Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2007-0879

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 Veridian Connections Inc. for an order or orders approving or fixing just and reasonable distribution rates and other charges, to be effective May 1, 2008.

BEFORE: Paul Vlahos
Presiding Member

Paul Sommerville
Member

DECISION

Introduction

Veridian Connections Inc. ("Veridian") is a licensed distributor of electricity providing service to consumers within its licensed service area. Veridian 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, 2008.

Veridian is one of over 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010. As part of the plan, Veridian is one of the electricity distributors to have its rates adjusted for 2008 on the basis of the 2nd Generation Incentive Rate Mechanism ("IRM") process.

To streamline the process for the approval of distribution rates and charges for 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. Among other things, the Report contained the relevant guidelines for 2008 rate adjustments (the "Guidelines") for distributors applying for rate adjustments pursuant to the IRM process.

Notice of Veridian's rate application was given through newspaper publication in Veridian's service area advising of the availability of the rate application and advising how interested parties may intervene in the proceeding or comment on the application. There were no intervention requests and no comments were received.

The Board issued Procedural Order No.1 on December 18, 2007, in which the Board announced that it would proceed by way of a written hearing. Procedural Order No. 1 also established a schedule for the filing of and response to interrogatories, and the filing of and response to submissions. Board staff submitted interrogatories and a submission on the application.

While the Board has considered the entire record in this rate application, it has made reference only to such evidence as is necessary to provide context to its findings.

Price Cap Index Adjustment

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

As outlined in the Report, distribution rates under the 2nd Generation IRM are to be adjusted by a price escalator less a productivity factor (X-factor) of 1.0%. Based on the final 2007 data published by Statistics Canada, the Board has established the price escalator to be 2.1%. The resulting price cap index adjustment is therefore 1.1%. The rate model was adjusted to reflect the newly calculated price cap adjustment. This price cap index adjustment applies to distribution rates (fixed and variable charges) uniformly across all customer classes. An adjustment for the transition to a common deemed capital structure of 60% debt and 40% equity was also effected. In addition, a change in the federal income tax rate effective January 1, 2008 was also incorporated into the rate model and reflected in distribution rates.

The Board also considered the reduction in Ontario capital tax and the increase in capital cost allowance (CCA) applicable to certain buildings and computers acquired after March 2007. The Board has decided that adjustments related to these items are not required, either because the changes are not of general application, or because they do not appear to be material.

The price cap index adjustment does not apply to the following components of the rates:

- the specific service charges;
- the smart meter rate adder (an amount in the fixed components of the rates associated with smart meter cost recovery); and
- any continuing rate riders.

Accordingly, the Board is providing Veridian with a rate model (spreadsheet) that reflects the price cap adjustments described above. Veridian is required to review the rate model (spreadsheet) and to confirm its completeness and accuracy with the Board at the time it files its Draft Rate Order. Veridian shall file with the Board a Draft Rate Order attaching the proposed Tariff of Rates and Charges which will reflect the Board's price cap adjustments as verified by Veridian. Veridian shall also provide the rate model (spreadsheet) that underpins the Tariff of Rates and Charges. Any changes to the Board's rate model (spreadsheet) shall be clearly identified and explained.

Rate Riders

When the Board approved new rates for distributors for 2006, it also approved the recovery of regulatory asset balances on a final basis. The Board approved rate riders to facilitate the recovery of the approved balances over the two remaining years of the four-year recovery period mandated by the Minister of Energy (i.e. May 1, 2004 to April 30, 2008). The rate rider(s) associated with the recovery of regulatory assets will cease on May 1, 2008 and shall be removed from the Tariff of Rates and Charges, unless a previous Board decision authorized the continuation of such riders beyond April 30, 2008. No such authorization has been previously provided by the Board for Veridian. The final balance in account 1590 cannot be confirmed until after the current recovery period has expired, i.e. after April 30, 2008. Once the residual balance in deferral account 1590 is finalized, the residual balance will be disposed in a future proceeding.

Smart Meter Rate Adder

Veridian requested the continuation of the smart meter rate adder previously approved by the Board in order to provide funding for possible future implementation of smart meter costs and to minimize future rate impacts. The Board-approved rate adder for Veridian of $0.73 per month per metered customer shall continue. Veridian's variance accounts for smart meter program implementation costs, previously authorized by the Board, shall also be continued.

Rate Harmonization

Background

Veridian is comprised of three service areas with separate distribution rates: its main service area, Scugog and Gravenhurst. Its main service area is the result of the harmonization of several distributors that were acquired by Veridian or merged with Veridian. Veridian's most recent rate harmonization was approved in the RP-2005-0020/EB-2005-0422 proceeding and resulted in the reduction of four geographically-based rate schedules to one for its main service area, effective May 1, 2006.

Timing and Scope

As part of its 2008 IRM application, Veridian requested that the rates charged in its main service area and its Scugog service area ("Scugog") be harmonized. In its submission, Board staff noted that the Board, in its *Report of the Board on Rate-Making Associated with Distribution Consolidation* (the "Board Report"), stated that rate harmonization is better examined at the time of rebasing because it is when the consolidated entity will apply for its combined revenue requirement. Veridian submitted that PowerStream Inc. performed its rate harmonization during the 2007 IRM rate year and that Veridian had informed the Board in earlier proceedings of its intent to harmonize its rates in 2007. Veridian also finds that proceeding with the rate harmonization at this time will reduce cross subsidization across service areas sooner than if it is postponed until Veridian is rebased in 2010. The Board accepts that there are benefits to proceeding with the rate harmonization of Veridian's main service area and Scugog at this time.

Veridian did not request that the rates in its Gravenhurst service area (“Gravenhurst”) be harmonized with the balance of Veridian’s service areas. Veridian explained that while its main service area and Scugog have homogeneous characteristics in terms of customer density, topography and costs of service, Gravenhurst is markedly different. Gravenhurst has a lower customer density with a number of remote access customers on lakeshores and islands, many of whom are seasonal customers. Also, while Veridian has one common service centre for its main service area and Scugog, Gravenhurst has a dedicated regional service centre. The Board agrees that the characteristics of the Gravenhurst service area and the balance of Veridian’s service areas differ and accepts Veridian’s proposal to only harmonize Scugog and Veridian’s main service area at this time.

Methodology

To harmonize its rates, Veridian performed the following three steps:

1. Combined the approved 2006 EDR revenue requirements of its main service area with Scugog’s, as adjusted for the new capital structure and payments in lieu of taxes, and harmonized the retail transmission service rates and loss factors. These inputs were applied to the 2006 EDR model to produce one set of new harmonized 2006 rates;
2. Applied the harmonized 2006 rates to the 2007 IRM model to produce the harmonized 2007 rates;
3. Applied the harmonized 2007 rates to the 2008 IRM model to generate the proposed rates.

Board staff noted in its submission that Veridian’s approach is consistent with PowerStream’s harmonization proposal, as approved by the Board in the EB-2007-0074 Decision and Order. The Board agrees.

In reviewing the evidence, the Board considered the following:

1. What is the impact on the revenue requirement?
2. Are the changes in the levels of the fixed monthly charges reasonable?
3. Are the total bill impacts reasonable?
4. Other rate matters addressed by Veridian in their application; combining retail transmission service rates and combining distribution losses.

Revenue Requirement Impact

The application is not revenue neutral. The 2006 revenue requirement for Veridian increases by $103,136 to $ 41,516,646, which represents about a 0.25% increase. The main drivers for the net change in the revenue requirement are:

- Correction of errors related to the Cost of Power in Veridian's approved 2006 EDR model;
- Treatment of Scugog's non-capital loss carry-forward; and
- A Change in Scugog's Debt Equity ratio from 50/50 to 55/45 and its weighted debt rate from 6.25% to 7.11%.

The correction of errors relates to the normalization of consumption per customer performed in the approved 2006 EDR model and results in a $44,310 increase in working capital allowance. This increase in the working capital allowance in turns increases the revenue requirement by $3,527. The Board has reviewed and approves the correction proposed by Veridian to its 2006 EDR model.

In its 2006 tax model, $174,599 of non-capital loss carry-forward had been deemed to be used by Scugog to reduce its 2006 taxable income. This amount is now being deemed to be used to reduce the combined income of Veridian's main service area and Scugog in 2005. Board staff noted that this treatment was similar to three recent applications approved by the Board (ENWIN Utilities Ltd. EB-2007-0522, Welland Hydro-Electric System Corp. EB-2007-0663, and PUC Distribution Inc. EB-2007-0723). The Board finds that the request for an adjustment to current rates to reflect the reduction of the loss carry-forwards present in the 2006 rates is tax-related and is an anomaly. The request to rectify it does not constitute any deviation from the letter or the spirit of Z-factor adjustments permitted by the Board as documented in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*. The Board therefore approves Veridian's proposal.

As a result of these changes, in addition to changes in the deemed capital structure and debt costs for the Scugog service area, Net Income Before PILs and PILs changed, which resulted in a net increase in the revenue requirement.

The Board approves the changes in the deemed capital structure and related costs for the purposes of setting the 2006 revenue requirement as the first step in the harmonization of rates.

Fixed Monthly Charges

By virtue of the proposed harmonization, existing and distinct distribution rates by rate class change to a new and common set of rates by rate class. The split between the fixed monthly charge and the variable charge consequently changes. The Board has reviewed the resulting change to the portion of the typical total bill recovered from the fixed monthly charge for all rate classes and is satisfied that they will not result in an undue burden for any rate class. The Board finds the proposed fixed monthly charges to be reasonable.

Total Bill Impacts from Harmonization

Based on the evidence filed by Veridian, the total bill impacts range from a 35.8% decrease to a 1.2% increase. A residential customer consuming 1,000 kWh per month would experience an approximate change in the electricity bill ranging from a decrease of 0.4% to an increase of 0.4%, depending on their service area. A small general service customer consuming 2,000 kWh per month and having a monthly demand of 50 kW or lower would see an approximate change in the electricity bill ranging from a decrease of 0.1% to an increase of 0.4%.

The Board notes that these figures were calculated by Veridian prior to incorporating the federal tax adjustment described earlier and using the estimated 1.9% price escalator instead of the final 2.1% price escalator based on data published by Statistics Canada in March 2008. Moreover, these estimated bill impacts do not take into account the retail transmission service rate adjustments to be effected, as described in a later section of this decision. The Board estimates that these three adjustments will result in a reduction of the total bill impacts calculated by Veridian. The Board finds the estimated total bill impacts to be acceptable.

Other Rate Matters

In the process of harmonization, Veridian also addressed the issues of combining retail transmission service rates and distribution losses. The proposed approach would result in the harmonization of the retail transmission service rates within each rate class that reflect the aggregation of the costs of the two service areas. As for distribution losses, Veridian proposes that Scugog adopts Veridian’s main service area’s loss factors, which are lower. The Board accepts the proposed approach.

Conclusion

For the reasons set out above, the Board approves Veridian's rate harmonization proposal.

Retail Transmission Service Rates

Background

On October 17, 2007, the Board issued its EB-2007-0759 Rate Order setting new Uniform Transmission Rates for Ontario transmitters, effective November 1, 2007. The Board approved a decrease of 18% to the wholesale transmission network rate, a decrease of 28% to the wholesale transmission line connection rate, and an increase of 7% to the wholesale transformation connection rate. The combined change in the wholesale transmission line connection and transformation connection rates is a connection rate reduction of 5%.

On October 29, 2007, the Board issued a letter to all electricity distributors directing them to propose an adjustment to their retail transmission service (RTS) rates to reflect the new Uniform Transmission Rates for Ontario transmitters effective November 1, 2007. The objective of resetting the rates was to minimize the prospective balance in variance accounts 1584 and 1586 and also to mitigate intergenerational inequities.

RTS Rate Adjustment

Veridian proposed, for its main service area and Scugog, to reduce both its RTS – Network Service Rates and its RTS – Line and Transformation Connection Service Rates by 20.0% for all its rate classes. These proposed changes are based on a comparison of RTS revenue under existing rates and adjusted wholesale transmission costs. No changes were assumed regarding the level of transmission related charges payable to Hydro One Networks Inc. on the grounds that Veridian's main service area and Scugog are partially embedded within Hydro One Distribution and that the RTS rates Hydro One Distribution charges have not yet changed. The Board notes that the RTS rates of Hydro One Distribution are currently under review by the Board as part that utility's 2008 distribution rate application. Hydro One Distribution has proposed changes to its existing RTS rates as a result of the changes in the Uniform

Transmission Rates for Ontario transmitters effective November 1, 2007. While there is uncertainty regarding the exact quantum and timing of this upcoming rate change, the Board finds that, in order to minimize the prospective balance in variance accounts 1584 and 1586 and mitigate intergenerational inequities, wholly embedded or partially embedded distributors should adjust their RTS rates to reflect the proposed changes in the RTS rates charged by their host distributor. Since the proposed changes in the RTS rates of Hydro One Distribution are similar to the approved changes in the Uniform Transmission Rates for Ontario transmitters, the Board directs Veridian to recalculate its proposed RTS rates adjustments assuming that the portion of transmission related charges payable to its host distributor will be reduced by 18% for its RTS – Network Service Rates and by 5% for RTS – Line and Transformation connection Service Rates. Veridian is required to include these changes in its rate model (spreadsheet) to be filed with the Board.

Veridian did not file a proposal to adjust its RTS rates for Gravenhurst on the basis that this service area is fully embedded within Hydro One Network Inc.'s distribution system. For the reasons listed above, the Board directs Veridian to reduce its Gravenhurst's RTS – Network Service Rates by 18% and its RTS – Line and Transformation connection Service Rates by 5%. Veridian is required to include these changes in its rate model (spreadsheet) to be filed with the Board.

Variance Accounts 1584 and 1586

For its main service area and Scugog, Veridian proposed to dispose of the balances in variance accounts 1584 and 1586 as of September 30, 2007. Those variance account balances, a credit of $1,404,790 and a credit of $8,330,270 respectively, would be disposed of by means of a rate rider over a one-year period.

In its submission, Board Staff noted that the usual practice for disposing of variance and deferral accounts in the electricity sector is to use the most up-to-date audited balances, as supported by audited financial statements, plus forecast carrying charges on those balances up to the start of the new rate year. The disposition of deferral and variance account balances is also generally dealt with in aggregate rather than clearing discrete accounts.

The Board notes Staff's observations and further notes that, on February 19, 2008, the Board announced an initiative for the review and disposition of commodity account 1588

(RSVA-Power). Also, as part of this initiative, the Board will consider whether to extend this initiative to other accounts that are similar in nature, including RSVA accounts 1584 and 1586. The Board finds it more appropriate to defer this matter to this initiative. Therefore, the Board will not approve the disposition of variance accounts 1584 and 1586 in this proceeding.

Implementation

Veridian's new distribution rates are effective May 1, 2008. The Board directs that:

1. Veridian shall file with the Board a Draft Rate Order attaching the proposed Tariff of Rates and Charges and the supporting rate model (spreadsheet) within seven (7) days of the date of this Decision. The proposed Tariff of Rates and Charges shall be filed in a Word format. The adjusted rate model shall be filed in an Excel format.

DATED at Toronto, March 19, 2008.

Original signed by

____

Paul Vlahos
Presiding Member

Original signed by

____

Paul Sommerville
Member