Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2007 ELECTRICITY DISTRIBUTION RATES

Lakeland Power Distribution Ltd.

EB-2007-0551

April 12, 2007

INTRODUCTION

The purpose of this document is to provide the Board with the submissions of Board Staff after staff's review of the evidence filed in the 2007 electricity distribution rates application by Lakeland Power Distribution Ltd. ("LPDL" or the "Applicant").

LPDL is a licensed electricity distributor in Muskoka. The Applicant filed its 2007 Electricity Distribution Rate application with the Board on January 26, 2007. As part of its application, LPDL included a Z-factor claim for $217,870 to reimburse it for severe damage inflicted by an August 2006 storm.

The methodology used by Board Staff in its review of the application was to identify deficiencies between the application and the Board's Report on 2nd generation incentive regulation[1] (the "Report"), and any inconsistencies with approved recovery methodology for similar costs in past claims by other distributors.

This submission will focus exclusively on LPDL's application for Z-factor recovery and will address the Z-factor application in two parts. First, Board Staff will comment on cost eligibility, i.e. the type of costs applied for, and whether in staff's view these costs satisfy the eligibility criteria set out in the Board's Report. Second, staff will comment on the accounting and recovery methodology proposed by LPDL and whether the proposal is consistent with the recovery of similar type costs approved in past claims.

THE APPLICATION

On January 26, 2007 LPDL filed its application for 2007 electricity distribution rates – EB-2007-0551. The application was based on the Board's 2nd generation incentive regulation mechanism as per the Board's Report. Also included was a request for Z-factor recovery for costs relating to the August 2006 storm.

Concerning the Z-factor claim, the application states that on the evening of Wednesday, August 2, 2006 a storm with winds in excess of 100 mph inflicted significant damage to LPDL's distribution system. The storm created a power outage for most customers in the Applicant's service area. Twenty distribution lines were brought down, 25 hydro

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[1] December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors

poles were broken and 40 trees were downed. While most of the damage was confined to Bracebridge where 6,000 customers were left without electricity, smaller numbers of customers in other parts of the service area were affected. Media reports referred to the storm as one of the most brutal acts of nature to ever hit Muskoka.

In order to restore power as quickly and efficiently as possible, LPDL enlisted aid from utilities in the surrounding region and non-utility assistance was also obtained. The average outage per customer was in excess of 12 hours due to the extreme nature of the damage. Power to outlying areas was restored within the week.

The total cost incurred by LPDL due to storm restoration was $217,870; the Applicant states that no LPDL management charges are included in the total. The two primary components of this total are LPDL labour at $79,730.86 and contract labour at $96,752.28; the other components are materials at $25,347.55, meals/lodgings at $3,760.98 and truck usage at $12,278.33.

COST ELIGIBILITY

Background

In its December 20, 2006 Report, the Board established the criteria to be used in determining the reasonableness of Z-factor amounts claimed under the 2nd generation incentive adjustment mechanism. In the Report, the Board recognized that contingencies need to be built into the regulatory regime to provide the flexibility to accommodate extraordinary events outside the control of distributor management. The Board limited the Z-factors to changes in tax rules and to natural disasters.

In the Report, the Board stated that Z-factor amounts must satisfy the three criteria of causation, materiality and prudence[2].

Discussion and Submission

Causation

The Board Report states that amounts claimed should be directly related to the Z-factor event and must be clearly outside the base upon which rates are derived[3].

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[2] Board Report, Page 34 and Appendix C: Z Factors
[3] ibid

LPDL states that the costs that were incurred are solely related to getting power restored to the regulated utility's customers as quickly as possible and in the most cost-effective manner and, additionally, providing a call centre to answer customer inquiries throughout the outage period. However, with respect to the charges claimed, Board Staff submits that there is an absence of evidence showing that all of the $79,730.86 labour expenses incurred by LPDL directly (as distinct from the expenses incurred through the LDCs and non-LDCs it contracted to provide restoration services) are incremental to normal operations. LPDL does not explicitly state that these expenses (that total 45% of all labour expenses and 37% of the total expenses) associated with the Z-factor claim are indeed incremental. In particular, the evidence shows that LPDL incurred $7,133.63 in expenses for its staff who worked at the regular hourly rate; this expense, at the $39.66 per hour lineman rate, equates to approximately 180 hours. Since most unionized labour agreements require a premium rate to be paid for any work in excess of the normal work week, Board Staff does not understand how a small utility with only about 8 unionized staff[4] has perhaps 4 staff available who do not support normal operations. Charges from LPDL's affiliate company Bracebridge Generation which assisted with the restoration activities, may be responsible for the apparently incremental resources. Board Staff submits that the Applicant has not met the test of causation with regard to the $7,133.63 amount.

In order to adequately demonstrate the incremental nature of all claimed costs, an applicant should provide information on historic annual storm costs. The Board Report states, "The Board is of the view that the operational response to normal events, including winter storms, is within the planning control of management and that distributors are already adequately compensated for the risk of these types of events"[5]. Board Staff submits that in order to adequately demonstrate the incremental nature of these costs, an applicant should compare these costs to the annual recurring cost levels related to storms or other normal events.

In response to a Board Staff interrogatory, the Applicant did provide its historic storm costs. LPDL has stated that it budgets annually for funds to cover normal storm damage but, because the restoration costs associated with the August 2, 2006 storm are exceptionally large, this Z-factor claim is needed. Storm costs and Maintenance and Operations costs (actual for the years 2004, 2005 and 2006; forecast for 2007) are:

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[4] In its 2006 EDR application, LPDL stated that in 2004 (the latest year for which the data was reported) it had 8 full time equivalent (FTE) unionized staff.
[5] Board Report, page 35

	2004	2005	2006	2007
M&O	$715,000	$816,000	$785,000	$760,000
Storm only	$122,100	$167,000	$169,500 (Note A)	$170,000

Note A: Excludes expenses associated with August 2, 2006 storm.

Board Staff notes that the "storm only" costs are 17% to 22% of the Maintenance and Operations costs for each year and that the $217,870 claim represents an *additional* 28% of the 2006 Maintenance and Operations costs. This evidence supports LPDL's position that it does indeed budget adequately for *normal* storm damage and that the expenses associated with the 2006 storm are exceptional.

Materiality

The Board Report states that amounts claimed will be considered material and therefore eligible for potential recovery if they meet a certain materiality threshold. For expenses incurred, the total expenses on a per event basis must involve 0.2% of total distribution expenses before taxes. Capital costs will be considered material if, on a per event basis, they involve 0.2% of net fixed assets[6].

The claimed expenses represent 6.34% of the total distribution expenses as calculated using the 2006 EDR model. LPDL achieves the materiality threshold based on its distribution expenses and the $217,870 Z-factor claimed amount meets the threshold based on net fixed assets also. Specifically:
Distribution expenses: 0.2% of $3,398,147 = $6,796
Net fixed assets: 0.2% of $12,982,926 = $25,966

Prudence

The Board Report states that amounts claimed must represent the most cost-effective option (not necessarily the least initial cost) for ratepayers. Consequently, the distributor will need to justify the reasonableness of the amounts relative to other options that the distributor may have had[7].

[6] Board Report, page 34 and Appendix C: Z Factors
[7] Board Report, Appendix C: Z Factors, page V, VI

LPDL does not appear to have any prior arrangements with any other LDCs or non-LDCs to assist with the provision of emergency response services. When storms hit, LPDL calls on those neighbouring LDCs who are able to assist within 24 hours. Having prior agreements in place has permitted some utilities to establish caps on the charges that the other parties make in the event of an emergency. Board Staff's analysis of the invoices indicates that the hourly rate charged by the other LDCs and non-LDCs are generally higher than LPDL's own charges. It is unclear if LPDL had been charged a premium or if LPDL's labour rates are consistently lower than neighbouring utilities.

ACCOUNTING AND RECOVERY METHODOLOGY

Background

In the December 9, 2004 Decision with Reasons on the Review and Recovery of Regulatory Assets, Phase 2 involving Hydro One, Toronto Hydro, London Hydro and Enersource Hydro, the Board established the principles and process to determine the reasonableness of regulatory asset amounts for the remaining distributors. As part of the final review for remaining distributors involving year end 2004 balances, the Board approved the recovery of similar storm related costs for EnWin Utilities, CNPI-Fort Erie and Port Colborne recorded in account 1572, Extraordinary Event Costs. With respect to recovery methodology, the Board approved 2004 customer numbers as the appropriate allocator in determining the class specific revenue requirement and 2004 volumetric data as the billing determinant (kWs or kWhs as applicable).

Discussion and Submission

<u>Interest</u>

The Applicant has not made any specific request for interest on the storm restoration expenses.

<u>Allocation</u>

The Board Report does not specify whether the recovery should be in the form of a fixed charge, volumetric charge, or both. Board Staff notes that in the past the Board has used various methods to implement recovery of approved variance account balances. LPDL proposes that it be reimbursed for its $217,870 storm expenses by charging *all* customers the same additional monthly amount of $1.64 independent of customer class or consumption. In making the calculation, LPDL utilized the customer statistics contained in the 2006 EDR model. Board Staff notes that this method yields an allocation to the classes based on customer count consistent with the methodology used in the regulatory assets proceedings. Furthermore, no evidence was tabled to indicate that more costs were expended on one class of customer - or a few classes of customers – to restore service after the storm.

The proposed billing determinant to customers within classes is not consistent with past Board decisions in that the rate rider is not based on a volumetric charge. However, the proposed increase in fixed monthly charge as a rate rider – as a percentage of the total bill - translates to 1.2% increase for residential customers consuming 1,000 kWh per month and 0.6% increase for GS<50 kW customers consuming 2,000 kWh per month. Board Staff submits the Applicant has proposed a reasonable simplification in view of the magnitude of the requested monthly increase.

Mitigation

LPDL proposes that the rate rider be implemented for a one year period. No mitigation is proposed by LPDL so not to extend the costs to the ratepayers over a prolonged period. In noting that the requested increase is in the 1% order and thus well below the 10% mitigation threshold, Board Staff submits that LPDL's single year approach is reasonable.

Implementation

The remaining implementation issue is whether the additional charge (if any) ultimately approved by the Board is visible as an explicit charge in the tariff sheet (i.e. a "rate rider" as it is usually referred to and as has been requested by LPDL) or if it is embedded into other charges in the tariff sheet (i.e. a "rate adder"). The Board Report refers to the use of a "rate rider" when discussing Z-factors,[8] though Board Staff notes that the term "rate rider" is not defined in the Report. Moreover, there does not appear to be consistent practice on the use of rate riders versus rate adders.

Board Staff submits that since the additional charge is intended to be a temporary measure (specifically, a one year measure as requested by the Applicant) it would be best if it were included as a rate rider in order to achieve transparency.

[8] Board Report, Appendix C: Z-Factors, pages VII, VIII

With a one year recovery period, there is a smaller risk of generating a large residual balance (either positive or negative) than if there was a long recovery period. Therefore, Board Staff submits that a true-up of the storm cost recovery account is unnecessary.

Reporting and Record Keeping

LPDL is requesting that its storm expenses be included in account 1572, Extraordinary Event Costs. LPDL states that it is prudent to record all costs on the Profit and Loss statement due to the uncertainty of Z-factor approval. Board Staff notes however, that the Board report on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors, Appendix C at page vii[9] requires that Account 1572, Extraordinary Event Costs be used to record such costs.

Regardless of the method the Board chooses to implement the approved amounts, the Applicant will be recovering those amounts through a rate rider (or adder) beyond costs recovered in the “base” distribution rates (i.e. those determined through the 2006 distribution rate applications with prescribed adjustments in 2007 such as those for LCT removal). Accordingly, Board Staff submits that the Applicant should not capitalize any of the approved costs related to damaged distribution facilities for rate base purposes nor should any approved costs be treated as distribution expense for purposes of determining a future revenue requirement.

All of which is respectfully submitted.

[9] December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario’s Electricity Distributors