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

Ontario

BY EMAIL

November 19, 2012

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

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Festival Hydro Inc.
2013 IRM3 Distribution Rate Application
Board Staff Submission
Board File No. EB-2012-0124

In accordance with the Notice of Application and Hearing, please find attached the Board Staff Submission in the above proceeding.

As a reminder, Festival Hydro Inc.'s Reply Submission is due by December 3, 2012.

Yours truly,

Original Signed By

Marc Abramovitz
Advisor, Applications & Regulatory Audit

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2013 ELECTRICITY DISTRIBUTION RATES

Festival Hydro Inc.

EB-2012-0124

November 19, 2012

Board Staff Submission
Festival Hydro Inc.
2013 IRM3 Rate Application
EB-2012-0124

Introduction

Festival Hydro Inc. ("Festival Hydro") filed an application (the "Application") with the Ontario Energy Board (the "Board") on August 27, 2012, seeking approval for changes to the distribution rates that Festival Hydro charges for electricity distribution, to be effective May 1, 2013. The Application is based on the 2012 3rd Generation Incentive Regulation Mechanism.

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 Festival Hydro.

The Application

Festival Hydro completed the Tax-Savings Workform with the correct tax rates and amounts which reflect the Revenue Requirement Work Form from the Board's decision in EB-2009-0263 (Festival Hydro's last cost of service proceeding). Board staff has no concerns with the workform as filed.

Board staff also has no concerns with the data supporting the updated Retail Transmission Service Rates proposed by Festival Hydro. Pursuant to Guideline G-2008-0001, updated on June 28, 2012, Board staff notes that the Board will update the applicable data at the time of this Decision based on any available updated Uniform Transmission Rates.

Board staff has reviewed Festival Hydro's Group 1 Deferral and Variance account balances and notes that the principal balances as of December 31, 2011 reconcile with the balances reported as part of the *Reporting and Record-keeping Requirements*. Also, the preset disposition threshold has not been exceeded. Accordingly, Board staff has no issue with Festival's request to not dispose of its 2011 Deferral and Variance Account balances at this time.

Board staff submits that the revenue-to-cost ratio adjustments are in accordance with the Board's findings in its EB-2009-0263 decision and therefore Board staff has no issues with Festival Hydro's proposal.

Board staff makes a detailed submission on the following matter:

- Incremental Capital Module ("ICM")

Incremental Capital Module ("ICM")

The Request

Festival Hydro proposed to recover, through an ICM, the incremental capital costs of $15,863,113 associated with the construction of a new municipal transformer ("TS") station in the city of Stratford.

Festival Hydro proposed to allocate the revenue requirement associated with the incremental capital expenditures eligible for cost recovery (i.e. $672,412) on the basis of distribution revenue. Festival Hydro proposed to recover these amounts by means of fixed and variable rate riders that would be in place until such time that Festival Hydro files its next rebasing application (scheduled for 2014 rates).

Eligibility Criteria

The *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Report") requires 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 amounts exceed the Board-defined 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 of the base upon which rates were derived.

(i) Materiality

Festival Hydro has claimed total incremental capital of $7,777,903. This represents half of the total cost of the TS ($15,863,113) plus the total non-discretionary capital budget ($3,489,000) less the threshold calculation of $3,642,654.

(ii) Project Need and Prudence

Festival Hydro indicated that the incremental capital expenditures are related to the construction of the new TS scheduled to be in-service by April 30, 2013. The project is forecasted to be 65% complete by the end of 2012 and on schedule to meet its in-service date. The TS is being constructed to alleviate a potential overload condition at the existing Hydro One owned Stratford TS that provides the sole supply to the City of Stratford and the surrounding area. In its Application, Festival Hydro stated that it will continue to exceed its assigned capacity on a regular basis until the new municipal TS is constructed. The applicant stated that if load continues to increase as most recently forecasted, by 2014 a failure of a single major component at the existing Stratford TS during peak loads could result in rotating blackouts for the City of Stratford and surrounding area. As load in Stratford continues to grow, the likelihood of rotating blackouts will also increase. In addition to adding capacity, the new municipal transformer will eliminate low voltage issues at the end of the longest feeders and significantly improve reliability for all customers in Stratford.

In 2009, Festival Hydro considered the following options:

1. Hydro One upgrades one transformer at the existing TS in 2010 to meet the immediate capacity requirement, and then Hydro One builds a second TS in 2015 to provide the long term capacity.
2. Hydro One upgrades one transformer at the existing TS in 2010 to meet the immediate capacity requirement, and then Festival Hydro builds a second TS in 2015 to provide the long term capacity.
3. Hydro One builds a second TS in 2010 to meet the immediate and long term capacity requirement.
4. Festival Hydro builds a second TS in 2010 to meet the immediate and long term capacity requirement.

Festival Hydro selected option 4 as it was the one with the lowest net present value and the one that addressed its capacity, voltage and reliability issues. In response to VECC interrogatory 2B, Festival Hydro stated that it had approached Hydro One on several occasions to discuss potential cost sharing arrangements. However, Hydro One indicated that it did not foresee sufficient growth within its service area that could not be accommodated from the existing Stratford TS or other existing Hydro One delivery points. Therefore, Hydro One did not feel it had a need for the additional capacity provided from the new TS.

In 2010, Festival Hydro retained RJ Burnside and Associates to conduct an environmental assessment on a property purchased to construct the new TS. The environmental assessment did not identify anything that would prevent the construction of a TS on the property.

In 2011, Festival Hydro retained the services of Costello & Associates to provide advice on the technical details of the new TS. The final report from Costello & Associates concluded that the load forecast prepared by Festival Hydro was consistent with typical utility practices, that a new TS is required to meet load growth and that Festival Hydro should design, construct and operate a new TS.

Festival Hydro noted that if the incremental capital rate riders were not approved, it would cause further carrying costs to Festival Hydro in terms of additional interest expense. In addition, customers will receive immediate benefit from the new TS which supports matching Festival Hydro’s cost recovery to commence during the same period.

<u>The incremental Revenue Requirement Calculation</u>

(i) The Half Year Rule

Festival Hydro applied the half year rule when calculating the incremental revenue requirement associated with the allowable ICM amount.

(ii) The Capital Structure

Festival Hydro used a 60% debt and 40% equity deemed capital structure when calculating the revenue requirement associated with the incremental capital expenditures.

Festival Hydro used the cost of capital parameters from its last rebasing application.

Submission

Eligibility Criteria

Board staff agrees with Festival Hydro's response to Board Staff Interrogatory 4 that the ICM is intended to address the treatment of new capital investment needs that arise during the IRM plan term which are incremental to the materiality threshold. While the Board has not set a specific limit to the amount that can be included in the ICM in any one year, in this case, the proposed incremental capital of $7,777,903 included in the ICM model represents almost 20% of Festival Hydro's current approved rate base of $40,127,578.

Board staff notes that the total eligible incremental capital calculated in accordance with recent ICM Board decisions would be $15,709,459 ($15,863,113 plus $3,489,000 (regular capital forecast) minus the materiality threshold of $3,642,654). Based on this calculation, $15,709,459 is the total amount of the TS that Festival Hydro is eligible to base its revenue requirement calculation on. Since Festival Hydro is scheduled to rebase one year after the ICM, the half year rule should apply. Therefore, the amount used in the model should be $7,854,730. Board staff estimates that Festival Hydro has understated the revenue requirement impact by approximately $6,000. Festival Hydro may wish to confirm this in its reply submission.

With respect to the prudence of the investrment, Festival Hydro considered four alternatives (as described above) in its 2009 study. These appear to be appropriate alternatives for providing the required load-meeting capacity and Festival Hydro chose the lowest cost alternative.

With respect to the need and timing, Board staff has no concerns subject to clarification by Festival Hydro in its reply submission on two matters.

Festival Hydro's response to Board Staff Interrogatory 8 shows that in an updated 2011 load forecast, the expected 2013-2015 load is approximately 10-13% less than the 2009 load forecast on which the earlier studies were based. With the latest forecast, the limited time rating ("LTR") of Festival Hydro's portion of the Stratford TS capacity would be exceeded in 2015 rather than 2012 (with 2014 coming close to meeting the capacity limit). Below are two tables from the referenced interrogatory that identify the forecast from both the 2009 and 2011 studies.

2009 Load Forecast

	Capacity of Existing Stratford TS – Festival Hydro Allocation	LTR of Existing Stratford TS – Festival Hydro Portion	Expected Loading – Festival Hydro Based on 2009 Forecast
2012	77.7 MW	85 MW	91.34 MW
2013	77.7 MW	85 MW	93.95 MW
2014	77.7 MW	85 MW	95.43 MW
2015	77.7 MW	85 MW	96.69 MW

2011 Load Forecast

	Capacity of Existing Stratford TS – Festival Hydro Allocation	LTR of Existing Stratford TS – Festival Hydro Portion	Expected Loading – Festival Hydro Based on 2011 Forecast
2012	77.7 MW	85 MW	80.2 MW
2013	77.7 MW	85 MW	81.7 MW
2014	77.7 MW	85 MW	84.3 MW
2015	77.7 MW	85 MW	87 MW

Festival Hydro submitted that, based on the latest forecast, the decision to construct a new TS would remain the same. Festival Hydro noted that the 2011 forecast showed that the load would exceed the allocated capacity in 2012 and LTR in 2015. Festival Hydro further stated that approximately 40% of the work was completed as of September 30, 2012 and that the TS is under construction and is on schedule to meet an in- service date of April 30, 2013.

Board staff notes that Festival Hydro began incurring significant costs for this project in 2012. It is unclear whether or not Festival Hydro had knowledge of the updated load forecast at the time the decision was made to establish an April 2013 in service date. If it did, Festival Hydro may wish to clarify in its reply submission, why it maintained the same in service date target given that the loading issues on the existing TS appeared not to be as imminent as indicated by the older study.

In the above Tables, Festival Hydro has provided two values for the existing Stratford transformer station that seem to relate to the station’s capacity allocation for Festival Hydro, i.e. 77.7 MW capacity and 85 MW LTR. Board staff is unclear as to how Festival Hydro uses these two ratings to determine the timing of the additional capacity requirement. Festival Hydro may wish to clarify (using evidence already on the record of this proceeding) the rating it uses, the methodology applied to determine the in-service date requirement for the new transformer station and its rationale for doing so. Festival Hydro should clarify why the higher LTR could not accommodate the increasing load requirements, thereby allowing Festival Hydro to delay the in service date.

The Incremental Revenue Requirement Calculation

The Board's general guidance on the application of the half-year rule is provided in the *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* dated September 17, 2008. In this report the Board determined that the half-year rule should not apply so as not to build a deficiency for the subsequent years of the IRM plan term. In a subsequent decision with respect to the application of the half-year rule in the context of an ICM, the Board clarified that the half-year rule would apply in the final year of the IRM plan term. Since Festival Hydro is scheduled to be rebased in 2014, Board staff submits that the half-year year was correctly applied.

As previously indicated, Festival Hydro used the cost of capital parameters underpinning its last cost of service application. Board staff submits that this is consistent with *Chapter 3 of the Filing Requirements for Transmission and Distribution Applications*, dated June 28, 2012 ("the Filing Requirements").

Festival Hydro used a 60% debt and 40% equity deemed capital structure when calculating the revenue requirement associated with the incremental capital expenditures. Board staff submits that the revenue requirement calculation provided by Festival Hydro is consistent with the Filing Requirements.

Recovery of the Incremental Revenue Requirement

Festival Hydro proposed to allocate the revenue requirement associated with the incremental capital expenditures eligible for cost recovery (i.e. $672,412) on the basis of a combined fixed and variable rate riders. The rate riders would be in place until such time that Festival Hydro files its next cost of service rate application (i.e. one year).

Board staff notes that the Board previously approved in the case of Guelph Hydro (EB-2010-0130), Oakville Hydro (EB-2010-0104) and Centre Wellington (EB-2011-0160) an allocation of the revenue requirement on the basis of distribution revenue and the recovery of the incremental annual revenue requirement amount by means of a variable rate rider only. Board staff is of the view that the recovery of the amount by means of fixed and variable rate riders creates additional complexities that may not be warranted.

All of which is respectfully submitted