
Group 1 Total		\$188,528	-\$24,228	\$164,300

For accounting and reporting purposes, the respective balance of each Group 1 account approved for disposition shall be transferred to the applicable principal and interest carrying charge sub-accounts of Account 1595 pursuant to the requirements specified in Article 220, Account Descriptions, of the *Accounting Procedures Handbook for Electricity Distributors*. The date of the journal entry to transfer the approved account balances to the sub-accounts of Account 1595 is the date on which disposition of the balances is effective in rates, which generally is the start of the rate year (e.g. May 1). This entry should be completed on a timely basis to ensure that these adjustments are included in the June 30, 2012 (3rd Quarter) RRR data reported.

Review and Disposition of Account 1521: Special Purpose Charge

The Board authorized Account 1521, Special Purpose Charge Assessment (“SPC”) Variance Account in accordance with Section 8 of *Ontario Regulation 66/10 (Assessments for Ministry of Energy and Infrastructure Conservation and Renewable*

Energy Program Costs) (the “SPC Regulation”). Accordingly, any difference between (a) the amount remitted to the Minister of Finance for the distributor’s SPC assessment and (b) the amounts recovered from customers on account of the assessment were to be recorded in “Sub-account 2010 SPC Assessment Variance” of Account 1521.

In accordance with Section 8 of the SPC Regulation, distributors are required to apply no later than April 15, 2012 for an order authorizing the disposition of any residual balance in sub-account 2010 SPC Assessment Variance. The Filing Requirements sets out the Board’s expectation that requests for disposition of this account balance would be heard as part of the proceedings to set rates for the 2012 year.

HHI originally requested the disposition of a residual debit balance of \$13,776 as at December 31, 2010, plus collections in 2011 and carrying costs until April 30, 2012 over a one year period. In response to Board staff interrogatory #16, HHI updated the residual debit balance to \$13,387.

Board staff submitted that despite the usual practice, the Board should authorize the disposition of Account 1521 as of December 31, 2010, plus the amounts recovered from customers in 2011, including interest, because the account balance does not require a prudence review, and electricity distributors are required by regulation to apply for disposition of this account. Board staff submitted that the \$13,387 debit balance in Account 1521 should be approved for disposition on a final basis. In its reply submission, HHI reiterated its request for the disposition of a debit balance of \$13,387 over a one-year period. .

The Board approves the disposition on a final basis of a debit balance in Account 1521 of \$13,387, representing principal and interest to April 30, 2012, over a one year period from May 1, 2012 to April 30, 2013. The Board directs Hydro Hawkesbury to close Account 1521 effective May 1, 2012.

Review and Disposition of Lost Revenue Adjustment Mechanism (“LRAM”)

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.

HHI requested the recovery of an LRAM claim of \$48,919 over a one-year period. In

response to interrogatories from Board staff and intervenors, HHI updated its LRAM claim to \$48,981 to reflect the Ontario Power Authority's ("OPA") 2010 final results. HHI's LRAM claim consists of the effect of 2010 programs in 2010, and persisting effects of 2006, 2007, 2008, 2009 and 2010 programs from January 1, 2010 to April 30, 2012.

Board staff's submission noted that HHI's rates were last rebased in 2010. Board staff noted that in its Decision and Order in the EB-2011-0174 proceeding, 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.

Board staff noted that 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. Board staff requested that HHI highlight in its reply submission whether the issue of an LRAM application was addressed in their cost of service application.

Board staff submitted that in the absence of the above information, HHI should not be permitted to recover the requested persisting lost revenues from 2010 CDM programs in 2010, and lost revenues from 2006 - 2009 programs persisting from 2010 through 2012 since these should have been built into HHI's last approved load forecast in 2010.

Board staff supported the recovery of 2006, 2007, 2008, and 2009 lost revenues, including the persisting lost revenues from 2006 programs in 2007, 2008 and 2009, the persisting lost revenues from 2007 programs in 2008 and 2009, and the persisting lost revenues from 2008 programs in 2009 as these lost revenues took place during IRM years and HHI did not previously recover these amounts. Board staff requested that HHI provide an updated LRAM amount to only include these amounts and the associated rate riders.

VECC submitted that the LRAM claim approved by the Board should be adjusted to include lost revenue for the years 2006, 2007, 2008 and 2009 resulting from the impact of 2006 – 2009 CDM programs.

HHI agreed with Board staff's and VECC's submission with respect to lost revenues prior to 2010. With respect to 2010 programs and persisting amounts in 2011 and 2012, HHI indicated that while some LDCs in their applications specifically lowered their load forecast to include expected future load reduction due to CDM, HHI did not have the sophistication to adopt this approach. HHI confirmed that it did not include CDM programs in its 2010 load forecast.

In response to Board staff's request, HHI indicated that the LRAM associated with the recovery of 2006, 2007, 2008, and 2009 lost revenues, including the persisting lost revenues from 2006 programs in 2007, 2008, and 2009, the persisting lost revenues from 2007 programs in 2008 and 2009, and the persisting lost revenues from 2008 programs in 2009, would be \$33,950.55.

HHI submitted that its LRAM claim is appropriate and is fully consistent with previous Board decisions. HHI requested that the Board approve its LRAM claim for \$48,981.

The Board approves an LRAM claim of \$33,950.55 representing lost revenue for the years 2006 to 2009 resulting from the impact of CDM programs implemented from 2006 to 2009, as Hydro Hawkesbury was in IRM during these years and has not otherwise claimed LRAM for this period. The Board will not approve an LRAM for lost revenues in 2010 from 2010 CDM programs or the persisting lost revenues from 2006, 2007, 2008, 2009, and 2010 CDM programs in 2010 to 2012, as these amounts should have been reflected in Hydro Hawkesbury's last approved load forecast. The 2008 CDM Guidelines state that 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. The Board notes that absent specific wording in the Decision and Order of the Board relating to Hydro Hawkesbury's last cost of service application, there is no reasonable basis upon which to diverge from the 2008 CDM Guidelines. The Board approves a one year disposition period from May 1, 2012 to April 30, 2013.

Review and Disposition of Account 1562: Deferred Payments in Lieu of Taxes

In 2001, the Board approved a regulatory payments in lieu of tax proxy approach for rate applications coupled with a true-up mechanism filed under the 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 amount of taxes paid. The variances resulting from the true-up were tracked in Account 1562 for the period 2001 through April 30, 2006.

On November 28, 2008, pursuant to sections 78, 19 (4) and 21 (5) of the *Ontario Energy Board Act, 1998*, the Board commenced a Combined Proceeding (EB-2008-0381) on its own motion to determine the accuracy of the final account balances with respect to Account 1562 Deferred Payments in Lieu of Taxes (“Deferred PILs”) (for the period October 1, 2001 to April 30, 2006) for certain electricity distributors that filed 2008 and 2009 distribution rate applications.

The Notice in the Combined Proceeding included a statement of the Board's expectation that the decision resulting from the Combined Proceeding would be used to determine the final account balances with respect to Account 1562 Deferred PILs for the remaining distributors. In its decision and order, the Board stated that, “[e]ach remaining distributor will be expected to apply for final disposition of Account 1562 with its next general rates application (either IRM or cost of service).”²

HHI originally applied to dispose of a debit balance in Account 1562 of \$4,138 including carrying charges projected to April 30, 2012 over a one-year period. In response to Board staff interrogatories, HHI amended its evidence to support a credit balance of approximately \$6,299.

Board staff submitted that the revised credit amount of \$6,299 has been calculated in accordance with the regulatory guidance and the Board's decision in the Combined PILs Proceeding³.

The Board approves the disposition on a final basis of a credit balance in Account 1562 of \$6,299 representing principal and interest to April 30, 2012, over a one year period, from May 1, 2012 to April 30, 2013. The Board finds that the revised credit amount has been calculated in accordance with the regulatory guidance and prior decisions issued by the Board.

² EB-2008-0381 Account 1562 Deferred PILs Combined Proceeding, Decision and Order, p. 28

³ Decisions in Combined Proceeding, EB-2008-0381 – August 12, 2011; June 24, 2011; December 23, 2010; December 18, 2009. Hydro One Brampton, EB-2011-0174, December 22, 2011. Whitby Hydro, EB-2011-0206, December 22, 2011. Staff Discussion Paper, August 20, 2008.

For accounting and reporting purposes, the balance of Account 1562 shall be transferred to the applicable principal and interest carrying charge sub-accounts of Account 1595 pursuant to the requirements specified in Article 220, Account Descriptions, of the *Accounting Procedures Handbook for Electricity Distributors*. The date of the journal entry to transfer the approved account balances to the sub-accounts of Account 1595 is the date on which disposition of the balances is effective in rates, which generally is the start of the rate year (e.g. May 1). This entry should be completed on a timely basis to ensure that these adjustments are included in the June 30, 2012 (3rd Quarter) RRR data reported.

Z-factor Claim

HHI applied to recover the revenue requirement associated with an amount of \$712,909 intended for the replacement of a 44KV substation and site preparation through a Z-factor claim. HHI proposed to recover these costs through fixed and variable rate riders that would be in place until HHI's next rebasing application.

HHI stated that the 44KV substation has a scheduled in-service date of February 2012. HHI noted that this purchase was deemed necessary to provide safe and reliable electricity supply to customers.

On July 14, 2008, the Board issued the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors (the "Report"). In section 2.6 of 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. The Board determined a materiality threshold of \$50,000 for small size distributors such as HHI. In the Report, the Board noted that it expects that any application for a Z-factor will be accompanied by a clear demonstration that the distributor's management could not have been able to plan and budget for the event and that the harm caused by extraordinary events is genuinely incremental to the distributor's experience or reasonable expectation.

In its submission, Board staff noted that risk management of this distribution asset was clearly within management's control and that the replacement of a transformer station is

not an extraordinary event. Therefore, Board staff submitted that this event does not qualify for Z-factor treatment. Board staff however submitted that cost recovery should be considered under the umbrella of an incremental Capital Module ("ICM").

VECC submitted that given the age of the assets, the recent studies documenting the condition of the transformer and the timeline of the events and the preventative measures undertaken by HHI, the need to replace the asset should not be treated as an unforeseen event. VECC submitted that HHI should seek recovery of the amounts under an ICM, not a Z-factor.

Similarly, SEC agreed with the Applicant that HHI should be allowed to recover expenditures for its replacement of its failing 44KV transformer, but submitted that the appropriate regulatory mechanism is the ICM, not a Z-factor.

In its reply submission, HHI requested approval of an ICM claim in the amount of \$712,909 to replace its defective 44 KV substation.

The Board finds that the proposed replacement of the 44 kV substation does not qualify for Z-factor treatment, as the requirement to replace the asset is not an unforeseen event that is outside of the control of management. As such, the proposed Z-factor treatment for this expenditure is inconsistent with the policy of the Board as set out in section 2.6 of the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*. The Board agrees with the submissions of Board staff and intervenors that it is appropriate to consider the cost recovery associated with this proposal in the context of the ICM.

Incremental Capital Module

The Request

HHI proposed to recover, through an ICM, the incremental capital costs of \$1,517,813 associated with the replacement of existing transformers with a new 25MVA in addition to the incremental capital cost of \$712,909 associated with the above mentioned 44kV substation.

HHI currently receives electricity at a substation at 110kV with two distribution transformers in the West end and a 44kV station in the East end of Hawkesbury. HHI

noted that the two transformers at the 110 KV station are approximately 45 years of age and have shown signs of deterioration.

HHI indicated that if the approval is not granted, it has no other alternative but to take a reactive stance and wait until the 110KV fails. HHI also noted that if one transformer fails, the other cannot support its load.

HHI proposed to allocate the revenue requirement associated with the incremental capital expenditures eligible for cost recovery on the basis of distribution revenue. HHI proposed to recover this amount by means of fixed and variable rate riders that would remain in effect until its next cost of service application (scheduled for the 2014 rate year).

The Eligibility Criteria

The Reports referenced in the introduction of this Decision and Order require that incremental capital expenditures satisfy the eligibility criteria of materiality, need and prudence in order to be considered for recovery prior to rebasing. Applicants must demonstrate that the amounts exceed the Board's materiality threshold and clearly have a significant influence on the operation of the distributor, must be clearly non-discretionary and the amounts must be outside the base upon which rates were derived. In addition, the decision to incur the amounts must represent the most cost-effective option for ratepayers.

(i) Need and Prudence

Two Transformers at the 110KV station

HHI indicated that the incremental capital expenditures are related to the replacement of one of the existing transformers with a new 25 MVA that will have the capability to support the entire service area.

HHI provided evidence supporting the need for this project in its application and interrogatory responses. HHI indicated that the transformer at the 110KV station is non-discretionary and that the assets are reaching end of life and showing signs of deterioration.

In support of its Application, HHI submitted an assessment of the two transformers, dated November 2, 2010 by GE Canada International and an evaluation of alternatives in the form of a report by BPR, dated September 5, 2011.

Board staff submitted that HHI's request for incremental capital funding associated with the design, construction, and operation of the 25MVA transformer for the 110kV station should be granted. Board staff also submitted that HHI has demonstrated immediate short term and long term need as evidenced by the GE and BPR reports.

VECC submitted that the incremental capital meets the Board's materiality, need and prudence criteria based on the evidence provided. However, VECC noted that the failing condition of the aging assets at the West substation have been identified by HHI on an ongoing basis and were most recently identified in its last cost of service application in 2010. VECC submitted that the proposed capital investment is not new, and because its condition has not changed significantly since 2010, VECC submitted that HHI should continue with its original plan to budget for the replacement of this transformer in its next cost of service application in 2014.

SEC submitted that the Board previously stated that the need for a specific project under an ICM must be unusual and outside the ordinary course of business. SEC stated that in this specific Application, the evidence does not demonstrate that the replacement cannot wait until the Applicant's next cost of service application. SEC submitted that the Applicant has not shown that the change in condition is material enough to be considered outside the base from which rates were derived. SEC also submitted that the evidence provided by the Applicant does not demonstrate that the condition of the transformer is that of near catastrophic failure or is an unacceptable risk to the health and safety of the community or any worker. SEC submitted that the cost should not be recovered from ratepayers until its next cost of service proceeding in 2014.

In its reply submission, HHI interpreted VECC and SEC's position as "taking no action", which was one of the options considered in GE's report. HHI dismissed this option, since it would put the distributor's customers at considerable risk and would also pose an unacceptable risk to the distributor. HHI stated that there is a high probability that

the 110kV could fail unexpectedly in the next year given the age of the transformers and HHI's experience with the 44kV station. HHI submitted that the potential financial cost associated with a reactive stance, estimated from \$5,215,000 to \$6,455,000, could be devastating to the distributor and its customers.

HHI further noted the GE report regarded a "take no action" alternative as an unacceptable risk of losing service for a long period of time and re-submitted its request for an ICM claim of \$1,517,813 for the 110kV station and \$712,909 to replace its defective 44kV substation.

44kV substation

As noted earlier in this Decision and Order, the Board finds it appropriate to consider the cost recovery associated with the replacement of the 44kV substation in the context of the ICM claim.

Board staff noted in its submission that HHI provided an extensive evaluation of the alternatives considered and the reasons supporting the preferred solutions and that HHI's request satisfies the prudence requirement for an ICM claim. It was Board staff's view that while the costs of the options adopted by HHI are marginally higher than some of the alternatives considered, HHI's preferred options are cost effective.

VECC submitted that HHI has satisfied the Board's materiality, need and prudence criteria regarding this incremental capital project. VECC further submitted that the replacement of the 44kV transformer should be eligible for recovery through the ICM.

Similarly, SEC submitted that the project met the requirements of an ICM and that materiality, prudence and need have been met.

(ii) Materiality

Board staff indicated that HHI completed the 2012 IRM3 ICM Workform and calculated a materiality threshold of \$121,150. Board staff also noted that HHI's 2012 forecasted capital expenditures amount to \$2,458,840, which includes the forecasted costs of \$712,909 to replace the failing transformer at the 44KV station and the forecasted cost

of \$1,517,813 to replace an existing transformer at HHI's 110KV station with a 25 MVA for a total amount of \$2,230,722. On that basis, Board staff noted that the maximum amount eligible for recovery would be \$2,337,690 (\$2,458,840 - \$121,150).

VECC submitted that the calculation of the threshold should be updated to reflect the 1.7% price escalator announced by the Board on November 10, 2011. VECC also submitted that the model will need to be updated to reflect the price escalator when updated data becomes available.

VECC noted that in response to interrogatories, HHI indicated that it could potentially defer \$20,000 in capital projects under account 1830 (Poles, Towers, Fixtures) to a later date. VECC submitted that the 2012 proposed capital expenditures, less the \$20,000 under account 1830, can be reasonably viewed as non-discretionary.

The Board notes that Hydro Hawkesbury has applied for ICM treatment for two projects: (i) to replace two transformers at the 110 KV substation with a new 25 MVA transformer at a cost of \$1,517,813; and (ii) to replace and undertake site preparation for a 44 KV distribution transformer at a cost of \$712,909. The total applied-for ICM is \$2,230,722.

As set out in the IR Report, the incremental capital module was designed to address the treatment of incremental capital needs that may arise during the IRM term and do so on a modular basis. The Supplemental Report, states that the capital module is intended to be reserved for unusual circumstances that are not captured as a Z-factor and where the distributor has no other options for meeting its capital requirements within the context of its financial capacities underpinned by existing rates.

Both reports set out incremental capital investment eligibility criteria, which are repeated below:

Materiality: The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with a rebasing.

Need: Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.

Prudence: The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

The materiality threshold is based on the premise that revenue generated under the price cap plan automatically generates more revenue for capital investment. The materiality threshold set by the Board in its Supplemental Report established a level of capital expenditure that can be financed by increases in revenue due to the price cap formula and load growth. The Board also set a 20 percent adder, or dead band, to prevent marginal applications.

The Board is of the view that the applied-for projects are consistent with the purpose of the ICM, and that it is appropriate to evaluate each of the two projects using the incremental capital investment eligibility criteria.

The Board finds that the need, prudence and materiality for each for the two applied-for projects have been established. HHI has provided sufficient evidence documenting potential asset failure, the cost consequences of deferring action and risking asset failure, condition deterioration and safety issues to establish materiality, need and prudence of each project in the context of this application. In the case of the 110 KV project, a number of alternatives were also assessed.

The Board also highlights that each project individually exceeds the materiality threshold. The Board points out that the materiality threshold calculates the amount of ongoing capital expenditures that can be supported by rates during IRM. As such, there is no question that the costs of the applied-for projects are not presently reflected in current rates. The Board is of the view that Hydro Hawkesbury has also adequately demonstrated that its 2012 capital budget of \$2,458,840 is non-discretionary.

In light of the evidence presented, the Board finds that the revised materiality threshold should be further adjusted to reflect the 2.0% price escalator announced by the Board on March 13, 2012, a stretch factor of 0.2%, and growth using the 2010 Board-approved load forecast. Using these parameters, the Board has calculated a materiality threshold of \$126,961. The maximum amount eligible for recovery will be the difference between the total non-discretionary capital expenditures of \$2,458,840 and the materiality threshold value of \$126,961 or \$2,331,879. Hydro Hawkesbury has applied for an ICM

of \$2,230,722, which is less than the maximum amount eligible for recovery. The Board therefore approves an incremental capital module of \$2,230,722.

Incremental Revenue Requirement Calculation

(i) The Half Year Rule, Capital Structure and Treatment of Capital Contribution

In its Application, HHI used a full year depreciation amount to calculate its incremental revenue requirement amounts. HHI used a 60% debt and 40% equity deemed capital structure and the cost of capital parameters approved in its 2010 cost of service application when calculating the revenue requirement associated with the ICM.

Board staff agreed that the half-year rule should not apply in this case, since HHI is at the half-point of its IRM plan term. Board staff also submitted that the capital structure used to calculate the revenue requirement associated with the incremental capital expenditures is appropriate.

The Board finds that the half-year rule will not apply as HHI is not scheduled to file a rebasing application until 2013 for 2014 rates. The Board also approves a 60/40 (debt/equity) capital structure and the use of the cost of capital parameters as approved in HHI's 2010 cost of service application.

(ii) Allocation of the Incremental Revenue Requirement

HHI proposed to allocate the revenue requirement associated with the incremental capital expenditures eligible for cost recovery on the basis of distribution revenue.

Board staff submitted that the transformers are distribution assets. Board staff was of the view that an allocation based on distribution revenue is appropriate and took no issue with HHI's proposed cost allocation methodology.

The Board approves the allocation of the revenue requirement associated with the incremental capital on the basis of distribution revenue, consistent with the methodology contained within the Incremental Capital Workform.

(iii) Recovery of the Incremental Revenue Requirement

HHI proposed to recover the revenue requirement associated with the ICM amounts by means of fixed and variable rate riders that would remain in effect until its next cost of service application. Board staff noted that the Board previously approved in the case of Guelph Hydro (EB-2010-0130) and Oakville Hydro (EB-2010-0104) the recovery of the incremental annual revenue requirement by means of a variable rate rider. Board staff was of the view that recovery by means of fixed and variable rate riders creates additional complexities that may not be warranted and invited HHI to provide in its reply submission a schedule showing rate riders expressed on a variable basis.

The Board finds that the incremental revenue requirement should be recovered by means of a variable rate rider, as this approach is consistent with the Board's approach in the Guelph (EB-2010-0130) and Oakville (EB-2010-0104) decisions.

IMPLEMENTATION

The Board has made findings in this Decision which change the 2012 distribution rates from those proposed by HHI

The Board expects HHI to file a draft Rate Order, including all relevant calculations showing the impact of this Decision on HHI's determination of the final rates. Supporting documentation shall include, but not be limited to, filing completed versions of the 2012 IRM Rate Generator model, shared tax savings model, updated SIMPIL models and continuity tables to support the claim for disposition of account 1562 Deferred PILs, LRAM calculations showing the derivation of the final rate riders to recover the approved LRAM amount and the updated Incremental Capital Workform and Incremental Capital Project Summaries for each of the ICM projects.

A Rate Order will be issued after the steps set out below are completed.

THE BOARD ORDERS THAT:

1. HHI shall file with the Board, and shall also forward to VECC and SEC, a draft Rate Order that includes revised models in Microsoft Excel format and a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision and Order within **7 days** from the issuance of this Decision and Order.

2. Board staff, VECC and SEC shall file any comments on the draft Rate Order including the revised models and proposed rates with the Board and forward to HHI within 7 days of the date of filing of the draft Rate Order.
3. HHI shall file with the Board and forward to VECC and SEC responses to any comments on its draft Rate Order including the revised models and proposed rates within **4 days** of the date of receipt of comments from Board staff and the intervenors.

Cost Awards

The Board will issue a separate decision on cost awards once the following steps are completed:

1. VECC and SEC shall submit their cost claims no later than **7 days** from the date of issuance of the final Rate Order.
2. HHI shall file with the Board and forward to VECC and SEC any objections to the claimed costs within **21 days** from the date of issuance of the final Rate Order.
3. VECC and SEC shall file with the Board and forward to HHI any responses to any objections for cost claims within **28 days** from the date of issuance of the final Rate Order.
4. HHI shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote file number **EB-2011-0173**, be made through the Board's web portal at, www.errr.ontarioenergyboard.ca and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at

www.ontarioenergyboard.ca. If the web portal is not available parties may email their document to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 2 paper copies.

DATED at Toronto, April 19, 2012

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary