



EB-2007-0542

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 distribution rates and other charges,
to be effective May 1, 2007.

BEFORE: Paul Sommerville
Presiding Member

Paul Vlahos
Member

Ken Quesnelle
Member

DECISION AND ORDER

Hydro One Networks Inc. (“Hydro One”) is a licensed distributor providing electrical service to consumers within its licensed service area. Hydro One filed an application with the Ontario Energy Board (the “Board”) for an order or orders approving or fixing just and reasonable rates for the distribution of electricity and other charges, to be effective May 1, 2007.

Hydro One is one of 85 electricity distributors in Ontario that are regulated by the Board. To streamline the process for the approval of distribution rates and charges for these distributors, the Board issued its *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario’s Electricity Distributors* (the “Report”) on December 20, 2006. The Report contained the relevant guidelines for 2007 rate adjustments (the “guidelines”) for distributors applying for rates only on the basis of the

cost of capital and 2nd generation incentive regulation mechanism policies set out in the Report.

Public notice of Hydro One's rate application was given through newspaper publication in Hydro One's service area. The evidence filed as part of the rate application was made available to the public. The Board granted intervenor status to the Schools Energy Coalition ("SEC"), the Vulnerable Energy Consumers Coalition ("VECC") and Union Gas Limited. Both Hydro One and the intervenors had the opportunity to file written submissions in relation to the rate application. The Board received written submissions from VECC and Board staff. The Board received a letter of comment from Mr. Derek Welford, Mr. Tom Johnston, Mr. Rob Beresford, Mr. and Mrs. Werner and Ursula C. Krebs. While the Board has considered the entire record in this rate application, it has made reference only to such evidence and submissions as is necessary to provide context to its findings.

Hydro One's rate application was filed on the basis of the guidelines. In fixing new rates and charges for Hydro One, the Board has applied the policies described in the Report.

After confirming the accuracy of the 2006 rate tariffs and accompanying materials submitted in the rate application, the Board applied its approved price cap index adjustment to distribution rates (fixed and variable) uniformly across all Core and Acquired retail customer classes and to low voltage distribution rates uniformly across the Direct and Embedded LDC classes. The price cap index is calculated as a price escalator less an X-factor of 1.0%, intended to represent input price and productivity trends. Based on the final 2006 data published by Statistics Canada, the Board has established the price escalator to be 1.9%. The resulting price cap index adjustment is therefore 0.9%.

The large corporation tax allowance that was included in 2006 rates was removed prior to the application of the price cap index adjustment.

The price cap index adjustment was not applied to the following components of the rates:

- the specific service charges, including the standby rate;
- the regulatory asset recovery rate riders; and
- the smart meter rate adder (an amount in the fixed components of the rates associated with smart meter cost recovery).

Hydro One requested an amount for smart meter costs. The Board has approved an amount of \$0.93 per month per metered customer. Hydro One's variance accounts for smart meter program implementation costs, previously authorized by the Board, are continued. As the notice of this application indicated, the Board will be holding a combined proceeding to consider, among other things, appropriate recovery of smart meter costs.

Hydro One's standby rate was approved as interim by the Board in its 2006 distribution rates order. The Board is still examining the issues related to standby rates, and is not in a position to make a final order for these rates at this time. The standby rate will remain interim.

Notwithstanding Hydro One's general compliance with the guidelines, the Board reviewed the following issues in detail:

- A variance account to track costs associated with municipal permit fees;
- An extension for an interim time-of-use pilot program; and
- A variance account to track incremental forgone revenues resulting from the interim time-of-use pilot program.

Municipal permit fee variance account

Hydro One requested a variance account to capture the cost increases over the current revenue requirement associated with permit fees assessed by municipalities. Hydro One stated that the assessment of these permit fees is consistent with Ontario Regulation 584/06 made under the *Municipal Act, 2001* (the "Regulation") approved on December 21, 2006. Hydro One also stated that it expects the annual balance to be approximately \$5 million.

In its submission Board Staff noted that these types of costs are a straight pass through for all distributors.

VECC also filed a submission in which it stated that the variance account request should be denied unless Hydro One can demonstrate that the variance account will track a totally new cost. VECC argued that the 2007 adjustment mechanism provides an increase in all costs. Therefore, the variance account should only be approved if this is a new cost for which there is no provision made in 2006 rates. In addition, VECC

stated that Hydro One should clarify whether all or only part of the \$5 million is incremental and whether the incremental amount meets the materiality criteria.

In its reply submission Hydro One stated that the costs associated with municipal permit fees are new unanticipated costs that were not included in Hydro One's currently approved revenue requirement. A variance account is therefore required to track the cost for the eventual pass-through to customers. Hydro One confirmed that the incremental amount is expected to be \$5 million and that this amount meets the materiality criteria.

The Board notes that the Regulation addresses fees or charges associated with permits for certain works outlined in section 9 of the Regulation. The essence of the Regulation from a ratemaking perspective is that municipalities can now, if they wish, charge for reasonably incurred costs associated with the issuance of permits with respect to those works in order to "place those works on a municipal highway and to cut the pavement of or otherwise dig up a municipal highway for the works" (section 10). The Regulation is effective January 1, 2007.

The Board's first observation is that the imposition of such costs by municipalities is elective, not mandatory. There is no information provided as to the extent to which municipalities have imposed any charges or will impose such charges in 2007 to justify Hydro One's request.

Second, there is no information as to the kind of regulatory treatment that may be warranted for such charges. If they relate to capital oriented activities, charges may be capitalized. This point may be critical in assessing materiality.

The need and purpose of a request for a deferral or variance account, and the detailed proposed mechanics of the account, are important elements in assessing the reasonableness of the request. These are not found in Hydro One's application in any meaningful detail.

The Board considers that there is a lack of information preventing the Board from assessing the merits of Hydro One's request and determining whether or not the variance account request and the potential quantum meet any reasonable standard of predictability or certainty. Furthermore, and before any of the aforementioned assessments can be made, the Board must first understand the nature of the subject

costs. The Board finds that more clarity is needed regarding the nature of the variance account in order to define the purpose and scope of any qualifying costs so that it can apply the appropriate regulatory treatment; therefore, the Board denies this request at this time.

The Board understands that there may be a need in the future for a variance account and encourages Hydro One to track the costs and activities associated with the subject permit fees until such time as sufficient information is available to clarify the nature of the costs. The Board suggests Hydro One include a report on the costs and activities as part of its evidence supporting its next cost of service application.

Time-of-use pilot program extension and associated variance account

Hydro One requested an extension to its interim time-of-use (“TOU”) rates pilot, a component of its 3rd tranche CDM program. The TOU pilot was targeted at commercial customers with the intent of achieving significant contributions to peak load reduction. The TOU pilot was scheduled to end by September 30, 2007. Hydro One asked for an extension to run until the next rebased distribution rates are established. Hydro One also requested a variance account to track forgone revenues resulting from the TOU program that are incremental to the level contemplated by the original budget.

In its submission, Board Staff argued that although Hydro One’s request for an extension to its TOU rates pilot to beyond September 30, 2007 does not involve a request for additional funding at this time (i.e. no increase to 2007 rates), the request should be treated in the same manner as a request for incremental CDM funding. Pursuant to the March 1, 2007 filing requirements for incremental CDM funding, Board Staff submitted that if the extension is to be granted it should include the proviso that Hydro One must file a TRC analysis demonstrating that the TOU pilot passes the TRC test before the program is approved on a final basis. With respect to the variance account, Board Staff identified no concerns with Hydro One’s request but noted that granting of the variance account should not in any way imply any certainty of recovery to Hydro One. Board Staff submitted that Hydro One should still have to demonstrate that the interim TOU rates pilot passes the TRC test.

Board Staff also submitted that the extension of the interim TOU rate pilot should be approved to run only until the end of the 2007 rate year i.e. April 30, 2008 as per the March 1 filing requirements and not necessarily until the next rebased distribution rates are established as per Hydro One's request.

In its submission, VECC supported the submissions made by Board Staff on the above matters, namely, the extension of the TOU rate pilot and the granting of the variance account on the condition that Hydro One files an analysis demonstrating that the program passes the TRC test when an application is made for approval and recovery of the costs in the variance account.

In its reply submission, Hydro One noted that a TRC test was not required for 3rd tranche CDM expenditures and that a preliminary analysis indicates that the program would not pass the TRC test. In addition, Hydro One amended its request for the extension to run only until April 30, 2008.

In assessing the reasonableness of Hydro One's request, the Board is guided by its March 2, 2007 Report on the Regulatory Framework for Conservation and Demand Management by Ontario Electricity Distributors in 2007 and Beyond. A key component of that report is the requirement for distributors to undertake program evaluations on CDM activities and provide results on those evaluations. For CDM activities funded through distribution rates, the evaluation would include the cost effectiveness results as determined by the TRC test analysis. The Board notes that the requirement to pass the TRC test is included in the March 1 filing requirements for incremental 3rd tranche funding for 2007. The Board agrees with Board Staff and VECC that Hydro One's request for the extension of the TOU rate pilot and the associated variance account should be treated in the same manner as a request for incremental funding.

The Board notes that Hydro One has yet to file actual TRC results for the interim TOU pilot as part of its annual reporting for either 2005 or 2006. In its reply submission, Hydro One stated that its preliminary analysis indicates that the TOU rate pilot would not pass the TRC test. Therefore, the Board finds that Hydro One's request for an extension to the interim TOU rates pilot to beyond September 30, 2007 and its request for the associated variance account are denied, unless Hydro One, in accordance with the March 1 filing requirements, files with the Board a TRC analysis demonstrating that the TOU rate pilot passes the TRC test. Should Hydro wish to make such filing, it must do so no later than July 31, 2007.

Draft rate order

The Board directs Hydro One to file with the Board and all intervenors of record a draft rate order attaching its Tariffs of Rates and Charges to reflect the Board's findings in this decision. Unlike other distributors in the 2007 distribution rates process, Hydro One prepares its own rate order and tariff sheets. The rate order and Tariffs shall have an effective date of May 1, 2007 and shall be final with the exception of the standby rate which shall remain interim. Intervenors shall have three days from the date of receipt of the drafts to respond to Hydro One's draft rate order and Tariffs. Hydro One should respond as soon as possible to any comments from intervenors.

Cost Awards

SEC and VECC requested and were granted cost eligibility in this rate application. Parties who were granted cost eligibility shall submit their cost claims by May 4, 2007. A copy of the cost claim must be filed with the Board and one copy is to be served on Hydro One. The cost claims must be done in accordance with section 10 of the Board's Practice Direction on Cost Awards.

Hydro One will have until May 18, 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 May 25, 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 Hydro One.

DATED at Toronto, April 20, 2007

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary