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BY EMAIL

February 3, 2010

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: Board Staff Submission on Espanola Regional Hydro Distribution Corporation
2010 Electricity Distribution Rates Application
Board File Number EB-2009-0224**

Please see attached Board staff's submission for the above proceeding. Please forward the attached to Espanola Regional Hydro Distribution Corporation and any intervenors in this proceeding.

Espanola Regional Hydro Distribution Corporation's reply to submissions is due February 24, 2010.

Yours truly,

Martin Benum
Advisor, Applications and Regulatory Audit



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

Espanola Regional Hydro Distribution Corporation

EB-2009-0224

February 3, 2010

**Board Staff Submission
Espanola Regional Hydro Distribution Corporation
2010 IRM3 Rate Application
EB-2009-0224**

Introduction

Espanola Regional Hydro Distribution Corporation (“Espanola”) filed an application with the Ontario Energy Board (the “Board”), received on October 20, 2009, under section 78 of the Ontario Energy Board Act, 1998, seeking approval for changes to the distribution rates that Espanola charges for electricity distribution, to be effective May 1, 2010. The application is based on the 2010 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 Espanola.

Board staff makes submissions on the following matters:

- Disposition of Deferral and Variance Accounts as per the Electricity Distributors’ Deferral and Variance Account Review Report (the “EDDVAR Report”);
- Adjustments to the Revenue to Cost Ratios;
- Adjustments to the Retail Transmission Service Rates; and
- Accounting for the implementation of the Harmonized Sales Tax (“HST”).

DISPOSITION OF DEFERRAL AND VARIANCE ACCOUNTS AS PER THE EDDVAR REPORT

General Background

For purposes of 2010 IRM applications, the EDDVAR Report requires a distributor to determine the value of its December 31, 2008 Group 1 Deferral and Variance account balance and determine whether the balance exceeded the preset disposition threshold

of \$0.001 per kWh using the 2008 annual kWh consumption reported to the Board. When the preset disposition threshold is exceeded, a distributor is required to file a proposal for the disposition of Group 1 account balances (including carrying charges) and include the associated rate riders in its 2010 IRM Rate Generator for the disposition of the balances in these accounts. The onus is on the distributor to justify why any account balance in excess of the threshold should not be cleared.

Any distributor exceeding the preset disposition threshold was required to file a Deferral and Variance Account Workform.

Espanola Specific Background

Annual Disposition

Espanola has requested the disposition of its Group 1 account balance over a one-year period. Board staff interrogatory # 6 requested that Espanola complete and submit an updated version 4 of the Deferral Variance Account Workform. Espanola has complied with this request.

Global Adjustment

In response to Board staff interrogatory # 2a, Espanola stated it had reviewed the Regulatory Audit & Accounting Bulletin 200901 and confirmed that it had accounted for its Account 1588 RSVA power and global adjustment sub-account in accordance with this Bulletin. In response to Board staff interrogatory # 2b, Espanola confirmed that it had not made adjustments subsequent to its initial application to comply with the Regulatory Audit & Accounting Bulletin 200901 with respect to account 1588 and the global adjustment sub-account.

In response to Board staff interrogatory # 3a, Espanola agreed that a separate rate rider be prospectively applied to non-RPP customers to dispose of the global adjustment sub-account balance would be appropriate on the basis of cost causality.

In response to Board staff interrogatories # 3b, Espanola stated that it did not currently have the billing capability to have a separate rate rider applicable to non-RPP customers to dispose of the global adjustment sub-account balance. Espanola however indicated that its billing system could be modified to include a separate non-RPP rate rider but further analysis of the alternatives would need to be completed by Espanola.

As of November 1, 2009 the MUSH sector (Municipalities, Universities, Schools and Hospitals) and other designated institutional customers that remained as RPP customers were required to switch to non-RPP customer status as per O. Reg. 95/05 of the Ontario Energy Board Act, 1998. In response to Board staff interrogatories # 5d, Espanola indicated that the rate rider should not apply to RPP customers, and should exclude customers in the MUSH sector who had remained on RPP until November 2009. Espanola further indicated that the issue is generic to the industry and that a stakeholder consultation may be required to fully address this issue. Espanola's billing system would require some modification to exclude customers in the MUSH sector if a separate rate rider were to be applied.

Espanola have requested that the Board review and approve the disposition of the December 31, 2008 balances of other Group 1 Deferral and Variance accounts as defined by the EDDVAR Report. The total balance of the Group 1 accounts, excluding the 1588 global adjustment sub-account is a debit of \$137,166. The balance in the 1588 global adjustment sub-account is a debit of \$36,083. Espanola has included interest, using the Board's prescribed interest rates, on these account balances up to April 30, 2010. Debit balances are amounts recoverable from customers.

Submission

As a matter of principle, Board staff would suggest that the Board may wish to consider establishing a separate rate rider for the disposition of the global adjustment sub-account balance. The rate rider would apply prospectively to non-RPP customers, and would exclude the MUSH sector and other designated customers that were on RPP.

This approach would be more reflective of cost causality since it was that group of customers that were undercharged by the distributor in the first place.

Board staff however notes that Espanola's current billing system could not readily accommodate that change. Board staff suggests that it would be useful to the Board were Espanola to review the Board's EB-2009-0405 Decision dated January 29, 2010 and provide comments in its reply submission as to whether the approach for the disposition of the global adjustment contained in that Decision (i.e. implementation through an adjustment to the Provincial Benefit item on the bill) could be readily implemented by Espanola. The Board may wish to consider, as an alternative, to recover the allocated global adjustment sub-account balance from all customers in each class. This approach would recognize the customer migration that might occur both away from the non-RPP customer group and into the non-RPP customer group.

In addition to the decision on whether a separate rate rider should be established for the disposition of the global adjustment sub-account, the Board must decide on the time period over which the rate riders should apply. As previously noted, customer migration might occur in the low volume group. For this group of customers, there would be a benefit to dispose of the global adjustment sub-account balance over a relatively short period of time in order to reduce inter-generational inequities. Board staff submits that a disposition period no longer than one year would be appropriate. These balances have been accumulating over the last four year period and to delay immediate action is not in the customer's best interest. Board staff recognizes that some volatility in electricity bills may result. That aside, Board staff believes that a one year disposition period would be in the interest of all parties. Board staff hence agrees with Espanola's proposal.

In order to reduce inter-generational inequities, Board staff submits that the disposition period for all Group 1 accounts should not exceed one year. This is also consistent with Espanola's proposal.

The EDDVAR Report includes filing guidelines for the disposition of deferral and variance account balances. With respect to the reliability of account balances, the EDDVAR Report at page 27 states "...The Board believes that ...additional audit certification is not necessary. The Board however will require a distributor to file a reconciliation of the regulatory trial balance that is reported to the Board as part of RRR and the audited financial statements."

Board staff notes that the final proposed balances for disposition may no longer reconcile with previously audited balances nor with Espanola's RRR filings. Board staff has reviewed the balances and notes that the changes do result in material differences. Board staff notes that Espanola stated in response to staff's interrogatory # 6d that Espanola has complied with the Board's accounting policies and procedures. Board staff is mindful of the importance of a timely disposition of deferral and variance account balances and does not believe that the disposition should be delayed. Board staff suggests that the Board consider approving the proposed deferral and variance account balance disposition rate riders on a final basis.

ADJUSTMENTS TO THE REVENUE TO COST RATIOS

Background

The Board's Decision (EB-2007-0901) for Espanola's 2008 cost of service rate application prescribed a phase-in period to adjust revenue to cost ratios. The 2010 Supplemental Filing Module included schedules for Espanola to complete to address this matter. The process adjusts base distribution rates before the application of the price cap adjustment.

Submission

Board staff submits that Espanola has complied with the filing requirements of the 2010 Supplemental Filing Module. Board staff takes no issue with Espanola's revenue to cost ratio adjustments.

ADJUSTMENTS TO THE RETAIL TRANSMISSION SERVICE RATES (RTSR)

General Background

Electricity transmitters in Ontario charge Uniform Transmission Rates (UTR) to their transmission connected customers. These UTRs are charged for network, line connection and transformation connection services. Based on the Decision and Rate Order of the Board in the EB-2008-0272 proceeding, the new UTRs effective July 1, 2009 were as follows:

- Network Service Rate was increased from \$2.57 to \$2.66 per kW per month, a 3.5% increase;
- Line Connection Service Rate remained unchanged at \$0.70 per kW per month; and
- Transformation Connection Service Rate was decreased from \$1.62 to \$1.57 per kW per month, for a combined Line and Transformation Connection Service Rates reduction of 2.2%.

On July 22, 2009 the Board issued an amended "Guideline for *Electricity Distribution Retail Transmission Service Rates*" ("RTSR Guideline"), which provided electricity distributors with instructions on the evidence needed, and the process to be used, to adjust Retail Transmission Service Rates ("RTSRs") to reflect the changes in the UTRs effective July 1, 2009. The Board set as a proxy at that time an increase of 3.5% for the Network Service Rate and reduction of 2.2% for the combined Line and Transformation Connection Service Rates. The Board also noted that there would be further changes to the UTRs in January 2010.

Based on the Decision and Rate Order of the Board in the EB-2008-0272 proceeding, a Rate Order issued January 21, 2010 revised the UTRs effective January 1, 2010 as follows:

- Network Service Rate has increased from \$2.66 to \$2.97 per kW per month, an 11.7% increase over the July 1, 2009 level or 15.6% over the rate in effect prior to July 1, 2009;
- Line Connection Service Rate has increased from \$0.70 to \$0.73 per kW per month; and
- Transformation Connection Service Rate has increased from \$1.57 to \$1.71 per kW per month, for a combined Line and Transformation Connection Service Rates increase of 7.5% over the July 1, 2009 level or 5.2% over the rate in effect prior to July 1, 2009.

Espanola Specific Background

Espanola has applied for an adjustment to its RTSR rates based on the July 22, 2009 RTSR Guideline proxy rate adjustments.

Submission

Board staff notes that very few distributors, including Espanola, included in their 2009 rates the July 1, 2009 level of UTRs since for most of them, distribution rates would have been implemented on May 1, 2009. Therefore, in accordance with the July 22, 2009 RTSR Guideline, Board staff submits that the revisions to the RTSRs ought to reflect the changes from the current level to the January 1, 2010 level, that is an increase of about 15.6% to the RTSR Network Service rate, and an increase of about 5.2% to the RTSR Line and Transformation Connection Service Rate.

Board staff has reviewed the evidence provided by the applicant and submits that the proposal by Espanola may no longer be reasonable, based on the January 1, 2010

level of the UTRs. Board staff submits that the applicant's proposed rates be revised to reflect the January 1, 2010 values.

ACCOUNTING FOR THE IMPLEMENTATION OF THE HARMONIZED SALES TAX

General Background

The Ontario provincial sales tax ("PST") (currently at 8%) and the Federal goods and services tax ("GST") (currently at 5%) will be harmonized effective July 1, 2010, at 13%, pursuant to Ontario Bill 218 which received Royal Assent on December 15, 2009.

The PST is currently an incremental cost applied to the price of goods purchased by an electricity distributor and is included in a distributor's OM&A expenses and capital expenditures. The PST is therefore included in the distributor's revenue requirement and is recovered from ratepayers through the application of distribution rates.

When the PST and GST are harmonized, distributors will pay the HST on purchased goods and service but will now claim an input tax credit for the PST portion. The mechanics of HST as a value added tax means that the distributor will no longer incur that portion of the tax that was formerly applied as PST (i.e. the 8%) on goods purchased. However, the current rates as applied will continue to effect cost recovery as if the PST was still in place. If no action is taken, the distributor will realize a savings in the cost of goods purchased while applying rates which do not reflect those savings.

Espanola Specific Background

In response to Board staff interrogatory # 7a which asked if Espanola agreed that a deferral account should be established to capture the reductions in OM&A and capital expenditures, Espanola stated:

"At this time ERHDC would not agree to capture in a variance account the reduction in OM&A and capital expenditures as a result of PST and GST being

harmonized. The harmonization of sales taxes are said to reduce a utility's OM&A costs and capital expenditures in the long term. However, in the short term, during the IRM period a utility's OM&A costs and capital expenditures are not likely to decrease. Prices may not go down at all. Further, growth/reduction in capital expenditures is not incorporated into rates during the IRM period unless such growth/reduction exceeds the materiality threshold limit set by the OEB.

There are numerous other elements of a utilities cost (other than PST) embedded into distribution rates such as property taxes, employment insurance rates, Canada pension plan rates, etc. and increases/decreases to all components of rates should be considered simultaneously. In addition, there would be an increased exposure to bad debts as accounts receivable increase. Addressing only the commodity tax component of rates during the IRM period amounts to "a single-issue rate adjustment" and on that basis it should be rejected.

Furthermore, establishing a variance account during the IRM period to track reductions in OM&A and capital expenditures imposes an enormous administrative burden on a utility. "

Submission

Board staff notes that many distributors' comments on the administrative burden and costs of sales tax harmonization are at odds with the provincial and Federal governments' pronouncements regarding the stimulative and competitive results of harmonization. Because the costs and savings are not clear at this point, Board staff submits that tracking of these is warranted at this point to quantify, per government pronouncements, that the potential savings for corporations like Espanola could be significant. Accordingly, Board staff submits that the Board may wish to consider establishing a deferral account to record the amounts, after July 1, 2010 and until Espanola's next cost-of-service rebasing application, that were formerly incorporated as

the 8% PST on capital expenditures and expenses incurred, but which will now be eligible for an HST Input Tax Credit (“ITC”). The intention of this account would be to track the incremental change due to the introduction of the HST that incorporates an ITC from the 5% to the 13% level. To qualify for this treatment, the cost of the subject items must be in the category of distribution revenue requirement. Tracking of these amounts would continue in the deferral account until Espanola’s next cost of service application is determined by the Board or until the Board provides guidance on this matter, whichever occurs first.

Espanola would apply to clear the balance in the account as a credit to customers at the next opportunity for a rate change after the account balance information becomes available and is supported by audited financial statements.

All of which is respectfully submitted