

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

AND IN THE MATTER OF the preparation of a handbook for
electricity distribution rate applications.

**BRANTFORD POWER INC. ("BRANTFORD POWER")
AURORA HYDRO CONNECTIONS INC. ("AURORA HYDRO")
AND SCUGOG HYDRO ENERGY CORPORATION
("SCUGOG HYDRO") WRITTEN SUBMISSIONS ON
CHAPTER 3 OF THE DRAFT 2006 EDR HANDBOOK –
TEST YEAR AND ADJUSTMENTS**

FEBRUARY 14, 2005

This submission is organized as follows:

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**PART TWO: POLICY ISSUES - LDCs SHOULD NOT HAVE BEEN PUNISHED
FOR NEGATIVE 1999 RETURNS**

**PART THREE: LDCs WITH NEGATIVE 1999 RETURNS SHOULD BE
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WITHOUT BEING SUBJECT TO TESTS OF HARDSHIP OR
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MITIGATION-RELATED ADJUSTMENTS UNDER CHAPTER 13**

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PART ONE: INTRODUCTION

1. Brantford Power, Aurora Hydro and Scugog Hydro are Ontario local electricity distribution companies ("LDCs") that experienced negative returns in 1999, the year on which LDCs initial revenue requirements and distribution rates were based. By operation of Section 3.4.1.4 of the Ontario Energy Board's (the "OEB's") initial electricity distribution rate handbook issued in 2000, which provided in part that "Any utility with a negative ROE in 1999 will be subject to the floor value of 0 per cent"¹, these LDCs were not permitted to earn the maximum permitted regulatory rate of return on equity of 9.88%, to which other LDCs were entitled.
2. Chapter 3 of the draft 2006 Electricity Distribution Rate ("EDR") Handbook contemplates the use of "a test year derived from the applicant's 2004 (historical) audited financial statements, subject to the adjustments provided for in this chapter."² The chapter contains mandatory "Tier 1 adjustments" that would address "non-routine unusual adjustments applying to 2004 only", and limited post-2004 adjustments.³ Chapter 3 also contains optional "Tier 2 Adjustments", the purpose of which is described at p.22 of Chapter 3 as being "to restore both capital investments not made and distribution expenses not incurred due to one or both of the following circumstances: the applicant began the 1999 RUD process with negative returns; and/or the applicant did not receive the second third of the market-adjusted revenue requirement increment."
3. The following submissions pertain to the provisions in the draft EDR Handbook relating to the proposed Tier 2 adjustments. They also pertain, in general terms, to the draft Chapter 13 – Mitigation – insofar as they address the exclusion of Tier 2 adjustments from the proposed mitigation requirements of the Handbook.
4. In short, Brantford Power, Aurora Hydro and Scugog Hydro are concerned that the draft Handbook bases the Tier 2 adjustments on hardship and system deterioration, and that OEB staff, and the OEB itself, will set the threshold for hardship so high that it will be

¹ Revision 1.0, issued November 3, 2000, at p.3-8

² Section 3.0, at p.16

³ Section 3.2, at p.17

impossible to meet, thereby rendering the possibility of Tier 2 adjustments meaningless. Additionally, Brantford Power, Aurora Hydro and Scugog Hydro are concerned that, even where the threshold for a Tier 2 adjustment can be met, the adjustment will effectively be clawed back by operation of a mitigation requirement.

PART TWO: POLICY ISSUES - LDCs SHOULD NOT HAVE BEEN PUNISHED FOR NEGATIVE 1999 RETURNS

5. Prior to the OEB's assumption of the regulation of municipal electric utilities ("MEUs", the hydro-electric commissions that were the predecessors of the LDCs) in 1999, Ontario Hydro acted as their regulator, and they were subject to Ontario Hydro policies. In certain cases (for example, with respect to Aurora Hydro and Scugog Hydro), MEUs had been directed by Ontario Hydro in previous years to reduce their working capital balances, as they were considered by Ontario Hydro to be too high. In other cases (such as that of Brantford Power), decisions were made in previous years by the MEUs or their corresponding municipal councils to reduce electricity rates or working capital. In either case, the negative returns in 1999 were not the result of mismanagement or inefficiency, and Brantford Power, Aurora Hydro and Scugog Hydro are not aware of any suggestion having been made by the OEB to that effect. In the cases of these three LDCs, the negative returns were the result of external actions that were not the fault of the LDCs. In the normal course, had the approach to ratemaking not changed with the OEB's 2000 Rate Handbook, the negative returns would simply have continued until the working capital levels were satisfactory to the former regulator. Rates would then have been readjusted to levels that would have allowed the MEUs to avoid operating at a loss.
6. However, the OEB's determination in the 2000 Rate Handbook to use 1999 data created a snapshot of these LDCs as being in a loss position. This could have been addressed in the initial Rate Handbook by allowing these LDCs to earn returns slightly in excess of 9.88% so that they could first bring themselves to 0% and be on an even footing with the rest of the province's LDCs, and then earn the 9.88% maximum regulatory return on equity to which all other LDCs were entitled. Instead, the arbitrary setting of a floor value of 0% for LDCs that had earned negative returns in 1999 will have prevented these

LDCs from earning the regulatory return on equity of 9.88% to which other LDCs have been entitled, because while they, like the vast majority of LDCs, elected MBRRs of 9.88% in their initial rate applications in 2000, the 9.88% was in reality not being added to a 0% return. Instead, it was being added to their 1999 returns of -\$937,730.00 for Brantford Power, -\$166,760.00 for Aurora Hydro and -\$65,325.00 for Scugog Hydro. With the Market Adjusted Revenue Requirement being phased in as a result of the Minister's Directive of June 2000, the floor value has affected each MARR-related rate adjustment for each of these LDCs, in that each adjustment has been less than that to which other LDCs have been entitled as of right.

7. Although it confirmed in its Decision with Reasons in its proceeding in response to the Minister's Directive of June 2000 (RP-2000-0069),⁴ that utilities could make their cases before the OEB in the event of "financial hardship", the OEB defined that term as generally meaning "the inability to meet financial obligations incurred prudently."⁵ The OEB specifically stated that "In the context of the phase-in period, financial distress generally does not mean below market returns, lower returns compared to other utilities, or loss of revenue due to restructuring or from anticipated adverse business conditions." In effect, therefore, to meet the "hardship" test, an LDC would have to be approaching insolvency before it could approach the OEB for a rate adjustment.
8. Accordingly, LDCs such as Brantford Power, Aurora Hydro and Scugog Hydro will have been subject to this punitive provision of the Handbook for five years, notwithstanding that their negative 1999 returns were not the result of inefficiency or mismanagement, or forces that they were in a to position control. This was an inappropriate policy five years ago, and it remains an inappropriate policy today. Brantford Power, Aurora Hydro and Scugog Hydro also understand that certain LDCs that experienced negative 1999 returns but that were parties to amalgamations, had their 1999 losses netted against the positive returns of their partners, the result being that that the amalgamated entity would be in a position to earn a full 9.88% return on equity and would not be affected by the negative

⁴ At Section 3.2 of the Decision

⁵ At Section 3.2.2 of the Decision

returns of one of the amalgamating LDCs.⁶ Accordingly, it would appear that not all LDCs have been subject to this punitive provision of the current Rate Handbook. Brantford Power, Aurora Hydro and Scugog Hydro are pleased that the draft Handbook recognizes that some LDCs will have been unable to move to the full permitted Market Based Rate of Return during first generation Performance Based Regulation as a result of negative returns in 1999 or the operation of the *Electricity Pricing, Conservation and Supply Act, 2002* ("Bill 210"), and that it proposes certain measures to address this. However, Brantford Power, Aurora Hydro and Scugog Hydro are concerned that the provisions of the draft 2006 EDR Handbook, which on their face suggest that there may be some relief from this punitive treatment in 2006, will be applied in such a way as to perpetuate it.

PART THREE: LDCs WITH NEGATIVE 1999 RETURNS SHOULD BE PERMITTED TO RECOVER ALL FORGONE RETURNS WITHOUT BEING SUBJECT TO TESTS OF HARDSHIP OR SYSTEM DETERIORATION

9. Brantford Power, Aurora Hydro and Scugog Hydro will qualify for Tier 2 adjustments under the terms of Section 3.2 of the draft 2006 EDR Handbook, as they all "began the 1999 RUD process with negative returns." However, the draft Handbook notes that "Tier 2 adjustments are not an entitlement." This is despite the fact that the maximum regulatory rate of return on equity *was* effectively an entitlement for all other LDCs in the province.
10. The draft 2006 EDR Handbook contains two alternatives with respect to Tier 2 adjustments. Both would allow for adjustments for the recovery of forgone incremental MARR-related revenue for 2004, but Alternative 2 would also allow for the recovery of forgone MARR-related incremental revenue from previous years. At p.23, the draft Handbook provides:

"In order for the Board to approve proposed Tier 2 adjustments, the applicant must do the following:

- demonstrate that it has suffered hardship as a result of one or both of the circumstances outlined above

⁶ For example, RP-2000-0245/EB-2000-0530 and RP-2000-0249/EB-2000-0534

- demonstrate that the proposed incremental distribution expenses and capital spending levels are justified by the hardship it has experienced, including how the applicant determined that these amounts are attributable to the two circumstances outlined above
 - provide details on the activities that will be undertaken if the proposed incremental spending is approved, including specific details as to the nature of the envisaged activities and their timing on a monthly basis"
11. Brantford Power, Aurora Hydro and Scugog Hydro have some difficulty with the premise that the Tier 2 adjustments are tied to distribution expenses and capital expenditures, when the forgone incremental returns that are being recovered by a qualifying LDC would have been part of the LDC's commercial returns. However, Brantford Power, Aurora Hydro and Scugog Hydro are prepared to accept the proposition that an LDC wishing to obtain adjustments for the recovery of the forgone incremental revenue will be required to provide details on the projects that will be undertaken if the recoveries are approved, notwithstanding that this represents inequitable treatment in relation to all other LDCs that were entitled to their regulatory returns without such a requirement (with the exception of the 3rd tranche of MARR, which was linked to the LDC's Conservation and Demand Management Plan).
12. However, once the LDC has established that the activities were not undertaken, and that the undertaking of the activities is reasonable for the proper maintenance and operation of its distribution system, then the LDC should be entitled to the recovery. The use of a "hardship" standard suggests that the LDC must have been on the brink of insolvency, which may be very difficult, if not impossible, to establish to the OEB's satisfaction. Since the issuance of their initial unbundled rate orders in 2001, LDCs have been required to live within their PBR limits – as a practical matter, they could only approach the OEB (or the Minister of Energy) for relief if they were experiencing "financial hardship" or "financial distress." The difference between qualifying LDCs and the rest of the province's LDCs is that the limits within which the qualifying LDCs were required to live were arbitrarily set at lower levels than those of the other LDCs. The other LDCs were not required to prove their need to earn their full 9.88% regulatory rates of return on equity. It is inequitable that qualifying LDCs must prove hardship or system degradation in order to achieve the levels of return on equity to which other LDCs have been entitled as of right. Moreover, it is not reasonable to require LDCs to demonstrate "identified

material degradation of the distribution system" in order to be eligible for the adjustments, whether for 2004 or previous years. Given that LDCs would risk being in breach of their licence conditions if they were to allow their systems to degrade, the requirement to show degradation would likely be quite difficult to meet.

13. Brantford Power, Aurora Hydro and Scugog Hydro submit that the distinctions between the two alternatives for Tier 2 adjustments set out in the Handbook are difficult to understand. In either qualifying circumstance, the LDC has lost more than one year's worth of incremental returns – there is no apparent reason to limit the LDC to the recovery of only one year's worth of incremental returns, other than arbitrariness. If the OEB is going to insist that LDCs justify their recoveries on the basis of forgone activities, then that should be the driver for the recovery. If the LDC has forgone activities with a value equal to several years' worth of incremental revenues, then that is the amount of revenue that should be recovered.

14. With respect to the requirement to advise, in the application for the Tier 2 adjustments, as to the timing of the activities to be performed by the qualifying LDC, and the proposed reporting requirements in respect of the activities related to the Tier 2 adjustments, Brantford Power, Aurora Hydro and Scugog Hydro suggest that it is not reasonable to require LDCs to be able to commit to the timing of proposed activities on a monthly basis when they have no idea at the time of applying for the recovery as to whether the requested relief will be granted – the timing of activities on a quarterly or less-frequent basis is far more feasible. Similarly, monthly reporting on the activities is unnecessarily burdensome – Brantford Power, Aurora Hydro and Scugog Hydro note that the OEB's "RRR" requirements are based on quarterly reporting, and that the OEB has imposed quarterly reporting requirements on LDCs with respect to the activities set out in their 2005 Conservation and Demand Management Plans. Quarterly, or less-frequent reports should also be adequate for the activities contemplated by the Tier 2 adjustments.

PART FOUR: TIER 2 ADJUSTMENTS SHOULD NOT BE SUBJECT TO MITIGATION-RELATED ADJUSTMENTS UNDER CHAPTER 13

15. Chapter 13 of the 2006 EDR Handbook may include an arbitrary impact threshold beyond which LDCs will be required to file additional material in support of their rate applications.
16. Brantford Power, Aurora Hydro and Scugog Hydro do not intend to comment at this time on the mechanics of any adjustments for mitigation, although they may wish to make submissions in response to those of other participants in this proceeding in that regard.
17. Brantford Power, Aurora Hydro and Scugog Hydro have two concerns with respect to the possibility of arbitrary mitigation measures being incorporated into the 2006 EDR Handbook. First, as a general matter, once a distributor has established its costs for 2004 and made the necessary and permitted adjustments to make those costs more reflective of 2006, all in accordance with the OEB's requirements, the distributor should not then be subject to arbitrary reductions in its revenue requirement and/or its rates. For some time, the provincial government has maintained that Ontario's electricity consumers should pay the true cost of their electricity. Brantford Power, Aurora Hydro and Scugog Hydro submit that this should include the true cost of delivering that electricity.
18. Second, and more particularly, even if the OEB were to determine that the Handbook must provide for mitigation, Brantford Power, Aurora Hydro and Scugog Hydro submit that if it is appropriate to adjust a distributor's rates in order to allow it to recover revenues that were forgone through first generation PBR as a result of negative returns in 1999 or a missed second tranche of the distributor's MARR; and if it is appropriate that the distributor perform the activities that it has indicated should be performed in order to obtain that adjustment, then effectively denying that adjustment at the end of the ratemaking process by clawing back the adjustment on the grounds of mitigation simply perpetuates the inequities that the qualifying distributor has faced since 2001 or 2002, depending on the circumstance under which it qualifies. Brantford Power, Aurora Hydro and Scugog Hydro submit that to properly address those circumstances and correct those

inequities, the Tier 2 adjustments must not be subject to mitigation provisions of the Handbook.

PART FIVE: CONCLUSIONS

19. In light of the foregoing, Brantford Power, Aurora Hydro and Scugog Hydro submit that:
- (a) LDCs should be permitted to recover all forgone incremental MARR-related revenues, and should not be limited to the recovery of revenues forgone in 2004;
 - (b) Tier 2 adjustments should not be based on a "hardship" or "system degradation" standard. Instead, the qualifying LDC should, at most, be required to show how it intends to make use of the Tier 2 adjustment funds, and that the planned activities are reasonable for the proper maintenance and operation of its distribution system. If the OEB determines that the recovery of the Tier 2 adjustment must be linked to the performance of certain activities by the qualifying LDC, then the recovery of the Tier 2 adjustment may be subject to reasonable reporting requirements in order that the OEB can be satisfied that the funds are being spent on the activities identified by the qualifying LDC; and
 - (c) Tier 2 adjustments should not be subject to any mitigation requirements in the EDR Handbook. If they are, the effect will be that the inequitable treatment experienced by certain utilities in 2001 or 2002 (depending on the circumstances that qualify the LDC for the Tier 2 adjustment), which will have continued to 2006 and which could be fixed at that time, will be perpetuated.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 14th DAY OF FEBRUARY, 2005.

Original signed by James Sidlofsky for
J. Mark Rodger

Original signed by James Sidlofsky
James C. Sidlofsky

Counsel to Brantford Power Inc., Aurora Hydro
Connections Inc. and Scugog Hydro Energy
Corporation

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