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March 27, 2015

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)
Final Submissions: EB-2014-0096 Niagara Peninsula Energy Inc.
2015 Electricity Distribution Rate Application**

Please find enclosed the submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above noted proceeding.

Yours truly,

Michael Janigan
Counsel for VECC

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ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B, as amended;

AND IN THE MATTER OF an Application by Niagara Peninsula Energy Inc. pursuant to section 78 of the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for electricity distribution to be effective May 1, 2015.

FINAL SUBMISSIONS

ON BEHALF OF THE

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

March 27, 2015

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Vulnerable Energy Consumers Coalition (VECC)
Final Argument
Niagara Peninsula Energy Inc. 2015 Rates

1. WORKING CAPITAL ALLOWANCE

1.1 NPEI Position

The Parties were not able to reach a complete settlement on the appropriate percentage of controllable operating and maintenance expenses that should be used for the purpose of calculating the notional amount of working capital to be included in rates. NPEI proposes to use 13%. Apart from reliance on the filing guidelines below, it provided no evidence in support of that figure. As we will note later, there was, however, evidence that the 13% was too generous an allotment for working capital.

In 2012 the Board adjusted section 2.5.1.4 of the Filing Requirements for Transmission and wrote distributors stating:

The Board has reviewed the approaches to the calculation of WCA and will not require distributors to file lead/lag studies for 2013 rates, unless they are required to do so as a result of a previous Board decision. However, the Board has reviewed the results of lead/lag studies filed by distributors in cost of service applications and in each of those cases both the applied-for WCA and the final Board-approved WCA have been lower than 15%. The Board has determined that it is not appropriate for a default value for WCA to be set at a higher level than those resulting from lead/lag studies. Based on the results of WCA studies filed with the Board in the past few years, the Board has determined that the default value going forward will be 13% of the sum of cost of power and controllable expenses. This default value will be applicable to 2013 rate applications and beyond. Distributors still have the option of completing and filing a lead/lag study as part of a cost of service rate application for determination by the Board.¹

¹ Board Letter April 12, 2012, "Update to Chapter 2 of the Filing Requirements.."

While no lead/lag studies were presented to confirm or negate the applicability of the default rate to the actual circumstances of NPEI, there was other indicia on the hearing record that supported the view that rate was too high. First, the results of lead/lag studies for other distribution utilities completed post 2011 were referenced that tend to show that the default value of 13% over-compensates monthly billers.² This is hardly an immaterial issue: for each 100 basis point change in the applicable working capital percentage NPEI's revenue requirement is adjusted by \$117,934.

While the derivation of the default Working Capital Value is somewhat obscure, and the underpinning evidence untested in any hearing, what is known is that the default value was based on applying the result of lead-lag studies of other utilities completed a number of years ago, and prior to April 12, 2012 (the date of the Board's letter).

However, if one averages the most recent four Board-approved lead-lag studies, NPEI's working capital allowance multiplier would be 10.2% or 300 basis points below the requested amount. The result would be a savings to ratepayers of approximately of \$354,000.

The disconnect between the Board's default rate of 13% in the absence of a lead/lag study, and the increasing evidence of the applicability of a lower percentage for a monthly billing utility has been raised in other proceedings. The Board has stated that it is not appropriate to impose a working capital allowance percentage on a utility based on lead-lag studies of other utilities. In the recent case of *Fort Frances Power Corporation* (EB-2013-0130) it said: "[T]he Board does not consider it appropriate to adopt the results of a lead-lag study from another utility without a thorough analysis concluding that the two utilities are comparable." VECC notes that in its recent decision with respect to *Hydro One Brampton Networks Inc.* (EB-2014-0083) the Board repeated the statements made in the Fort Frances case.

What is puzzling is that the 13% default value was implemented by using the average of lead-lag studies of other utilities and then letting applicants who do not do their own study adopt that figure. Once adopted, the use of comparative WCA

² Exhibit K1.3, p.17

percentages derived from other utility lead/lag studies was then seemingly deemed not relevant or potentially misleading.

In this case however, there is evidence beyond the applicability of recent lead/lag studies of other utilities that must erode any confidence in the fairness of the application of the default value of 13%

1.2 NPEI's actual working capital requirements

In 2010, NPEI moved all of its customers to monthly billing. Monthly billing has a clear and unequivocal impact on working capital needs by reducing service lag to 15.21 days from the 30 plus days. In fact, NPEI itself has acknowledged that there are working capital savings when moving to monthly billing. An internal memo states:

The benefits of monthly billing are numerous. First, cash flow increases for both the collection of electric and water usage by 30 days. This increase in cash flow represents approximately \$55,000 of interest on cash held in our bank account at approximately 2% annually. A savings of approximately \$5,000 annually in reminder notices not having to be printed and mailed. A reduction in doubtful accounts of approximately \$4,800 as well as reduced collection costs annually.³

Working capital is defined as the difference between a firm's current assets and its current liabilities. In more general terms, it is a supply of funds to meet current expenses such as payroll, prudently held inventories, debt management or short term financing and to meet the cost of emergencies. In rate regulation, the purpose of a working capital allowance is to compensate investors for use of funds which they must provide for these day-to-day operations. Ratepayers cannot be obligated to pay a return on an amount that is any more than is necessary to meet the essential short-term requirements of the Utility.

In this case NPEI is seeking to earn a return on approximately \$20.8 million in notional working capital. In response to the question as to what NPEI's actual

³ Exhibit No. K1.3 pg. 15

average working capital for 2011-2012 the Utility provided the following:⁴

Average Working Capital					31-Oct	31-Oct
	2010	2011	2012	2013	2014	2013
Current Assets	33,133,662	34,173,966	38,960,135	42,618,606	31,338,188	36,922,634
Current Liabilities	22,714,322	27,023,564	25,086,680	24,965,616	17,810,631	27,199,828
Regulatory Liabilities	7,616,488	3,764,714	2,894,654	4,107,313	4,797,594	(589,916)
Total Current Liabilities	30,330,810	30,788,278	27,981,334	29,072,929	22,608,225	26,609,912
Working Capital	2,802,852	3,385,688	10,978,801	13,545,677	8,729,963	10,312,722
Average Working Capital		3,094,270	7,182,245	12,262,239	9,521,343	

The table shows that NPEI's actual working capital needs are far less than the notional amount being sought for rate recovery. NPEI qualified the table by stating:

“[T]he calculation [below] is a definition of average working capital, however for purposes of revenue requirement calculations the table does not provide sufficient information.”

No explanation was provided as to why the facts as presented should not be taken at face value. In fact, the table is consistent with the response NPEI has made in past rate cases where it estimated the savings in moving to monthly billing as \$3 million.⁵

It is also clear is that NPEI is confident that 13% would sufficiently compensate it to meet its needs. Had it had real concerns about the level of working capital compensation it would have carried out its own lead-lag study. This issue was clearly pursued in Mr. Shepherd's (SEC) cross-examination at the oral hearing which showed that the Utility went through an analysis - perhaps not a working capital calculation - but a robust analysis nonetheless - to understand its actual working capital needs.⁶

This exchange also demonstrates the asymmetrical risk and inherent bias in the

⁴ Interrogatory 78. 2.0-VECC-12

⁵ Vol. 1 pg. 46

⁶ Vol. 1 pgs. 64-68

Board's current policy. Utilities who understand (or suspect) that the default value overcompensates them are less inclined to do their own-lead lag studies.

Conversely, those utilities that believe they are under compensated are more likely to undertake such studies. This means that the Board's methodology of using existing studies is inherently biased toward higher values.

1.3 Submission

In the past the Board has stated that it is not appropriate to impose a working capital allowance percentage on a utility based on lead-lag studies of other utilities.

However this appears to be the method used by Board's to establish the proxy working capital values. None of the Board's decisions to date have addressed the apparent incongruity of finding the methodology acceptable, but only if derived from pre-2013 studies. This is especially puzzling given the clear trend of utilities moving to monthly billing.

In VECC's submission, the record is clear and unequivocal that a working capital proxy of 13% far exceeds the real needs of a monthly billing utility like NPEI. In this case, the evidence of the correctness of that proposition extends beyond the results of lead/lag studies done by other utilities. We believe that the Board's obligations in setting just and reasonable rates extend to setting aside previously derived default values where the facts show that other values are likely more applicable. VECC would accordingly recommend a working capital allowance percentage for NPEI of 10%

2. RATE DESIGN: RESIDENTIAL FIXED-VARIABLE SPLIT

2.1 NPEI Position

In its Application, NPEI proposed that the residential fixed-variable split be set at 65% fixed / 35% variable for purposes of setting 2015 rates⁷. This compared with a split of

⁷ Exhibit 8/Tab 1/Schedule 1, page 3

58.53% fixed and 41.47% variable based on existing rates⁸. However in its response to undertakings⁹ made during the oral hearing, NPEI conducted more detailed analysis which indicated that that “approximately 40% of customers would benefit from the proposed shift to a 65:35fixed-variable split”. Based on these result, NPEI indicated in its response to the same undertaking that “NPEI will be revising its request to maintain the current fixed-variable split for the residential class in order to provide a benefit to the greater number of customers”.

2.2 Submission

VECC agrees with NPEI’s revised position regarding the residential fixed-variable split and supports maintaining the current 58.53% fixed and 41.47% variable split.

Not only do more residential customers see lower bills than under NPEI’s initial proposal, but there are several other reasons why maintaining the current fixed-variable split is the appropriate approach. First, the range of bill impacts experienced by Residential customers will be substantially reduced from 2.5% to 15.0% (a spread of over 12 percentage points) under the initial proposal to 3.9% to 9.0% (a spread of just over five percentage points) based on the current fixed-variable split¹⁰. Second, the maximum total bill impacts are less than 10% when the current fixed-variable split is used, which is not the case under the original 65/35 proposal.

Initially, another reason offered by NPEI for increasing the fixed portion of the Residential rate design was that it was consistent with the direction indicated in the Board’s EB-2012-0410 Draft Report on Rate Design for Electricity Distributors. However, the suggested policy changes in this report are still under review and the final direction that will be taken by the Board is unknown¹¹. In contrast, NPEI’s revised proposal is consistent with current practice and the Board has noted that, when it comes to changes in policy, “the Board’s practice to date has been to apply any changes to policies prospectively” and that existing policy remains in effect until

⁸ Exhibit 8/Tab 1/Schedule 1, page 2

⁹ Exhibit J1.1

¹⁰ Partial Settlement Agreement, page 29

¹¹ Vol. 1, page 52

the completion of the policy review¹². Furthermore, NPEI's revised proposal is consistent with its own past policies and practice¹³.

Overall, VECC submits that the Board should accept NPEI's revised proposal to maintain the current Residential fixed-variable split.

3.0 COSTS

VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC request an award of costs in the amount of 100% of its reasonably incurred fees and disbursements

All of which is respectfully submitted this 27th day of March 2015.

End of Document

¹² EB-2014-0116, Exhibit K8.1, page 43

¹³ Vol. 1, pages 521-52