Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2007-0753

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 Norfolk Power Distribution Inc. for an order or orders approving or fixing just and reasonable distribution rates and other charges, effective May 1, 2008.

BEFORE: Paul Sommerville
Presiding Member

Ken Quesnelle
Member

DECISION

Background

Norfolk Power Distribution Inc. ('Norfolk Power" or the "Applicant") filed an application with the Ontario Energy Board (the "Board"), received on November 16, 2007 under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15 (Schedule B), seeking approval for changes to the rates that Norfolk Power charges for electricity distribution, to be effective May 1, 2008.

Norfolk Power 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. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year, by electricity distributors.

On May 4, 2007, as part of the plan, the Board indicated that Norfolk Power would be one of the electricity distributors to have its rates rebased in 2008. Accordingly, Norfolk Power filed a cost of service application based on 2008 as the forward test year.

Norfolk Power requested a revenue requirement of $12,800,352 to be recovered in new rates effective May 1, 2008. The application indicated that the existing rates would produce a revenue deficiency of $1,925,705 for 2008. The resulting requested rate increase was estimated at 2.1% on the electricity bill for a residential customer consuming 1,000 kWh per month.

The Board assigned the application file number EB-2007-0753 and issued a Notice of Application and Hearing dated December 5, 2007. The Board approved two interventions, one from the School Energy Coalition ("Schools") and the other from the Vulnerable Energy Consumers Coalition ("VECC"). Both were active in submitting interrogatories and submitting arguments. Board staff also posed interrogatories and made submissions. Norfolk Power's reply argument was filed on April 9, 2008.

The full record is available at the Board's offices. The Board has chosen to summarize the record to the extent necessary to provide context to its findings.

THE ISSUES

The following issues were raised in the submissions filed by Board staff, Schools and VECC:

- Load Forecast
- Operating, Maintenance & Administrative Expenses
- Payments in Lieu of Taxes
- Capital Expenditures and Rate Base
- Cost of Capital
- Cost Allocation and Rate Design
- Deferral and Variance Accounts

LOAD FORECAST

Norfolk Power's load forecast was developed using a normalized average consumption ("NAC") estimate for a given rate class multiplied by a customer count forecast for that rate class. The NAC value was based on 2004 consumption data that had been developed with the assistance of Hydro One. Norfolk Power's load forecast is based on a forecast customer count of 22,373 for 2008, an increase of 0.1% annual average growth during the 2006 to 2008 period; the historical growth rate was 0.2% per annum. The resulting load forecast is a 2.2% annual average kWh growth from 2006 to 2008 which compares with an historical 2.9% per annum growth. Board staff submitted that based on the historic relationship between customer growth and kWh growth, the forecasted kWh growth is not inconsistent.

Board staff observed that the Applicant's methodology utilized only a single year of weather-normalized historical load to determine the future load and this may not be a robust assumption; this may result in a filed load forecast that is a few percent higher than the data would suggest. Board Staff invited Norfolk Power to clarify the method Hydro One used to weather-normalize Norfolk Power's load. VECC, in its submission, suggested that Norfolk Power may wish clarify why it adjusted the actual 2006 average use for the GS>50 kW class by the 2004 weather normalization factor.

In reply to the Board staff submission, Norfolk Power stated that it had reviewed the effect of weather-normalization on its load forecast and, based on the results, it believed its forecast to be reasonable and that no further adjustment should be made. Norfolk also stated that it had attempted to include additional weather normalization analysis for its 2008 application but was not able to obtain the services required to do so at a reasonable price. Norfolk did not address the specific matter of Hydro One's weather normalization calculation. In response to VECC's submission, Norfolk Power explained that the forecasting method used produced a higher forecast than the alternative. Norfolk Power continued that, in its view, the forecast appears reasonable based on recent experience.

<u>Board Findings</u>

The Board is prepared to accept, for the purposes of this rebasing, the Applicant's load forecast. This approval should not be construed as specific approval of the methodology employed by the Applicant in arriving at its load forecast.

Norfolk Power has used a methodology that relies upon a single year of weather normalized historic load to determine future load. This seems an abnormally small sample upon which to base a key driver for rates. Norfolk did attempt to have additional weather normalization performed for this application but concluded that it could not be done at a reasonable cost. Conclusions of this nature should be included in the applicant’s evidence complete with the supporting cost to benefit analysis. This analysis has not been provided. Furthermore, supporting information central to the Applicant’s proposals should be included in the pre-filed evidence as opposed to being discovered in response to interrogatories. As noted above, the evidence was not clear as to whether the weather normalization that was applied was consistent with the Board's approved method, arising from EB-2005-0317 and Hydro One's 2006 distribution rates case.

Norfolk’s response to VECC regarding its adjustment to the GS > 50 kW class stated that its determination on the reasonableness of the approach was based on recent experience and that an alternate approach would have resulted in a significantly lower NAC projection, resulting in a corresponding rate increase.

The Board expects that when an Applicant provides its “recent experience” as a supporting rationale for a conclusion, it will provide the salient details of that “recent experience”.

The Applicant’s load forecast methodology does not include any forward looking analysis of underlying drivers. Other than the recognition of the impact of a single large customer, which was discovered in a response to an interrogatory, as opposed to being revealed in the pre-filed evidence, the load forecast analysis is based entirely on historic data.

A forward test year application should include evidence that the applicant has considered potential outcomes beyond that of the projection of its empirical knowledge. As an example, information regarding residential and industrial development plans is readily available from municipal economic development offices and should form part of the supporting analysis of the applicant’s load forecast conclusions. The inclusion of this type of information irrespective of the degree to which it alters the forecast, demonstrates that a key variable has been considered thus increasing the reliability of the forecast.

The Board also notes that the forecast does not include any consideration of conservation and demand management (CDM) activities, either Norfolk Power’s own local initiatives or the Ontario Power Authority’s province wide programs. The fact that inclusion of the impact of these measures has the effect of placing an upward pressure on rates does not negate or lessen the Applicant’s responsibility to provide the analysis.

Norfolk's past CDM spending was approved on the basis of economic analysis that demonstrated the anticipated reduction in either the volumetric or demand level of electricity. Projections of the impact on electricity usage of these initiatives should form part of the load forecast analysis. This is the case irrespective of any plans the applicant may or may not have to file Loss Revenue Adjustment Mechanism (LRAM) and/or Shared Savings Mechanism (SSM) applications.

OPERATING, MAINTENANCE & ADMINISTRATIVE ("OM&A") EXPENSES

The following table is derived from Board staff's submission and sets out amounts contained in Norfolk Power's evidence and confirmed by Norfolk Power to be accurate:

Norfolk Power
Controllable Operating, Maintenance and Administrative Expenses

	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
	$	$	$	$
Operation	757,522	1,073,025	1,197,000	1,207,774
Maintenance	747,613	641,406	925,000	933,326
Billing and Collections	856,868	814,191	944,000	952,497
Community Relations	24,718	24,169	28,000	28,252
Administrative and General Expenses	1,459,232	1,244,865	1,447,000	1,822,023
Total Controllable OM&A	**3,845,953**	**3,797,656**	**4,541,000**	**4,943,872**

The test year total controllable OM&A expenses (Operations, Maintenance, Billing & Collection and Administration & General Expenses) forecast is $4.9 million, an increase of 30.2%, or $1,146,216, from 2006 actual spending. Controllable OM&A expense in 2007 was 19.6% higher than the 2006 actual. The forecast increase from 2007 to 2008 is 8.9% and mainly attributed to smart meters. Smart meters will be discussed in the following section.

Board staff and intervenors highlighted four main areas of concern with the increases including smart meters, regulatory costs, bad debt expenses, and other costs. The

Board has approved an envelope approach to overall OM&A costs which is described in the Board Findings under Other Costs and with specific directions as described below.

Smart Meters

In its application, Norfolk Power has proposed to include in its 2008 revenue requirement amounts related to capital and operating expenses related to Smart Meter implementation. The amounts are $4,061,000 for smart meter capital expenditures that were included in rate base, and $362,000 for operating expenses.

Norfolk Power is not one of the thirteen named distributors authorized to undertake smart meter activities, and was not named in the combined Smart Meter proceeding conducted by the Board in 2007 under file number EB-2007-0063.

Norfolk Power did not file a smart meter plan in its 2006 EDR application, but has been authorized by the Board to collect a smart meter rate adder amount of $0.26 per month per metered customer (equivalent to $0.30 per residential customer per month) in anticipation of smart meter activities pending Government authorization.

Norfolk Power states that it is participating in the Niagara Erie Power Alliance group and provided a copy of a letter, dated December 21, 2007 and signed by the Assistant Deputy Minister, Consumer and Regulatory Affairs of the Ministry of Energy. This letter, while supportive, does not provide approval for Norfolk Power to undertake smart meter activities.

Board staff and intervenors raised several issues on Norfolk Power's smart meter proposal. Board staff noted that Norfolk Power provided a reconciliation of continuity schedules for deferral accounts, including Account 1555 – Smart Meter Capital and Recovery Offset Variance with an April 30, 2008 credit balance of $40,417, while it is indicated in Ex 1 / Tab 1 / Sch 8 that Norfolk Power is requesting the continuation of the credit balances in the smart meter deferral/variance accounts.

VECC noted that Norfolk Power's proposed capital expenditures for smart meters represent approximately 40.0% of Norfolk Power's total 2008 forecasted capital expenditures. VECC further stated that the Smart Meter capital should not be included in Norfolk Power's rate base, but rather in Variance/Deferral Accounts 1555 and 1556, and this approach was also supported by Schools.

Absent authorization to undertake smart meter activities, VECC submitted that it is premature for the Board to approve a 2008 revenue requirement assuming a significant, and in this case full, deployment of smart meters in 2008. VECC submitted that the Board should authorize a smart meter rate adder for 2008 distribution rates and that Norfolk Power should continue to track costs in the Board-approved deferral/variance account. For an appropriate smart meter rate adder, VECC suggested that it should be determined assuming full deployment in 2008, but then discounted to reflect uncertainty about authorization and completion of smart meter deployment in 2008, and suggested that the resulting rate adder should be set between 50% and 75% (i.e., a discount rate of 25% to 50%) of the incremental cost assuming full deployment of smart meters in 2008. VECC noted that the discount factor “is a matter of judgment”.

In its Reply Submission, Norfolk Power agreed with VECC’s proposal of setting a Smart Meter rate adder. In the event that Norfolk Power is allowed to undertake Smart Meter activities in 2008, Norfolk Power also agreed with Board staff that the credit balance of $40,417 (as of April 30, 2008) in the smart meter deferral account, be deducted from the 2008 Smart Meter revenue requirement.

Board Findings

The Applicant's proposal with respect to the treatment of costs associated with smart meters has evolved considerably over the course of the proceeding. In its final submission Norfolk Power agreed that the most appropriate approach with respect to these costs is to continue to track them in their respective deferral and variance accounts for later review and disposition. This approach is sensible given the fact that it is unclear how and when this Applicant will be authorized by the provincial government to commence or complete its deployment of smart meters within its service area. It is also true that the Board will not authorize the disposition of unaudited deferral or variance account balances, except in the most compelling case.

Most local distribution companies, including the Applicant, have been authorized to impose a smart meter rate adder in the amount equivalent to $0.30 per month per residential customer. The Board authorized this collection in order to allow distributors to accumulate some funds which could be used for smart meter deployment, when the provincial government authorized it. In this way, future rate shock could be avoided, and the utilities would be at least partially funded for the initial stages of their rollout.

While the Applicant is still not authorized to deploy smart meters within its service area, the Board considers it prudent to permit the Applicant to collect an increased amount by way of smart meter rate adder in anticipation of that authorization. In the Board's view, increasing the rate adder to $1.00 per meter going forward will provide the Applicant with funds to support its initial rollout and to avoid rate shock when that occurs, and the Board so orders.

Regulatory Costs

Norfolk Power is claiming $95,855 in regulatory expenses for the 2008 test year. This includes $65,000 in Ontario Energy Board annual assessment fees, $2,000 for Ontario Energy Board section 30 costs, and $28,855 for non-Ontario Energy Board costs related to the 2008 EDR application and cost allocation.

In its submission, Board staff noted that it was unclear whether Norfolk Power would require the non-Ontario Energy Board costs in future years and invited parties to provide comments on the issue in their respective submissions.

VECC submitted that Norfolk Power’s response to Board staff interrogatory #23c indicates that, with respect to the $28,855 of non-Ontario Energy Board regulatory expenses in 2008, Norfolk Power does not expect similar costs to be incurred over the next two years. In VECC’s view, it would be appropriate for Norfolk Power to spread these costs over a three year period. VECC stated that the 2008 rates are meant to position Norfolk Power for the Ontario Energy Board’s third generation IRM framework which is expected to last for a number of years. As a result, principles of inter-generational equity and matching would suggest that the costs should be amortized over the third generation IRM period.

Schools stated that it believed that Norfolk Power should, in its reply submission, identify all one-time cost components in 2007 and 2008 separately and include only one-third of the 2008 one-time costs in the 2008 rate year to prevent an over-recovery of the operating expenses in non-rebasing years.

Norfolk Power’s reply submission stated that consultant and other costs were significantly higher in the 2007 Bridge and 2008 Test years due to regulatory obligations imposed by the Board, including cost allocation and the preparation of the 2008 EDR application. Norfolk Power stated that it believed these are “one-time” costs and pertain to the above years respectively.

Board Findings

One of the key features of the Board's multiyear incentive rate mechanism plan is regulatory efficiency. The plan is designed to require a utility to file a rebasing application, which is then followed by a number of years of mechanistic rate adjustments. This approach avoids undue regulatory burden and cost.

In its original proposal the Applicant sought to embed in its rate structure all of the costs associated with the rebasing application for each of the subsequent years.

In its final submission the Applicant has acknowledged that these costs are one-time costs which are to be amortized over the expected three-year period of mechanistic adjustment following this rebasing year.

Accordingly, the approved OM&A envelope will reflect a reduction in this area of two thirds as it relates to costs associated with the rebasing application and the Applicant should provide specific information that this reduction has occurred in the draft Rate Order it files.

Bad Debt Expense

In Ex 4/Tab 2/Sch 1/Page 4 of Norfolk Power's original application, bad debt expense is shown as increasing from $63,170 in 2006 to $121,080 in 2008. In response to Board staff interrogatory #23d, Norfolk Power provides additional details on this increase and its plan to manage it by redefining existing policy for collecting deposits, implementing a more aggressive collection policy, making use of Service Interruption Devices or Load Limiters on delinquent accounts, and revising billing and payment cycles.

In its submission, Board staff stated that the Applicant had not explained why such a large increase in the expense was necessary, especially given the measures it planned to undertake to improve collections.

In its submission, Schools expressed concern regarding the method Norfolk Power had chosen to use to record its bad debt expense. Schools stated that Norfolk Power has adopted a direct write-off method rather than the allowance method. Under the direct write-off method, bad debts are considered expenses in the period in which they are written off. Schools stated that this method is not considered acceptable under GAAP unless the amounts are immaterial. Schools is of the view that the proper treatment should be the allowance method, which seeks to estimate the amount of uncollectible receivables and establish a contra valuation account for the amount estimated to be uncollectible. Schools argued that Norfolk Power should be urged to revisit its accounting treatment for bad debt provision and its collection policy to manage doubtful accounts. Schools submitted that the amount of $121,080 in bad debt expense for 2008 is not justified and is not an appropriate base upon which to project 2009 and 2010 bad debt expense under the incentive regulation mechanism. Consequently, Schools submitted that the bad debt expense for 2008 should be frozen at the 2006 level of $63,170.

In its reply submission, Norfolk Power responded that upon further review of its bad debt expense, it was of the view that the components that have increased the expense are beyond its control. These include customer accounts signed with retailers that become delinquent and subsequently are written-off. Under the current rules from the Board, Norfolk Power noted that this expense is borne by Norfolk Power and not the retailers. As well, over the past few years, Norfolk Power stated that it has experienced a decline in the economy of Norfolk County with losses in employment and a General Service less than 50 kW tobacco farm.

Board Findings

In its proposal the Applicant seeks to roughly double its provision for bad debts. While the Board is pleased that the Applicant has devised a business strategy designed to limit bad debts, it is concerned at the extent of the increase sought for provision for bad debts.

For ratemaking purposes, the bad debt expense is designed to represent a typical year's bad debt experience. It is not intended to reflect the very specific experience of the Applicant within the historic year, or anecdotal expectations or fears relating to specific accounts. It is a structural element designed to reflect a reasonable provision over time for bad debts.

In its reply submission the Applicant cited specific circumstances relating to the decline in the economy in its franchise area related to tobacco production, and a phenomenon where customers who have signed contracts with retailers have failed to pay their accounts. The circumstances cited by the Applicant do not support the increase sought.

Accordingly, the OM&A envelope will reflect a bad debt expense provision of $70,000 and the Applicant should provide specific information that this reduction has occurred in the draft Rate Order it files.

Other Costs

Board staff noted in its submission that in certain cost areas Norfolk Power failed to provide adequate explanations to justify an overall increase of 30% in OM&A. These included load dispatching ($123,841), customer billing ($116,138), maintenance of distribution station equipment ($85,485), maintenance of building and fixtures – distribution station ($64,368), and maintenance supervision and engineering ($62,350).

In its submission, VECC stated that in 2007 a number of increases are attributed to an increased allocation of IT expenses. However, nowhere in the application does Norfolk Power explain why IT costs themselves are increasing overall. As well, VECC noted a number of discrepancies between Norfolk Power's original application and interrogatory responses. For example, as stated in Norfolk Power's original application, a year over year change for 2006 to 2007 for customer billing shows a variance of $86,816. However, in its response to Board staff interrogatory #23, Norfolk Power suggests a year over year change of $116,138.

In addition, VECC noted that some of the variance explanations for 2007 would appear to be one-time expenses that should not re-occur in 2008 but, according to Norfolk Power do occur. Examples include Forestry Audit and Ontario Energy Board mandated re-verification of TS Equipment.

Overall, Board staff and intervenors expressed concerns in their respective submissions regarding the lack of supporting explanations provided by Norfolk Power for its proposed 30% increase in OM&A.

VECC submitted that Norfolk Power has not adequately explained the significant increase in OM&A between 2006 and 2008 of over 20% (excluding smart meters). In VECC's view, the requested increase of $748,214 should be reduced by at least 20% (i.e. $150,000).

Schools stated that for a number of areas where Norfolk Power shows substantial spending increases, Norfolk Power has not provided an adequate explanation for the increases, with the result that there is insufficient information on the record to be able to comment. Schools recommended that Norfolk Power's allowed OM&A be reduced by $300,000 based on the issues discussed above and given the fact that Norfolk Power has not adequately explained various spending increases in 2007.

Norfolk Power's reply submission stated that the proposals by VECC and SEC are purely arbitrary in nature and, if implemented, would jeopardize the ability of Norfolk Power to provide safe and reliable distribution service to its customers. In Norfolk Power's view, neither VECC nor SEC has pointed to any evidence that would justify a reduction in the OM&A cost.

Board Findings

It is to be expected that many utilities making a forward year cost of service application for the first time at this early stage in the incentive rate mechanism plan are uncertain as to the nature of and quality of the evidence that is required to support their proposals.

The proposal itself is not evidence of anything. What is needed to support cost of service applications is specific evidence that demonstrates the need for funding for rates.

For capital expenditures such evidence may include studies conducted internally or with the assistance of third-party expertise that demonstrate the need to replace specific equipment within the overall plant of the utility.

Reliability statistics can also support requests for additional capital spending where they are corroborated by other cogent evidence.

For OM&A spending, applicants should develop detailed evidence supporting spending plans which include as much detail as is available for factors underpinning forecasts. For example, when advancing a proposal respecting wages and salaries, applicants should be prepared to file with their applications specific factors, incidents, and conditions relied upon to support forecast increases. Similarly, forecast spending on maintenance should be supported by detailed analysis and operational plans.

Such information and analysis is required for each element of proposed spending.

The Board notes that in this case there were significant increases in expenditures during the Bridge year, 2007. Utilities should be aware that without appropriate evidentiary support Bridge year spending levels are at risk, and ought not to be relied upon as a foundation for test year spending.

In the instant case it cannot be said that the evidence in support of the OM&A elements of the application was all that it could be. This is especially so given the relatively large increase in revenue requirement sought by the Applicant. In so far as this is the applicant's first attempt at a forward year cost of service application, and because it falls within this early stage of the incentive rate mechanism plan the Board is prepared to extend some latitude with the qualifications expressed herein.

Utilities bringing cost of service applications later in this process should ensure that the evidence they provide in support of their proposals is focused, competent, and detailed with respect to each element of the application. Otherwise they must expect to be unsuccessful in their proposals.

As noted above the Applicant's proposal, excluding smart meters, would result in an overall increase in OM&A of approximately 20%. An increase of this magnitude requires commensurate evidentiary support. In this respect this application is deficient. While the Applicant had every opportunity to resolve evidentiary gaps related to these cost items it failed to do so.

The Board's rate setting process seeks to provide the right balance between the interests of the consumers in rates that properly reflect the costs associated with providing the service, on the one hand, and the ability of the utility to earn a reasonable rate of return on its investment. From a public policy point of view, of paramount importance is the provision of electricity in a safe, reliable, and efficient manner. Evidentiary shortfalls such as those which are present in this case complicate this process immeasurably.

Typically, past spending is a good indication of the normal pattern of expenditures for the utility. By examining past spending it is possible to put the Applicant's proposal in a useful and informative context. That is not to say that past spending is determinative of appropriate spending levels going forward. The Applicant may have reasonable spending plans which are sharply increased or decreased from year-to-year. This can occur for a variety of reasons, both within and outside the control of the utility. But in any case, the utility must be able to demonstrate with evidence the need for such departures from normal spending patterns.

In this case, the Board has examined the historic spending pattern of the utility, and it shows that year-over-year spending from 2002 to 2006 actually decreased. There has been a very sharp increase in the bridge year and this proposal is for an increase as between 2007 and 2008 of a further 0.9%, exclusive of smart meters. The Board believes that in general spending should be relatively smooth from year to year and where there are exceptions to the smooth pattern of spending these variations need to be fully explained. The Board expects that Norfolk Power will strive to attain a relatively smooth pattern going forward and will fully explain any and all exceptions to this pattern in its next rebasing application.

The Applicant has not provided any evidence to support some of its sharply increased spending plans, and where it has provided evidence, the evidence is not commensurate with the magnitude of the increase sought.

Accordingly the Board will approve an increase in other costs of an amount equivalent to 12% over the 2006 actuals, excluding costs associated with smart meters. The Board will not stipulate how the overall OM&A budget ought to be spent beyond the direction provided for regulatory and bad debt costs, but rather will approve an envelope increase of 12% to be managed by Norfolk Power as it sees fit. The utility will be accountable for the decisions it makes in prioritizing its spending plans within the envelope as it supports its historic spending as a basis for its proposed going forward revenue requirement in its next rate application. In arriving at this decision the Board has been guided by the initial proposal of the Applicant and the lack of specific supporting evidence in support of much of it. The reduction from the proposal is as a result of this lack of evidentiary support, but the Board finds the approved amount is a reasonable level of funding to allow the Applicant to operate effectively.

EMPLOYEE COMPENSATION AND STAFFING

Salary and Benefits

In its reply submission, Norfolk Power identified a total increase of $306,336 in OM&A costs for 2007 and 2008 related to increases in salary and benefits.

Board staff’s submission noted that one of the key components of this increase is the two-year increase in average executive and management benefits of 13% and 15%, respectively. In response to Board staff interrogatory #16, which asked Norfolk Power to explain this increase, it stated that the increase was due to annual cost of living adjustments of 3% and increases in health care premiums of 5%. Norfolk Power further stated that in 2006, it had implemented a new benefit plan which also increased executive and management benefits by 2%.

Staff's submission further noted that a second major component of this increase was total management salary and wages, which have increased by 34% from 2006 to 2008. In response to Board staff interrogatory #14, which asked Norfolk Power to provide test year data for 2008 and to explain any variances between 2007 and 2008 amounts, Norfolk Power stated that there has been a 4% increase for executive and management employees related to progression and a 3% cost of living adjustment for inflation.

Staff Additions

Neither Board staff nor Intervenors made comments on Norfolk Power's proposed increases in employee compensation and benefits or staff additions.

In its reply submission, Norfolk Power stated that it has had an increase of 4 employees from 2006 to 2008.

<u>Board Findings</u>

As noted above as part of its OM&A proposal Norfolk Power seeks significant increases in spending directed to executive and management benefits and total management salary and wages.

In its initial filing the Applicant did not provide detailed support for the amounts claimed in this category of spending. In making a forward test year application, it is reasonable to expect that where a utility is seeking significant increases, detailed evidentiary support should be included with the initial filing. Failure to do so does not necessarily compromise the application, or the success of the Applicant in having claimed amounts approved, but it certainly lengthens and complicates the process. In this case given the extent of the increases sought it would have been preferable for the Applicant to have provided detailed support from the beginning.

Through interrogatories and its reply submission Norfolk Power referenced cost-of-living adjustments, increases in health care premiums, an enhanced benefits program, and the creation of two management positions as the underlying cause for the substantial increase sought. The Applicant also asserted that management salary and wages would increase as between 2006 and 2008 by 34% because of progression of employees within or into the executive and management category and an adjustment for cost of living.

The Applicant's proposal also makes provision for the addition of four new employees in between 2006 and 2008. It is not clear from the record why this increase in staffing is required. That is not to say that these additional employees are not required, simply that the Applicant has not provided detailed evidence outlining the nature of the work these additional employees would be performing and why they are needed at this point.

While it is difficult on the record provided by the Applicant to assess its proposal with desired accuracy, the Board finds the Applicant's claims in this category to be excessive and not well supported by the evidence. For example, it would have been useful if the Applicant had been able to provide greater detail respecting the current composition of the executive and management group compared to the rest of the organization. A focus on the progressions into the management group and within it would have assisted the Board in assessing the reasonableness of what is clearly a high percentage change in this area of cost.

Similarly, it would have been helpful if the Applicant could place its wage, benefit package, incentive program, and management/workforce ratio within some context, such as benchmarking evidence. The Board will not make a specific disallowance with respect to this category of costs, and the company will have to manage this area, as with all other areas of OM&A, within the envelope of funding approved by the Board in this Decision.

PAYMENTS IN LIEU OF TAXES (“PILS”)

Norfolk Power’s reply submission stated that it will use the appropriate CCA classes for computer hardware and software and will recalculate PILs reflecting the most recent tax legislation when it submits its draft Rate Order.

Board Findings

The Board has observed that no party commented on the interest addition and deduction used in the determination of regulatory taxable income and PILs. While the net difference is a non-material deduction, there is a policy matter which has been discussed in another 2008 rate case, that of Halton Hills Hydro (EB-2007-0696). In that proceeding, the Board required the Applicant to remove the interest addition and deduction in determination of the PILs proxy amount.

The Board finds that Norfolk Power should incorporate all known income and capital tax changes into its PILs calculations for 2008. This approach incorporates the most current information.

In calculating the PILs provision, the Board directs Norfolk Power to reflect in its draft Rate Order the new combined income tax rate for 2008 of 33.5%, the Ontario capital tax exemption amount of $15 million, and the new CCA class rates applicable. The interest expense additions and deductions should not be used in the determination of regulatory taxable income and the PILs proxy. Changes in amounts resulting from other sections of this Decision should be reflected in the final PILs calculations that Norfolk will use in its draft Rate Order.

RATE BASE AND CAPITAL EXPENDITURES

The following table summarizes Norfolk Power's 2008 rate base and capital expenditures. Norfolk Power forecasts capital expenditures (excluding smart meters) of $5,938,600 in 2008, approximately a 17.6% increase from 2006 actual capital expenditures.

Summary of Capital Expenditures and Rate Base 2006-2008

	2006 (Actual)	2007	2008 - Projected	
			Total (including Smart Meters)	Excluding Smart Meters
Capital Budget Expenditure	$5,049,756	$5,620,200	$10,189,600	$5,938,600
% of increase as compared to the prior year	-	+11.3%	+81.35%	+5.7% [17.6% from 2006 actual]
Rate Base (average)	$42,046,838	$44,797,683	$50,499,606	calculated as $48,374,106
% of increase as compared to the prior year	-	+6.5%	+12.7%	+8.0%

Rate Base

Board staff submitted that Norfolk Power included a $120,000 deposit for a new transformer to be purchased in 2008 rate base, but not expected to be in service in 2008. In response to a Board staff Interrogatory, Norfolk Power stated that the inclusion of this item in the 2008 rate base was an oversight, and agreed that the deposit for new transformer at the Bloomberg TS should be removed from the 2008 rate base[1]. In their submissions, VECC and Schools agreed that the $120,000 for this transformer should be removed from the 2008 Rate base.

Working Capital Allowance

VECC noted that the rate base depends on working capital, which in turn is influenced by the cost of power, and that Norfolk Power has used $59.2/MWh instead of the Board-approved cost of $54.3/MWh. Norfolk Power did not provide any explanation for this in its reply submission.

Capital Expenditures

Based on Norfolk Power's Application, the main drivers for the increase in 2007 and 2008 are as follows:

- Customer Demand Projects;
- Renewal Projects;
- Stations Spending; and
- Smart Meters.

Board staff raised questions about the justification for renewal projects and how reliability considerations may support the justification for station capital upgrades. Norfolk Power provided information in response in its reply submissions, under the areas of Reliability and Asset Management.

VECC noted that the renewal projects spending varied widely from year to year. In response to a VECC interrogatory[2] Norfolk Power stated that one of the reasons for the variance was that resources were shifted to Customer Demand projects.

[1] Board Staff Interrogatory # 6d (ii)
[2] VECC Interrogatory #9 h)

VECC was concerned whether Norfolk Power will be able to resource the increased spending in 2008 for both Customer Demand and Renewal projects. VECC submitted that the spending on Customer Demand and Renewal projects in 2008 should be capped at $3.3 million which is a 3% increase over its 2007 spending where the 3% amount approximately reflects the inflation. In its reply submission, Norfolk Power stated that any reduction to the Customer Demand and Renewal projects as proposed by VECC would be purely arbitrary in nature and would hinder the ability of Norfolk Power to fulfill its obligation to customers.

Smart Meters are discussed elsewhere in this Decision.

Intervenors did not question other aspects of Norfolk Power's proposed capital expenditures, acknowledging that they are in line with expenditures in recent years.

Reliability Performance

The System Average Interruption Duration Index ("SAIDI") and System Average Interruption Frequency Index ("SAIFI") are measures of reliability performance – of service continuity experienced by the distributor's customers. Norfolk Power filed its annual reliability performance, as measured by SAIDI and SAIFI, for the years 2002 through 2006 in response to a Board staff interrogatory.

Subsequently, in its reply submission, Norfolk Power updated this information with its 2007 SAIDI and SAIFI figures.

Annual Reliability Performance Statistics

	2002	2003	2004	2005	2006	2007
SAIDI	21.090*	1.285	1.957	2.244	2.949	5.066*
SAIFI	2.120	1.330	3.405	2.238	4.451	1.891
CAIDI	9.948	0.966	0.575	1.003	0.663	2.679

* Includes Ice and Wind Storm

Board staff expressed concerns on the quality of data for the reliability performance indicators as provided by Norfolk Power. However, most of the original figures were confirmed by Norfolk Power, although corrections were made to the following:

- SAIDI for the years 2006;
- SAIFI for the years 2002, 2004 and 2006; and
- CAIDI for the years 2002, 2004, and 2006.

These corrections are incorporated in the above table.

Board staff stated that Norfolk Power did not confirm its 2008 reliability targets. In its reply submission, Norfolk Power stated that it would concentrate its effort to reduce SAIFI. As a result, Norfolk Power's 2008 target for SAIFI will be consistent with the 2007 level, and Norfolk Power would expect to lower SAIDI in 2008 and future years.

Assessment of Asset Condition and Asset Management Plan

Board staff submitted that it was unable to assess the adequacy of Norfolk Power's plan to maintain its infrastructure and improve its performance on the basis of Norfolk Power's evidence and the interrogatory responses. VECC and Schools shared the concern that a suitable asset management plan was necessary to address any reliability and asset condition issues and for the Applicant to prioritize its capital spending.

In its reply submission, Norfolk Power disputed the claims and stated that it has a prudent and effective asset management plan in place. In support, it provided a flow chart showing the decision making process in relation to Asset Management. Norfolk Power stated that it also reviews the following factors for identifying Renewal projects:

- Age of the plant;
- Condition of insulation on open bus secondary;
- Small conductors;
- Non-Standard construction;
- Condition of hardware; and
- Condition of protective devices.

Norfolk Power stated that it considers these factors in prioritizing its capital projects.

<u>Board Findings</u>

The Board is satisfied, with some qualifications, that the Applicant's proposal for rate base is reasonable.

Elsewhere in this Decision the Board comments on the Applicant's proposal with respect to smart meters, and no portion of the Applicant's claim relating to smart meters will be included in rate base. This approach is consistent with the Board's decisions in a number of other cases where like claims have been made by unnamed, and unauthorized distributors.

Board staff expressed some concern with respect to the variation between 2006 Board-approved rate base and the Applicant's actual rate base for that year. The Board is satisfied that the overrun was the result of reasonable management decisions in that year.

The Applicant's proposal provides for an increase for 2008 which the Applicant has defended as being necessary to ensure a reliable and safe delivery of electricity to its customers. It would have been helpful if the Applicant had provided more support in its original filing, rather than in its reply submission. In future rates applications the Board expects the Applicant to provide full scope of justification with its application, and not as part of the submissions stage of the proceeding.

The Applicant in its reply submission provided some reliability statistics in support of its rate base and capital expenditure program. While these reliability statistics are of interest, the Board is not convinced that this Applicant or indeed many other Applicants develop them on the basis of a well understood protocol. It is also true that the Board does not necessarily regard these indices as being determinative with respect to reliability performance. That said, the Board is satisfied at this time that the Applicant has a reasonable approach to managing reliability performance and that is reasonably supported by its rate base and capital spending programs.

In its reply submission the Applicant also provided detail respecting customer driven projects and the capital contribution aspects of the same. Once again, the Board is satisfied that the Applicant's approach is reasonable, but expects this kind of information to be made available with the original application in the next rebasing year.

In its submissions VECC urged the Board to reduce the Applicant's customer demand and renewal projects budget by $300,000. This reduction was intended to limit the increase in the Applicant’s spending in this category to the rate of inflation. In the Board's view this reduction is not appropriate. While the Applicant's support for this area came late in the process, the Board is satisfied that the Applicant's proposal is not excessive.

With respect to working capital allowance the Board notes the Applicant does not appear to be proposing an approach that is consistent with that taken by the Board and other utilities. The governing approach, applied in a number of 2008 rebasing applications, has been to direct Applicants to use the Board's most recent RPP commodity cost forecast. The Board announced a May 1, 2008 RPP of $54.50/megawatt hour. In the draft Rate Order giving effect to this Decision the Applicant will apply this factor to its working capital allowance calculation.

The Board notes that in so far as it has approved the Applicant's load forecast in this application, the other variables with respect to the working capital calculation are the Applicant's implementation of the Board's direction related to retail transmission changes, which are dealt with elsewhere in this decision and the changes to the overall OM&A budget.

An issue that arose with respect to the Applicant's capital spending plans was the nature of its assessment of asset condition and asset management plan. There has recently been considerable interest in the methodology, or methodologies, used by utilities to better understand and manage the condition of the physical plant used in the delivery of electricity to its customers.

In some cases utilities have purchased or developed very sophisticated and complicated asset management programs designed to assess and predict equipment condition according to a wide range of inputs.

While such systems may be very useful in given circumstances, they are not the only method that can be used to reliably assess equipment condition. In many cases, an apparently less sophisticated method can be just as effective.

Norfolk Power has provided a flowchart that describes its process for the assessment of the condition of its plant and its management process in response. The Board is satisfied that Norfolk Power's approach can provide necessary information to assist the utility in the management of its resources and its equipment in an organized manner. However, the Board does note that the Applicant made specific reference in its reply submission to the interdependence of its Service Reliability Indicators (SRI) and its proposed capital projects and yet there is no illustration of the use of the SRIs in its plant condition assessment process. The Board expects Norfolk Power to keep itself informed of the conventional industry approach to these matters and in particular the use of historical information on equipment failure and unplanned outages.

COST OF CAPITAL

The Board's guidelines for the cost of capital are set out in its *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Board Report"). The Board Report sets out the formulas and policy guidelines to be used to determine the return on equity and the deemed costs of long-term and short-term debt and sets out the process by which these figures will be updated.

Norfolk Power's proposed capital structure for 2008 is 53.3% debt (49.3% long-term debt and 4.0% short-term debt) and 46.7% equity. Norfolk Power also used a short-term debt rate of 4.77% and a return on equity of 8.68% in its original Application, but acknowledged that these would be updated in accordance with the Board's Report. The Board announced updated cost of capital parameters on March 7, 2008.

Board staff submitted that Norfolk Power's proposal was generally consistent with the policies documented in the Board Report, but raised a question about whether the 6.70% long-term debt rate applied for accurately reflected Norfolk Power's weighted average cost of long-term debt. VECC and Schools supported Board staff's submission.

Norfolk Power in its reply submission acknowledged an error in the calculation of its weighted average cost of long-term debt. On page 17 of its reply submission, Norfolk Power provided a table showing a revised cost of long-term debt of 6.10%.

Board Findings

With the revision to Norfolk Power's weighted average cost of capital as documented in its reply submission, the Board finds that Norfolk Power's proposals for the capital structure and cost of capital are in accordance with the Board's Report and are appropriate.

The table below sets out the Board's updated costs for the various components of the capital structure, which reflects the Board's recently published cost of capital parameters. Norfolk Power's weighted average cost of capital for 2008 is 7.19%.

Board-approved 2008 Capital Structure and Cost of Capital

Capital Component	% of Total Capital Structure	Cost (%)
Short-Term Debt	4.0	4.47%
Long-Term Debt	49.3	6.10%
Equity	46.7	8.57%
Preference Shares	-	
Total	**100.0**	**7.19%**

COST ALLOCATION AND RATE DESIGN

The following issues are dealt with in this section:

- Low Voltage
- Revenue to Cost Ratios
- Fixed Variable split
- Retail Transmission Service Rates
- Line Losses

Low Voltage

Board staff noted that Norfolk Power receives Low Voltage service from two host distributors, and that one of these, Hydro One Distribution, currently has an application with the Board that, if approved, would result in lower costs to Norfolk Power. Norfolk Power's application would recover costs at the current rates, and does not include an adjustment for the lower rates. Norfolk Power agreed in its reply submission that the lower cost should be reflected in its final rates.

Board staff noted that the allocation of LV costs to Norfolk Power's customer classes is proportional to total Retail Transmission Service revenues, i.e. Network and Connection combined. The currently approved allocator is Connection service only. Staff submitted that the amounts allocated are very similar as between methods.

Board Findings

The Board notes that Norfolk Power agreed in its reply submission that the lower costs contained in Hydro One Distribution's current application should be reflected in its final rates and the Board finds this to be appropriate. As noted above, this will result in a reduction of the low voltage rates attributable to the Hydro One connection. In the event that the Hydro One low voltage rates proposal is not approved, the difference will be recorded in a variance account and disposed of at the next appropriate opportunity.

Revenue to Cost Ratios

The following table shows the revenue to cost ratios in Norfolk Power's Informational Filing and in its Application. For convenience, the Board's target range for each class is shown in column 3.

Norfolk Revenue to Cost Ratios

%	Informational Filing Run 2 Col 1	Application: Exhibit 8 / Tab 1 / Schedule 2 / p. 2 Col 2	Board Target Range Col 3
Customer Class			
Residential	103.8	102.6	85 – 115
GS < 50 kW	96.0	99.1	80 – 120
GS 50 - 4999 kW	102.5	98.8	80 – 180
Street Lights	30.7	54.3	70 – 120
Sentinel Lights	19.6	47.0	70 – 120
USL	98.5	100.7	80 -- 120

Norfolk Power's proposal involves re-balancing in favour of two classes, Residential and General Service 50 – 4999 kW, that were above 100% in the Informational Filing, and an increase in the revenue to cost ratio for the other four classes that have ratios below 100%.

The proposed distribution rates for Street lighting would be increased over the currently approved rates by 149.8% for the Monthly Service Charge and by 161.9% for the volumetric charge, which yields a revenue to cost ratio of 54.3%. Schools submitted that the rates should be increased to yield a ratio of 100%, because the Street lighting customer is an affiliate of Norfolk Power. Schools submitted that “unless there is an exemption by the Board, it is Schools’ submission that Norfolk Power is not entitled to charge an affiliate for any service at less than cost”.

Norfolk Power submitted that the proposed increase in rates reduces the gap between the current ratio (30.7%) and the lower end of the target range (70%) by 60%. Board staff noted that in Norfolk Power’s response to Board staff interrogatory # 56 the increase on the total bill for Street lighting has been calculated by Norfolk Power at 64.9%.

Board staff further noted that the proposed rates for Sentinel Lights would increase the revenue to cost ratio to 47.0%, which narrows the gap between the ratio in the Informational Filing and the lower end of the target range by approximately 54%. There were no other submissions on Sentinel Lights.

VECC submitted that the revenue to cost ratio for the GS 50 – 4999 kW class in the Informational Filing is affected by the allocation of the cost of the transformer ownership allowance, and that if the cost had been allocated directly then the ratio would have been less than 100%. VECC submitted that the additional revenues gained from increasing the share of revenue from various classes should be used only to reduce the share of the Residential class. Norfolk Power agreed with VECC’s analysis and conclusion.

Board Findings

The Board has recently issued a report which addresses the diversity in the distribution sector respecting revenue to cost ratios by customer class. In that report the Board established desired ranges for revenue to cost ratios. Those ranges are reflected in the ”Board target range” column in the table titled “Norfolk Revenue to Cost Ratios”.

As can be seen from the table the only revenue to cost ratios that do not fall within the Board target range are those respecting Street lighting and Sentinel lights.

In its proposal the Applicant addressed both of these rate classes.

The Applicant proposes to increase the distribution rates for its street lighting customer, such that the total bill would increase by approximately 65%. This would have the effect of reducing the extent to which this class under contributes to the revenue requirement, from a current revenue to cost ratio of 31% to 54%. This change would not cure the under contribution by this rate class entirely.

Schools' submission to the effect that the Affiliate Relationships Code requires that the revenue to cost ratio move to 100 immediately has been dealt with in the case of Toronto-Hydro Electric System Limited (EB-2007-0680) in its 2008 rebasing application. In that case the Board found that the Affiliate Relationships Code has no relevance to this issue, and the Board reiterates that finding here.

The Board is concerned at the continuing under contribution of the Street lighting customer. The rates for 2008 shall be set so that these ratios shall move by 50% toward the bottom of the Board's target ranges. The Board expects the Applicant to achieve the remaining 50% move by equal increments in years 2009 and 2010.

The same line of reasoning applies to the Sentinel lights customer class. The Board is concerned at the continuing under contribution of the Sentinel lights customer. The rates for 2008 shall be set so that these ratios shall move by 50% toward the bottom of the Board's target ranges. The Board expects the Applicant to achieve the remaining 50% move by equal increments in years 2009 and 2010.

In its reply submission, the Applicant indicated that the increased allocation to, and hence increased revenues deriving from the Street lighting and Sentinel lights rate classes would be applied to the Residential class to reduce its revenue to cost ratio, and the Board adopts that proposal in this Decision.

Fixed/Variable Split

Norfolk Power has proposed distribution rates that maintain the existing fixed/variable split for the main customer classes. Both the monthly service charge and the volumetric rate are proposed to increase by 25.9% for the Residential class, and by 31.5% for the General Service < 50 kW class. For the General Service 50 – 4999 kW class, the increase is 23.3% for both the Monthly Service Charge and the volumetric rate, after making adjustments for the low voltage adder and the transformer ownership allowance.

VECC submitted that the monthly service charge for the Residential class is above the ceiling based on the Minimum System methodology, and that the charge should be maintained at its current approved level. Board staff submitted that the monthly service charges for both of the General Service classes are above the ceiling.

Norfolk Power submitted that its understanding was that a ceiling is not established by the Board's report *Application of Cost Allocation for Electricity Distributors*.

Board Findings

As noted above the Applicant does not propose to change the relationship between the fixed portion of the customer's bill and the portion that varies with load.

The Board has convened a consultation with the industry and stakeholders respecting many aspects of rate design, including the fixed/variable split. (EB-2007-0031). The relationship between the fixed and variable portions of the customer bill has important implications for ratemaking, and the magnitude of the fixed charge has benefits and drawbacks for various stakeholders.

In light of the consultation initiated by the Board on these subjects it would be inappropriate to attempt to predict its outcome and to impose a new structure on the Applicant. Accordingly the Board accepts the Applicant's proposal.

Retail Transmission Service Rates

Norfolk Power's proposed Retail Transmission Service Rates are designed to recover its costs under the recently approved Uniform Transmission Rates. Board staff noted that the proposed retail rates have also been designed to correct for the annual imbalance between wholesale cost and revenue for each of Network and Connection service.

Board staff noted that the forecast of wholesale costs was not adjusted for any change in the retail transmission service rates of Norfolk Power's host distributors, Hydro One and Haldimand County Hydro. Hydro One currently has an application with the Board that, if approved, would lower the cost to embedded distributors such as Norfolk Power. Haldimand County Hydro, for its part, was directed by the Board in its Decision of March 18, 2008 to reduce its retail transmission rates.

Norfolk Power agreed that a further adjustment should be made to its Retail Transmission Service Rates for the effect of the Hydro One application.

Board Findings

As noted above there is an application by Hydro One Distribution currently before the Board for new distribution and other rates effective May 1, 2008 (Board file EB-2007-0681). Although the Board has not yet approved Hydro One Distribution's new rates, the latest available information about what Norfolk Power and other embedded distributors may be charged in the 2008 test year are the retail transmission rates contained in Hydro One Distribution's application.

The Board directs Norfolk Power to reduce its current RTS – Network Service Rate by 18% and its current RTS – Line and Transformation Connection Service Rate by 5%. Those percentages are based on the reductions in wholesale transmission rates that were effective November 1, 2007 and are similar to the reductions proposed by Hydro One Distribution in its current rates case.

Line Losses

Norfolk Power has proposed a Total Loss Factor (TLF) of 1.0560, which is the continuation of the approved TLF for 2007. The underlying Distribution Loss Factor (DLF) corresponding to the proposed TLF is 1.0513.

Norfolk Power is a partially embedded distributor, served by host distributors Hydro One and Haldimand County Hydro. In an interrogatory response, Norfolk Power stated that the DLF values provided do not include losses that occur in the Hydro One and Haldimand County Hydro distribution systems. In its submission, Board staff expressed concern that the DLF associated with a distributor with a compact service territory, as is the case with Norfolk Power, would be as high as the value proposed (1.0513). In its reply submission, Norfolk Power responded that losses incurred in the Hydro One and Haldimand County Power systems are included in the DLF.

Board Findings

Board staff has raised issues respecting the distribution line loss factor proposed by the Applicant. In its view, the fact that the Applicant operates within a "compact" service area means that its line losses should be lower than the factor proposed provides for.

The Board accepts Norfolk Power's clarification that its calculated DLF includes the losses in the distribution systems of the host distributors for portions of its load through the host distributor's delivery points. The Board approves the proposed TLF of 1.0560 for secondary metered customers < 5,000 kW.

DEFERRAL AND VARIANCE ACCOUNTS

The following table shows the deferral and variance account balances the Applicant is seeking to recover.

Deferral and Variance Accounts Proposed for Disposition (as of April 30, 2008)

ACCOUNT #	ACCOUNT NAME	BALANCE REQUESTED FOR DISPOSITION -$
1518	RCVA – Retail	($33,338)
1548	RCVA – STR	$49,135
1550	LV Variance	$9,162
1572	Extra–ordinary Event Losses	$161,763*
1580	RSVA – Wholesale Market Service Charge	($19,464)
1584	RSVA – Retail Transmission Network Charges	$52,872
1586	RSVA – Retail Transmission Connection Charges	($258,706)
1588	RSVA – Power	($642,558)
	TOTAL	($681,134)

* Includes only the principal balance from damage caused by one storm, no carrying charges. When the Applicant withdrew the second claim, it did not update its evidence to reflect the changes in carrying charges accrued to this account. This balance was incurred in 2007 and is the only regulatory asset that Norfolk Power is applying for disposition on a post December 31, 2006 principal balance basis.

Norfolk Power's proposal is to refund to its customers the credit of ($681,134) over three years.

Accounts 1518, 1548, 1580, 1584, 1586, 1588

The Applicant is requesting the disposition of these accounts including account 1588, RSVA power. Account 1588 is part of the Board's ongoing "Bill 23" process. The Board has recently announced, by letter dated February 19, 2008, that it intends to launch an initiative for the review and disposition of Account 1588 and that it will consider the use of “disposition triggers”. In this letter, the Board also indicated it will consider whether to extend this initiative to all of the RSVA and RCVA accounts.

Norfolk Power did not directly respond to concerns raised by Board Staff in regards to the February 19, 2008 letter.

Board Findings

The Board is of the view that it is appropriate to defer the disposition of the RCVA and RSVA accounts until the completion of the announced generic review of these accounts.

Account 1572

Norfolk Power is requesting disposition of Account 1572, Extra-ordinary Event Losses. The original balance requested for disposition in the application was related to damage to Norfolk Power’s system caused by two storms in 2007.

Board staff’s submission stated that a distributor is required to demonstrate that the costs meet the four eligibility criteria established in the 2000 Electricity Distribution Rate Handbook and the guidelines of the Accounting Procedures Handbook Article 480. The criteria are: causation, materiality, inability of management to control and prudence. Board staff submitted that as per the July 31, 2007 Decision EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551, and per the December 20, 2006 Board Report, for extra-ordinary event costs, “amounts claimed will be considered material and therefore eligible for potential recovery if they meet a certain materiality threshold. For expenses incurred, the total expenses on a per event basis must be at least 0.2% of total distribution expenses before taxes. For capital costs to be considered material if, on a per event basis, they are at least 0.2% of net fixed assets.”

VECC stated that only one of the two storms for which cost recovery is requested meets the materiality criteria set by the Board.

In its reply submission Norfolk Power agreed with Board staff and VECC, and withdrew the application for the damage caused by the smaller storm. Although the total carrying charges for account 1572 for the two storms were provided in its response to Board staff interrogatory # 43 and VECC interrogatory # 27, carrying charges for each storm were not provided leaving the exact amount of carrying charges for each storm requested for disposition unclear.

Board staff submitted that Norfolk Power had not provided in its reply to Board staff Interrogatory # 43 support for its view that the damage inflicted on their systems by these two extraordinary events is genuinely incremental.

VECC stated that there is no discussion in the application as to the historical level of storm costs nor the amount of expenditures on storm-related activity during the balance of the year.

Schools was concerned that Norfolk Power had not demonstrated that the costs claimed were incremental to the normal risk for this type of event that is already imputed into Norfolk Power's rates.

In its reply submission Norfolk Power stated that it provides for storm damage in its annual O&M budget and is based on historical data. Norfolk Power also argued that storms in Norfolk County are typically created by wind and ice, causing minor system outages and customer interruptions, for which Norfolk Power has the internal resources to respond and restore power on a timely basis. Norfolk Power argued that the storms it is requesting recovery for were not typical because the damage was excessive and that Norfolk Power required outside assistance to restore power. While Norfolk Power did refer to historical data in its submission, it did not provide this information. Norfolk Power provided the 2007 costs of these storms in its response to Board staff interrogatory # 43 and VECC interrogatory # 27.

The final issue raised by Board staff was that the balances requested for disposition have not been independently verified, although the Applicant stated that the principal balances will be independently verified as part of the 2007 year-end audit. Board staff noted that it was not Board practice to order disposition of forecasted balances of principal transactions on deferral and variance accounts. 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 forecasted carrying charges on those balances up to the start of the new rate year. Norfolk Power was following usual Board practice except for account 1572.

VECC was concerned that there had been no independent verification of the costs claimed nor were the costs even based on 2007 audited results.

Norfolk Power responded that it understood that the Board's 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. Norfolk Power stated that the 2007 audit has been performed and Norfolk Power has received an unqualified opinion on its financial statements, thus implying that the storm damage costs had been audited. Norfolk Power did not provide a copy of these audited financial statements.

Due to its concerns, VECC proposed that the recovery of these costs should not be approved at this time.

In its submission, Schools proposed that the costs be denied given the incomplete information and the large distribution rate impacts stemming from this application.

Norfolk Power believes that it is the appropriate to dispose of these balances.

Board Findings

The Board is of the view that the Applicant has not provided sufficient evidence on the merits of its claim that the amount sought for extra-ordinary expense should be recovered.

The Board would entertain an application to dispose of the amount in this account at a later date if the Applicant chooses to make such an application. The Board would expect such an application to include an analysis of the historic spending on storm damage that has been built into the revenue requirement on which the current rates are based. The Board notes that the Applicant accounts for storm damage separately within its OM&A accounts as is evident in the audited statement for year end 2006. A comparative analysis of the spending levels attributable to storm damage as indicated by the audited statements for 2007, 2006 and 2005 would be of assistance to the Board in making its determination.

Treatment of Carrying Charges

In its response to Board staff interrogatory # 41, Norfolk Power stated that it had been using the interest rate of 4.59% to calculate carrying charges for the deferral and variance accounts from January 1, 2005 to April 30, 2008. Board staff in its submission stated that Norfolk Power was not following the Board direction regarding the calculation of interest for regulatory deferral and variance accounts.

VECC also stated that any questions regarding the appropriateness of the balances (including interest calculations) need to be resolved before they are disposed.

Norfolk Power responded that it believes this rate was fair and reasonable, given the fact that the prescribed rate of interest for the last quarter of 2007 and first quarter of 2008, was 5.14%. Norfolk Power did not give reasons why it believed that it was fair and reasonable to use a lower interest rate than that prescribed by the Board for certain periods when it was applying to clear a refund to the ratepayer.

Board Findings

The Board does not agree with the Applicant's assertion that the interest rate of 4.59% is the appropriate rate to be used for the period commencing January 1, 2005 and ending April 30, 2008. The Board has provided ample guidance as to its expectations in this area. It has done so through the issuance of the 2006 Electricity Distribution Rate Handbook and a letter of direction. The Applicant has not provided cogent reasoning as to why it considers a departure from the Board's guidelines and directions results in a fair and reasonable outcome and therefore the Board finds that a recalculation of the carrying charges should be reflected in the draft Rate Order.

The manner in which adherence with the Board's guidelines, as they pertain to the Applicant's situation, has been achieved is to be detailed and provided with the draft Rate Order.

Request for New Deferral Accounts

Norfolk proposed to establish a new account, Future Capital Projects Deferral Account. This account was proposed to record the revenue requirement associated with the cost of construction during future non-rebasing years.

Board staff submitted that requests for new accounts should be considered in light of the four regulatory principles: materiality, prudence, causation and management ability to control. Board staff also submitted that this account is analogous to including a capital investment factor in an IRM year. Board staff noted that this request may be premature as the mechanism for 3^{rd} Generation IRM ("3GIRM") has not yet been finalized and may include a capital component.

In VECC's view it is pre-mature to approve such a deferral/variance account at this point in time. VECC argued that should the need arise, the Board can authorize its creation and use on an industry wide basis and establish a common set of rules for use of the accounts at that time. VECC submitted that the best way is to approach the matter on an industry wide basis, as opposed to on a piece-meal, utility by utility basis.

Schools' argued that the treatment of revenues in the 3GIRM period is a matter for the panel deciding the 3GIRM process. Schools argued that Norfolk Power's application was premature as it preempts the 3GIRM process.

Norfolk Power stated that it understood this deferral account is analogous to including a capital investment factor in an IRM year. Norfolk Power's position was that as of the date of this submission, the Board has not approved the capital component in the 3GIRM and it is only prudent for Norfolk Power to request the establishment of a new deferral account for capital works during the non-rebasing years.

Both VECC and Schools had concerns about Norfolk Power's response to Board staff interrogatory # 38 (h) in that the Applicant intends to "record any under-forecast or over-forecast of 2008 capital costs in this deferral account." VECC submitted there was no basis or rationale for this while Schools submitted that "there is no justification at all, and contrary to regulatory principles, to allow a utility to have deferral account treatment against its own forecasting errors."

Norfolk Power responded that the Board staff interrogatory suggested it would be preferable for it to include any under-forecasts or over-forecasts of the 2008 capital costs in this deferral account as there was only a need to provide a rationale for not doing this. Norfolk Power stated that a rationale for doing it was not required and submitted that it assumed the Board would look more favourably on establishing this deferral account if the under-forecasts or over-forecasts of the 2008 capital cost was included in the capital work deferral account from a Board staff question.

Board Findings

The Board agrees with the common contention of VECC and Schools that it would be inappropriate to establish a capital spending variance account. The policy work currently in progress on the third generation IRM is the appropriate forum for consideration of the treatment of capital spending in an IRM regime.

Revenue Offsets

Norfolk Power has stated that it clears SSS revenues and costs monthly to the balance sheet and as such these amounts were not used as a revenue offset.

VECC in its submission expressed concern about Norfolk Power's approach and submitted that Norfolk Power should be directed to use the same approach and include SSS Admin Revenue as an offset to its Distribution Revenue Requirement.

Board Findings

The Board notes that the Accounting Procedures Handbook requires distributors to record SSS revenues in Account 4080B which is in turn used as a revenue offset. The Board directs Norfolk Power to follow this approach.

IMPLEMENTATION

The Board has made findings in this Decision which change the revenue deficiency and change the deferral and variance account balances for disposition, and therefore the proposed 2008 distribution rates. These are to be reflected in a Draft Rate Order prepared by Norfolk Power. This Draft Rate Order is to be developed assuming an effective date of May 1, 2008, but the Board will not implement new rates on May 1, 2008.

The Board issued an Interim Rate Order on April 22, 2008, which allows for an effective date as early as May 1, 2008. However, as Norfolk Power was late in filing its application, the Board has determined that an effective date as of the date of the final Rate Order is appropriate in the circumstances of the case. The current, interim rates are in effect until the Board approves the final Rate Order.

In filing its draft Rate Order, it is the Board's expectation that Norfolk Power will not use a calculation of the revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects Norfolk Power to file detailed supporting material, including all relevant calculations showing the impact of this Decision on Norfolk Power's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Norfolk Power should also show detailed calculations of the revised retail transmission rates and variance account rate riders reflecting this Decision.

A Rate Order and a separate cost awards decision will be issued after the processes set out below are completed.

THE BOARD THEREFORE ORDERS THAT:

1. Norfolk Power shall file with the Board, and shall also forward to VECC and Schools, a draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.

2. VECC and Schools shall file any comments on the draft Rate Order with the Board and forward to Norfolk Power within 20 days of the date of this Decision.

3. VECC and Schools shall file with the Board and forward to Norfolk Power their respective cost claims within 26 days from the date of this Decision.

4. Norfolk Power shall file with the Board and forward to VECC and Schools responses to any comments on its draft Rate Order within 26 days of the date of this Decision.

5. Norfolk Power shall file with the Board and forward to VECC and Schools any objections to the claimed costs within 40 days from the date of this Decision.

6. VECC and Schools shall file with the Board and forward to Norfolk Power any responses to any objections for cost claims within 47 days of the date of this Decision.

7. Norfolk Power shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, May 26, 2008
ONTARIO ENERGY BOARD

Original Signed by

Paul Sommerville
Presiding Member

Original Signed by

Ken Quesnelle
Member