Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2007 ELECTRICITY DISTRIBUTION RATES

Hydro One Networks Inc.

EB-2007-0542

April 4, 2007

INTRODUCTION

Hydro One Networks Inc. ("Hydro One") is a licensed distributor that carries on the business, among other things, of owning and operating distribution facilities in Ontario.

The purpose of this document is to provide the Board with the submissions of Board Staff after its review of the evidence filed in the 2007 electricity distribution rates application by Hydro One. The methodology used by Board Staff in its review of the application was to identify any deficiencies between the application and the Board's Report on 2nd generation incentive regulation[1] (the "Report") and any inconsistencies between the additional requests made by Hydro One and other relevant Board decisions or documents such as Hydro One's CDM approved plan and the Board's March 1, 2007 filing requirements regarding extension of 3rd tranche CDM programs and 2007 incremental funding[2].

This submission will only briefly address the formulaic rate adjustment component of Hydro One's application and Hydro One's request for a variance account related to municipal permit fees. This submission will focus almost exclusively on Hydro One's request for an extension of the interim time-of-use ("TOU") pilot program and the associated variance account.

This submission will address the interim TOU issue in two parts. First, Board Staff will comment on program eligibility i.e. the nature of the program and whether in Staff's view it satisfies the eligibility criteria set out in the Board's March 1, 2007 filing requirements. Second, Staff will comment on variance account recording methodology outlined by the Board in its March 1, 2007 letter and whether the purpose of the requested variance account is consistent with the tracking of incremental 3rd tranche CDM funding.

THE APPLICATION

On February 19, 2007 Hydro One filed its application for 2007 electricity distribution rates – EB-2007-0542. The application was based on the Board's 2nd generation incentive regulation mechanism as per the Board's Report and the January 29, 2007

[1] December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors
[2] March 1, 2007, letter to Licensed Electricity Distributors re: Conservation and Demand Management Funding

Addendum[3]. In addition to the automatic adjustments outlined in the Board Report and Addendum, Hydro One also requested the following:

- A variance account to track costs associated with municipal permit fees that are incremental to amounts currently in Hydro One's approved revenue requirement
- An extension to an interim TOU pilot program scheduled to end by September 30, 2007 and
- A variance account to track incremental forgone revenues resulting from the TOU program.

Hydro One applied the incentive regulation mechanism to adjust its currently approved revenue requirement as per the Board's Report. Hydro One also submitted the Smart Meter Model as per the Addendum. Board Staff found no deficiencies or inconsistencies with the Board Report or the Addendum. Board Staff notes that Hydro One's distribution rates will be adjusted by the following:

- Removal of the Large Corporations Tax of 0.443%
- The GDP-IPI - X escalator factor of 0.90%
- An increase to the smart meter rate adder from $0.27 to $0.93 per metered customer per month in accordance with the Smart Meter Model.

Board Staff notes that the resulting total bill impacts for a residential customer at 1,000 kWh averages to an increase of approximately 0.5%.

With respect to the variance account request for costs associated with municipal permit fees, Hydro One stated that it expects the annual balance to be approximately $5,000,000. Board Staff notes that these types of costs are a straight pass through for all distributors. Board Staff also notes that a certain level of costs associated with municipal permit fees are included in Hydro One's currently approved revenue requirement and that Hydro One is simply seeking to remain whole.

Hydro One has requested an extension to their approved interim TOU rates pilot to beyond the scheduled end date of September 30, 2007 until such time as new rebased distribution rates are established. Hydro One has also requested that it be allowed to

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[3] January 29, 2007 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors – Addendum for Smart Metering Rates

accrue any difference in distribution revenues between the standard rates and the TOU rates commencing in October 2007 and to establish a variance account to track amounts that exceed the available funds in the approved CDM program.

CDM PROGRAM ELIGIBILITY

Background

In 2004, the Ministry of Energy authorized distributors to apply for their third instalment of their market adjusted revenue requirement ("3rd tranche"). The approval of the recovery of this amount was conditional on a financial commitment to invest an amount equal to one year's incremental returns in CDM activities. The Board issued its Order approving Hydro One's CDM plan on March 17, 2005[4]. In that order, the Board stated that Hydro One was required to file quarterly and annual reports on the progress of the initiatives including a cost benefit analysis on the programs included in the CDM plan. This analysis, also known as the Total Resource Cost or "TRC" test, was not included as part of Hydro One's original CDM application due to a lack of available data[5].

Among other initiatives, the program included an interim TOU rates pilot targeted at commercial customers with the intent of achieving significant contributions to peak load reduction. The interim TOU pilot project received advance approval first on an interim basis effective November 10, 2004 and on a final basis on December 21, 2004[6]. The approved budget for the program is $475,000 and includes both one-time set up costs and amounts related to the forecasted revenue shortfall resulting from the implementation of TOU rates and the re-classification of qualifying customers[7]. The amounts budgeted annually for revenue losses is $150,000. In its 2007 EDR application, Hydro One stated that the actual difference in distribution revenues at standard rates and at interim TOU rates is approximately $30,000 to $35,000 per month[8]. Board Staff notes that this results in an annual shortfall of $360,000 to $420,000 or approximately $210,000 to $270,000 more than anticipated in the original annual budget.

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[4] Order, RP-2004-0203/EB-2005-0198
[5] Oral Decision, February 18, 2005, RP-2004-0203/EB-2005-0198, para 781
[6] RP-2004-0203/EB-2004-0203 and RP-2004-0203/EB-2004-0461 respectively
[7] Hydro One Networks Inc. and Hydro One Brampton Networks Inc. Conservation and Demand Management Plan, RP-2004-0203/EB-2004-0533, page 15
[8] Exhibit B, Tab 1, Schedule 3, EB-2007-0542

Discussion and Submission

In its March 1, 2007 letter, the Board extended incremental funding with respect to 3rd tranche CDM programs to run the entire 2007 rate year. In that letter, the Board outlined an expedited approach by which a distributor may apply to extend a 3rd tranche CDM program and funding for that program to April 30, 2008. That approach was based on the following filing requirements:

- A budget forecast for activities needed to keep the MARR-based CDM Program fully funded until Aril 30, 2008
- A TRC analysis of 2006 performance identical to the analysis required for the annual CDM reporting requirements. The extension of the Program must meet the requirement of the TRC analysis; and
- The allocation of CDM costs to the customer classes that will benefit from the MARR-based CDM Program and the specific rate adder for each class.

Hydro One's request for an extension to its TOU rates pilot to beyond September 30, 2007 does not involve a request for additional funding at this time i.e. no increase to 2007 rates. However, Board Staff notes that the interim TOU rates initiative is an approved CDM program and that the request to extend the program is consistent with the spirit and intent of the March 1, 2007 letter. Essentially, Hydro One's request involves an extension of a 3rd tranche CDM program with a request for what amounts to a deferral of incremental "funding" until a later date. This "funding" is in the form of compensation for revenue losses associated with implementing the TOU rates to be tracked, as per Hydro One's request, in a variance account for disposition at a future date. Board Staff notes that the Board did approve a certain level of revenue losses as a legitimate budgeted expense when it approved Hydro One's interim TOU rates program.

Although Board Staff is satisfied that Hydro One's request to extend the program may be deemed to fall within the purview of the March 1 letter, Board Staff submits that Hydro One should also demonstrate that the program meets the three criteria outlined in the March 1 letter.

Board Staff will deal with the first and third criteria before addressing the second.

In providing the Board with an estimate of the actual differences in distribution revenue between the standard and TOU charges, Board Staff submits that Hydro One has in fact met the first criterion with respect to the provision of a budget forecast. As stated earlier, the majority of the budget in the original plan was targeted for potential revenue losses. By identifying the current levels of revenue losses, Board Staff submits that Hydro One has essentially provided a budget forecast, albeit on a monthly basis.

Also, Board Staff notes that since no actual revenues are being recovered as part of 2007 rates, i.e. Hydro One is not asking for the disposition of the variance account at this time, the third criterion listed on the March 1 letter (the allocation of any incremental costs and the identification of the associated rate adders) should be deferred until such time as the extension of the program and the variance account is subject to review and final approval.

With respect to the second criterion, Board Staff notes that Hydro One's 2005 and 2006 annual reports do not include TRC results for the interim TOU pilot[9] nor does Hydro One's 2007 EDR application.

Board Staff submits that since the disposition of Hydro One's incremental funding for the program is deferred until a future date when the program extension and variance account are subject to a review and final approval, it may be acceptable to the Board to allow Hydro One to defer the filing of the TRC analysis as well. Board Staff submits that as a condition of this approval, Hydro One should make every effort to file this information at Hydro One's earliest convenience and in any event, before the extension of the program can be approved on a final basis.

Therefore, Board Staff supports Hydro One's request to extend the interim TOU rates pilot to beyond September 30, 2007 on the proviso that Hydro One files an analysis that demonstrates that the program passes the TRC test when the applicant files for approval and recovery of the costs in the variance account. This requirement would be consistent with the Board's second criterion of the March 1 filing requirements.

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[9] Hydro One Networks Inc., Conservation and Demand Management Plan, RP-2004-0203/EB-2004-0198, , Appendix B, Interim Time of Use , Annual Reports, March 31, 2006 and April 2, 2007

Finally, the March 1, 2007 filing requirements provided for the extension of 3rd tranche programs and incremental funding to run the entire 2007 rate year ending April 30, 2008. The implementation of Hydro One's next rebased distribution rates may or may not happen by May 1, 2008. Board Staff submits that the extension of the interim TOU rate pilot should be approved to run only until the end of the 2007 rate year i.e. April 30, 2008 as per the March 1 letter and not necessarily until the next rebased distribution rates are established as per Hydro One's request.

VARIANCE ACCOUNT RECORDING

Background

In the Board's March 1, 2007 filing requirements, the Board stated that applications to extend funding for 3rd tranche programs into 2007 (filed before March 23, 2007) will involve the recording in a variance account of all amounts collected in rates for 2007 in relation to 3rd tranche CDM program costs, until such time as the program is subject of a review. If the program is approved, the account will be closed, if not, the amounts will remain and be the subject of disposition in the future.

Discussion and Submission

Board Staff submits that although Hydro One is not requesting additional funding at this time, Hydro One's request for a variance account is consistent in nature with the purpose of the variance account established by the Board to track incremental 3rd tranche recoveries for 2007. First, the request was filed before March 23, 2007. Second, in Hydro One's case, if the program is approved at a future date, the variance account will be the subject of disposition and potentially the amounts will be approved for recovery from ratepayers at that time. If the program is not approved, and/or if Hydro One fails to demonstrate that the interim TOU rate pilot meets the requirement of the TRC analysis, the amounts may be disallowed.

Therefore, Board Staff supports Hydro One's request for a variance account to track the difference in distribution revenues between the standard rates and the interim TOU rates that is incremental to the allocated funds from Hydro One's 3rd tranche CDM program.

Furthermore, Board Staff submits that the granting of the variance account should in no way imply any certainty of recovery to Hydro One. Board Staff submits that the extension of the CDM program will still have to be approved by the Board via a public hearing and as part of that review Hydro One will still have to demonstrate that the interim TOU rates pilot meets the TRC test.

All of which is respectfully submitted