Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2010-0104

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 Oakville Hydro Electricity Distribution Inc. for an order or orders approving or fixing just and reasonable distribution rates and other charges, to be effective May 1, 2011.

BEFORE: Karen Taylor
Presiding Member

Paula Conboy
Member

DECISION AND ORDER

Introduction

Oakville Hydro Electricity Distribution Inc. ("Oakville Hydro"), a licensed distributor of electricity, filed an application with the Ontario Energy Board (the "Board") on September 17, 2010, 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 Oakville Hydro charges for electricity distribution, to be effective May 1, 2011.

Oakville Hydro is one of 80 electricity distributors in Ontario regulated by the Board. In 2008, the Board announced the establishment of a new multi-year electricity distribution rate-setting plan, the 3rd Generation Incentive Rate Mechanism ("IRM") process, which would be used to adjust electricity distribution rates starting in 2009 for those distributors whose 2008 rates were rebased through a cost of service review. As part of the plan, Oakville Hydro is one of the electricity distributors that will have its rates adjusted for 2011 on the basis of the IRM process, which provides for a mechanistic and formulaic adjustment to distribution rates and charges between cost of service applications.

To streamline the process for the approval of distribution rates and charges for distributors, the Board issued its *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on July 14, 2008, its *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on September 17, 2008, and its *Addendum to the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on January 28, 2009 (together the "Reports"). Among other things, the Reports contained the relevant guidelines for 2011 rate adjustments for distributors applying for distribution rate adjustments pursuant to the IRM process. On July 9, 2010 the Board issued an update to Chapter 3 of the Board's *Filing Requirements for Transmission and Distribution Applications* (the "Filing Requirements"), which outlines the Filing Requirements for IRM applications based on the policies in the Reports.

Notice of Oakville Hydro's rate application was given through newspaper publication in Oakville Hydro's service area advising interested parties where the rate application could be viewed and advising how they could intervene in the proceeding or comment on the application. No letters of comment were received. The Vulnerable Energy Consumers Coalition ("VECC") and the School Energy Coalition ("SEC") applied and were granted intervenor status in this proceeding. Both parties were granted cost eligibility for their participation in the proceeding in relation to Oakville Hydro's request for an incremental capital module. Board staff also participated in the proceeding. The Board proceeded by way of a written hearing.

While the Board has considered the entire record in this proceeding, it has made reference only to such evidence as is necessary to provide context to its findings. The following issues are addressed in this Decision and Order:

- Price Cap Index Adjustment;
- Changes in the Federal and Provincial Income Tax Rates;
- Smart Meter Funding Adder;
- Revenue-to-Cost Ratios;
- Retail Transmission Service Rates;
- Review and Disposition of Group 1 Deferral and Variance Accounts;

- Late Payment Penalty Litigation Costs; and
- Incremental Capital Module.

Price Cap Index Adjustment

Oakville Hydro's rate application was filed on the basis of the Filing Requirements. In fixing new distribution rates and charges for Oakville Hydro, the Board has applied the policies described in the Filing Requirements and the Reports.

As outlined in the Reports, distribution rates under the 3rd Generation IRM are to be adjusted by a price escalator less a productivity factor (X-factor) of 0.72% and Oakville Hydro's utility specific stretch factor of 0.4%. Based on the final 2010 data published by Statistics Canada, the Board has established the price escalator to be 1.3%. The resulting price cap index adjustment is therefore 0.18%. The rate model reflects this price cap index adjustment. The price cap index adjustment applies to distribution rates (fixed and variable charges) uniformly across all customer classes.

The price cap index adjustment will not apply to the following components of delivery rates:

- Rate Riders;
- Rate Adders;
- Low Voltage Service Charges;
- Retail Transmission Service Rates;
- Wholesale Market Service Rate;
- Rural Rate Protection Charge;
- Standard Supply service – Administrative Charge;
- Transformation and Primary Metering Allowances;
- Loss Factors;
- Specific Service Charges;
- MicroFIT Service Charge; and
- Retail Service Charges.

Changes in the Federal and Provincial Income Tax Rates

In its *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* dated September 17, 2008, the Board determined that a

50/50 sharing of the impact of currently known legislated changes, as applied to the tax level reflected in the Board-approved base rates for a distributor, is appropriate for the 3rd Generation IRM applications. This was based on a decision of the Board in a proceeding in relation to natural gas distributors' (EB-2007-0606/615) incentive regulation applications in which tax as a Z-factor was being considered. In this decision, the Board found that a 50/50 sharing is appropriate because it recognizes that tax changes already flow to some extent through the inflation factor, though the precise timing and quantum of the tax reduction during a current IRM period is not known.

The calculated annual tax reduction over the plan term will be allocated to customer rate classes on the basis of the Board-approved base-year distribution revenue. These amounts will be refunded to customers each year of the plan term, over a 12-month period, through a volumetric rate rider derived using annualized consumption by customer class underlying the Board-approved base rates.

In 2011, the maximum income tax rate is 28.25%, the minimum rate for those distributors eligible for both the federal and Ontario small business deduction is 15.50%, and the blended tax rate varies for certain distributors that are only eligible for the Ontario small business deduction. The model provided to distributors calculates the amount of change caused by the tax rate reductions and adjusts distribution rates by 50% of the total change from those taxes included in the most recent cost of service base distribution rates.

The Board finds that a 50/50 sharing of the impact of changes from the tax level reflected in the Board-approved base rates to the currently known legislated tax level for 2011 is appropriate and shall be effected by means of a rate rider over a one-year period.

Smart Meter Funding Adder

On October 22, 2008 the Board issued the *Guideline for Smart Meter Funding and Cost Recovery* which sets out the Board's filing requirements in relation to the funding and recovery of costs associated with smart meter activities conducted by electricity distributors.

Oakville Hydro requested the continuation of its utility-specific smart meter funding adder ("SMFA") of $1.69 per metered customer per month. Since the deployment of smart meters on a province-wide basis is now nearing completion, the Board expects distributors to file for a final prudence review at the earliest possible opportunity following the availability of audited costs. For those distributors that are scheduled to file a cost-of-service application for 2012 distribution rates, the Board expects that they will apply for the disposition of smart meter costs and subsequent inclusion in rate base. For those distributors that are scheduled to remain on IRM, the Board expects these distributors to file an application with the Board seeking final approval for smart meter related costs. In the interim, the Board will approve the continuation of Oakville Hydro's SMFA of $1.69 per metered customer per month from May 1, 2011 to April 30, 2012. This SMFA adder will be reflected in the Tariff of Rates and Charges, and will cease on April 30, 2012. Oakville Hydro's variance accounts for smart meter program implementation costs, previously authorized by the Board, shall be continued.

The Board has not made any finding on the prudence of the proposed smart meter activities, including any costs for smart meters or advanced metering infrastructure whose functionality exceeds the minimum functionality adopted in O. Reg. 425/06, or costs associated with functions for which the Smart Metering Entity has the exclusive authority to carry out pursuant to O. Reg. 393/07. Such costs will be considered at the time that Oakville Hydro applies for the recovery of these costs on a final basis, if applicable.

Revenue-to-Cost Ratios

Revenue-to-cost ratios measure the relationship between the revenues expected from a class of customers and the level of costs allocated to that class. The Board has established target ratio ranges (the "Target Ranges") for Ontario electricity distributors in its report *Application of Cost Allocation for Electricity Distributors*, dated November 28, 2007.

The Board's Decision (EB-2009-0271) for Oakville Hydro's 2010 cost of service rate application prescribed a phase-in period to adjust its revenue-to-cost ratios.

In response to interrogatories from VECC and Board staff, Oakville Hydro revised its proposed revenue-to-cost ratios. The revised revenue-to-cost ratios are shown in Column 2 of Table 1.

Table 1 – Oakville Hydro's Revenue-to-Cost Ratios (%)

Rate Class	2010 Ratio Column 1	Proposed 2011 Ratio Column 2	Target Range Column 3
Residential	109.1%	107.8%	85 – 115
GS < 50 kW	114.3%	113.0%	80 – 120
GS 50 – 999 kW	85.0%	85.0%	80 – 180
GS > 1000kW	131.8%	130.5%	80 – 180
Street Lighting	120.0%	120.0%	70 – 120
Sentinel Lighting	36.8%	53.4%	70 – 120
USL	40.6%	55.3%	80 – 120

VECC submitted that the revised proposed revenue-to-cost ratios are in accordance with the Board's findings in its EB-2009-0271 Decision.

The Board agrees that the revised proposed revenue-to-cost ratios are in accordance with the Board's findings referenced above. The Board therefore approves the proposed revenue-to-cost ratios.

Retail Transmission Service Rates

Electricity distributors are charged the Ontario Uniform Transmission Rates ("UTRs") at the wholesale level and subsequently pass these charges on to their distribution customers through the Retail Transmission Service Rates ("RTSRs"). Variance accounts are used to capture timing differences and differences in the rate that a distributor pays for wholesale transmission service compared to the retail rate that the distributor is authorized to charge when billing its customers (i.e., variance accounts 1584 and 1586).

On July 8, 2010 the Board issued revision 2.0 of the *Guideline G-2008-0001 - Electricity Distribution Retail Transmission Service Rates* (the "RTSR Guideline"). The RTSR Guideline outlines the information that the Board requires electricity distributors to file to adjust their RTSRs for 2011. The RTSR Guideline requires electricity distributors to adjust their RTSRs based on a comparison of historical transmission costs adjusted for the new UTR levels and the revenues generated under existing RTSRs. The objective of resetting the rates is to minimize the prospective balances in accounts 1584 and 1586. In order to assist electricity distributors in the calculation of the distributor's specific RTSRs, Board staff provided a filing module. On January 18, 2011 the Board issued its Rate Order for Hydro One Transmission (EB-2010-0002) which adjusted the UTRs effective January 1, 2011. The new UTRs are shown in the following table:

Table 2 - Uniform Transmission Rates	**kW Monthly Rates**		**Change**
	Jan 1, 2010	**Jan 1, 2011**	
Network Service Rate	$2.97	$3.22	+8.4%
Connection Service Rates			
Line Connection Service Rate	$0.73	$0.79	
Transformation Connection Service Rate	$1.71	$1.77	
			+4.9%

The Board has adjusted each distributor's rate application model to incorporate these changes.

Based on the filing module provided by Board staff and the new UTRs effective January 1, 2011 noted in the table above, the Board approves the changes to the RTSRs calculated in the filing module.

Review and Disposition of Group 1 Deferral and Variance Accounts

The *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Report* (the "EDDVAR Report") provides that, during the IRM plan term, the distributor's Group 1 account balances will be reviewed and disposed if the preset disposition threshold of $0.001 per kWh (debit or credit) is exceeded. The onus is on the distributor to justify why any account balance in excess of the threshold should not be disposed.

(i) Balances

Oakville Hydro requested that the Board defer the disposition of the December 31, 2009 Group 1 account balances as defined by the EDDVAR Report even though the preset disposition threshold of $0.001 per kWh was exceeded.

The combined total of Group 1 account balances is a credit of $3,807,146 (credit balances are amounts payable to customers). Oakville Hydro included interest on these account balances using the Board's prescribed interest rates to April 30, 2011. Oakville Hydro's account balances as at December 31, 2009, plus projected carrying charges to April 30, 2011, are shown below ($'s).

Table 3 – Deferral and Variance Account Balances

Account Description	Account Number	Principal Amounts	Interest Amounts	Total Claim
		A	B	C = A + B
LV Variance Account	1550	468,441	5,664	474,105
RSVA - Wholesale Market Service Charge	1580	(843,875)	364,299	(479,576)
RSVA - Retail Transmission Network Charge	1584	(77,468)	249,379	171,911
RSVA - Retail Transmission Connection Charge	1586	(784,283)	(81,176)	(865,459)
RSVA - Power (Excluding Global Adjustment)	1588	(5,105,895)	88,244	(5,017,651)
RSVA - Power (Global Adjustment Sub-account)	1588	1,867,515	22,735	1,890,250
Recovery of Regulatory Asset Balances	1590	1,983,200	(1,963,926)	19,274
		(2,492,365)	(1,314,781)	(3,807,146)

Oakville Hydro's rationale for not proposing to dispose of its Group 1 account balances at this time is that its Group 1 account balances as of August 31, 2010 is a credit of $1,186,618, which would not exceed the preset disposition threshold. Oakville Hydro also indicated that if this trend were to continue, a disposition at this time may create rate instability and customer confusion.

Board staff submitted that the unaudited August 31, 2010 Group 1 account balances provided by Oakville Hydro do not provide enough evidence to suggest that the bias in the Group 1 accounts will continue throughout the remainder of 2010. Board staff concluded that in order to maintain a systematic approach to Group 1 account disposition, the Board should direct Oakville to dispose of its Group 1 account balances as of December 31, 2009.

In its reply submission, Oakville Hydro stated that in keeping with the Board's objectives of mitigating the total bill impact on customers, it is requesting that the Board approve the disposition of its Group 1 account balance.

The Board approves the proposed balances for Group 1 accounts as presented by Oakville Hydro. The December 31, 2009 balances and projected interest up to April 30, 2011 are considered final. For accounting purposes, the respective balance in each of the Group 1 accounts shall be transferred to the applicable sub-accounts in account 1595 established by the Board pursuant to the December 23, 2010 Frequently Asked Questions document accompanying the Accounting Procedures Handbook for disposition of balances in 2010, as soon as possible but no later than June 30, 2011 so that the RRR data reported in the second quarter of 2011 reflect these adjustments.

(ii) ***Disposition***

The EDDVAR Report includes guidelines on the cost allocation methodology and the rate rider derivation for the disposition of deferral and variance account balances.

In its reply submission, Oakville Hydro proposed to dispose of its Group 1 account balances over a two-year period in order to mitigate the rate impact on customers. .

The Board finds that, in accordance with the EDDVAR Report, the disposition period for the Group 1 accounts shall be one year.

(iii) Global Adjustment Sub-Account Disposition

Oakville Hydro requested that the global adjustment ("GA") rate rider be recovered through the electricity component of the customer's bill. In its reply submission, Oakville Hydro noted that the Settlement Agreement in its rebasing application provided for the disposition of the GA sub-account account by means of a rate rider applicable to non-RPP customers to be recovered in the electricity component of the customer's bill.

Board staff noted in its submission that the Board approved this approach in 2010 IRM applications only in cases where the distributor could not readily accommodate a separate rate rider in the delivery component of the bill that would apply to non-RPP customers and submitted that this approach be continued.

In its reply submission, Oakville Hydro indicated that it is seeking the Board's guidance on whether the GA rate rider should be recovered through the electricity component or the delivery component of a non-RPP customer's bill.

The Board agrees with Board staff that the prevalent practice amongst distributors is to dispose of the GA sub-account by means of a separate rate rider applicable to non-RPP customers that is included in the delivery component of the bill. The Board also notes that in the Tariff of Rates and Charges approved by the Board in its 2010 cost of service application, the global adjustment rate riders were included in the delivery component of the bill. The Board therefore directs Oakville Hydro to dispose of the GA sub-account balance by means of a rate rider included in the delivery component of the bill that will apply prospectively to non-RPP customers.

Late Payment Penalty Litigation Costs

In this application, Oakville Hydro requested the recovery of a one time expense of $257,572 related to the late payment penalty ("LPP") costs and damages resulting from a court settlement that addressed litigation against many of the former municipal electricity utilities in Ontario.

On October 29, 2010 the Board commenced a generic proceeding on its own motion to determine whether Affected Electricity Distributors[1], including Oakville Hydro, should be allowed to recover from their ratepayers the costs and damages incurred as a result of the Minutes of Settlement approved on April 21, 2010 by the Honourable Mr. Justice Cumming of the Ontario Superior Court of Justice (Court File No. 94-CQ-r0878) and as amended by addenda dated July 7, 2010 and July 8, 2010 in the late payment penalty class action and if so, the form and timing of such recovery. This proceeding was assigned file No. EB-2010-0295.

On February 22, 2011, the Board issued its Decision and Order and determined that it is appropriate for the Affected Electricity Distributors to be eligible to recover the costs and damages associated with the LPP class action in rates. The decision set out a listing of each Affected Electricity Distributor and their share of the class action costs that is approved for recovery. The Board also directed Affected Electricity Distributors such as Oakville Hydro to file with the Board detailed calculations including supporting documentation, outlining the derivation of the rate riders based on the methodology outlined in the EB-2010-0295 Decision and Order. The Board noted that the rate riders submitted would be verified in each Affected Electricity Distributor's IRM or cost of service application, as applicable. Oakville Hydro elected to recover the amount approved in the EB-2010-0295 proceeding and accordingly filed the associated rate riders.

The Board has reviewed Oakville Hydro's proposed rate riders and approves them as filed.

[1] As defined in the Board's Decision and Order EB-2010-0295

Incremental Capital Module

Background

The Request

Oakville Hydro proposed an incremental capital module to recover the incremental capital costs of $20,488,000 (updated to $21,360,209[2]) associated with the design and construction of a municipal transformer station in North Oakville ("MTS#1"). Oakville Hydro requested that these costs be recovered by means of a rate rider that would be in place until such time that Oakville Hydro files its next rebasing application.

The *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* and *The Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors;(together the "Report")* requires that incremental capital expenditures satisfy the eligibility criteria of materiality, need and prudence in order to be considered for recovery prior to rebasing. Applicants must demonstrate that the amounts exceed the Board's materiality threshold and clearly have a significant influence on the operation of the distributor, must be clearly non-discretionary and the amounts must be outside the base upon which rates were derived. In addition, the decision to incur the amounts must represent the most cost-effective option for ratepayers.

Oakville Hydro completed the 2011 IRM3 Incremental Capital Work Form, and calculated that the costs of the MTS#1 exceed the materiality threshold of $13,633,026. Oakville Hydro's 2011 total forecasted capital expenditures are $32,228,000 (updated to $33,100,209[3]), which includes the forecasted cost of $20,488,000 (updated to $21,360,209) to design and construct the municipal transformer station that is the subject of this incremental capital claim.

Oakville Hydro indicated that the incremental capital expenditures related to the design and construction of a municipal transformer station are required to provide relief for the critical shortage of supply to Oakville Hydro and to meet the requirements of the Town of Oakville's planned development in North East Oakville. Oakville Hydro stated that

---

[2] See Oakville Hydro's response to SEC IR#3
[3] See Oakville Hydro's response to SEC IR#3

the expenses are non-discretionary, and that the expenditures have not previously been included in Oakville Hydro's Board approved rate base.

The MTS#1 has a scheduled in-service date of June 2011. Oakville Hydro indicated that if there is a failure of a single critical component at one of the local Hydro One stations prior to that date, the Town of Oakville could experience wide-scale blackouts.

Oakville Hydro requested to recover the costs of MTS#1 by means of a rate rider over a three-year period. Oakville Hydro proposed the establishment of a variable rate rider on the grounds that it would be less costly to administer than two separate rate riders.

Oakville Hydro has indicated that if the approval is not granted, Oakville Hydro will likely be faced with a significant negative cash flow in the short term and possible financial hardship during the incentive regulation term if no return is allowed. Oakville Hydro indicated that it may be forced to consider early rebasing if it fails to secure incremental revenues through its claim.

The Issues

Project Need

Oakville Hydro provided evidence supporting project need in its application and interrogatory responses. Oakville Hydro indicated that the transformer station is non-discretionary, and that the asset must be in place in 2011 to properly serve its customers and continue to provide reliable electricity services.

Board staff submitted that Oakville Hydro's request for incremental capital funding associated with the design, construction, and operation of MTS#1 should be granted.

Board staff submitted that Oakville Hydro has provided adequate evidence to demonstrate that the long term need outweighs its load forecast over the near term, and light loading of the transmission station in the early years. Board staff acknowledged that system reliability is maintained by adding new supply capacity in advance of the development of load.

The utilization factors of transformer stations serving as supply points to Oakville Hydro's service area, and the feeder loading profile over recent years lead Board staff to the conclusion that there is insufficient transformation capacity to meet Oakville Hydro's system demands, and that new transformation capacity is necessary to meet future load growth in the immediate area identified by Oakville Hydro.

Board staff noted that from the evidence, it is unclear whether Oakville Hydro will be required to make payments to Hydro One in respect of bypass. Board staff submitted that the bypass issue, and associated costs, have not been adequately addressed in Oakville Hydro's application.

VECC and SEC both agreed that Oakville Hydro provided adequate evidence to demonstrate that the MTS#1 is non-discretionary and supported the incremental capital claim.

In its reply submission, Oakville Hydro stated that it will not be required to make bypass payments to Hydro One.

Prudence

Oakville Hydro noted that it analyzed three potential options that would provide sufficient transformer station capacity for Oakville Hydro for the next 25 years, based on current load forecasts. Oakville Hydro proposed that the Oakville Hydro Self Build option (MTS#1) would be the most prudent expenditure.

Oakville Hydro Self Build (MTS#1)

Oakville Hydro would design and construct a 170 MVA (153 MW) municipal transformer station, to be owned by Oakville Hydro or jointly owned with Milton Hydro. The municipal transformer station would be in-service by summer 2011.

The preliminary budget for this project was $20.5M. If owned solely by Oakville Hydro, this option would provide enough capacity to service all of the forecasted growth in the north Oakville area. If the capacity was shared with Milton Hydro, it would provide local capacity for about ten years. Oakville Hydro noted that this option results in the least rate impacts in Oakville Hydro's immediate service area. In addition, Oakville Hydro noted that the transformer station is ideally located to serve the expected load growth in the immediate area of its distribution system.

Oakville – Milton Co-ownership Option

If Oakville Hydro elected to co-own the transformer station a second municipal transformer station would be necessary in 2022. Co-operation with Milton Hydro would allow for the construction of the second station to be scheduled according to the load requirements at that time.

Hydro One Options

Hydro One proposed two options. The first option was for the construction of a transformer station, Tremaine TS, to be ready for service in 2012 that would provide new capacity for Oakville Hydro, Burlington Hydro and Milton Hydro. The proposed location of the transformer station would be west of Oakville Hydro's service territory. This option only provided for a small portion of the planned growth in North Oakville.

The second option was that the design and construction of the North Oakville transformer station would be done by Hydro One. Oakville Hydro noted that Hydro One's preliminary budget was significantly higher than Oakville Hydro's self-build preliminary budgetary estimate.

Board staff submitted that the proposed MTS#1 results in the least rate impacts in Oakville Hydro's immediate service area, and the transformer appears to be ideally located to serve Oakville Hydro's expected load growth in the immediate area of its distribution system.

Board staff submitted that the other alternatives to construction of MTS#1 are less suitable based on total cost, in-service dates, and the associated risk of supply outages. The transformer station proposed is the most cost-effective alternative presented, and Board staff submitted that it is in the best interest of Oakville Hydro's ratepayers that MTS#1 be built.

VECC submitted that Oakville Hydro has adequately demonstrated the prudence of the proposed expenditure. In its study of supply alternatives, Oakville considered a number of options including self-build, co-ownership with Milton and two different Hydro One ownership options. VECC submitted that the Oakville "owned" option was the lowest cost. VECC also noted that Oakville Hydro used an RFP process to obtain professional engineering services for the proposed station. SEC supported VECC's position.

Materiality

Oakville Hydro completed the 2011 IRM3 Incremental Capital Work Form, and calculated that the costs of the MTS#1 exceed the materiality threshold of $13,633,026. Oakville Hydro's 2011 forecasted capital expenditures are $32,228,000 (updated to $33,100,209), which includes the forecasted cost of $20,488,000 (updated to $21,360,209) to design and construct the municipal transformer station that is the subject of this incremental capital claim.

Oakville Hydro noted that none of the projects included in its 2011 capital budget ($33,100,209) are discretionary in nature.

VECC submitted that the requested incremental capital amount is material, not only in that the spending exceeds the threshold value but that the quantum involved (approximately $20,000,000) is well more than half the total 2011 capital budget. SEC supported VECC's position.

Incremental Capital Amount Eligible for Recovery

Oakville Hydro requested that the updated MTS#1 capital costs of $21,360,209 be approved as the 2011 incremental capital amount upon which the annual revenue requirement would be calculated.

VECC submitted that Oakville Hydro improperly applied the threshold value in determining the capital spending eligible for inclusion in the Incremental Capital Adjustment calculations. VECC noted that in the Supplemental Report of the Board (EB-2007-0673) the Board stated that, "the incremental capital for which the Board may provide rate relief is the new capital sought in excess of the materiality threshold". VECC submitted that the total projected (non-discretionary) capital spending for 2011 is $32,228,000 and the threshold value is $13,633,026. Therefore, the maximum that would eligible for rate relief is $18,594,974. VECC submitted that the amount of capital spending to be included in the Incremental Capital module for rate relief should not exceed this amount.

SEC supported VECC's position that the maximum amount eligible for rate relief is $18,594,974. SEC also submitted that the incremental revenue forecast by Oakville Hydro for 2011 to 2013 should be deducted from the revenue requirement calculated in the Incremental Capital Module ("ICM") claim. SEC noted that the Applicant has argued that this deduction should not be made, because these amounts "will be used to reduce the capital contributions needed from developers".

SEC submitted that since the capital budget in the Application does not include any capital contributions from developers, there is no amount to "reduce" relative to the ratepayers. SEC further argued that the Applicant will receive these revenues, and thus will have a net cost of the TS in the IRM period that is less by that amount.

Oakville Hydro submitted that it viewed the materiality threshold as an eligibility test for an incremental capital claim. Having exceeded the materiality threshold, Oakville Hydro included a request based on the total capital spending on the MTS#1 project. Oakville Hydro submitted that this project is an extraordinary, one-time capital project for which total capital spending related to the project should be considered for relief. Oakville Hydro noted that this is not a situation in which Oakville Hydro can choose to complete only portions of a project in order to remain within the threshold.

Oakville Hydro noted, in response to SEC's comments regarding the capital budget not including any capital contributions from developers, that the 2011 capital forecast of $600,000 under the Services category is comprised of $1,250,000 in capital expenditures less $650,000 in capital contributions. Oakville Hydro submitted that the offsetting revenue will be included in the economic evaluation model for the new developments, which in turn will be used to reduce the capital contribution from the developer for the costs associated with the new development, and not to reduce the revenue requirement related to the MTS. Oakville Hydro added that the offsetting revenue does not offset the costs associated with the new MTS#1 and noted that it will incur additional OM&A of $242,000 as a result of the MTS#1 which will not be recovered in rates.

In its reply submission, Oakville Hydro reiterated its request that the updated MTS#1 capital costs of $21,360,000 be approved. Oakville Hydro noted that if the Board accepts VECC and SEC's position regarding the maximum eligible incremental capital amount, the eligible capital amount is $19,467,183 rather than $18,594,974 (Updated 2011 non-discretionary capital budget of $33,100,209 less threshold value of $13,633,026).

Deemed Distribution Asset

Oakville Hydro requested that the Board deem MTS#1 to be a distribution asset pursuant to section 84(a) of the *OEB Act* in order that it may recover the revenue requirement related to MTS#1 through distribution rates. No parties disagreed with this proposal.

Board staff supported Oakville Hydro's request to deem MTS#1 a distribution asset.

Board Findings

Project Need, Prudence, and Materiality

The Board finds that Oakville Hydro's Incremental Capital request meets all the eligibility criteria set out in The *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*. The MTS#1 project is a non-discretionary expenditure that is clearly outside of the base upon which rates were derived. The MTS#1 project is required to meet load growth requirements in Oakville Hydro's service area. The capital costs to be incurred are prudent as Oakville Hydro has provided adequate evidence that potential alternatives were analyzed and that the MTS#1 option represents the most cost-effective option for ratepayers. In addition, Oakville Hydro's non-discretionary 2011 capital expenditures meet the Board's materiality threshold.

Incremental Capital Amount Eligible for Recovery

The Board finds that the Incremental capital amount eligible for recovery is $19,467,183.

The Board notes that the Supplemental Report of the Board (EB-2007-0673) states that "the incremental capital for which the Board may provide rate relief is the new capital sought in excess of the materiality threshold".

The Board also notes that Oakville Hydro's proposed approach to seek relief for the total capital spending on the MTS#1 project would not take into consideration the additional revenue generated through organic growth and the application of the price cap index adjustment to the rate base amount approved in Oakville Hydro's last rebasing application. In the Board's view, Oakville Hydro's approach is counter to the methodology adopted by the Board in its determination of the materiality threshold calculation.

Therefore, the Board finds that the eligible incremental capital amount for recovery is the difference between 2011 non-discretionary capital expenditures ($33,100,209) and the threshold value ($13,633,026).

With respect to the issue of whether the revenue offset should reduce the revenue requirement of the MTS#1, the Board notes that the formula used to determine the threshold value incorporates a factor for growth. As stated in the Supplemental Report of the Board: "There is no dispute among participants that the price adjustment and organic growth factors should be captured in the calculation of the threshold and that not doing so would amount to "double-dipping"." It is clear that the inclusion of the growth factor "g" in the threshold value formula was intended to address this issue of incremental growth.

The issue here is whether additional growth over and above the growth factor "g" should be factored into the revenue requirement for MTS#1. The Board notes that as a result of future new developments, Oakville Hydro will also incur incremental capital costs to connect new customers to the grid. Under a price cap, the incremental revenue generated from load growth act as an offset to the costs that a distributor incurs to connect new customers. Therefore, the Board finds that the incremental revenue requirement for MTS#1 should not be reduced by the revenue offset.

The Board therefore approves the recovery of the incremental annual revenue requirement amount related to the Incremental Capital claim of $19,467,183. The Board directs that the incremental annual revenue requirement amount be recovered by means of a variable rate rider expiring April 30, 2014.

Half-Year Rule

The Board notes that in the Report, it was determined that the half-year rule would not apply so as not to build a deficiency for subsequent years in the IRM plan term. Since Oakville Hydro is not scheduled to file a rebasing application until 2014, the Board has determined that the half-year rule will not apply.

Determination of the Revenue Requirement

The Board directs Oakville Hydro to file an updated Incremental Capital Project Worksheet and an updated Incremental Capital Workform. The updated Workform should reflect the approved incremental capital claim of $19,467,183 (reduced by depreciation to determine the rate base amount), Oakville Hydro's Board-approved 2010 Cost of Capital parameters, and the 2011 PILs rates.

Reporting Requirements

Pursuant to the Report*,* Oakville Hydro will be required to track the difference between the capital expenditure it has proposed in this application and the actual spending. Oakville Hydro will be required to report annually on the actual amount spent.

At the time of rebasing, the Board will carry out a prudence review of the actual costs to determine the amounts to be incorporated in rate base. The Board will also make a determination at that time regarding the treatment of differences between forecast and actual spending during the IRM plan term.

Deemed Distribution Asset

Pursuant to section 84(a) of the *OEB Act,* the Board deems MTS#1 to be a distribution asset.

THE BOARD ORDERS THAT:

1. Oakville Hydro's new distribution rates shall be effective May 1, 2011.

2. Oakville Hydro shall file with the Board an updated Incremental Capital Project Worksheet and an updated Incremental Capital Workform reflecting the Board`s findings within seven (7) calendar days of the date of this Decision and Order. The Board will subsequently provide Oakville Hydro with a rate model (spreadsheet) and applicable supporting models and a draft Tariff of Rates and Charges that reflect the elements of this Decision and Order.

All filings to the Board must quote file number **EB-2010-0104,** be made through the Board's web portal at, www.errr.ontarioenergyboard.ca and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available parties may email their document to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

DATED at Toronto, March 14, 2011

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary