RP-2004-0188

Enersource Hydro Mississauga Inc.

and

PowerStream Inc.

Ontario Energy Board

2006 Electricity Distribution

Rate Handbook

February 28, 2005

Reply Argument to Stakeholders Argument-in-Chief

Submitted on February 14, 2005

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On the Ontario Energy Board
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Introduction

1. By way of Procedural Order No. 5 dated February 4, 2005, the Ontario Energy Board ("OEB") has invited all participants in the RP-2004-0188 proceeding to respond to the submissions filed by stakeholders on February 14, 2005. These reply submissions are due on February 28, 2005. Enersource Hydro Mississauga Inc. ("Enersource") and PowerStream Inc. ("PowerStream") are pleased to provide a combined reply submission. Enersource and PowerStream are members of the Coalition of Large Distributors ("CLD"). Although the CLD is not submitting a joint submission most of the positions outlined in this submission are consistent with other members of the CLD.

2. Enersource and PowerStream have provided some general comments and structured their remaining reply comments by chapter and section of the second draft of the 2006 electricity distribution rate handbook ("EDRH"). As a result of time constraints associated with this proceeding Enersource and PowerStream have limited their comments to those that are of critical concern to the companies rather than providing comprehensive argument on all the issues addressed by the various stakeholders in their submissions.

3. In reviewing the submissions of the various stakeholders, there appears to be a "Ratepayer" and "LDC" view on many of the issues outlined in the EDRH and in

most cases the two views are opposite. It will be the OEB's task to balance the views of the stakeholders and render a decision that, overall, will be beneficial to the electricity market and its participants. Enersource and PowerStream are hopeful this submission will be helpful to the OEB in approving an EDRH that balances the interests of all parties involved in this proceeding.

General Comments

4. Enersource and PowerStream continue to be concerned with the inadequate period allowed by the OEB to assess the numerous submissions made by participants in this proceeding. This concern has been supported by the fact that in some cases stakeholders have proposed substantially new filing requirements, rules, or constraints that, in our mind, the OEB has indicated are clearly out of scope for the 2006 EDR process.

5. In particular, in the Schools Energy Coalition ("Schools") Argument in Chief, Schools is seeking to have applicants prepare new filing requirements as well as put additional rules and constraints on the applicant to address a rate disparity issue. In paragraph 285 of the Schools submission it states:

"Instead, we proposed that the Board do the following:

(a) At the time it issues its decision with respect to the 2005 rate applications, the Board should prepare and publish (on its Web site) a comparison between all franchise areas/distributors of the monthly distribution charges for each sample customer listed in Sheet 13 of the 2005 RAM model. The comparison lists should in our submission be presented in a manner similar to Appendix C to these submissions, and should include maximum, minimum, median, mean, and variations from median calculations.

(b) *In that decision, and in order to ensure that the published comparisons are not misunderstood by stakeholders or members of the public, it is submitted that the Board should prepare an explanation of the various reasons why rates can differ from one area to the next, and a caution that the raw data comparison is only a starting point to a review of the reasons for the disparities.*

(c) *The Board should, either in the 2006 Rate Handbook or in the 2005 rate decision, require each applicant whose charges to any of the standard sample customers are more than 20% above the provincial median (a "Major Variance") to report to the Board as part of or prior to their 2006 rate application:*

   i. *Advising the Board in detail the primary reasons for each Major Variance, including in particular any reasons that are driven by 1) higher than average costs of the utility, 2) cost allocation and rate design anomalies, and 3) historical problems with their rates;*

   ii. *Where any Major Variance is capable in whole or in part of being reduced or eliminated, a plan for reducing or eliminating such Major Variance in 2006 or in multiple years, including an analysis of options and the reasons for selecting the plan proposed; and*

   iii. *Where any Major Variance is not capable of being reduced or eliminated, the reasons why the Major Variance should be allowed to remain outstanding."*

6. During Issues day on November 2, 2004, Ken Snelson, representing AMPCO, requested that steps should be taken to address the disparity in Large User distribution charges in the 2006 EDR. Mr Snelson' submission indicated:

> *".. the disparity is quite striking. If you note that Peterborough has a large-user bill of $1,470 a month, and at the other end of the spectrum,*

Oakville, I believe, has a bill of $32,000 a month. So these are huge disparities."

7. On November 3, 2004 the OEB rendered their decision in regards to Mr Snelson's issues. Mr. Kaiser, Presiding Member and Vice Chair provided the OEB's oral decisions as follows:

"*MR. KAISER:*

Scope issue number 4 under this heading was: "Should large-user disparity issues be addressed in 2006, rather than waiting for the 2007 cost-allocation study?" The Board recognizes the apparent inconsistencies in the treatment of large users, as Mr. Snelson has identified. The Board believes that this is an important issue and deserves attention. However, the Board finds that the number of issues that are on the table for the 2006 EDR process are significant, and is unwilling to increase the work in this process in the absence of extreme urgency. Accordingly, the Board finds that this issue will not be considered as part of the 2006 process. The Board has indicated, however, that a review of cost allocation will occur in time for the implementation of 2007 rates, and encourages the active participation of Mr. Snelson's clients in that process."

8. Enersource and PowerStream submit that the issue of rate disparity raised by Schools in their 2006 Argument-in-Chief, for the school customers they represent, is equivalent to the issue raised by Mr. Snelson during Issues Day for the large users. Enersource and PowerStream also note the <u>annual</u> disparity in large school customers outlined in the Schools submission is essentially in the same range as the <u>monthly</u> disparity for large users. In our view, since the OEB declared the large user disparity was out of scope for the 2006 EDR it only follows that the

disparity in school customers across the province is out of scope for the 2006 EDR as well.

9. Enersource and PowerStream further submit that Schools also raised the rate differential issue during the 2005 rate proceeding when it was clearly an issue that the OEB indicated would be dealt with in 2007. Responses to the Schools 2005 rate submission were required during the same time this submission was being prepared. Assuming the rate disparity issue was also out of scope for 2005 rates, Enersource and PowerStream submit that the time used to prepare the reply response to the Schools 2005 rate submission could have been better used to prepare a more comprehensive reply argument for the 2006 EDR. Enersource and PowerStream recommend to the OEB that this factor be taken into consideration when awarding costs to Schools.

Chapter 1 - Introduction

10. At pages 2 through 5 of the Argument-in-Chief from the Schools a number of substantial new filing requirements are proposed, as well as the creation of a new category of intervenor.

11. Consistent with Toronto Hydro, Enersource and PowerStream submit that these proposals are designed to further the unnecessary and undesirable development of a parallel regulatory process in which self-appointed interest groups seek to act as auxiliary regulators.

12. Enersource and PowerStream are quite prepared to act in accordance with directions from the OEB and submit that no deficiency in access to information currently exists for the Schools or any other intervenor. We reject the concept of

extending special treatment to Schools or any other intervenor, as Schools recently requested in connection with the 2005 rates applications.

13. Schools suggest that new requirements be added to the EDRH to compel utilities "to co-operate with their (i.e., intervenor) participation as long as it is reasonable and does not generate material unnecessary costs to the applicant" (para. 12). Enersource and PowerStream submit that they and other utilities currently do cooperate with intervenors in accordance with OEB directions. As a result, the OEB should reject this suggestion from Schools because it is vague, unnecessary, and likely to create undue controversy.

Chapter 3: Test year and adjustments

3.0 Test Year and Adjustments – Disclosure of 2006 Events

14. Generally, most ratepayer intervenors submit that utilities filing historical test year applications should nevertheless be required to disclose material events expected to occur in 2006.

15. It is Enersource's and PowerStream's understanding that the historical test year approach is at best a proxy that was initiated by OEB Staff to reduce the workload for Staff and stakeholders in processing the 2006 rate applications. We would submit that disclosure of the 2006 events would potentially allow the OEB to adjust rates for these events. In essence, the OEB could be moving in the direction of a forward 2006 test year application and eliminate the cost savings achieved by preparing an application based on a historical test year.

16. The prospect may appear to be that under historical applications, utilities will be permitted to recover the lower of their historical costs or their 2006 costs in each

identified category. Together with the fact that the draft EDRH limits Tier 1 adjustments for many material identifiable cost pressures, disclosure of 2006 material events may effectively force many LDCs to seriously consider filing a forward test year application and in turn increase the regulatory burden to all participants. Therefore, Enersource and PowerStream recommend that the Board adopt alternative 2 (i.e. not obliged to disclose).

3.2 Test Year Adjustments

17. Certain intervenors take the view that CDM investments ought not to be allowed in utility rate base, "since those amounts have been paid for in full by the third tranche" [of MBRR].

18. In November 2003 the Ontario Government announced, "*As of March 1, 2005, LDCs would be allowed to achieve their full commercial return, which in many cases would result in an increase on average of approximately 0.3 cents per kilowatt-hour. This increase would be conditional on LDCs* <u>*reinvesting*</u> *the equivalent of one year of these monies in conservation and demand management initiatives"* Several intervenors fail to appreciate that by definition, the third tranche of MBRR constitutes utility earnings, not utility expenses and the government has directed LDCs to "reinvest" these monies in CDM initiatives not expense the cost of the CDM initiatives. In our mind "reinvesting" implies the Government intended the LDC to earn a rate of return on these investments. As a result, investment made by utilities in CDM and found by the Board to be prudent, should certainly be permitted in rate base and earn a reasonable rate of return.

19. In addition, the ratepayer intervenors have recommended that new transformer stations with an in-service date of 2006 should not be allowed in the rate base.

Enersource and PowerStream reiterate that allowable test year adjustments to rate base should include new transformer stations and directly-associated assets with an in-service date of 2006. These are material adjustments that are readily known, identifiable, quantifiable and verifiable. By the time the 2006 rate applications are prepared, work on the transformer stations will have begun and a completion date will be known. These transformer stations are unique types of additions to the rate base as they are typically the only assets that are constructed over a longer term than one year in advance of the in-service date. These assets are mainly built to provide system reliability and optimization to the customer base.

20. Enersource and PowerStream submit there is very little contention between stakeholders regarding the other historical test year adjustments outlined on page 18 of the EDRH and these adjustments should be approved as written.

<u>Chapter 4 Rate Base</u>

4.1 Definition of Rate Base

21. LPMA is the only ratepayer intervenor that supports that the level of detail should be equal to the uniform system of accounts (i.e. Alternative 2) to determine the level of rate base. Other ratepayer intervenors support the level of detail outlined in Schedule 4-1 of Appendix B in the EDRH (i.e. Alternative 1) or have no position on this issue. As a result, Enersource and PowerStream submit that Alternative 1 should be adopted to address this issue.

22. Certain intervenors such as CCC, Schools and LPMA urge the use of an average figure for 2004 rate base as the most appropriate proxy for 2006 rate base. CCC indicates that this is consistent with the approach used for the Ontario natural gas

utilities. Schools assert that an average rate base figure is consistent with the volumes 'it was generating'. LPMA states that using year-end rate base figures will create a 'phantom return on equity'. However, VECC supports year end 2004 to determine the rate base for Tier 1 applications since 2006 is using a historical test year.

23. Enersource and PowerStream agree with VECC. For utilities filing historical test year applications, 2004 year-end rate base will in any case provide the best estimate of the 2006 rate base. Whether a utility's rate base is assumed to be declining, static, or growing in the 2004-2006 period, a figure further removed in time cannot produce a closer estimate of 2006 values.

24. Enersource and PowerStream submit that it is clear that 2004 year-end figures for rate base will produce better estimates of the 2006 values, and that the OEB should dismiss other proposals that create a larger lag between 2006 actual and proxy values.

4.3 Capital Investments

4.3.1 Non IT related

25. Enersource and PowerStream support alternative 2, on the basis that it depends simply on a percentage of net fixed assets and therefore would apply uniformly across utilities. An analysis conducted by Toronto Hydro indicates that Alternative 1 as stated becomes a proposal to use a coarse step function to determine materiality thresholds. We are not persuaded by any evidence or submissions that such an approach is fairer or otherwise superior to a simple proportional approach, as suggested by alternative 2.

4.4 Interest on Deferral Accounts and CWIP

26. With regards to interest on deferral accounts, the ratepayer intervenors support the use of a short term debt rate. In regards to interest on CWIP, except for AMPCO all other ratepayer intervenors support an AFUDC process using the embedded cost of debt. AMPCO supports the use of a short term debt rate that would also be used for CWIP.

27. Enersource and PowerStream can generally support the position of most ratepayer intervernors on this issue. For deferral accounts that will be recovered on an annual basis, Enersource and PowerStream would support the use of a short-term debt rate. For interest on CWIP, the AFUDC approach should be adopted.

Chapter 5 Cost of Capital

5.2 Debt Rate

28. Enersource and PowerStream support Alternative 2 and endorse Hydro One's submission on this topic.

5.4 Working Capital Allowance

5.4.1 Introduction

29. LPMA asserts that forecasts of the cost of power should be avoided as this would be 'dangerously close to a forward test year process'. In addition, LPMA and other ratepayer intervenors support the need to adjust the working capital allowance for customer deposits.

30. With regards to LPMA position on cost of power, Enersource and PowerStream reject this position, as it seems to imply that the 2006 costs of power are what are under scrutiny in this process.

31. Enersource and PowerStream understand that the mechanistic adjustment to the cost of capital calculation does not reflect the additional risk that LDCs have had to shoulder as a result of their exposure to the entire electricity market settlement costs. In addition the Regulated Price Plan, once implemented, will place additional working capital pressures on LDCs. The use of the Alternative 2 would be appropriate in this case as an update to the 15% of historical COP and other power supply expenses would be a reasonable adjustment to the working capital. As well, no reduction to working capital for security deposits should be made since these funds do not form part of the Distributor's general cash reserves for payment of monthly business activities. These total values are to be available for refund within the deposit policy criteria.

Chapter 6 Distribution Expenses

6.0 Introduction

32. Consistent with the detail of rate base information, LPMA is the only ratepayer intervenor that supports the level of detail for distribution expense should be equal to the uniform system of accounts (i.e. Alternative 1). Other ratepayer intervenors support the level of detail outlined in Alternative 2 or have no position on this issue. As a result, Enersource and PowerStream submit that Alternative 2 should be adopted to address this issue.

6.2.4 Advertising, Political Contributions, Employee Dues, Charitable Donations, Meals/Travel and Business Entertainment, Research & Development

Charitable donations

33. There is significant disagreement among the ratepayer intervenors on how charitable donations should be handled in the 2006 distribution rates. Enersource and PowerStream propose a compromise and suggest this type of expense be recoverable but capped at a percentage of revenue or percentage of net income threshold for all LDCs. This will facilitate comparability amongst the Distribution sector and allow some level of donations, which will benefit the ratepayers in the community.

6.2.5 Employee Compensation – Incentive Plans

34. Several intervenors have placed great emphasis on disallowing costs for employee incentive programs that are said to benefit shareholders only. Enersource and PowerStream support Toronto Hydro on this issue and question both the conceptual as well as the practical basis for making such distinctions, and submit that the Board should exercise great caution in categorizing incentive plan expenses as non-recoverable in rates.

35. Conceptually, we are yet to be convinced that a clear distinction can be made between performance goals such that some are categorized as being to the benefit of shareholders only. Typically, the suggestion is that an earnings target is to the benefit of shareholders and not ratepayers. However, it would be very difficult in any particular case to conclude based on isolated or partial information that ratepayers do not benefit from earnings, since earnings are a prime source of funds for re-investment in a distribution system.

36. Furthermore, a target involving earnings may involve nothing more than achieving the allowed rate of return. Given that the OEB expressly authorizes a rate of return and sets rates to provide utilities with the opportunity (but not a guarantee) to earn that rate of return, it is difficult to rationalize disallowing the expenses associated with that target. Therefore, the Board would be faced with having to more specifically state what kinds or levels of earnings are considered objectionable.

37. Enersource and PowerStream submit that the proposition that some incentive plan costs should be disallowed on the basis that the benefits somehow flow only to the shareholder is vague, conceptually flawed, and not possible to implement in a fair manner without involving the Board in undue micro-management. The Board should dismiss this proposal.

Chapter 7, Taxes/PILs

7.1.1 General Principles Underlying the 2006 Tax Calculation

38. There is general consensus among the ratepayer intervenors and the CLD members supporting the methodology proposed by the partial true up in Alternative 1. This limits the potential swings in rates, which may be caused by the full true up methodology. There is continual catch up whether increases or decreases in future rates for activity and earnings of the previous rate years. The partial true up methodology provides the customers with better rate transparency and stability. The partial true up also mitigates the risks of the shareholders if events outside of the Corporation control materialize. If there are changes in any tax rates/law/assessments, losses could be incurred if tax rates were increased with no true up mechanisms. These increases would be unrecoverable during a

rate year with no true up mechanisms. Conversely, ratepayers are protected if tax rates are lowered under the partial true up.

39. Enersource and PowerStream recommend the OEB adopt the partial true up method outlined in Alternative 1.

7.1.2.2 Non-recoverable and disallowed expenses

40. Enersource and PowerStream support and rely upon the reply submission of the Coalition of Issue Three Distributors in regards to this issue.

<u>Chapter 10 – Rates and Charges</u>

Section 10.1 – Fixed/Variable Split

41. The draft EDRH states, without alternatives, that the 2004 proportions of fixed and variable charges should be maintained for 2006, absent a specific justification in a particular application to change the proportions.

42. However, Schools asserts that the proportions should be those of 2005, since the Board unilaterally altered those proportions in the 2005 RAM.

43. The consensus position stated in the draft EDRH was clearly made in reference to the 2004 proportions, and this issue was not identified as unresolved. Had it been, we would have made submissions regarding this in the hearing.

44. In addition, Schools now makes proposals to require LDCs to file further information to justify the rate disparity across the province and to arbitrarily adjust the fixed charges of certain distributors in advance of the cost allocation study results. As outlined under the General Comment section above, it is our

position that this proposal is out of scope for the 2006 EDR proceeding and should be rejected by the OEB.

Chapter 14 Comparators & Cohorts

45 Enersource and PowerStream support the use of comparators and cohorts as a screening tool only. However, we strongly disagree with those intervenors that refer to this process as a benchmarking exercise and recommend "benchmarking" wording not be used in the approved EDRH. In addition, filing information prior to the preparation of the 2006 rate application in order to understand which cohort Enersource and PowerStream will be assigned to, would be beneficial in preparing the rate application. In particular, if Enersource or PowerStream had the potential to be an outlier and be under a higher level of scrutiny the reasons for being an outlier could be addressed in the application.

46 Enersource and PowerStream support Alternative 2 in regards to distribution of the comparators and cohorts analysis. Enersource and PowerStream are concerned that the initial analysis will be based on data that may still be compromised and inconsistent to a degree and if released to the public may result in misleading conclusions that could be harmful.

Conservation and Demand Management

47. Enersource and PowerStream are committed to initiatives that will enable Conservation and Demand Management (CDM) and believe that LDCs should continue to be involved at the local level to promote conservation. The companies are still ramping up their programs and determining how savings will be tracked and measured. For 2006 EDR, Enersource and PowerStream

recommend the OEB approve a fair and reasonable LRAM and approve the continuation of the 5% SSM which the OEB adopted for 2005.

48. Enersource and PowerStream generally support the submissions of Hydro One Networks Inc. and Toronto Hydro in this area.

49. Enersource and PowerStream agree on the necessity for revenue protection, a shareholder incentive and timely recovery of CDM expenditures. However, the timeline for the 2006 EDR has been very short for such an important topic as CDM and therefore, Enersource and PowerStream hope that any decisions made will be considered preliminary and will be revisited when distributors are required to re-base distribution rates in 2008.