



EB-2004-0513

IN THE MATTER OF the Ontario Energy Board Act, 1998,
S.O. 1998, C.15 (Schedule B);

AND IN THE MATTER OF a rehearing of an Application by
West Coast Huron Energy Inc. for an order or orders
approving or fixing just and reasonable rates for the
distribution of electricity .

BEFORE: Paul Sommerville
Presiding Member

Cathy Spoel
Member

DECISION WITH REASONS

April 20, 2006

BACKGROUND

This proceeding is a review of a Board decision (“Decision”) issued on November 16, 2001 respecting an Application for just and reasonable rates made by West Coast Huron Energy Inc. (“WCHE”, “Utility”), bearing Board file number RP-2000-0263/EB-2000-0563/EB-2001-0226.

This review has been commenced by Sifto Canada Inc, (“Sifto”) a customer of WCHE, pursuant to Section 44 of the Board’s Rules of Practice and Procedure.

In its materials, Sifto asserts that the Decision under review was based on faulty evidence, and the use of a flawed methodology. The Decision was the initial unbundled rates decision made under the new rules established in 2000, in anticipation of the opening of the electricity market in May, 2002.

WCHE applied to the Ontario Energy Board to unbundle its distribution rates in December 2000. On February 7, 2001 WCHE published a Notice of Application in local newspapers, notifying customers of the application.

Sifto did not respond to the Notice at that time, and was not directly notified of the application. However, when Sifto became aware of the rate application in late February 2001, Sifto retained a consultant (Mr. Ken Snelson) to examine the application. Sifto applied to the Board for late intervenor status on April 25, 2001 but did not receive approval to become an intervenor in the proceeding.

During the summer of 2001 Sifto raised its concerns with WCHE and Mr. Snelson met with Mr. Peter Ioannou of RCS Consultants, who had assisted WCHE in the preparation of its unbundling rate application. An initial meeting in August 2001 was followed by a number of subsequent meetings.

Sifto’s initial concerns centered on revenue neutrality and particularly on what it considered the improper omission of \$132,413 in Large User class revenue from the Utility’s unbundling application. This revenue was attributable to Sifto’s involvement in a special rates program, known as the Real Time Pricing Rates Program or RTP II. WCHE representatives acknowledged to Mr. Snelson that the omission of this amount was inappropriate. In addition, Sifto had concerns respecting the omission of a credit known as the diversity credit, which also would have reduced the revenue requirement

allocated to the Large User Class, of which Sifto was the sole member. WCHE also acknowledged that this omission was inappropriate.

After a number of amendments to the application unrelated to the concerns of Sifto, the WCHE application was approved by the Board. This Order set rates retroactively to March 1, 2001. As a result of this Order, Sifto received an additional invoice of about \$250,000 representing amounts owed over actual bills issued from March 1, 2001 to November 2001. This retroactive billing represented an increase of almost 10% in the rates charged to Sifto.

On November 21, 2001 Sifto requested a rehearing of the Board's decision by letter and on November 26, 2001, filed a Notice of Motion requesting a rehearing. Sifto and WCHE engaged in discussions throughout 2002 to settle the outstanding issues regarding the approved rates, however, no resolution was achieved.

At that time, further scrutiny of the application revealed a number of other discrepancies in addition to the RTPII issue, regarding the power factor, the coincidence factors for the Large User class and the RTPII administration fee. Submissions on these issues were filed with the Board in 2002 by both parties. Both parties were in general agreement on the power factor and diversity credit issues but not on the remaining issues.

As a result of legislative changes in 2002 (Bill 210, the Electricity Pricing, Conservation and Supply Act, 2002), written approval of the Minister of Energy was required before a rehearing could occur before the Board. Sifto wrote to the Minister of Energy seeking such approval on December 13, 2002. Sifto's request was denied in a letter dated May 9, 2003, but not received until July 10, 2003.

Sifto responded to the Minister of Energy on October 24, 2003, again requesting a rehearing. Sifto did not receive a response and sent another letter to the Minister on November 2, 2004. On November 4, 2004 the Minister of Energy directed the Board to review the approved WCHE electricity distribution rates.

On December 15, 2004 the Board issued its Notice of Hearing for the review under Board file number EB-2004-0513. No interventions were received. The parties sought and were granted considerable time to arrive at a settlement of the outstanding issues.

A formal settlement conference was held at the Board's offices on November 4, 2005. Settlement between the parties was not achieved. At the request of the parties, the oral hearing was delayed for a period of time but subsequently took place on March 1, 2 and 29, 2006.

BOARD FINDINGS

As indicated above, this dispute has its origins at the very beginning of the electricity rate unbundling process mandated by the provincial government in the Electricity Competition Act of 1998. Pursuant to that legislation, municipal utilities were transformed into for-profit entities, and they were directed to develop rates for their customer classes which unbundled the cost of power, transmission, and distribution elements of rates according to rules established by legislation and the Ontario Energy Board.

The unbundling exercise was based on the Distribution Rate Handbook ("Handbook") which was issued by the Board on November 1, 2000. The Handbook and the related Rate Unbundling and Design Model ("RUD Model") provided a simplified procedure for unbundling existing rates. The objective of the unbundling exercise was to segregate the cost of the electricity commodity from the costs associated with its distribution. The procedure was based on the simple equation:

$$\text{Class Distribution Revenue Requirement} = \text{Total Class Revenue} - \text{Allocated Cost of Power.}$$

An important feature of the model was that the resulting rates were intended to be revenue neutral at the class level, that is, class revenues before the unbundling were to be equal to class revenues after unbundling. Utilities were directed to calculate class revenue at existing rates and power bills.

The pivotal question in this case is whether WCHE adopted the proper methodology in establishing the unbundled rates for the Large User Class, of which Sifto was, and is, the only member, as part of the unbundling process in 2001.

WCHE asserts that the Handbook strictly required the application of 1999 data to the unbundling process, without update. According to their argument, they were obliged by the Handbook and by license condition to regard 1999 as in the nature of an historical test year for the purposes of establishing the appropriate allocation of revenue

requirement to the specific rate classes. WCHE argues that changes in the status of a customer, which occurred after 1999, should not have been and ought not now to be taken into account in establishing the rate for Sifto, its sole customer in the Large User Class.

On the other hand, Sifto argues that WCHE ought to have ensured that the Board, when considering the unbundling application, had the best available evidence respecting the profile of the sole customer in the Large User Class.

The change in the status of Sifto, which occurred after 1999 and before the Board's decision in 2001, relates to Sifto's participation in a rate program commonly referred to as Real Time Pricing Rates II or RTP II. This rate program, an Ontario Hydro initiative which began in 1996, was designed to provide a market for power surplus to provincial system needs. Put simply, the RTP II program offered Large Users attractive prices for power incremental to their normal base load. The program represented an opportunity for Ontario Hydro to spur sales of surplus power to large users across the province.

Sifto participated in RTP II starting in 1997. However, in late 2000, Sifto decided to abandon any participation in the real-time pricing program, formally withdrawing in January 2001. This withdrawal from the RTP II program took place after WCHE had filed its unbundled rates application, but before the actual notice of the application was published.

Sifto's evidence was that it realized immediately upon becoming aware of the terms of the unbundled rates application that the application could have serious and negative implications for Sifto's energy costs. For whatever reason, Sifto failed to file a timely intervention in the unbundled rates application. When it realized that it had not filed an intervention it applied to the Board for leave to file a late intervention. The Board did not grant intervenor status to Sifto.

Nonetheless, Sifto immediately began discussions with WCHE focused on its concerns with the terms of the unbundled application. In the course of those discussions it became clear to both WCHE and Sifto that the unbundling application contained at least a couple of serious evidentiary errors. Specifically, it was clear to both WCHE and Sifto that the treatment of RTP II revenues of \$132,413 and the diversity credit adjustment had been improperly omitted from the unbundling application. These errors were not trivial.

The full implication of WCHE's approach became clear to Sifto when it received a supplementary account from WCHE following the approval of its unbundled rate application in November 2001. The supplementary account reflected the retroactive rate increase applicable to Sifto for the 8 months preceding the Board's decision; an additional \$250,000, an overall bill increase of about 10%.

In further meetings between the representatives of the two parties in 2002, it became apparent that a correction for the Power Factor penalty was also required. By this time WCHE had retained the services of Mr. Bruce Bacon.

The issues to be determined in this review are:

- What corrections should be made to account for the errors made in the unbundling application respecting the Power Factor penalty and the Diversity Credit adjustment?
- Was the approach used by WCHE in establishing the revenue requirement allocated to the Large User Class appropriate? Should it have used evidence reflecting the fact that the single large user customer in its service area had ceased to be an RTP II customer? If the approach used by WCHE was not appropriate, what correction should be made?

POWER FACTOR PENALTY AND DIVERSITY CREDIT ADJUSTMENTS

One of the ways in which the WCHE application was flawed concerned the double counting of Power Factor penalties. Similarly, WCHE also inappropriately applied the Diversity Credit, resulting in higher costs to Sifto.

The parties have agreed that the Power Factor Penalty correction amount is \$277,483, and that the Diversity Credit adjustment should be \$163,284, both of which were inappropriately applied by the Utility. These payments enured directly to the benefit of WCHE's shareholder, and did not affect the rates paid by other customers in WCHE's service area.

Accordingly, the Board directs WCHE to pay to Sifto the sum of \$440,767 plus 7% GST and 5% interest from March 1, 2001 onward, forthwith. The Utility may not seek to recover any portion of this payment from its ratepayers.

THE APPLICATION OF THE RUD MODEL

Revenue Neutrality by Class

The RUD model presented a standardized methodology for the development of rates at the time of unbundling. For ease of application, and in order to capture actual data, it posited that 1999 should serve as a baseline year for the establishment of unbundled rates. The RUD Model was endorsed in the Distribution Rate Handbook.

The RUD “formula” basically consisted of the subtraction of Allocated Power Costs from the Total Class Revenue to find the Class Distribution Revenue Requirement. The Class Distribution Revenue Requirement represents the amount of revenue that must be generated by the Class through the Distribution Rate. As noted earlier, Sifto was the sole occupier of the Large User rate class. One of the key unbundling objectives of the RUD Model and the Handbook was to achieve revenue neutrality by class. While the effects of the resulting unbundled rates on specific customers may vary, the Class itself was intended to be held revenue neutral throughout the unbundling process. The Consultants for both sides in this case agreed on that principle. The Handbook itself at Section 3.2 indicates that rate class revenue neutrality was an objective of its unbundling methodology. That means that Sifto, as the sole customer in the Large User Class, should not have experienced fluctuation in its rate following unbundling. In fact, the evidence shows that WCHE’s unbundling approach resulted in an almost 10% increase in electricity bills for Sifto.

The Handbook also contemplated that where a utility had better information about customers and rate classes, it could and should use such information in formulating its application:

Ideally, cost allocation studies would be available to guide the unbundling process. Unfortunately, the studies that are available are old. Hence, a simplified procedure is described here for unbundling existing rates. Should a utility have better information on which to unbundle rates, they are encouraged to use such information, as long as justification can be provided in support of initial rates. (Section 3.2 of the Handbook).

The Board does not agree with Mr. Bacon’s assertion that this provision was intended to be limited to using the best information respecting cost allocation and not to other aspects of the unbundling process. A simple reading of this text does not lead to that conclusion.

It is important to note that neither the RUD Model, nor the Handbook, addressed the existence of the RTP II rate program at all. The focus of the RUD Model and the Handbook was to provide guidance to utilities in unbundling rates, and preserving rate class revenue neutrality in the process.

The use of 1999 data was intended to allow utilities to have reasonable recourse to actual data. It cannot be assumed that where a material change had occurred in the profile of a class/customer, such as occurred with Sifto early in 2001, that such a change should be ignored in developing the unbundled rates. A rate that is based on a fundamental mis-characterization of the status of a customer that represents the sole member of the Large User Class and consumes 40% of the power distributed by the Utility cannot be considered to be just and reasonable.

In the Board's view, where a utility had better actual information about a rate class, it should have been used in the 2001 unbundling process. From early in 2001 WCHE knew that Sifto was no longer engaged in the RTP II program. Its rate application should have reflected that set of circumstances, not what had become an inaccurate representation of the class. Use of the inaccurate data resulted in a class revenue requirement that was overstated and not revenue neutral, to the direct prejudice of Sifto.

As noted above, it became clear to both parties that the application for unbundling contained material errors related to the application of the RTP II revenues and the diversity credit adjustment to Sifto. While WCHE chose to revise its application on a couple of occasions in mid 2001, it chose not to revise it with respect to these material and patent errors. Sometime later WCHE developed a rationale for this failure, which consisted essentially of the view that if it were to alter some portions of the application, it would need to revisit the application as a whole in order to apply a whole range of adjustments which it wanted to set off against any reduction in Sifto's rate. This does not explain its failure to highlight these material inaccuracies in the period leading up to the Board's November 2001 decision. These corrections should have been made by WCHE prior to the Board's decision. If additional adjustments were indeed warranted, as suggested by WCHE, the Board could have addressed them in its initial rates Order.

It is clear from the record that the use of RTP II data to form the basis of a RUD Model/ Handbook unbundling application was problematic. Under the best circumstances, this approach required a nimble and thoughtful translation. The key point in this case is that Sifto had ceased to be an RTP II customer. In those circumstances, the most

appropriate approach to unbundling was to consider them as such, and to apply the best available data to the unbundling exercise.

Coincidence Factors

The selection of the appropriate coincidence factor is an important element in the determination of the appropriate rate for a given rate class. The coincidence factor reflects the degree to which the peak usage of the customer or class corresponds to the peak usage of the local distribution system as a whole.

The level of the coincidence factor used by WCHE is an issue. At the time of the RUD unbundling WCHE applied coincidence factors which it now disavows (0.981 winter and 0.991 summer). WCHE's position at the time of this hearing is that the appropriate coincidence factors are those purportedly applied to RTP II customers in 1999, which are comparatively very low (0.721 winter and 0.711 summer).

Sifto urges the Board to apply the coincidence factors developed by the former Ontario Hydro in 1996 for the establishment of the Large User rates for the Goderich PUC, now WCHE (0.969 winter and 0.932 summer). The Ontario Hydro coincidence factors are slightly lower than those used by WCHE in their 2001 RUD model, but now disavowed by them, and much higher than those purportedly applied to RTP II customers.

WCHE, through its expert, Mr. Bacon, attempted to establish that the much lower RTP II coincidence factors were the most appropriate. This evidence was based on Mr. Bacon's discussions with his associate in his consulting firm, Mr. Bill Harper, a former employee of Ontario Hydro. It was suggested that Mr. Harper had special knowledge or expertise in these matters. Sifto objected to this evidence on the grounds that it was hearsay evidence, which under all the circumstances should not be considered.

It is well established that an administrative tribunal can and should consider hearsay evidence if it is relevant to matters in issue. The difficulty here is that the hearsay evidence relied upon by WCHE is not nearly definitive on the subject. At best, it suggests that the lower coincidence rates were possibly used, but no rationale for the use was presented, nor did the evidence represent a clear declaration that the lower rates were in fact used in each case of an RTP II customer. If Mr. Harper could have provided that clarity, the Board assumes that he would have been called as a witness, or at least that he would have provided more definitive material to Mr. Bacon to establish the proposition WCHE was advancing. That did not happen.

The coincidence factors arising from Ontario Hydro were intended to be applied to Large User customers across the province. They represented a workable default figure in the absence of customer-specific data. In this case, it appears that the utility has not chosen to develop coincidence factors specific to Sifto. The Utility has now disavowed the coincidence factor figures it used in its unbundling application. At the relevant time, which in the Board's view is 2001, Sifto was a customer to which the Ontario Hydro coincidence factors would normally apply.

Accordingly, the Board finds that the most appropriate coincidence factors to use in developing the revenue requirement attributable to Sifto were the Large User factors developed by Ontario Hydro, namely, 0.969 winter, and 0.932 summer.

The Administration Fee Claim

WCHE seeks to have an administration fee set off against the sums outstanding to the credit of Sifto related to the Power Factor Penalty adjustment and the diversity credit adjustment. WCHE asserts that this fee, equivalent to \$2,000 per month from 1996 to 2001, was a common feature in RTP II arrangements, and Sifto, in its view, should now be obliged to pay it.

There is simply no basis upon which the Board can impose the administration fee as suggested by WCHE. The evidence shows that while WCHE sought to sign Sifto up to a "standard" RTP II contract, it never did so. Further, the proffered and never executed contracts did not contain unequivocal terms respecting the payment of the administration fee. Nor did WCHE conduct itself as if it had an enforceable right to the fee. The fee was never billed to Sifto until the broader dispute respecting the unbundled rate crystallized, and was not billed at all until well after Sifto had ceased to be an RTP II participant. There simply is no rationale upon which to impose any such amounts to any portion or period. Considerable effort was made to suggest that the fact that Sifto was on the RTP II program creates an equitable entitlement on the part of WCHE to the administration fee.

The fact that there is no contract requiring the payment is fatal to this claim, as is the fact WCHE did not act as if the money was genuinely owed until after the customer was no longer engaged in the RTP II program.

The Board will not allow this claim by WCHE and accordingly, will not accept the adjustment to the RUD model to reflect this fee in total class revenue for unbundling purposes.

The Current Board Sponsored Cost Allocation Consultation

It has been suggested by WCHE that this review of the November 2001 Order is unnecessary in light of the ongoing cost allocation consultation being undertaken at the Board. This argument overlooks the fact that the customer has been systematically prejudiced since the original Rate Order was made and implemented. It may be that new cost allocation information will radically alter the rates and circumstances of Sifto going forward. But that cannot justify ignoring the fact that according to the rules properly governing its rate treatment over the last number of years it has overpaid, a situation that cannot be corrected by the cost allocation exercise. This would result in Sifto being treated in a fundamentally different way than the rest of the WCHE customers.

CONCLUSION

Sifto has been specifically and quantifiably prejudiced by its rate treatment since the time of unbundling, and the Board must determine what steps ought to be taken to address this circumstance. There are really two options that present themselves. First, the Board could order that the utility re-imburse Sifto for the overpayment from its own resources, and without recourse to the other ratepayers. This approach would punish the Utility for its various errors in its 2001 rate unbundling application.

In the Board's view, this is not an appropriate response. While we have found that WCHE made errors in developing the unbundled rate, there is no evidence upon which the Board could make a finding that its process was intended to create an inaccurate and prejudicial rate. There was no specific guidance in either the RUD Model or the Handbook to assist WCHE.

This leads the Board to conclude that the reimbursement of the overpayment made by Sifto since unbundling should be redressed by the other rate classes, who benefited from the over-allocation of revenue requirement to the sole Large User in the franchise area, namely Sifto. The rates paid by the other rate classes were inappropriately, if inadvertently, lower as a result of Sifto's overpayment than they should have been. If properly informed in November 2001, the Board would have approved a rate package

that was somewhat lower for Sifto, and correspondingly higher for other rate classes. Correction of the error means that the difference accumulated since unbundling must be assessed against those who benefited from the error.

The Board abhors retroactive ratemaking.

But the correction of error of this nature is not retroactive ratemaking. In this case, WCHE misapplied the unbundling methodology. There is no element in Sifto's claim that the methodology itself was inappropriate, or should not have been applied. Sifto seeks nothing more than an orthodox implementation of the ratemaking methodology approved by the Board for unbundling, and adopted by the WCHE. It is WCHE's flawed implementation of the methodology that has resulted in the need to make an adjustment to the rates payable by Sifto.

It is important to appreciate that this proceeding is a review of a Board decision pursuant to Section 44 of our Rules of Practice and Procedure. By its nature, the Board's inquiry is into the correctness of the original decision, and the remedy, if one is warranted, is unavoidably a revision of that original decision. A review by its nature is retrospective in its process, and likely retroactive in its effect. But that is not retroactive ratemaking. A very different result might well obtain if the matter had come to the Board as a rates application, or under some other process, or if Sifto had been any less diligent in pursuing this review.

For these reasons the Board finds that, in addition to the amounts attributable to the Power Factor Penalty adjustment and the Diversity Credit, which is referenced above, and which is payable solely by WCHE's shareholder, and reflecting the finding that the Ontario Hydro coincidence factors are to be used, a further sum of \$ 537,922 plus 7% GST and 5% interest is payable to Sifto. This amount is to be allocated to the overall revenue requirement of WCHE, and payable by all ratepayers of WCHE, including Sifto. This amount will be applied to WCHE's 2006 EDR rate application, and will be subject to whatever bill impact mitigation measures the Board may determine to be appropriate in that case. This additional sum reflects the overpayment by Sifto of its share of WCHE's overall revenue requirement. In effect, other classes of ratepayers have benefited by this over-allocation of revenue requirement to the Large User Class since the Board's Order of November 2001. This Decision merely corrects that overpayment.

In addition, the 2006 EDR application must be adjusted to correct for the allocation of costs to the Large User class going forward from May 1, 2006. Sifto has substantiated

a distribution revenue adjustment in the reference year of \$142,476 to correct the historical overpayment by Sifto in that class. This will prevent any further over-allocation to the Large User customer class, but will necessitate an increase for the other customer classes, allocated on the basis of the proportion of existing distribution revenue among the remaining classes. The Board expects WCHE to submit this adjustment to its 2006 EDR application as soon as practical in order to facilitate the appropriate rate changes effective May 1, 2006.

Sifto has provided an estimate of the costs owing in its closing submissions in this case. The total owed, \$978,690 with GST and 5% Interest, comes to \$1,093,132.

Of this total, and using the same GST and interest factors, the Board orders WCHE to pay to Sifto \$492,308 for the Power Factor Penalty adjustment and Diversity Credit amounts.

The remaining amount, \$600,824 is to be refunded by WCHE to Sifto. The payment of this amount will take place not later than two years from the date of this decision, with the details of payment timing to be negotiated between the two parties. This is also the amount, adjusted for GST that is to be collected from all WCHE ratepayers as a Regulatory Asset beginning on May 1, 2006. As mentioned earlier, this recovery will be subject to whatever measures are required to mitigate an undue bill impact on WCHE customers.

WCHE suggested that the Board ought not to grant Sifto's application on the grounds that Sifto did not take all possible steps to have the matter resolved earlier. WCHE also argued that it was Sifto's obligation to bring the errors identified in 2001 to the Board's attention and that Sifto's failure to do so should be fatal. The Board does not agree. Applicants have an obligation to advise the Board of material changes affecting their applications, whether there are intervenors or not. WCHE cannot rely on Sifto's failure to be granted intervenor status to absolve itself of its own obligations to the Board.

The Board is of the view that Sifto pursued its remedy assiduously. It made an application for late intervention once it became aware of WCHE's application and pursued its cause with WCHE through 2001, and thereafter took reasonable and repeated steps to seek Board review. These efforts were thwarted by a turbulent legislative and policy environment, which made an earlier review impossible to achieve. It cannot be said that Sifto failed to prosecute its claim diligently.

Sifto is awarded its costs of this motion, in accordance with the Board's tariffs. It shall file its claim for costs within 10 days of this decision.

Dated at Toronto, April 20, 2006

Original Signed by

Paul Sommerville
Presiding Member

Oiriginal Signed by

Cathy Spoel
Member