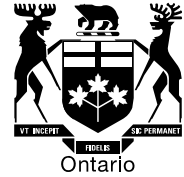


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BY EMAIL

January 16, 2015

Ontario Energy Board
P.O. Box 2319
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2300 Yonge Street
Toronto ON M4P 1E4
Kirsten.Walli@ontarioenergyboard.ca

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: Niagara-on-the-Lake Hydro Inc. ("NOTL Hydro")
2015 Price Cap IR Distribution Rate Application
Board Staff Submission
Board File No. EB-2014-0097**

In accordance with Procedural Order No.1, please find attached the Board staff Submission in the above proceeding. The applicant and intervenors have been copied on this filing.

NOTL Hydro's reply Submission, if it intends to file one, is due by February 6, 2015.

Yours truly,

Original Signed By

Stephen Vetsis
Advisor, Electricity Rates and Prices

Encl.



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2015 ELECTRICITY DISTRIBUTION RATES

Niagara-on-the-Lake Hydro Inc.

EB-2014-0097

January 16, 2015

**Board Staff Submission
Niagara-on-the-Lake Hydro Inc.
2015 IRM Distribution Rate Application
EB-2014-0097**

Introduction

Niagara-on-the-Lake Hydro Inc. (“NOTL Hydro”) filed an application (the “Application”) with the Ontario Energy Board (the “Board”) on September 24, 2014, seeking approval for changes to the rates that NOTL Hydro charges for electricity distribution, to be effective May 1, 2015. The Application is based on the 2015 Incentive Regulation Mechanism (“Price Cap IR”).

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 NOTL Hydro.

The Application

Board staff has no concerns with the RTSR Workform provided with the Application, notwithstanding the comments regarding billing determinants in the section that follows. Board staff submits that the Uniform Transmission Rates (“UTRs”) in NOTL Hydro’s RTSR Workform should be updated to reflect the 2015 UTRs approved in Hydro One Network Inc.’s most recent transmission rate application (EB-2014-0140).

NOTL Hydro filed a shared tax savings calculation indicating no changes in taxes from NOTL Hydro's last cost of service application. Board staff submits that NOTL Hydro's calculation of zero shared tax savings is correct as NOTL Hydro last rebased for 2014.

Board staff notes that the Group 1 principal balances to be disposed as of December 31, 2013 reconcile with the amounts reported by NOTL Hydro as part of the Reporting and Record-keeping Requirements and that NOTL Hydro’s proposed one-year disposition period is consistent with the guidelines outlined in the Report of the Board on Electricity Distributors Deferral and Variance Account Review Initiative. Therefore, Board staff has no issues with this request.

Incremental Capital Module

NOTL Hydro has applied for Incremental Capital Module (“ICM”) funding to upsize a transformer at its MTS#2 transformer station, expected to be in service by May 2015. NOTL Hydro states that its total capital budget for 2015 is \$3,877,000 which includes \$2,577,000 in estimated costs for the replacement of the transformer at MTS#2. The Application indicated an ICM materiality threshold of \$1,876,146. Based on its 2015 capital budget, NOTL Hydro projects \$1,950,854 in total incremental capital above the ICM materiality threshold eligible for ICM funding. This amount produces an incremental revenue requirement of \$164,263 to be recovered from customers through an ICM rate rider. As NOTL Hydro is not in the last year of its IRM term, NOTL Hydro did not apply the half-year rule. NOTL Hydro has proposed to recover the incremental revenue requirement using variable rate riders that would be in effect until its next cost of service application. NOTL Hydro is scheduled to file its next cost of service application for 2019 rates. NOTL Hydro proposed that the incremental revenue requirement be allocated to each class on the basis of recovery of transmission connection costs from each class, to reflect cost causality.

Background

NOTL Hydro owns two supply level transformer stations, MTS#1 and MTS#2, which were deemed distribution assets in its last cost of service application (EB-2013-0155). Both stations are supplied by Hydro One Networks Inc. at 115 kV.

In 2011, NOTL Hydro engaged Raven Engineering to conduct a long-term supply study of its load growth and transformer station capacity. The study recommended increasing capacity at each of NOTL Hydro's two transformer stations to permit each station individually to supply peak utility load in order to avoid rotating blackouts in the event of a lengthy station loss during peak loads. Following the study by Raven Engineering, detailed transformer testing was performed which showed signs that the transformers at MTS#2 were approaching end-of-life and replacement within 5 years was recommended.

In addition to the recommendations provided in the long term supply study conducted by Raven Engineering, NOTL Hydro noted that MTS#2 has a capacity of 50 MVA and reported that its system peak load exceeded that level in both 2002 and 2011 and

almost reached the station's capacity in 2012 and 2013. NOTL Hydro also noted that since the study, it has connected a new customer with a peak load capability of 8MVA.

In response to Energy Probe Interrogatory #1, NOTL Hydro indicated that capital costs for MTS#2 station assets were allocated to rate classes on the basis of the Transformation Coincident Peak 4 ("TCP4") allocator in the cost allocation study filed in its last cost of service application (EB-2013-0155). NOTL Hydro provided an updated allocation of the proposed incremental revenue requirement using the TCP4 allocator. In its response, NOTL Hydro states that the "TCP4 approach is an alternative assumption with some merit." Board staff submits that NOTL Hydro should use the TCP4 allocator to allocate the incremental revenue requirement between classes as is it more accurately reflects cost causality and how costs for these types of assets have already been allocated in NOTL Hydro's current base rates.

In response to Board staff Interrogatory #2, NOTL Hydro indicated that billing determinants in Sheet C1.1 of the ICM Workform do not reconcile with NOTL Hydro's 2013 RRR 2.1.5 filing because the consumption data in the ICM Workform includes unbilled adjustments "so as to total to the delivered kWh in the 2013 Yearbook." Board staff notes that page 61 of the RRR Filing Guide, updated in April 2014, states that "to match the time period of supplied kWhs and the delivered kWh it is appropriate to include an adjustment for unbilled kWh to the delivered kWh." Board staff submits that since the 2013 billing determinants are used across the filing modules, such as the RTSR Workform and ICM Workform, they should be consistent. Further they should reflect actual calendar consumption for the calendar year, including adjustments for unbilled amounts. For purposes of clarity, Board staff submits that NOTL Hydro should confirm the correct 2013 billing determinants to be used in its filing modules.

On September 18, 2014, the Board issued the Report of the Board, EB-2014-0219: *New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, ("the ACM report") in which the Board updated definitions of the three criteria that must be met to qualify for an ICM. Board staff submits that NOTL Hydro's proposed ICM meets the required criteria, discussed in further detail below, and that it should be approved for recovery. Board staff takes no issue with NOTL Hydro's proposal to recover the incremental revenue requirement via variable rate riders that will be in effect until NOTL Hydro's next cost of service application.

Materiality

Board staff submits that NOTL Hydro's proposed ICM is material as the amounts are significant (i.e. 66% of the total capital budget for 2015) and are clearly above the materiality threshold that applies to ICM applications. In the Application, NOTL Hydro used the full CCA amount and amortization expense associated with the overall capital cost of the project (i.e. \$2.57M). In response to Energy Probe Interrogatory #6, NOTL Hydro recalculated the incremental revenue requirement using the CCA amounts and amortization expense associated only with the eligible incremental capital amount of \$1.9M. As a result of this change the incremental revenue requirement decreased from \$164,263 to \$160,809. Due to the immaterial nature of the resulting change Board staff does not see a need for NOTL Hydro to change its proposal.

Need

In response to Energy Probe Interrogatory #4, NOTL Hydro stated that it has seen a decline in average kWh consumption per customer in recent history due to changes in technology and conservation programs. NOTL Hydro noted that this per customer decline has been more than offset by the growth in number of customers due to ongoing development in its service area.

Consistent with the policy of considering conservation first to defer or avoid investments when possible, Board staff submits that distributors should rigorously examine conservation as an option well before any future major infrastructure investment is required. While Board staff notes that NOTL gave some consideration to conservation measures as an option to defer this investment. Board staff accepts that conservation measures by themselves were unable to provide the capacity relief necessary in this instance. Board staff accepts that capacity has already been exceeded and since conservation measures generally take a long lead time, it is appropriate to proceed with the project as planned.

Based on persistent load growth in NOTL Hydro's service area, the results of the study conducted by Raven Engineering, and the fact that NOTL Hydro's peak system load has already reached the capacity available at MTS#2, Board staff submits that NOTL Hydro has demonstrated the need for the proposed upsizing of the transformer at MTS#2.

Board staff also submits that, given the nature of the project, it is clear that it is a discrete project (i.e. not part of a typical annual capital program) and outside of the base upon which rates were derived in the 2014 COS. NOTL Hydro had included the proposed ICM project in the forecasted 2015 capital costs shown in the Distribution System Plan (“DSP”) filed with its last cost of service application. On page 7 of the DSP, NOTL Hydro stated that it “would come forward with an ICM application to address cost recovery prior to the next rate rebasing application” for the project to replace a transformer at the MTS#2 substation.

Under the ACM report, a distributor must pass the Means Test¹ in order to demonstrate need for ICM funding. NOTL Hydro’s 2013 RRR 2.1.5.6 filing indicated an achieved regulatory return on equity (“ROE”) of 3.84% in 2013 which is well below the deemed ROE of 8.01%. Therefore NOTL Hydro has met the Means Test.

Prudence

Following the recommendation in the long-term supply study, NOTL Hydro contracted IBI Group to prepare budgetary cost estimates for completing the recommended work. The IBI Group prepared cost estimates for three different options which were presented to NOTL Hydro’s Board for approval: 1) upgrading MTS#2 by replacing one old 25 MVA with a 50 MVA transformer and using the old transformer as a backup, 2) upgrading MTS#1 with a new 42 MVA transformer and 3) upgrading MTS#1 with a refurbished 25 MVA unit taken from MTS#2. NOTL reported that it selected option 1 because it was the most cost effective, involved the replacement of aging assets, provided a backup option for any possible failures and provided the additional capacity necessary for one station to be able to fully supply the peak system load.

In refining its estimate of the capital costs of the option selected, NOTL Hydro also issued two tenders to select a vendor for the purchase of the transformer and another vendor for Engineering, Procurement and Construction. In light of the options evaluated by NOTL Hydro and its procurement practises regarding the selection of vendors for the completion of the project, Board staff submits that the costs for NOTL Hydro’s proposed ICM are prudent and represent the most cost-effective option for ratepayers.

¹ EB-2014-0219, Report of the Board, pg. 15, “If the regulated return exceeds 300 basis points above the deemed return on equity embedded in the distributor’s rates, the funding for any incremental capital project will not be allowed.”

Board staff notes that a distributor is required to account for any differences between forecast and actual capital spending for an ICM in its next cost of service application, as per Chapter 3 of the *Filing Requirements for Electricity Distribution Rate Applications*.

Deemed Distribution Asset

NOTL Hydro requested that the Board deem the upgraded transformer in MTS#2 to be a distribution asset. Board staff notes that the assets at MTS#2 have been deemed distribution assets in prior applications before the Board and takes no issue with NOTL Hydro's request.

All of which is respectfully submitted