



RP-2005-0014
EB-2005-0099 to 0185

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

AND IN THE MATTER OF an Application by **Hydro
One Networks Inc** for an order or orders approving
or fixing just and reasonable rates.

BEFORE: Gordon Kaiser
Vice Chair and Presiding Member

Paul Vlahos
Member

Pamela Nowina
Member

DECISION

Background and Application

In November 2003 the Ontario Government announced that it would permit local distribution companies to apply to the Board for the next installment of their allowable return on equity beginning March 1, 2005. The Government also indicated that the Board's approval would be conditional on a financial commitment to reinvest in conservation and demand management initiatives, an amount equal to one year's incremental returns.

Also in November 2003, the Government announced, in conjunction with the introduction of Bill 4, the *Ontario Energy Board Amendment Act, (Electricity Pricing), 2003*, that electricity distributors could start recovering Regulatory Assets in their rates, beginning March 1, 2004, over a four year period.

In February and March, 2004, the Board approved the applications of distributors to recover 25% of their December 31, 2002 Regulatory Asset balances (or additional amounts for rate stability) in their distribution rates on an interim basis effective March 1, 2004 and implemented on April 1, 2004.

On December 20, 2004 the Board issued filing guidelines to all electricity distribution utilities for the April 1, 2005 distribution rate adjustments. The guidelines allowed the applicants to recover three types of costs. These costs concern (i) the rate recovery of the third tranche of the allowable return on equity (Market Adjusted Revenue Requirement or "MARR"), (ii) the 2005 proxy allowance for payments in lieu of taxes ("PILs") and (iii) a second installment of the recovery of Regulatory Assets.

A generic Notice of the proceedings was published on January 25, 2005 in major newspapers in the province, which provided a 14 day period for submissions from interested parties. On February 4, 2005, the Board issued Procedural Order No. 1, providing for an extension for submissions until February 16, 2005 and also providing for reply submissions from applicants and other parties.

On February 18, 2005, the Board issued its decision approving Hydro One's Conservation and Demand Management Plans (RP-2004-0203).

On March 14, 2005, the Board issued its rate order regarding Hydro One's application for final recovery of Regulatory Assets (RP-2004-0017, RP-2004-0018, EB-2004-0371).

The Applicant filed an application for adjustments to the rates for each of their Acquired local distribution companies ("LDCs") for the total amounts as follows:

MARR: \$ 8,746,000

2005 PILs Proxy: \$ 2,823,000

Regulatory Assets Second Tranche: \$ 10,022,000

The MARR amount requested by Hydro One is comprised of 2 tranches rather than the one tranche which is the normal circumstance in other applications. Over the period 2000-2002 Hydro One had acquired the 87 LDCs and had sought and received Board approval for the first phase of a three-phased adjustment to achieve market adjusted revenue requirements. In this first phase, cost of power was unbundled from Distribution costs and the fixed and variable distribution rates were adjusted to capture the incremental MARR. In 2002, Hydro One had applied for rates reflecting the 2nd phase of MARR and a 1.1% PBR related decrease; however the application was terminated by the passage of Bill 210. As a result, the current base rates for the Acquireds reflect only the first phase of MARR and PILs.

Submissions

The Board received one submission which addressed the 2005 rate setting process in general. This submission was made by School Energy Coalition ("SEC"). SEC objected to the guideline which caused the recovery of the 2005 PILs proxy to be reflected only on the variable charge. SEC was also concerned

that monthly service charges and overall distribution charges varied significantly between utilities across the province. SEC also raised concerns regarding the consistency of, and access to, information on the applications as filed by the utilities.

Reply submissions to SEC's general submissions were received from the Coalition of Large Distributors, the Electricity Distributors Association, Hydro One Networks, and the LDC Coalition (a group of 7 distributors). These parties generally argued against the recommendations put forward by SEC, by and large indicating that the Board's existing processes for 2006 and 2007 have been planned to address these issues going forward and that these issues should not be added to the 2005 rates adjustment process.

SEC in its submission also identified specific concerns regarding the rates proposed by Hydro One for its Acquired LDCs. These included the concerns that the proposed rates for the Acquired LDCs should be recalculated on the basis of one, and not two, tranches of MARR, with the PBR increment removed and PILs recalculated, that an earnings sharing mechanism be introduced and that the request for the final third of MARR be considered in the 2006 rates application.

The Board also received a reply submission on these concerns from Hydro One. Hydro One responded that its application before the Board is based on previous Board decisions and involves mechanical adjustments. In particular, Hydro One noted that (i) contrary to SEC's assertion, the proposed rates reflect a PBR reduction as opposed to an increase (ii) contrary to SEC's assertion, the Regulatory Asset balance to be recovered by the rate riders is net of recoveries (iii) the application identifies MARR 2/3 amounting to \$10.7 million and not \$15 million as claimed by SEC and (iv) introducing an after-the-fact review of earned

ROE is totally inappropriate given the regulatory construct the Board is developing through the 2006 proceeding.

Board Findings

The Board first addresses the general submission of SEC. While SEC raises important issues regarding electricity distribution rates, the Board has put in place a process which will address most of the issues raised by SEC on a comprehensive basis with coordinated cost of service, cost allocation and cost capital studies for all distributors in 2006, 2007 and 2008. The Board is of the view that there are compelling reasons to diverge from the Board's original filing guidelines for the 2005 distribution rate adjustment process.

The Board notes the specific concerns raised by SEC on some of the features of Hydro One's application for the Acquired LDCs, and Hydro One's response to these concerns. The Board does not agree with SEC's proposals. In some cases, SEC's proposals are based on incorrect facts and assumptions, and in general are not helpful to the matter at hand. Also certain other raised matters, such as harmonization and cost allocation, are more relevant to the 2006 and 2007 Electricity Distribution Rates proceedings.

The Board finds that the historical context of ratemaking for Hydro One's Acquired LDCs supports Hydro One's rate proposals. The objective in the 2005 rates adjustment process is to institute new rates through a mechanical process, leaving other more generic issues to future processes. The Board finds that Hydro One's rate proposals for the Acquired LDCs are largely consistent with this objective.

However, the Board is concerned with the rate impacts for some of the customers served by the Acquired LDCs resulting from Hydro One's application. Without mitigation, some of the residential, general service and large customers will see a double digit percentage increase on the total bill as a result of the proposed adjustments. In view of the commodity price increase that is scheduled to take effect on April 1, 2005, the Board is not prepared to approve a rate increase resulting in more than a 10 percent increase to a typical customer's bill that would stem from Hydro One's distribution rate adjustments. Accordingly, the Board is not prepared to grant the full requested recovery in 2005 rates.

Although the rate increase may be larger than expected, the Board recognizes that the customers served by Hydro One's Acquired LDC's have generally been paying lower rates. One reason is that they have not been paying the second tranche of MARR as is the case with other Hydro One customers and customers served by other electricity distributors.

The Board directs Hydro One to adjust its proposals to reflect an increase of no more than 10 percent, on an annualized basis, for a typical residential and general service customer of Hydro One's Acquired LDCs consuming 1,000 kWhs per month. The same 10 percent threshold shall apply to individual large customers served by these distributors.

The Board's direction will result in less revenue for Hydro One in 2005 than otherwise would be the case. The Board will allow for the recovery of this deferred revenue in future years. The deferred revenue resulting from this rate mitigation shall be reflected in the Regulatory Assets account # 1508, Other Regulatory Assets.

In implementing this Board decision, Hydro One shall file draft rate schedules for each of the acquired LDCs, bill impact data schedules for each customer class and the amount of deferred revenue arising from the Board's decision.

DATED at Toronto, March 15, 2005

Original signed by

On behalf of the Panel

Gordon Kaiser
Vice Chair and Presiding Member