Ontario Energy Board

Commission de l'Énergie de l'Ontario

Ontario

RP-2005-0020
EB-2005-0381

IN THE MATTER OF AN APPLICATION BY

HYDRO OTTAWA LIMITED

FOR ELECTRICITY DISTRIBUTION RATES 2006

DECISION WITH REASONS

April 12, 2006

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

AND IN THE MATTER OF an Application by Hydro Ottawa Limited for an Order or Orders approving or fixing just and reasonable rates for distribution service.

BEFORE: Gordon Kaiser
Vice Chair, Presiding Member

Ken Quesnelle
Member

Cathy Spoel
Member

DECISION WITH REASONS

April 12, 2006

1. INTRODUCTION

1.1 THE APPLICATION

1.1.1 Hydro Ottawa Ltd. filed an Application on August 2, 2005 with the Ontario Energy Board under section 78 of the *Ontario Energy Board Act, 1998*, c. 15 (Schedule B) as amended for Order or Orders approving or fixing just and reasonable rates for electricity to be implemented on May 1, 2006.

1.1.2 On November 18, 2005, the Board held an issues day and subsequently issued an issues list on September 1, 2005.

1.1.3 On December 1, 2005, the Board also directed the Applicant to hold a settlement conference. The Board further directed that any settlement proposal to be presented on January 23, 2006, at which time the Applicant would be expected to have witnesses available to speak on the settlement issues.

1.2 THE SETTLEMENT CONFERENCE

1.2.1 The Settlement Conferences were held on December 6 through to December 8, 2005. On January 16, 2006, Hydro Ottawa filed a settlement proposal and indicated that there was complete settlement of all topics with the exception of issues 5.2 and 8.2.

1.2.2 On January 23, 2006, the Applicant appeared before the Board to address the settlement proposal and produced four witnesses to answer questions with respect to that proposal. The witnesses were Lynn Anderson, Director of Regulatory Services, William Bennett, Director of Distribution Planning, Michael Grue, Treasurer, and Roger Marsh, Director of Customer Care.

1.2.3 On February 3, 2006, the Board issued a written Decision on this Settlement Proposal in which it rejected certain aspects of that Proposal.

1.2.4 The first concern was the proposed reduction of capital expenditures of $19.5 million. $5.5 million of that expenditure did not come into service in 2005 and the impact on rate bases from the Settlement Proposal was therefore, a reduction of $14 million. This proposed reduction in capital expenditure had an impact on amortization expenditures which in turn increased the taxes to be paid by the utility $800,077. As part of the settlement process, the Applicant and intervenors agreed that only $400,077 of that amount will be charged as a regulatory expense.

1.2.5 In its Decision, the Board stated;

> "the fact remains that the $800,077 will have to be paid in taxes. Therefore, the result of the Settlement Proposal is to reduce capital expenditures and increase tax payments. The Board is concerned with the reduction in capital expenditures. The utility, in its evidence, expressed concern with respect to an aging plant. The cost of reducing these capital expenditures is an increased expense of almost $1 million in taxes. The utility's explanation for reduction in capital expenditures is that it is simply deferred while the utility develop a long term plan. The Board believes that it is not wise to defer of all these capital expenditures. It is not clear to the Board that delaying the project is in the best interest of the ratepayers or the public in general."

1.2.6 Two aspects of the capital expenditures were of particular concern to the Board. The Board thought it was wise for the utility to proceed with GIS implementation plan in order to benefit from the enhanced asset management process as soon as possible. The Board also concluded that any delay in acting on the distribution transformation replacement program would increase the likelihood of negative environment and safety related incidents.

1.2.7 The geographic information system was a $4 million capital cost expenditure while the distribution transformation replacement program accounted for $1.5 million. The Board indicated that it believes these expenditures should proceed. The Board also stated that the taxes paid by the utility should be recovered by the utility as a regulated cost.

1.2.8 On February 14, 2006, Ottawa Hydro appeared before the Board with the revised Settlement Proposal. On February 14, 2006, the Board approved the Settlement, in an Oral Decision. The Applicant complied with the Board's earlier directions. Proceeding with the GIS project, with its high capital cost allowance resulted in significant reduction in the taxes payable. The revised settlement was achieved without any increase in the revenue requirement. All intervenors supported the Settlement Proposal and the Board agreed with the result. The base revenue requirement of the revised Settlement Proposal was very close to the original settlement addressing the concerns expressed by the Board in its Decision. The rates for the residential customers were exactly the same as in the original Settlement. This was also true of the general service > 50 kW customers.

1.3 THE DECISION

1.3.1 Hydro Ottawa in this Application applied for revenue requirement of $125.4 million for the 2006 test year. The Board's Decision in this matter grants the utility revenue requirement $122.4 million. The downward adjustment reflects the adjustment to the company's smart meter application. The Decision is summarized in Table 1.1.

1.3.2 The Decision will result in a rate increase for the average residential customer in the amount of $2.94 per month or an increase of 2.9% per month.

Summary of Decision with Reasons[1]
Hydro Ottawa 2006 Rates
(RP-2005-0020/EB-2005-0381)

Issue	Board Decision
• $ 411.2 million Rate Base • $ 93.1 million Working Capital Allowance	• Approved
• Capital Structure • Rate of Return on Equity of 9% • Debt Rate of 5.25%	• Approved
• OM&A $44.0 Million • $12.4 million PILs	• Approved
• Depreciation Costs $33.9 Million	• Approved
• Revenue from other Services • $4.1 Million	• Approved
• Smart Meters	• Approved as adjusted
• Load Forecast	• Approved
• Corporate Cost Allocation	• Approved
• Service Quality Performance	• Approved
• Regulatory Asset Recovery	• Approved
• Standby Rates	• Approved Interim Basis
• Transmission Assets Kanata MTS and Uplands MS to be deemed Distribution Assets	• Accepted as applied • Discontinue collection from HONI for Kanata MTS
• Low Voltage	• Approved and adjusted for HONI increase of 63/56
• Renaming of GS > 50 kW TOU class to GS> 50 kW <1500 kW	• Accepted as applied
• RTS GS >50 kW <1500 kW Harmonization	• Accepted as applied
• Low Voltage Switchgear credit treated as pass through	• Accepted as applied

[1] This summary does not form part of the Decision nor does it itemize all findings. It is not to be relied on for the purpose of applying or interpreting the Decision.

2. SETTLED ISSUES

2.0.1 The majority of the issues in the Hydro Ottawa case were settled. As indicated previously, there were two settlements, with the second settlement reflecting the recommendations of the Board in its written Decision of February 3, 2006. The effect of the settlements was to reduce the revenue requirements in the manner indicated in Tables 2.1 and 2.2.

Table 2.1

Summary of Settlement Proposal

	Proposed Revised Settlement		Original Settlement	
Base Revenue Requirement in Original Application	$124,877,822		$124,877,822	
Base Revenue Requirement in Settlement	$122,496,745		$122,457,385	
Difference:	($2,381,077)		($2,420,437)	
Reduction in return on Rate Base		($279,425)		($450,467)
Reduction in operating expenses		($1,640,000)		($1,500,000)
Increase in "other" revenue		($300,000)		($300,000)
Decrease in amortization expense		($217,333)		($647,333)
Increase in PILs		$55,681		$477,363
Reduction in rates due to load forecast increase (see note)	($936,333)		($936,036)	
Effective impact of Settlement on Rates	($3,317,410)		($3,356,473)	
Impact on Residential Customer, 1000 kWh per month				
Original Application	3.5%	$105.16	3.5%	$105.16
Settlement	2.8%	$104.45	2.8%	$104.45

Note: The impact of the load forecast has been changed. The previous calculation included affects that were more related to the rounding affects for the rate design methodology than the actual affect of the change in the load forecast. The revised numbers are now based on the "full precision" calculation in the EDR model that calculates revenue without the rounding. The calculation relates to the difference between the "full precision" calculation with and without the load forecast change.

Table 2.2		
Settlement with Intervenors		
Item Settled	**Description of Impact**	**Dollar Impact**
Forecast of capital expenditures for 2006 is reduced by $14,000,000 as follows: $8,500,000 in capital additions (i.e., distribution assets) and $5,500,000 in construction work in progress	Reduction in return on rate base Decrease in amortization expense	-$ 284,406 -$ 217,333
The settlement of the above causes an increase of $55,681 in Hydro Ottawa's forecast of its PILs allowance for 2006	Increase in PILs	$ 55,681
Forecast of distribution expenses for 2006 is reduced by $1,640,000 There is an additional reduction of $217,333 in Hydro Ottawa's forecast of amortization for 2006	Reduction in operating expenses	-$ 1,640,000
Additional reduction, in effect, of $300,000 vis-à-vis Hydro Ottawa's forecast of its base revenue requirement for 2006	Increase in "Other" revenue	-$ 300,000
Total Reduction in Revenue Requirement		**-$ 2,386,058**

3. CONTESTED ISSUES

3.0.1 There are only three contested issues in the Application of Hydro Ottawa Limited for 2006 rates: the return on equity, the treatment of line losses and standby rates.

3.1 RETURN ON EQUITY

3.1.1 The Applicant seeks a 9% return on equity which was the rate specified in the 2006 Electricity Distribution Rate Handbook. Board staff has argued that this is only a default position for utilities that file on the basis of a forward test year like Hydro Ottawa. Board staff notes that this principle is supported by the Board's Decision on the Motion in the Toronto Hydro hearing.[2]

3.1.2 The Board accepts the principle that where a distributor chooses to file on a forward test year basis, other parties are free to argue that more current data should be used for different cost items where that is reasonable and practical. The updating is not limited to the sole discretion of the utility.

3.1.3 In the case of return on equity, it appears that the return can easily be updated by using the current Canada bond rate. If this is done, the return on equity decreases to 8.36%.

3.1.4 The utility points out that if the return on equity is to be adjusted or updated, the Board should look at the other component which is the equity risk premium. The revised calculation was placed in the record by Ms. McShane[3] which shows that if the risk premium is adjusted from the current level of 3.8%; the new return on equity would be 8.65%, not 8.36%. Board staff do not take a position on updating the equity risk premium but did not oppose it. The utility argues that it would be unfair to update and lower the return on equity for Hydro Ottawa simply because it had chosen to file on a forward test year basis.

[2] EB-2005-0421, Transcript Volume 1, p. 113 - 123
[3] Transcript, Volume 4, p. 3

3.1.5 Hydro Ottawa also argues that it may be illegal to change the rate of equity with respect to Hydro Ottawa without making similar changes for the other utilities that are in the same risk profile group.

3.1.6 The Handbook sorts all the distributors into four groups as indicated in table 5.1, page 32 of the Handbook based on the size and rate case. Hydro Ottawa shares the 60% debt, 40% equity group with EnerSource, Hydro Mississauga, Horizon Utilities, and Power Stream. These four distributors are historical filers and using the methodology employed by Board staff, they would continue to have a 9% return on equity.

3.1.7 Hydro Ottawa argues that a lower ROE for Hydro Ottawa would imply that Hydro Ottawa's business risk is different than the other four utilities. They point out correctly that there is absolutely no evidence of that.

3.1.8 The courts in both the United States and Canada have established certain legal principles in rate setting[4]. One principle is that a utility is entitled to a rate of return which is comparable to the rate of return granted to other enterprises of like risk. They are also entitled to a rate of return which ensures that the financial integrity of the regulated enterprise will be maintained. That is, they are entitled to a rate of return which permits them to attract capital on reasonable terms and conditions.

3.1.9 Accordingly, Hydro Ottawa argues that all four distributors have the same business risk profile and consequently should, as a matter of law have the same rate of return. To discriminate against Hydro Ottawa and lower the rate of return would compromise the utility in terms of its ability to raise capital. Discriminatory rate treatment, they say is contrary to the fundamental rate making principle established by the courts.

3.1.10 The Board agrees that there is merit to this argument. The rate of return is not something that should be adjusted just because the company has chosen to file in a certain manner where that results in discriminatory treatment.

[4] Northwestern Utilities v Edmonton [1929] SCR 186 at 193; British Columbia Electric Railway Co v British Columbia Utilities Commission [1966] SCR 837 at 854; Federal Power Commission v Hope Natural Gas Co, 320 US S41 [1944] at 603

3.1.11 This is not a modification of the Board's ruling with respect to the Toronto Hydro Motion and the relevance of the Handbook to a forward test year filer. It may be a refinement. The Board believes that rate of return as a matter of law and practice is a unique cost category. The Motion Decision simply says that once a utility files on a forward test year basis other costs can be adjusted even where those adjustments are not proposed by the utility. It follows that the Board does not have to accept those arguments. This is such a case. In the Board's view, to discriminate against the utility in terms of its rate of return on equity simply because it chose to file on a forward test year basis is not appropriate. The cost of capital should be dealt with on a generic basis. That has been the practice in the past and it should be continued in the future.

3.2 LINE LOSSES

3.2.1 It is common ground that transmission and distribution line losses in Ontario account for about 7.5% of the electricity generation. That, all parties agree, is a substantial cost. In the case of Hydro Ottawa, the distribution losses in 2005 are estimated to be 3.3% of their electricity sales.

3.2.2 A number of parties have argued that there is no incentive for Hydro Ottawa to reduce its losses. That is because Hydro Ottawa proposes a variance account to accommodate variances between actual and forecasted losses. Hydro Ottawa will not be at risk if it does not achieve any of its goals with respect to line loss reduction.

3.2.3 The Board's report relating to the EDR Handbook (RP-2004-0118) acknowledged that line losses are a serious waste of electricity and that the distributors in the province have no direct financial incentive to reduce those losses. At the time, the Board stated that it would study the problem in greater detail but that in the short term, no workable solution was evident. That study is yet to be completed.

3.2.4 Pollution Probe and GEC argue that there has to be an incentive to reduce line losses. The only concrete plan advanced was to eliminate the variance account. That simply puts the utility at risk. The Board believes that may not provide a complete solution because the utility may simply adjust the forecast upward to provide enough cushions and is unlikely to exceed the line loss forecast.

3.2.5 The better view in the Board's opinion is to require utilities to file a plan to reduce line loss. If the plan fails to forecast any reduction in line losses, it can be subject to scrutiny and may or may not be accepted by the Board. If at the time of the next rate case, the utility fails to meet its goals, any losses above those forecasted reduction can be treated in a different fashion and possibly be disallowed as a regulatory cost. In short, line losses need to be considered on a utility specific basis. But there must be a plan. And the results must be measured and examined as part of the regulatory process. It is no longer acceptable to ignore the issue because the problem is complex. The costs to the province-wide distribution system are too great. Millions of dollars are at stake.

3.2.6 Accordingly, the Board directs Hydro Ottawa to file a plan to reduce its line losses by at least 5% within 90 days of this Decision. That plan should include concrete estimates of the costs of achieving this goal as well as the anticipated benefits. Upon review, the Board will determine a procedure to evaluate that proposal and the terms and conditions of implementation.

3.3 STANDBY RATES

3.3.1 Hydro Ottawa has proposed new standby rates for distributed generators in its service area. The Board has considered this matter in the generic hearing and has determined that separate proceeding should be established for standby rates for all Ontario electricity distributors. In order to protect the interests of all parties, all standby rates which are applied for as part of the rate application for 2006 rates are approved on an interim basis.

4. SMART METERS

4.0.1 In the 2006 rate year, Hydro Ottawa proposes to install 54,484 smart meters for residential customers and 5,783 for general service customers. The installed cost assumed for the residential meters is $250 and the installed cost of the general service meters is $1,500.

4.0.2 The installed cost of the residential meters is consistent with the Board's generic Decision. The Board's generic Decision did not deal with the cost of Smart Meters for General Service customers. Subject to certain adjustments to be discussed below, the Board accepts these costs. As indicated, the costs for residential customers are in keeping with the generic Decision. The Board accepts the costs proposed by Hydro Ottawa for the General Service meters.

4.0.3 Hydro Ottawa has applied for $13,621,000 in capital for residential Smart Meters, with associated depreciation expense of $454,033, and a resulting increase to the rate base is $6,684,497. The allowed return on rate base would be $451,017 with an operating expense of $673,422 and a depreciation expense of $454,033. This yields a revenue requirement of $1,846,145, as set out in Table 4.1.

4.0.4 In calculating the cost of residential meters, the utility used $2.47 per month for capital cost and $1.03 per month for operating cost in accordance with the generic Decision. However, the utility has assumed that the meters would all be installed the first day of the rate year. In its generic Decision, the Board assumed that the meters would be installed evenly over the course of the year. As a result there is a disallowance of $606,634, with a new revenue requirement of $1,503,513.

4.0.5 A similar adjustment has been made for the General Service customers, yielding a new revenue requirement of $264,002.

4.0.6 The result is a fixed rate adder of $0.41 per month for residential customers and $0.83 for General Service customers. In keeping with the generic Decision a variance account will be established, the details of which will be communicated in due course.

Table 4.1

Ottawa Hydro

Smart Meter Application

	Residential	General Service	Total
Meters Planned	54,484	5,783	60,267
Meter Months (Straight Line)	354,146	37,590	391,736
Capital Applied For	$ 13,621,000	$ 2,695,750	$ 16,316,750
Depreciation Expense	$ 454,033	$ 89,858	$ 543,892
Net Fixed Assets	$ 13,166,967	$ 2,605,892	$ 15,772,858
Net Fixed Assets (1/2)	$ 6,583,483	$ 1,302,946	$ 7,886,429
Working Capital Allowance	$ 101,013	$ 10,722	$ 111,735
Rate Base	$ 6,684,497	$ 1,313,668	$ 7,998,164
WACC	6.75%	6.75%	6.75%
Return On Rate Base	$ 451,017	$ 88,636	$ 539,653
Operating Expenses	$ 673,422	$ 71,478	$ 744,900
Depreciation	$ 454,033	$ 89,858	$ 543,892
PILs	$ 267,672	$ 52,747	$ 320,419
Revenue Requirement	$ 1,846,145	$ 302,719	$ 2,148,864
Net Amount Disallowed	-$ 606,634	-$ 38,717	-$ 645,351
New Revenue Requirement	**$ 1,239,511**	**$ 264,002**	**$ 1,503,513**

Metered Customers		
Regular Residential	254,379	
Less than 50 kW		23382
Greater than 50 kW non TOU(< 1500 kW)		3137
Greater than 50 kW TOU (> 1500kW)		65
Large Use (> 5000 kW)		10
Total Metered Customers	254,379	26,594
Monthly Fixed Rate Adder	**$0.41**	**$0.83**

5. RATE IMPLEMENTATION

5.0.1 Hydro Ottawa applied for a Distribution Revenue Requirement of $126.5 million for the 2006 test year. The major change made to this amount is the reduction in the revenue requirement associated with the installation of Smart Meters as set out in Table 5.1. The revised revenue requirement is $122.4 million. The Board accepts the results of the Settlements of January 16, 2006 and February 13, 2006.

5.0.2 The proposed allocation of distribution revenue requirements to the various customer groups is acceptable to the Board.

5.0.3 The Board directs the company to file with the Board and with all intervenors of record a draft rate order and its tariffs and rates reflecting the Board's finding in this Decision. The tariffs and rate schedule shall have an effective date of May 1, 2006, and shall be final, with the exception of the Standby Rates which shall be interim. The company shall consult with Board staff as to the form of the tariff and rate schedule so as to be consistent with those approved for the other electricity distribution utilities. The intervenors shall have five calendar days to respond to the company's draft rate order. The company should respond to any comments by the intervenors.

5.0.4 There are a number of intervenors eligible for costs. Any intervenors requesting costs shall file their cost requests with the Board and Hydro Ottawa within fifteen days of issuance of this Decision. Hydro Ottawa shall respond within fifteen days thereafter, and any response by intervenors shall be delivered within five days of the response from Hydro Ottawa.

Table 5.1

Ottawa Hydro
Revenue Requirement Adjustments per Decision

	Per Application	ADR Settlement	Removal of Residential SM	Removal of GS SM	LV Adjustment	Smart Meter Rate Rider	Per Decision	Change	% Change
Current Year Assets	$ 451,722,479	-$ 8,282,667	-$ 13,166,967	-$ 2,605,892			$ 427,666,954	-$ 24,055,525	
Prior Year Assets	$ 394,743,692						$ 394,743,692	$ -	
Net Fixed Assets	$ 423,233,086	-$ 4,141,334	-$ 6,583,483	-$ 1,302,946			$ 411,205,323	-$ 12,027,763	-2.8%
Working Cap Allow	$ 93,296,494	-$ 73,830	-$ 101,013	-$ 10,722			$ 93,110,929	-$ 185,565	-0.2%
Rate Base	$ 516,529,580	-$ 4,215,164	-$ 6,684,496	-$ 1,313,668			$ 504,316,252	-$ 12,213,328	-2.4%
Return On Rate Base	$ 34,851,334	-$ 284,406	-$ 451,017	-$ 88,636			$ 34,027,275	-$ 824,059	-0.7%
OM& A Expense	$ 46,372,410	-$ 1,640,000	-$ 673,422	-$ 71,478			$ 43,987,510	-$ 2,384,900	-1.9%
Amortization Expense	$ 34,730,789	-$ 217,333	-$ 454,033	-$ 89,858			$ 33,969,564	-$ 761,225	-0.6%
PILs	$ 12,700,788	$ 55,681	-$ 267,672	-$ 52,747			$ 12,436,050	-$ 264,738	-0.2%
Low Voltage	$ 492,206				$ 61,526		$ 553,732	$ 61,526	
Smart Meter Rate Rider RES						$ 1,239,511	$ 1,239,511	$ 1,239,511	1.0%
Smart Meter Rate Rider GS						$ 264,002	$ 264,002	$ 264,002	0.2%
Revenue Offsets	-$ 3,777,499	-$ 300,000					-$ 4,077,499	-$ 300,000	-0.2%
Hydro Ottawa Application	$ 125,370,028	-$ 2,386,058	-$ 1,846,145	-$ 302,719	$ 61,526	$ 1,503,513	$ 122,400,144	-$ 2,969,884	-2.2%

DATED at Toronto April 12, 2006

Original signed by

Gordon Kaiser
Vice Chair and Presiding Member
Signed on Behalf of the Board Panel