

Ontario Energy Board **Commission de l'Énergie
de l'Ontario**



EB-2007-0514
EB-2007-0595
EB-2007-0571
EB-2007-0551

IN THE MATTER OF APPLICATIONS BY

Canadian Niagara Power Inc. – Fort Erie,
Canadian Niagara Power Inc. – Port Colborne,
Peterborough Distribution Inc.

And

Lakeland Power Distribution Ltd.

**FOR THE COMBINED PROCEEDING ON STORM
DAMAGE COST CLAIMS**

DECISION WITH REASONS

July 31, 2007

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EB-2007-0514
EB-2007-0595
EB-2007-0571
EB-2007-0551

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

AND IN THE MATTER OF applications by Canadian
Niagara Power Inc. – Fort Erie, Canadian Niagara Power
Inc. – Port Colborne, Peterborough Distribution Inc. and
Lakeland Power Distribution Ltd. for an order or orders
approving or fixing just and reasonable distribution rates
and other charges for 2007.

BEFORE: Paul Sommerville
Presiding Member

Paul Vlahos
Member

Ken Quesnelle
Member

DECISION WITH REASONS

July 31, 2007

Introduction

General

On December 20, 2006 the Ontario Energy Board (the “Board”) issued the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario’s Electricity Distributors* (the “Board Report”).

The Board Report contained the relevant guidelines for 2007 rate adjustments for distributors applying for rates on the basis of the 2nd generation incentive regulation mechanism. The Board Report also recognized that contingencies need to be built into the regulatory regime to provide the flexibility to recognise extraordinary events outside the control of distributor management. The Board Report made provisions for “Z Factors” and outlined the guidelines for distributors applying for these types of adjustments. The Board limited the Z Factors to changes in tax rules and to natural disasters. The Board Report stated that the Z Factor amounts must satisfy the three criteria of causation, materiality and prudence and that they should be recorded in account 1572, Extraordinary Event Costs, with interest applied on the opening monthly balances at the Board approved rate for variance and deferral accounts¹.

As part of the 2007 rate adjustment process, four Ontario electricity distributors made applications to the Board for recovery of costs incurred due to extraordinary events, namely severe storms, which inflicted significant damage to their respective distribution systems. The four distributors requested recovery of these costs through the Z Factor recovery mechanism outlined in the Board Report.

The four distributors, namely Canadian Niagara Power Inc. (“CNPI”) – Fort Erie, CNPI – Port Colborne, Peterborough Distribution Inc. (“Peterborough Distribution”) and Lakeland Power Distribution Ltd. (“Lakeland Power”) filed their applications for 2007 electricity distribution rates under file numbers EB-2007-0514, EB-2007-0595, EB-2007-0571 and EB-2007-0551 respectively.

¹ Appendix C to the Board Report

In their applications for the establishment of 2007 rates, the applicants requested that their rates include the recovery of costs associated with extraordinary storm damage incurred in 2006. The Board issued notice of these applications. The Board granted intervenor status to the Vulnerable Energy Consumer Coalition (“VECC”) and the School Energy Coalition (“SEC”) in each of the proceedings. The Board issued Procedural Orders in each proceeding allowing for interrogatories on the claims and written submissions from parties.

On April 30, 2007 the Board issued decisions for each of the applicants, establishing new distribution rates reflecting only the automatic price index adjustment. The Board set the approved distribution rates as interim pending a more detailed review of the applicants’ Z Factor claims.

In order to expedite the review of issues related to the storm damage cost claims, the Board convened a combined oral hearing, which reviewed the storm damage cost claims for each of the applicants. The oral hearing took place on June 11, 2007 at the Board’s offices in Toronto. Witness panels appeared for each of the applicants and were cross examined by Board Staff, VECC and SEC.

Below is a list of parties and their representatives that participated in the oral hearing:

(“CNPI”) – Fort Erie and Port Colborne	Richard Stephenson
Peterborough Distribution	Andy Hoggarth
Lakeland Power	Chris Litschko
	Margaret Maw
Board Staff	Jennifer Lea
	Ted Antonopoulos
	Neil Mather
	Stephen Shields
VECC	Michael Buonaguro
SEC	Jay Shepherd
	Rachel Chen

The following witnesses appeared at the oral hearing:

CNPI – Fort Erie and Port Colborne

R. Scott Hawkes
Vice-President, Corporate Services and General Counsel

Glen King
Vice President, Finance and Chief Financial Officer

Douglas Bradbury
Director, Regulatory Affairs

Peterborough Distribution

Andy Hoggarth
Vice-President and Chief Financial Officer

Lakeland Power

Chris Litschko
President and Chief Executive Officer

Margaret Maw
Chief Financial Officer

Overview of Claims

In their applications for 2007 rates, CNPI – Fort Erie, CNPI – Port Colborne, Peterborough Distribution and Lakeland Power requested Z Factor recovery for costs relating to natural disasters that occurred in 2006. In aggregate, the costs incurred totalled approximately \$3.2 million. After adjustments related to non-incremental internal labour costs, and in the cases respecting CNPI – Fort Erie and Port Colborne, by insurance proceeds, the total aggregate claim before the Board for the four applicants is approximately \$2.6 million.

The four claims are broken down as follows:

	Fort Erie	Port Colborne	Peterborough	Lakeland
Total costs incurred	\$2,261,194	\$340,564	\$487,303	\$235,870
Less capitalized portion	0	0	50,200	18,000
Gross claim	2,261,194	340,564	437,103	217,870
Less non-incremental internal labour	211,090	31,793	62,517	7,133 ²
Less insurance proceeds	434,551	65,449	0	0
Less transmission work	4,500	0	0	0
Net claim	1,611,053	243,322	374,586	210,737
Plus Interest	101,678	9,722	0	0
Total claim	\$1,712,731	\$253,094	\$374,586	\$210,737

The nature of the storm events differed among the four distributors. CNPI stated that in Fort Erie and Port Colborne, over 30 centimetres of snow fell on fully leaved trees in October 2006. The CNPI distribution system in both service areas suffered severe damage resulting in all 15,000 customers in Fort Erie and 3,500 of the 9,000 customers in Port Colborne being without power. CNPI stated that the outage lasted for up to six days. CNPI replaced approximately 100 poles and 3km of overhead distribution line. Eighty-five percent of CNPI's claim for the two service areas is attributable to the billings of third party line crews and forestry workers who aided in the restoration and clean-up effort.

Peterborough Distribution stated that a strong thunderstorm inflicted significant damage to its distribution system in July 2006. Approximately 80 trees were uprooted and fell on

² Lakeland Power stated that this reduction should be made if the Board decided to treat the entire gross claim as O&M

power lines leaving 14,000 or 42% of Peterborough Distribution's customers without power. The outage lasted for approximately three days. Peterborough Distribution replaced 9 poles, 2km of secondary line, and approximately two tenths of a kilometre of primary and other distribution devices. Forty-seven percent of Peterborough Distribution's claim is attributable to third party contractors and other distributors that assisted with the recovery initiative.

Lakeland Power stated that a wind storm hit the Bracebridge area in August 2006 leaving the entire municipality without power for up to four days. Lakeland Power replaced 25 poles and seven transformers and other smaller hardware. Forty-four percent of Lakeland Power's claim is attributable to third party contractors and other distributors.

The remaining portion of the four claims were for internal overtime labour costs and materials used in the rehabilitation effort.

The Issues and Organization of this Decision

The main issues for the Board in this proceeding are:

- whether the claimed amounts are eligible for recovery based on the criteria of prudence, causation and materiality
- whether any of the claimed costs should be capitalized
- the appropriate cost allocation to the rate classes and method of recovery within a rate class
- the appropriate treatment of stranded assets.

The Board has chosen to organize the Decision by separating findings that are common to all applicants and findings that are distributor-specific. Issues such as prudence, capitalization, allocation and the treatment of stranded costs for which the Board has chosen to make findings that are identical for all applicants have been addressed in a common issues section. Other findings that are based on more distributor-specific information such as materiality levels, historic storm cost levels and the specific amounts claimed are dealt with in the distributor-specific section. The Board concludes with some general remarks on issues that the Board feels are of a generic nature to provide some guidance to applicants, Board Staff and stakeholders on the regulatory treatment of future storm damage cost claims.

Although the Board has considered the full record of the proceeding, the record has been summarized only to the extent necessary to provide context for the Board's findings.

Common issues and findings

This section addresses issues that are common to all four applicants.

Prudence

This section addresses the prudence of the costs incurred by the four applicants. The remaining eligibility criteria of materiality and causation are more distributor-specific and will be addressed in the Distributor-Specific Issues and Findings section below.

The Board Report states that amounts claimed for storm damage should represent the most cost-effective option (not necessarily the least initial cost) for ratepayers. Consequently, a distributor needs to justify the reasonableness of the amounts relative to other options that the distributor may have had³.

The supporting documentation provided by the applicants varied in level of detail. CNPI submitted a detailed restoration and response initiative report that outlined the course of action taken following the onset of the storm in Fort Erie and Port Colborne. Although Peterborough Distribution's and Lakeland Power's information was not as comprehensive, all applicants provided reasonable information supporting the choices made with respect to the procurement of external contractors and the level of incremental labour costs. For example, the applicants provided copies of invoices from third parties, derivations of their internal overtime labour rates and confirmation that they did not materially deviate from their storm contingency plans.

No party raised any concerns with respect to prudence. In its submissions regarding Fort Erie and Port Colborne, Board Staff stated that in situations arising from extraordinary events such as natural disasters, a distributor has few options available to it other than restoring power, including repairing and removing fallen powerlines, in a timely and safe manner.

³ Board Report, Appendix C, pages V - VI

The Board agrees. The applicants attested to the fact that they mobilized quickly to restore power at the earliest possible opportunity. All appeared to have exercised good judgement in mobilizing the forces available to them, in accordance with good utility practice. It also appears from the evidence that the applicants “right-sized” their respective responses to ensure that the restoration of power was accomplished responsibly.

The Board finds that the four applicants acted prudently in restoring power quickly and safely.

The Board notes that all four applicants reduced their gross claims by the amounts relating to internal regular labour costs. In CNPI’s case, the claims for Fort Erie and Port Colborne were also reduced by insurance proceeds and transmission work. Peterborough Distribution and Lakeland Power chose to capitalize a portion of the costs which they incurred and these amounts were not included in the original claims.

Capitalization

The four applicants treated their claims as entirely O&M and requested recovery of those amounts as current expenses. CNPI – Port Colborne, Peterborough Distribution and Lakeland Power sought to recover the amounts over a one year period, while CNPI requested a two year recovery period in order to mitigate total bill impacts for its Fort Erie customers. During the course of this proceeding the Board indicated that it would review the appropriateness of requests to recover capital related costs outside of rate base.

CNPI suggested that it did not capitalize any of its incurred costs because, in the past, the Board treated storm damage costs as O&M for purposes of recovery. CNPI also noted that it is also administratively simpler to recover the claims as a single one-time, time limited Z Factor amount. Peterborough Distribution and Lakeland Power did capitalize a portion of their incurred costs, which were not included as part of their claims. Both distributors resisted the suggestion to capitalize any additional amounts from their claims arguing that they had followed their respective capitalization policies in determining how much of the costs that they incurred would be treated as capital and how much would be expensed.

Specifically, Peterborough Distribution indicated that it did not include in its claim costs associated with repairing an overhead pole line; an area of its distribution system that exceeded three pole lengths. Peterborough Distribution stated that this section of the

distribution system was slated for refurbishment within the next few years and as a result it decided to capitalize the costs associated with its repair. The capitalized amount was \$50,200 or approximately 10% of the total costs incurred.

Lakeland Power indicated that it replaced seven transformers at a total cost of approximately \$18,000. These costs were capitalized and were not included in the claim because their value met Lakeland Power's capitalization threshold. These costs represent approximately 8% of the total costs incurred by Lakeland Power in addressing storm damage associated with the August, 2006 storm. Lakeland Power submitted that the costs associated with restoring the damaged poles were not capitalized as the poles were located randomly throughout Lakeland Power's distribution system. Under its system-specific capitalization rules, the replacement of isolated poles and wire is expensed. Where three or more contiguous poles are replaced, the costs are capitalized.

In its oral submissions Board Staff indicated that, in the past, the Board has taken two different paths with respect to the treatment of capital related costs.

In the regulatory assets review, the Board did not address the issue of the capitalization of storm damage costs. Some distributors included balances in account 1572 relating to storm damage costs. Three examples were EnWin Powerlines Ltd. (RP-2005-0020/EB-2005-0359), CNPI Fort Erie and Port Colborne (RP-2005-0020/EB-2006-0011) and Essex Powerlines Corporation (RP-2005-0020/EB-2005-0363). Staff noted that, in those proceedings, there was no requirement by the Board to distinguish between capital expenses and operating expenses. The Board-approved balances in account 1572 relating to storm damage are currently being recovered over a four year period by way of the regulatory assets rate rider, including any component costs that would ordinarily be considered capital.

By contrast, Board Staff noted that in a recent decision regarding an application by Lakefront Utilities Inc. (EB-2007-0106) regarding the recovery of \$550,000 of CDM capital costs over a one year period, the Board ordered recovery of only the annual capital related costs i.e. annual return, amortization and PILs rather than the full amount of \$550,000 over one year.

To illustrate the issue, Board Staff submitted four exhibits at the oral hearing showing a hypothetical cost of service calculation for each applicant. These calculations reflected

a value that would be a proxy for the annual amount that each distributor would recover as part of its revenue requirement, had 50% of their respective claims been incorporated into rate base, that is capitalized. With the understanding that the 50-50 split between capital and O&M was an arbitrary split for illustrative purposes only, the four applicants were unanimous in indicating that they would not be in financial jeopardy should the Board choose to adopt the cost of service approach when determining the appropriate method for recovering the approved amounts.

However, the applicants were also unanimous in indicating that they would prefer not to capitalize any amount of the proposed claims for the reasons indicated above.

In its oral submission, Board Staff stated that there was no reason why storm damage costs should be treated differently from other capital related costs. Board Staff noted that the regulatory assets proceedings may not be relevant precedents for the instant proceeding because of the four year recovery period mandated by the Minister. Staff also noted that the Board Report does identify two materiality tests; one for capital costs and one for O&M and that the Board's Accounting Procedures Handbook identifies two sub-accounts within account 1572; one for capital amounts and one for non-capital. Board Staff noted that this would suggest that storm damage costs could be properly divided into O&M and capital components.

Board Staff also stated that the fact that a Z Factor opportunity was provided at all appears to relate to the fact that 2007 is not a rebasing year. The Board recognized in its Report that it may need to provide relief to utilities that experience extraordinary events. To that end, the cost of service models submitted as exhibits provided a proxy for recovering the appropriate O&M and capital related costs. Board Staff did acknowledge that, given the evidence filed in the proceeding, it would be difficult to quantify storm-specific capital costs with any degree of precision.

In its oral reply, CNPI stated that there is merit in not having a capital / O&M split. CNPI submitted that the Board Staff proposal is not explicitly contemplated in the Board Report. CNPI noted that the Board Report did contemplate off ramps to the incentive regulation scheme by noting that distributors were expected to file comprehensive cost of service applications if the Z Factor adjustments were insufficient to address specific cost pressures, such as capital investments. CNPI also argued that the requirements for the Z Factor provisions in the Board Report were based on the Board's 2000 EDR Handbook which characterized Z Factors as transitory adjustment to rates, not

permanent adjustments. By applying an abridged cost of service approach, the Board would be placing the costs into rates for the entire useful life of the subject assets. CNPI submitted that this is contrary to the notion that Z Factors are intended to address unforeseen, temporary matters.

In its oral submission, SEC submitted that treating storm damage costs as entirely O&M may not be consistent with principle. However, SEC submitted that it is better for the Board to maintain consistency in treatment than it is to “chase the principle”, especially on the limited evidence before the Board in the instant proceeding. SEC argued that changes to the way storm damage costs are treated may very well be indicated, but only if it is done in the context of a broader policy review. In fact, the Board has committed to a review of capitalization practices in its Business Plan.

Board Findings

The Board accepts that any approved amounts relating to the subject claims should be recovered as O&M and will not order any portion of the approved claims to be capitalized. However, this finding should not be construed as providing the Board’s views on capitalization generally. The Board sees little advantage in attempting to derive capitalization principles of general application on the basis of the very limited record in this case. As noted by SEC, the Board will conduct a review of capitalization practices in accordance with its Business Plan.

The Board agrees with Staff’s submissions that the regulatory assets proceedings are not relevant precedents with respect to the issue of capitalizing storm damage costs. The recovery of regulatory assets was mandated by a Ministerial Directive during the period of a statutory rate freeze. The Directive granted distributors permission to apply to the Board to recover their prudently incurred costs associated with regulatory assets over a four year period commencing on March 1, 2004. Account 1572 was one of sixteen variance accounts designated as a regulatory asset.

Affording net fixed asset treatment to costs recorded in the regulatory asset variance accounts was not considered to be an appropriate option. All approved costs associated with regulatory assets are currently being recovered outside of rate base, by way of the regulatory assets rate riders.

No such constraint exists for the subject claims. Conventional rate making methodology calls for a differentiation between capital and operating costs. Since 2007 is not a

rebasing year, it would be necessary to develop a method to calculate an amount that would be a proxy for the utility's annual revenue requirement associated with the approved claim if a cost of service approach is to be adopted.

It is the Board's view that capitalization of a portion of storm damage claims, greater than what was capitalized by Peterborough Distribution and Lakeland Power may be appropriate.

However, the Board is content at this stage to recognize that two of the applicants in this proceeding acted in conformity with the capitalization practices each had developed for their respective purposes. CNPI did not capitalize any portion, an approach rooted in its interpretation of the Board Report. The Board's acceptance of these practices in this case should not be seen in any degree as predictive of the approach it may take in different circumstances or in its consideration of such practices generally.

Allocation Between Service Areas

The October 2006 storm that inflicted damage on CNPI's distribution system affected customers in both CNPI's Fort Erie and Port Colborne service areas. CNPI proposed an allocation of all claimed costs, including non-labour components, between their Fort Erie and Port Colborne service areas based on a summary of time records for both internal and contractor invoices resulting in an allocation of 87% of total costs to Fort Erie and 13% to Port Colborne.

The August 2006 storm that damaged Peterborough's distribution system affected only customers in the main Peterborough service area with little or no damage to the Lakefield and Norwood service areas. Consequently, as the rates for the three service areas have not yet been harmonized, and the fact that the storm appeared to be localized to the Peterborough service area, Peterborough Distribution proposed to allocate 100% of its claim to its Peterborough service area and none to its Lakefield and Norwood service areas.

No party proposed an alternate allocation methodology.

Board Findings

The Board finds that the allocations between service areas as proposed by the applicants are acceptable. With respect to CNPI's allocation, the Board agrees with

SEC that although the timesheet method may not be the best approach for allocating non-labour costs, identifying the specific cost drivers during the restoration efforts would be technically and administratively challenging.

Inter and Intra Class Allocations

CNPI allocated the claimed costs to the Fort Erie and Port Colborne classes on the basis of 2004 customer numbers. CNPI used consumption data from their approved 2004 EDR model as the billing determinants to allocate the costs within the classes.

Peterborough Distribution and Lakeland Power used a one-step process by directly allocating their claimed costs equally to each customer on the basis of a fixed charge. Peterborough Distribution allocated their costs by customer count to all metered customers only, resulting in a 99 cent monthly charge while Lakeland Power allocated their costs by customer count to the standard classes and by connection counts to the Unmetered Scattered Load, Sentinel and Street Lighting classes resulting in a \$1.64 monthly charge. As with CNPI, both distributors used 2004 data.

In support of their allocation proposals, CNPI stated that they used the method that was comparable to the one used in the regulatory assets proceedings for account 1572. Peterborough Distribution and Lakeland Power stated that they chose the fixed charge method based on customer count for simplicity and transparency. Peterborough Distribution and CNPI also stated that residential areas were the most affected by the storms.

VECC argued that the allocation between classes should have both a customer count and usage component and that this should be accomplished based on a proration of revenues by class similar to the methodology used in the 2006 EDR model. VECC argued that this would be consistent with the allocation of distribution costs associated with the types of damaged facilities noted in these claims in the Board's *Cost Allocation Informational Filing Guidelines for Electricity Distributors*. VECC also submitted that the allocations within each class should be based on volume.

The applicants were generally resistant to allocating the costs between the classes based on VECC's proposal. Lakeland Power argued that restoration costs did not differ based on customer volumes and the costs to rebuild were not specific to a customer

type. CNPI argued that there is no correlation between different customer classes and their demands on the system that would drive any of the costs for restoration.

CNPI and Lakeland Power provided a similar response to questions regarding the use of distribution revenue as the allocator to the classes. The applicants stated that there is no correlation between a) the presence of a particular customer and how much that customer contributes to the utility and b) the damage inflicted on the distribution system and the consequent recovery cost.

SEC submitted that a reasonable compromise between VECC's proposal and the 100% customer count-fixed charge method proposed by Peterborough Distribution and Lakeland Power would be to adopt CNPI's proposal to allocate the costs to the classes based on customer count and within the classes based on volumes.

Peterborough Distribution stated that it chose to allocate the claimed costs to only the metered customers because the damage was primarily in the residential areas. Lakeland Power chose to allocate the claimed costs to all customers. However, under cross examination, Lakeland Power indicated that it may be appropriate for the Sentinel Lighting class not to receive a charge since each customer within this class is already billed as a customer in another class and would therefore already be receiving a charge for the claimed costs. CNPI did allocate costs to its Sentinel Lighting classes in Fort Erie and Port Colborne.

The total bill impacts for a typical residential customer using 1,000 kWhs monthly for the four applicants based on their 2007 EDR adjustments, including the Z Factor claims and proposed allocation methodologies, is approximately 5.5% for Fort Erie, 2.9% for Port Colborne, 1.3% for Peterborough Distribution and 1.2% for Lakeland Power. In response to Board Staff interrogatories, all applicants provided bill impacts using 2005 data (in the absence of complete and verifiable 2006 data) rather than 2004 data. There is only a minor shift in cost apportionment created by using 2005 data. For example, in CNPI - Fort Erie's case, the total bill impacts for a typical residential customer would increase from 5.5% to 5.6%.

Board Findings

The Board notes that customer numbers was the allocator approved in the regulatory assets proceedings noted earlier for EnWin and CNPI with respect to inter class allocations. By contrast, the Board approved distribution revenue as the allocator for Essex. In all three cases however, a volumetric rate rider was used in facilitating recovery.

The Board finds that the approved costs shall be allocated to the classes on the basis of distribution revenue. The Board notes the arguments of the applicants. However, the Board also notes that storm damage is a general distribution system problem. Normally, in electricity distribution rate-setting, the Board allocates distribution costs between classes on the basis of distribution revenue. This ensures that the burden on each class of customers is not unreasonable. Given that the Board may be considering cost allocation for distributors in the near future, the Board finds that it will allocate costs between classes in this case in a manner consistent with the present methodology for the recovery of distribution costs.

The Board notes the arguments of Lakeland Power with respect to the Sentinel Lighting class. However, Sentinel Lighting is a distinct and separate class with its own contributions to a distributor's revenue and as such should be impacted in the same fashion as the remaining classes.

The Board accepts the use of 2004 data. The Board notes that the 2004 historical test year is generally the basis for the data that underpins the applicants' current distribution rates.

With respect to intra class allocations and billing determinants, the Board approves recovery of the approved amounts on the basis of the fixed/variable ratios that currently underpin each applicant's base distribution rates.

Rate Rider vs Rate Adder

In its written submissions for CNPI - Fort Erie and Port Colborne, Board Staff submitted that a rate rider is distinctly identified as being separate from the base volumetric and fixed charges, whereas a rate adder is embedded within either the fixed or volumetric

rates. Board Staff noted that a rate rider, being easier to identify and often time-limited, may be more commensurate with recoveries of a temporary nature.

Accordingly, Board Staff submitted that the rate rider approach is appropriate in facilitating recovery of the approved Z Factor amounts. Regardless of whether or not the applicants apply to the Board for a distribution rate adjustment for purposes of setting future rates, the subject rate rider would cease to be effective or “fall off” by the designated date.

In its written reply submissions for Fort Erie and Port Colborne, CNPI stated that the volumetric rate rider approach aids in the customer’s understanding of the process. CNPI stated that unlike a rate adder, a rate rider is transparent, clearly defined in a Board order and has a finite life.

Board Findings

The Board notes that the Board Report referred to the use of a rate rider in discussing the manner in which recovery would be facilitated. However, the term “rate rider” was not defined. Based on Board Staff’s definitions, it appears that Peterborough Distribution and Lakeland Power proposed the use of a rate adder, embedded within the fixed monthly charge. CNPI proposed the use of a volumetric rate rider, specifically identified outside of the main volumetric rate.

For the purposes of the relief requested in this proceeding, the Board is of the view that the use of two time-specific rate riders (one reflecting a temporary fixed charge and one a temporary volumetric charge) is transparent and has the advantage of not requiring another regulatory process to remove the riders.

Interest Charges

CNPI applied interest charges to its claims to cover the respective balances in account 1572 over the requested recovery periods for Fort Erie and Port Colborne. The interest rate used was 4.59%, the Board-approved rate for variance accounts as of the fourth quarter of 2006. As of the third quarter of 2007, the approved rate remains at 4.59%.

Peterborough Distribution and Lakeland Power did not request interest recovery.

Board Findings

The Board's practice has been to authorize the recording of interest charges on deferral or variance accounts if the accounts are considered long term in nature, "long term" generally considered to be more than one year. The Board Report also authorizes the tracking of interest charges for any Z Factor claims⁴.

The Board therefore finds that CNPI's methodology of applying interest charges is reasonable. It is open to Peterborough Distribution and Lakeland Power, when filing their revised rate riders, to include interest on the approved claim based on CNPI's methodology.

True-up

The applicants did not address this issue in their applications. In its written submissions for Fort Erie and Port Colborne, Board Staff suggested that there be no true-up and the applicants would retain any over-recoveries or forgo any under-recoveries that may arise.

In its reply submissions for Fort Erie and Port Colborne, CNPI stated that a true-up should be implemented in any event in a manner consistent with other deferral accounts, at the next rebasing.

Board Findings

The Board finds that there will be no true-up. The recovery period is relatively short, and variations in the amounts claimed and collected are not likely to be significant enough to warrant the additional administrative and regulatory costs associated with a true-up mechanism.

Stranded Assets

In its written submission for CNPI - Fort Erie, Board Staff commented on the appropriate treatment regarding the value of the damaged assets that currently remain in rate base.

⁴ Board Report, Appendix C, page VII

Board Staff broke down its analysis into two time periods, distinguishing between the intervening period between the commencement of cost recovery and the next rebasing, and going forward from the next rebasing.

Board Findings

The Board notes that for CNPI - Port Colborne and Lakeland Power, the evidence indicates that there is no value associated with the damaged assets that is currently being recovered by each distributor. The evidence for CNPI – Port Colborne indicates that the damaged assets are owned by Port Colborne Hydro Inc., and not by the applicant, CNPI – Port Colborne⁵. Consequently, there does not appear to be any impact on the applicant's rate base with respect to any damaged assets that are no longer used and useful. The evidence for Lakeland Power indicates that the damaged assets were fully depreciated in 2006, at the time of the onset of the storm. As a result, it appears that Lakeland Power's current revenue requirement, approved in 2006, is not recovering any amounts related to these assets. As such, the discussion below will focus on the remaining two applicants.

In the intervening period between the commencement of cost recovery and the implementation of the next rate rebasing, CNPI – Fort Erie and Peterborough Distribution will continue to recover through their distribution rates an amount related to the value of the damaged assets that are no longer used and useful. A question before the Board is whether or not to reduce the approved claims by an amount equivalent to the recoveries through rates during the intervening period.

With regard to the period commencing with the establishment of the next rebased distribution rates, a question before the Board is whether or not to order removal of the damaged assets from rate base thereby removing the annual value associated with these assets from each distributor's revenue requirement permanently.

In response to interrogatories, CNPI – Fort Erie and Peterborough Distribution stated that they had not adjusted their net fixed asset balances to account for the removal of the damaged assets.

⁵ All assets associated with the distribution system in Port Colborne that were in service prior to 2002 are leased by CNPI-Port Colborne pursuant to an operating leasing agreement with Port Colborne Hydro Inc.

Both applicants indicated that they use a grouped method of accounting for assets such as those damaged by the respective storms. Consequently, the treatment afforded these assets from a rate base perspective should be no different than that afforded to asset retirements driven by other reasons. Therefore, similar to other retirements, there should be no impact on rate base during non-rebasing years. The Board finds that no adjustment is required.

Likewise, at the time of the next rate rebasing, it is the Board's expectation that the applicants will update their depreciation expense and net fixed asset balances based on the new asset profile just as they would when accounting for normal asset retirements.

The Board commends all the witnesses testifying on behalf of CNPI, Peterborough Distribution and Lakeland Power. The information they provided, most notably on capitalization and allocation issues, was clear, concise and helpful to the Board in addressing these issues.

In its written submissions for CNPI - Fort Erie and Port Colborne, Board Staff provided certain comments regarding appropriate recording and record keeping procedures that CNPI should follow once it has received approval regarding its claims. The Board finds that many of the comments are pertinent to all four applicants and are worth repeating here.

As a consequence of this Decision, the applicants will be permitted to recover their approved amounts by way of rate riders outside of the base distribution rates. However, the applicants should not capitalize any of the approved costs related to the damaged distribution facilities for rate base purposes nor should any approved costs be treated as distribution expense for purposes of determining a future revenue requirement.

The Board notes that this proceeding has not reviewed in detail nor approved the capitalized costs that Peterborough Distribution and Lakeland Power excluded from their claims. Peterborough Distribution and Lakeland Power may include these capitalized costs as part of their next cost of service application at which time the Board will have an opportunity to conduct a review as part of that application. These costs should be included in each distributor's proposed rate base at the net book value as of the next rebasing.

Distributor-Specific Issues and Findings

Having found that the four claims do not raise any concerns regarding prudence, the Board will now address the remaining two eligibility criteria of materiality and causation on a distributor-specific basis as well as other distributor-specific issues.

The Board Report states that amounts claimed will be considered material and therefore eligible for potential recovery if they meet a certain materiality threshold. For expenses incurred, the total expenses on a per event basis must be at least 0.2% of total distribution expenses before taxes. Capital costs will be considered material if, on a per event basis, they are at least 0.2% of net fixed assets⁶. Since the Board has decided to treat the approved claims as expense items, only the test relating to distribution expenses applies.

With respect to causation, the Board Report states that amounts claimed should be directly related to the Z Factor event and must be clearly outside the base upon which rates are derived⁷.

CNPI – Fort Erie and Port Colborne

CNPI requested recovery of \$1,611,053 for Fort Erie and \$243,322 for Port Colborne. CNPI also requested \$101,678 in interest charges for its Fort Erie claim and \$9,772 for Port Colborne.

In its applications, CNPI stated that each claim met the materiality test. CNPI submitted that its materiality threshold for distribution expenses for the Fort Erie service area is \$11,803 and for Port Colborne is \$8,394.

No party raised any concerns with respect to materiality as it applies to the subject claims, although all the parties viewed the threshold to be too low.

Regarding the causation test, CNPI submitted that all claimed costs are incremental costs associated with the restoration effort and are extraneous to the normalized costs included in the 2006 EDR.

⁶ Board Report, page 34 and Appendix C: Z Factors

⁷ Board Report, page 34 and Appendix C: Z Factors

In its written submissions, Board Staff raised concerns about CNPI's inability to demonstrate that the claims for Fort Erie and Port Colborne were entirely incremental to the costs underlying their current rates. Board Staff highlighted CNPI's inability to identify the component costs related to storm damage from their actual operations and maintenance costs incurred for the 2004, 2005 and 2006 fiscal years and the pro forma budget for 2007.

In its written reply submissions and at the oral hearing, CNPI confirmed that although they do not track costs incurred due to storms, the 2004 year, which is the basis for their current rates, did not contain any material weather events.

In its oral submission, Board Staff stated that after hearing the evidence at the oral hearing, Staff was satisfied that the claimed costs were genuinely incremental.

CNPI also proposed mitigation strategies for each of its applications. For Fort Erie, CNPI proposed that the claimed amounts be recovered over a two year period in order to mitigate the impact on its customers. The impacts resulting from this mitigation are approximately 5.5% to the total bill for a typical residential customer using 1,000 kWh monthly and approximately 1% for a general service less than 50 kW customer using 2,000 kWh monthly. No party had any criticisms of the mitigation proposed.

For Port Colborne, CNPI proposed to recover the claimed amounts over a one year period, but applied to mitigate the impact on the Sentinel Lighting class by reducing the proposed rate rider by a factor of 10. This would result in mitigating the total bill impact from approximately 66% to 6%. As a result, CNPI – Port Colborne would be forgoing approximately \$570 from the \$636 allocated to the Sentinel Lighting class. No party had any criticisms of this proposal.

Board Findings

The Board approves \$1,611,053 for Fort Erie and \$243,322 for Port Colborne plus the applicable interest. The Board is satisfied that CNPI has successfully demonstrated that its claims for Fort Erie and Port Colborne meet the materiality and causation tests.

Although CNPI's original supporting documentation was deficient with respect to causation, the remaining components of the two applications were comprehensive and complete. The Board commends CNPI for its close adherence to the Board's

guidelines, past practices and precedents and for its diligence in preparing its applications. The Board was encouraged to hear from CNPI's witnesses that CNPI has already begun to plan for tracking storm costs separately from standard O&M.

The Board finds the mitigation proposals for Fort Erie and Port Colborne to be reasonable. However, the Board notes that the pressure to avoid rate shock underpinning the proposals may subside as a result of using distribution revenue to apportion the approved costs to the classes. It is therefore open to CNPI, in its re-filings for Fort Erie and Port Colborne, to keep its mitigation proposals or amend the rate rider calculations to reflect a one year recovery rather than two years for Fort Erie and complete recovery of the amount allocated to the Sentinel Lighting class for Port Colborne.

Peterborough Distribution

Peterborough Distribution requested recovery of \$374,586. Peterborough Distribution did not request that the Board approved interest rate for variance and deferral accounts be applied to the Z Factor amount.

Peterborough Distribution stated that its claim met the materiality test, as its materiality threshold for distribution expenses is \$16,522. No party raised any concerns with respect to materiality as it applies to the subject claim.

Regarding the causation test, Peterborough Distribution provided three years annual historic O&M costs (2004, 2005 and 2006) and a pro-forma budget for 2007.

Peterborough Distribution stated that it does not track historic storm damage costs separately. However, the amount for 2006 (\$1,519,364) is approximately 65% greater than the amount reported for 2004 (\$921,880), the test year that underpins Peterborough Distribution's current rates.

At the oral hearing, Peterborough Distribution confirmed that this increase is due mostly to the O&M costs incurred as a result of the storm. The applicant also clarified that it budgets approximately \$30,000 to \$50,000 per year for storm related events, noting that this is an engineering estimate based on an average number of storms for an average year.

Board Findings

The Board finds that Peterborough Distribution's requested amount of \$374,586 to be reasonable and is therefore approved. The Board will approve interest associated with that amount should Peterborough Distribution choose to include interest in its re-filing.

The Board is satisfied that Peterborough Distribution has successfully demonstrated that its claim meets the materiality test.

Peterborough Distribution did not provide the clarity in its evidence, either in its application, response to interrogatories or at the oral hearing that would have demonstrated definitively that the level of "normal" storm costs incurred in 2006 (excluding the subject storm) surpassed the value that underlies Peterborough Distribution's current rates, that is the level reported for 2004. While the engineering estimate of the \$30,000 to \$50,000 range is helpful, Peterborough Distribution's demonstration of causation was hindered by its inability to track actual historic storm costs. As was evident from Lakeland Power's application (discussed below), tracking actual historic costs for more typical storms is possible.

The Board is satisfied however that the evidence is sufficient to demonstrate that a significant portion of Peterborough Distribution's claim is incremental. Distributors should make every effort to track historic storm damage costs. For Peterborough Distribution, however, the Board is not inclined at this time to deny any portion of the claim. The applicant should begin to track storm damage costs so that it may be able to identify them separately from the remaining O&M costs should the need arise in future proceedings.

Lakeland Power

Lakeland Power requested recovery of \$217,870. Lakeland Power did not request interest.

In its application, Lakeland Power stated that its claim met the materiality test, as its materiality threshold for distribution expenses is \$6,800. No party raised any concerns with respect to materiality as it applies to the subject claim.

With respect to causation, Lakeland Power provided historic annual costs for 2004, 2005 and 2006 and a pro forma budget for 2007 with respect to both standard O&M and costs related to storm damage only. Lakeland Power attested to the fact that the amount shown for storm damage costs for 2006 (\$169,500) did not include any expenses associated with the August 2006 storm.

In its written submission, Board Staff raised concerns over the incremental nature of an amount of \$7,133 relating to internal labour. In the oral hearing, Lakeland Power confirmed that this amount relates to internal labour at regular hours and should in fact be removed from the claim, should the Board decide to treat the entire claim as O&M.

Board Findings

The Board finds that Lakeland Power's requested amount minus \$7,133 relating to non-incremental regular labour to be reasonable and therefore the Board approves an amount of \$210,737. The Board will allow interest associated with that amount, should Lakeland Power choose to include interest in its re-filing.

The Board is satisfied that Lakeland Power has successfully demonstrated that its claim meets the materiality and causation tests. With respect to the latter, the Board notes that the storm damage costs incurred by Lakeland Power in 2006 excluding the subject claim (\$169,500), are in excess of the amounts reported for 2004 (\$122,100), the test year underlying Lakeland Power's current rates. This is clear evidence demonstrating the incremental nature of the claim.

Although Lakeland Power's application was not as comprehensive as CNPI's, the Board commends Lakeland Power for providing clear evidence identifying historic annual storm costs.

Board General Remarks

In this section the Board makes some general remarks on issues that the Board feels are of a general nature to provide some guidance to applicants, Board Staff and stakeholders on the regulatory treatment of future storm damage cost claims.

Materiality

The Board Report states that recoveries are reserved for amounts which have a significant influence on the operations of a distributor. As indicated earlier, the Board's materiality threshold is based on 0.2% of either distribution expenses or net fixed assets, depending on the type of costs under consideration. The Board Report also states that should the impact on a distributor's operations not be significant based on the above tests, the amounts in question should be expensed in the normal course and addressed through organizational productivity improvements⁸.

The Board notes that this guideline was first included in the 2000 distribution rate handbook (noted as 0.25% of net assets) and has been used by the Board ever since, most notably in proceedings such as the 2006 cost of service and regulatory assets reviews.

During the course of the instant proceeding, several parties commented on the nature and appropriateness of the current materiality threshold. All parties agreed that the current threshold is too low.

Specifically, in its written submissions for CNPI – Fort Erie, CNPI – Port Colborne and Lakeland Power, SEC stated that recovery of storm damage costs should not be driven by utility size and that the current formula may be wrong by at least one order of magnitude. SEC submitted that the Board reconsider its current threshold.

At the oral hearing, Peterborough Distribution submitted that the company's own internal materiality threshold is higher than the value determined by the Board's methodology. Lakeland Power also stated that it believed the Board's threshold to be too low.

In its oral submission, SEC added that one of the effects of a low threshold is that it essentially renders the materiality test meaningless by leaving the issue of whether or not a storm event is claimable in the hands of the utility. The utility sets its own level of what is big enough to claim. SEC submitted that if the Board is to have a rule on materiality, it should have some operative effect. However, SEC submitted that the Board should not have a materiality threshold at all.

⁸ Board Report, Appendix C, pages V - VI

The Board notes the arguments of parties and will review the current materiality threshold in due course. In the meantime, the Board expects that distributors will exercise good judgement on whether or not claims should be filed, even if the costs incurred pass the materiality threshold.

Insurance and Reserves

Only one of the applicants carries storm damage insurance. CNPI, through its parent company, Fortis Inc., has transmission and distribution property coverage.

In its written submissions for CNPI – Fort Erie, CNPI – Port Colborne and Lakeland Power, SEC submitted that the current system of Z factor treatment is unfair to both the utility and ratepayers. SEC argued that it is unfair to the utility to make it go through a time-consuming and uncertain process, after the fact, to seek recovery. The ratepayers are faced with a sudden increase in rates because of an act of nature. SEC argued that both of these impacts could be ameliorated through a comprehensive risk management strategy that may involve some combination of commercial insurance, a common storm damage risk pool and/or hedging of extreme weather risks.

Concerning insurance, all applicants suggested that insurance may not be commercially available at reasonable rates in Ontario. In its oral submission, SEC acknowledged this but did suggest that the Board may wish to indicate its preference for some sort of pooling of the risk among all distributors so that the cost of this “insurance” is incorporated into each distributor’s operating costs and distributors would not have to periodically apply to the Board for compensation.

In support of this argument, SEC submitted a report from the Edison Electric Institute, “After the Disaster: Utility Restoration Cost Recovery” which recommended the establishment of self-insurance mechanisms for dealing with storms.

In response to SEC’s questioning regarding the establishment of an industry wide pooled self-insurance fund, CNPI agreed that the reserve could benefit CNPI, especially considering the geographic location of Fort Erie and Port Colborne and their susceptibility to storms.

All applicants however opined that such a fund would be difficult to administer.

CNPI argued that the Z Factor approach has some merit in that it allows a utility to choose whether or not it will make a claim and forces the utility to prove that the storm had a significant impact on its operations and that it meets the eligibility criteria. By contrast, the establishment of a storm fund may increase the frequency of claims as it may be easier for utilities to access funds.

Peterborough Distribution stated that it would be concerned about being included in a pool of companies some of which may have sporadic O&M expenditure patterns and may rely solely on the fund to repair damages. The applicant suggested that if a province-wide pool was potentially viable, the private sector or MEARIE⁹ would have addressed this need.

Although Peterborough Distribution and Lakeland Power made only casual inquiries about the availability of insurance coverage, it appears from the evidence heard in this proceeding that Ontario's LDCs do not have access to commercially available storm damage insurance.

The Board notes SEC's argument concerning a province-wide self-insurance fund. The Edison Electric Institute report submitted by SEC focussed more on the smoothing of earnings impact (thereby addressing investor concerns) than it did about minimizing the cash flow impact of having to pay major storm damage costs. The Edison Electric Institute report did suggest the possibility of a cash reserve but the Board agrees with the applicants that the fund would be difficult to administer.

With materiality, accounting procedures and capitalization practices firmed up, the Z Factor mechanism is preferable at this time to mandatory insurance in that it provides a reasonable expectation that prudently incurred costs are recoverable, where they can be shown to be genuinely incremental to costs already embedded in rates.

Tracking Storm Damage Costs

Over the course of this proceeding, the Board has heard about a number of different approaches with regard to the treatment of storm damage costs. Regardless of the capitalization treatment afforded storm damage claims, or whether distributors are compensated by way of a pre-paid pool or cash reserve, one thing is clear: in order for

⁹ Municipal Electric Association Reciprocal Insurance Exchange

distributors to determine whether or not they will make a recovery claim, they need first to be able to determine and substantiate the incremental nature of the claim.

Notwithstanding any future changes to the materiality methodology, and the importance of a prudence analysis, the Board feels that the key driver to a distributor initiating a claim should be the incremental nature of the costs incurred.

Although issue #1 on the Board's May 11, 2007 Procedural Order outlined the three criteria of prudence, materiality and causation, the Board felt it necessary to specifically identify causation as a stand alone issue #2, namely, "The appropriateness of the storm damage cost claims relative to the value associated with the risk for this type of event that is currently imputed in each distributor's rates".

The Board notes that only one applicant was able to readily and adequately identify their annual storm costs on an actual basis. The Board further notes that generally, some measure of cost recovery for storm damage is already included in distribution rates for Ontario LDCs. However, since the Board does not have information relating to distributors' historic storm cost levels, distributors should make every effort to demonstrate that damage inflicted on their systems by extraordinary events is genuinely incremental to their experience or reasonable expectations.

On a go-forward basis and as the industry routinely rebases, it is the Board's expectation that distributors will identify a forecast for storm damage costs within their greater O&M forecast.

Reporting Requirements

All four applicants engaged the services of other distributors in Ontario during their respective emergency response initiatives. The Board is in favour of distributors assisting their neighbours, and wants to encourage mutual agreements under which the assistance is provided at cost. While the Board does not want to create an impediment by imposing additional reporting and record-keeping requirements in that regard, the Board does expect distributors to forecast the revenue that they will likely receive for assisting other distributors, in the same way as they factor in rates a provision for normalized annual storm damage costs.

Implementation

The Board finds that both the effective and implementation dates for the approved recoveries shall be September 1, 2007.

The approved rate riders shall be calculated in such a manner as to facilitate recovery of the approved amounts over a twelve month period (twenty four months for CNPI – Fort Erie should CNPI choose to keep its mitigation proposal). The approved rate riders shall remain in effect until August 31, 2008 (August 31, 2009 for CNPI – Fort Erie if applicable).

For a September 1, 2007 implementation, upon receiving this Decision, all four applicants shall reflect the Board's findings in this Decision and shall include the following in a re-filing to be filed ten days following the issuance of this Decision:

- Approved balance
- Projected interest to the end of the approved recovery period (if applicable)
- Allocation of the approved balance to the rate classes based on 2004 distribution revenue
- Total amount allocated per class, (divided by two in Fort Erie's case if applicable), and divided into fixed and variable charges based on the class-specific percentage splits as per the approved 2006 EDR methodology
- Amounts allocated to each class-specific fixed charge divided by 2004 customer numbers or connections (as applicable) and divided by 12 to determine the fixed monthly charge rate rider for each class
- Amounts allocated to each class-specific volumetric charge divided by the 2004 volumes in each rate class to determine the volumetric rate rider for each rate class.

The applicants shall include all detailed calculations supporting the derivation of interest charges and the rate riders. The Board directs the applicants to file the above information with the Board and all intervenors of record. Intervenors shall have five days from the date of receipt of the information to respond to the applicants' re-filings. The applicants should respond within three days.

Cost Awards

SEC and VECC requested and were granted cost eligibility in these rate applications. VECC and SEC filed cost claims relating to the combined proceeding on June 29, 2007 and July 9, 2007 respectively. SEC filed a revised claim on July 25, 2007. Both parties noted that copies had been served on the applicants.

The applicants will have until August 14, 2007 to object to any aspects of the costs claimed. A copy of the objection must be filed with the Board and one copy must be served on the party against whose claim the objection is being made.

The party whose cost claim was objected to will have until August 21, 2007 to make a reply submission as to why its cost claims should be allowed. Again, a copy of the submission must be filed with the Board and one copy is to be served on the applicant.

The Board will then issue a separate decision and order on cost awards for this proceeding.

DATED AT Toronto, July 31, 2007

Original Signed by

Paul Sommerville
Presiding Member

Original Signed by

Paul Vlahos
Member

Original Signed by

Ken Quesnelle
Member