Essex Powerlines Corporation

Festival Hydro Inc.

Haldimand County

Innisfil Hydro Distribution Systems Ltd.

Lakefront Utilities Inc.

Midland Power Utility Corporation

Parry Sound Power

Welland Hydro Electric System Corp.

Westario Power Inc.

WhitbyHydro Electric Corp.

# ONTARIO ENERGY BOARD

## INFORMAL CONSULTATION

# PROCESS FOR ESTABLISHING 2006 ELECTRICITY DISTRIBUTION RATES

## July 2004

Prepared With The Assistance Of:

**RDII UTILITY CONSULTING & TECHNOLOGIES INC.**

# Executive Summary

- The following submission has been prepared by a coalition of utilities including Essex Powerlines Corporation, Festival Hydro Inc., Haldimand County, Innisfil Hydro Distribution Systems Ltd., Lakefront Utilities Inc., Midland Power Utility Corporation, Welland Hydro Electric System, Westario Power Inc. and Whitby Hydro Electric Corp.

- The coalition appreciates the opportunity to present its views and concerns to the Board. The group has identified broader strategic themes in this summary and has provided summarized comments on each issue identified by the Board.

- The coalition is concerned the “potential” issues list and the anticipated timelines are ambitious and, perhaps unachievable given the scope and complexity of the issues. The original intent was that PBR2 would be developed over a period of years and it appears that more issues have surfaced than originally contemplated.

- The coalition strongly believes the Board must prioritize the “potential” issues list and, give priority to issues with the highest order of magnitude contributing to an improved rate setting process. Specifically, the coalition advocates for the creation of a clearly defined PBR2 regulatory timetable.

- The coalition supports in principle the establishment and application of “meaningful” comparators. LDCs should aspire to efficiency measures that protect customer interests and meet shareholder expectations.

- The coalition believes certain issues identified on the issues list should not proceed in advance of cost allocation, as cost allocation is central to determining an outcome on the issue (un-metered scattered load, time-of-use rates, fixed/variable etc.)

- The coalition recommends the Board pursue a regulatory environment similar to the CRTC which employs a lighter handed regulatory regime on smaller organizations than larger organizations

- The potential significant increase in regulatory complexity has an impact on both LDC’s and the Board

- The coalition strongly believes the Board must establish clearer and more prescriptive accounting and code guidelines. The determination and adherence to specific accounting treatments and cost allocation should be a priority. Consistency in financial reporting and information is a must.

- Guidelines/comparators should not be applied immediately in the rate setting process. They must be clearly defined and LDCs must be afforded reasonable notice and timeframes to make appropriate adjustments to their operations.

- The coalition believes that certain issues (capital projects, employee compensation and staffing, advertising, entertainment……research and development) without further clarification, are approaching on intrusive regulation.

- The Board should clarify any areas of overlap and subsequent impacts resulting from the oral hearings on regulatory assets.

- The coalition has identified the following additional issues for consideration in the 2006 rate setting process:

    - SSS Administration Charge

    - General Service Customer Classification Guidelines

# General Summary Comments

## OEB – Potential Issues For Generic Methodology Review

## *Comparators and Cohorts:*

### *1.Comparators & Cohorts*

- Comparators and cohorts are a reasonable regulatory objective to set standards and assess productivity and effectiveness.

- Currently no common base for comparison. LDC measures are all over the map due to a variety of factors:

  Utility customer size
  Customer mix
  Customer density
  Asset vintages
  Etc.

- Reliability SQI's do not have a defined standard – unsure if over/under investing

- Some comparators will require completion of the cost allocation study (eg. cost/customer class) to be meaningful

- Broad based measures such as cost/customer could be used as an interim measure. Administrative costs and customer billing/collecting costs should be relatively stable

- Comparators should be fewer versus more – keep it simple. Recommend lighter handed regulation for smaller utilities than for larger utilities similar to existing CRTC approach to regulatory oversight

- Any comparators affecting distribution revenue should be specifically defined and utilities given sufficient time to amend operations in order to avoid punitive financial impacts

- Currently the consistency of financial information which will be used in establishing comparators suffers from a lack of consistency in interpreting and applying accounting guidelines and codes

## *Revenue Requirement - General Issues*

### *2. Test Year For Establishing Rate Base / Revenue Requirement*

- Coalition supports using latest historical year with adjustments for known material changes (removal of non recurring items and addition of new items)
- Inflationary increase could be addressed through application of the IPI
- future true-ups for material differences from revenue requirement used to determine rates
- Benefit in aligning fiscal year with rate year
- Example
    - rate application submitted in June 2005 for 2006 rate year (January 1 to December 31) based on 2004 actuals with adjustments for known differences
    - material differences between rate setting revenue requirement and actual revenue requirement to be adjusted in setting the next year's rates in June 2006

### *3. Load Forecast*

- Coalition favours a historical approach

### *4. Test Year Adjustments*

- See response to 2. re: true-ups to historical based rate setting
- Adjustments or true-ups should be subject to the same 4 criteria used to assess extraordinary and transition costs

### *5. Weather Normalization*

- Weather risk can be mitigated through a combination of rate design (larger fixed portion) and future revenue requirement true-ups

### *6. Return on Equity for 2006 Electricity Distribution Rates*

- Coalition favours multi year approach vs annual approach
- More stability in customer class rates and shareholder expectations

***7. Debt/Equity Structure***

- Favour a consistent deemed approach for all utilities
- No need to use utility specific D/E ratios if deemed ratios truly reflect the capital markets view utility balance sheets as there would only be slight differences between deemed and actual
- Customers should not be burdened with higher rates if utilities strategic goal is to increase equity financing

***8. Debt Rate / Cost of Capital***

- Utilities have different debt management practices with differing maturities and rates, portions of which is locked in
- Favour a cost pass through approach using actual weighted average cost of debt subject to a cap to be determined by the regulator using a multi year view similar to the cost of debt setting for PBR1

***9. Depreciation Rates***

- In the Coalition's view a process to review depreciation rates should not be considered for 2006 rates but follow the other more critical regulatory processes:
    - Resolving all the issues (including new issues) to complete PBR2
    - Cost Allocation
    - DSM

***10. Transfer Pricing and Shared Corporate Services***

- Coalition believes that more specific guidelines/examples should be developed by the Regulator to provide direction to utilities with respect to expectations and provide consistency of approach by utilities

***11. Low Voltage and Wheeling Costs***

- Hydro One LV charges to LDC's should not be a distribution revenue issue
    - Set up as another RSVA

- Insignificant issue for coalition members – defer as part of the cost allocation study

### *12. 2006 Taxes / PILS*

- LDC's make installment tax payments based on previous year actuals
- Recommend PILS included in rates be based on last actual tax return
- Future true-ups to actual to reflect original market design intent of cost pass through to end use customers

## *Distribution Rate Base Issues*

### *13. Definition of Distribution Rate Base*

- No initial comment from coalition

### *14. Rate Base Measurement Date*

- See response to 2.

### *15. Working Capital Component of Rate Base*

- Support common WCA formula to ensure efficient working capital management and avoid returns on "excess" working capital
- 15 % regulated level should be examined for appropriateness once stability is achieved in the deregulated market

### *16. Capitalizing Expenses*

- Inconsistent accounting practices amongst utilities contribute to different financial results re: profit and loss and total capital expenditures
- Recommend more prescriptive accounting guidelines from the Board to ensure consistency of financial results

### *17. Capital Projects*

- Majority of capital projects can be assessed by using a light handed regulatory approach through review of system reliability standards (to be determined by the Board)
- Significant concern over regulatory review of capital projects:
  - Increased regulatory complexity and administrative effort
  - No criteria currently exists for review
  - Pre-approval or post approval risk

***18. Contributed Capital***

- External audit review of LDC financial statements provides independent validation of appropriate contributed capital accounting

***19. No Cost Capital***

- No initial comment from coalition

***20. Rate Setting Treatment of Capital Gains***

- 100% of any gains related to the sale of assets or shares should accrue to shareholders
- Not an issue identified in initial market design or considered when municipalities decided to retain their LDC's

***21. Distribution Wires Only Expenses***

- No initial comment from coalition

***22. Post Retirement Benefits and Pensions***

- Coalition believes that Regulatory treatment for rate setting purposes should mirror GAAP accounting requirements

***23. Site Restoration and Removal Costs***

- No initial comment from coalition

***24. Insurance Expense***

- Coalition purchases insurance from MEARIE reciprocal and competitive insurance markets – no need to assess appropriateness of insurance expenses
- Board may wish to assess the level of coverages employed to assess appropriateness

***25. Bad Debt Expense***

- Coalition recommends establishing a tolerance band to establish acceptable levels of bad debt expense (eg. X to Y % of total billed revenue)
- Must be an "extraordinary" provision to accommodate unusual circumstances – eg. Bankruptcy of a GS>50 customer with no customer deposit

***26. Employee Compensation and Staffing***
***27. IT Costs***
***28. Advertising, Entertainment, Charitable/Political Contributions, Employee Dues, Research & Development***

- Coalition concerned about the level of regulatory intrusiveness contemplated in these 3 issues
- LDC's are OBCA entities with oversight by Boards of Directors having fiduciary responsibilities to appropriately manage the businesses
- LDC's already provide significant amount of detailed data through regulatory filings that would allow the Board to further investigate if they were concerned
- LDC's must compete for human resources in the marketplace

## *2006 Rate Design Matters*

***TOU Distribution Rates***

- In the Coalition's view the process to determine TOU distribution rates should not be considered for 2006 rates but follow the other critical regulatory processes:
    - Resolving all the issues (including new issues) to complete PBR2
    - Cost Allocation
    - DSM

***29. Specific Service Charges***

- Support standardization of some Miscellaneous Charges – eg. Change of Occupancy
- Other Charges must reflect the differing underlying cost structures of the individual utilities – eg. disconnection after hours
- Consideration must be given to any revenue differentials similar to the late payment charge adjustment to distribution revenue

***30. Unmetered Scattered Load***

- Should be resolved as part of cost allocation which will also deal with customer classifications

***31. Time of Use Rates***

- Again the coalition supports deferral of this issue to the cost allocation study process as any integration would be premature and somewhat arbitrary

### *32. Fixed/Variable*

- Support retention of existing individual utility rates until cost allocation completed
- Movement from existing rates would be arbitrary and not supported by any underlying cost causation analysis
- Changing fixed (and corresponding variable rates to maintain revenue neutrality) rates would result in revenue stability impacts to all utilities both positively and negatively

### *33. 2006 Rate Mitigation*

- Rate mitigation should wait until cost allocation study completed and “true” fixed/variable rates determined based on cost causation
- Any mitigation of distribution rates should based on distribution rates changes alone and not include pass through commodity and non competitive charge changes

## *Additional Issues*

### *SSS Administration Charge*

- Inadequacy of incremental $.25/customer/month charge to recover actual incremental costs
- No variance account relief currently afforded (RCVA)

### *GS<50 kw vs GS>50kw Customer Classification*

- Require specific criteria to determine customer classification
    - 1time >50kw
    - Calendar year average >50kw
    - Rolling 12 month average >50kw
    - Others

- Resolution of rate disparities moving from 1 class to the other
- Grandfathering of GS<50 kw customers (up to 100 kw of demand) based on initial unbundling)