

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.M15, Sched. B;

AND IN THE MATTER OF an application by Oakville Hydro Electricity Distribution Inc. for an order or orders approving just and reasonable electricity distribution rates.

Before: Bob Betts
Presiding Member

Paul Vlahos
Member

AMENDED REASONS FOR DECISION

Oakville Hydro Electricity Distribution Inc. (“Oakville Hydro” or the “Applicant”) filed an application dated November 30, 2004 pursuant to section 78 of the *Ontario Energy Board Act, 1998* for an order or orders of the Ontario Energy Board authorizing electricity distribution rates. The Board assigned the application Board file number EB-2004-0527.

The Board issued a Notice of Application on December 22, 2004 that the Applicant served and published in accordance with the Board’s Letter of Direction. The Board granted intervenor status to Mr. Michael Lowry, a residential customer of Oakville Hydro, and to Praxair Inc., a large use customer of Oakville Hydro. The Board issued two procedural orders in connection with this application. The first was dated January 31, 2005 and provided a discovery process. The second was dated March 16, 2005 and set the date for the oral hearing. The hearing was held in the Board’s hearing room on March 24, 2005.

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At the end of the oral portion of the evidence the Board rendered its decision orally approving the application. The Board indicated that the reasons for the Decision and some pertinent commentary would follow.

Summary of the Application

Oakville Hydro distributes electricity to approximately 65,000 customers. Two of these customers have demand greater than 5,000 kW and therefore are in Oakville Hydro's Large Use customer class. One of these customers is changing its operations and consequently will reduce its demand to less than 5,000 kW. This change in the customer's operations causes Oakville Hydro to reclassify the customer into a General Service Greater than 1,000 kW class. The combined effect of the change in the customer's energy consumption and the change in the rates charged upon reclassification, result in Oakville Hydro not collecting approximately \$1.261 million annually, approximately 4% of its annual distribution revenues.

Oakville Hydro proposes to adjust the rates it charges all its remaining customers in a way that will allow it to continue to recover this amount. Under this proposal, distribution rates will increase on average by 4%. As distribution charges are approximately 35% of a customer's total bill, the associated bill impact is approximately 1.5%. The average bill impact varies by customer class and energy consumption. For example, Oakville Hydro estimates that the average bill increase associated with its proposed rate adjustment for a residential customer consuming 1,000 kWh a month is approximately 1.4%.

Oakville Hydro's Evidence

Oakville Hydro's prefilled evidence detailed the determination of the relief requested and of the adjustments to rates to recover this amount from ratepayers.

Oakville Hydro claimed that it may not be able to satisfy its financial obligations if the requested relief was not provided. The Applicant's financial position and its ability to undertake planned maintenance were examined. The witnesses

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indicated that one of the possible consequences of the Board denying the application was an inability to support appropriate levels of maintenance and to undertake maintenance according to plan. The witnesses could not describe measures available to management to deal with the consequences of the Board denying the application. Neither could they describe the alternatives available to management - either to control or to mitigate the consequences arising from the reclassification of the subject customer.

In response to questions by Board counsel, the witnesses confirmed the financial consequences of the utility's increased customer base and the associated delivery of electricity. The witness' testimony touched on the lack of precision in determining the relief requested. This is due to the lack of an objective cost allocation. The witnesses lacked knowledge of the rationale for setting rates at a level that affords the utility an opportunity to earn a return on equity, whether equity could be apportioned into a reserve account or whether return could be applied to offset or reduce the claimed relief.

The Applicant's evidence detailed the appropriate adjustments to distribution rates to permit the recovery of the relief claimed. The applicant has determined each customer class' level of responsibility according to the class' distribution revenue responsibility. Based on that level, the applicant adjusted rates for all classes in a manner that allows the collection of the claimed relief and does not cause a material impact on any customer's bill.

Reasons for Decision

The rates authorized by the Board and charged by the utility are expected to allow the utility to recover the costs it incurs to provide distribution service. Rates are set at a level that provides the utility an opportunity to earn a return on equity to compensate it for the risks it incurs; they are not set to guarantee the recovery of the allowed return. The subject customer's reclassification from the utility's Large Use customer class to its General Service Greater than 1,000 kW customer class is an example of the realization of an aspect of business risk that return is designed to compensate for.

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The evidence indicates that no stranded assets are associated with or will arise from the subject customer's reclassification.

The reclassification of a customer of this size is an unusual event. For Oakville Hydro, the reclassification of the subject customer results in the potential to under-recover approximately 4% of the distributor's distribution revenues - a rare and extreme situation. The Board finds that it is not appropriate to expect a utility's management to be able to cope with the consequences of such a situation. For these reasons the Board will provide the relief requested and authorize the proposed adjustments to rates.

The Board notes the unusual circumstances in this case: the loss of a very material demand and consumption from a single customer and in a customer class consisting of only one other customer. The Board acknowledges that the Board approved rates include compensation to the utility for the risk of business losses. However, the Board finds that it is appropriate to reallocate revenue responsibility because the loss that would otherwise be incurred is material, beyond the control of the utility and beyond a reasonable level of business loss.

The Board further notes the Applicant's evidence that its rate of return in 2005 would fall to approximately 0.3% if the application were denied and amount to approximately 1.4% if the application were approved. The Board also notes that the Applicant may experience difficulty in properly maintaining its plant without some relief.

With respect to the allocation the lost revenue to the remaining customers, the Board finds that it is appropriate to spread the responsibility for revenue recovery over the larger customer base to avoid an unreasonable rate increase to any individual customer.

The Board notes that a more accurate quantification of the relief sought and most appropriate allocation of any stranded costs require an accurate cost allocation study and rates designed based on the findings of that study. While the Board is establishing plans for such studies, such information is not currently available. The Board accepts the relief sought and the proposed adjustment to rates as a practical solution.

Board Comments

The evidence filed by the Applicant and the testimony provided did not demonstrate a thorough understanding of the Board's rate setting methodology. In particular, the Board is troubled that the witnesses did not appreciate the purpose in allowing distribution utilities to collect return through the rates the Board approves. The Board is also concerned with the lack of a defensible cost allocation study competent to support an accurate quantification of the results of customer reclassification. The Board expects that applications filed with it in the interest of the utility will be founded upon a thorough evaluation of all regulatory principals and rate design methodology. The application must exhibit a clear understanding of why the relief is requested and the available alternatives, as well as an understanding of how the relief was determined.

Implementation

The Board's findings in this Decision has been combined with its decision and order in connection with Oakville Hydro's 2005 distribution rates application, Board file number RP-2005-0013/EB-2005-0059, which was issued on March 31, 2005.

Issued at Toronto, May, 11 2005

Signed on behalf of the Panel

Paul Vlahos
Member

Amended at Toronto, June 15, 2005
Amended by Gordon Kaiser, Vice Chair and Member
Oakville Hydro Motion to Vary, Board File: EB-2005-0292