Ontario Energy Board

Commission de l’énergie de l’Ontario

EB-2009-0113

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 North Bay Hydro Distribution Limited for an order approving just and reasonable rates to be effective July 1, 2009.

BEFORE: **Ken Quesnelle**
Presiding Member

DECISION AND ORDER

September 8, 2009

North Bay Hydro Distribution Limited (North Bay) filed an application with the Ontario Energy Board on April 21, 2009, under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15, Schedule B), seeking approval for a proposed schedule of rate riders to be effective July 1, 2009. The Board assigned file number EB-2009-0113 to the application.

The Board issued a Notice of Application and Written Hearing on May 26, 2009. The Vulnerable Energy Consumers Coalition (VECC) and Hydro One Networks Inc. (Hydro One) were approved as intervenors.

Procedural Order No. 1 was issued on June 18, 2009. The Board made provision for written interrogatories and for submissions. VECC and Board staff filed interrogatories and made submissions. Hydro One filed interrogatories, but made no submission. North Bay's reply submission was filed on August 11, 2009. The full record is available at the Board's offices.

THE APPLICATION

Background

North Bay requested disposition of a total of $2,029,825 of its Retail Service Variance Account ("RSVA") balances as of December 31, 2008. North Bay also requested the disposition of carrying charges associated with the above balances of $17,149 for the period of January 1, 2009 to through June 30, 2009. The total overall requested disposition is $2,046,974.

In its application, North Bay stated that Board Regulatory Audit staff initiated a review of North Bay's Account 1588 (RSVA Power) in 2008 due to the balances associated with this account being higher than the industry average. On December 2, 2008, following the review, Board Regulatory Audit staff issued a final letter and stated that North Bay should correct the entries in Account 1588 in accordance with the Account Procedures Handbook.

Following the Board Regulatory Audit staff review, North Bay engaged the services of a consultant to conduct a review of all five RSVAs[1]. As a result, North Bay's consultant,

1 Account 1580, Account 1582, Account 1584, Account 1586 and Account 1588

E360, provided the corrected balances which covered the period May 2002 to December 2008 and also recalculated the carrying charges. These corrected RSVA balances and carrying charges had been audited by North Bay's external financial Auditors, BDO Dunwoody LLP.

Board staff had no concerns with the calculations. VECC made no comments on the calculation of the balances; however VECC took the position that an adjustment regarding the allocation for the Account 1588 Global Adjustment sub-account is required.

VECC noted that North Bay proposed to allocate the total balances of Account 1588 to each class. Since the Global Adjustment sub-account is established to track the Global Adjustment for non-RPP customers only, VECC submitted that the balances from the Global Adjustment sub-account should be recovered based on the non-RPP load associated with each class. VECC further submitted that the rate riders should be based on the response to VECC's interrogatory[2] which reflected VECC's proposed form of recovery. In its reply submission, North Bay accepted the rate riders as submitted by VECC.

Significance of the Balance

North Bay submitted that the outstanding balance of $2,029,825.46 is of great significance to it and provided the following comments in that regard[3]:

a) The RSVA balances represent true costs that were incurred by the Applicant but were inadvertently not passed along to customers for recovery;
b) Using deferral accounts to identify and track costs for recovery at a future period is a standard industry practice;
c) The balance of $2,029,825.46 (comprised of $2,110,574 principal less $80,749 in a credit against carrying charges) represents approximately 2 years of net income for the Applicant's business;
d) Put another way, the balance is equivalent to almost 3 months of distribution revenue;
e) The balance, if written off would result in the distribution business reporting a significant net income loss; and

[2] Response to VECC interrogatory # 3 (c)
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f) The balance is material and, as discussed below, recovery of the balance will be used to assist in financing the costs of certain major capital projects planned for 2009 and 2010.

Retroactivity

North Bay's evidence included corrections made to its RSVA balances for the period prior to December 31, 2004. Board staff's submission noted that the Board had approved North Bay's request for recovery of regulatory assets as of December 31, 2004 in its 2006 Electricity Distribution Rate (EDR) decision. Board staff submitted that the Board may wish to consider the retroactive nature of North Bay's request. Board staff submitted that in the Board's decision on Northern Ontario Wires' (NOW) 2009 EDR application, the Board had disallowed NOW's requested correction to the balances of its Account 1571 (one of its variance accounts) as of December 31, 2004. Board staff further noted that the Board decision on Lakefront Utilities Inc.'s (Lakefront) 2008 EDR application had stated that the proposed adjustment to its error on Account 1570 would result in significant retroactivity and accordingly denied the adjustment.

In its reply submission, North Bay submitted that it should be permitted to make corrections to the RSVA balances in order to ensure that the costs were properly passed through. North Bay submitted that the RSVAs track the differences between the amounts paid by North Bay to the IESO for items such as electricity, transmission services and wholesale market services and the amounts billed to its customers. Therefore, the amounts tracked in RSVAs are considered to be a pass-through to customers. North Bay further stated that both the Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative[4] (EDDVAR Report) and the Report of the Board on Transition to International Financial Reporting Standards[5] (IFRS Report) indicated that pass-through accounts do not require a prudence review. As a result, North Bay submitted that the Board's role should be to ensure North Bay's practices had been corrected and that the corrected balances for these pass-through accounts are recovered.

North Bay further submitted that the cases cited by Board staff did not support staff's position concerning the recoveries sought in its application. The RSVA accounts for which North Bay is seeking adjustments are pass-through accounts which are ongoing

[4] Report of the Board, EB-2008-0046
[5] Report of the Board, EB-2008-0408

and will remain to be used to accrue for ongoing variances. By contrast, in North Bay's view, the cases referenced by Board staff, involve accounts that are neither pass-through nor ongoing in nature (Account 1571 for NOW and 1570 for Lakefront). As such, in North Bay's view these cases are not supportive of an "out-of-period" finding, as suggested by Board staff.

Board staff submitted that if the Board accepted the adjustment for the RSVA balances prior to 2005, this adjustment would, in effect, vary the Board's RP-2005-0020/EB-2005-0397 decision. That decision disposed of North Bay's RSVA balances as of December 31, 2004 on a final basis. Staff noted that the deadline for seeking any variance to that decision had long passed.

North Bay submitted that in the past, the Board had exercised its discretion to vary its own decision after the expiration of the 20-day period. North Bay cited the Board Decision on the Toronto Hydro-Electric System Limited third tranche Conservation and Demand Management Plan in which the Board varied its Decision one and a half years after the original Decision (RP-2004-0203/EB-2004-0485/EB-2006-0145).

Board staff also noted that if the Board decided to allow North Bay's RSVA balances to be disposed for the period January 1, 2005 to December 31, 2008 only, North Bay would refund the amount of $503,506.69 plus interest to its customers.

In its reply submission, North Bay rejected this suggestion on the basis that it would penalize North Bay for its efforts to correct its account practices and urged the Board to approve its application. North Bay submitted that the corrected balances for these pass-through accounts should be recovered.

Recovery period

In its original application, North Bay requested approval for proposed rate riders to be effective July 1, 2009 and a disposition period of three years. VECC submitted that it would be appropriate to change the effective date to November 1, 2009, which would coincide with the change in RPP rates.

In its reply submission, North Bay agreed with VECC's proposal and requested that the proposed rate riders be effective for the period November 1, 2009 to October 31, 2012.

BOARD FINDINGS

For the reasons that follow the Board denies the applicant's request to establish rate riders for the purpose of collecting revenues based on corrected RSVA account balances.

In support of its request, North Bay provided the following:

- A detailed record of the original account balances contrasted against the corrected balances to illustrate the variance that forms the basis of the relief sought as well as the chronology of events that resulted in the corrections.
- Its position regarding the significance of the corrected balances in terms of the quantum in relation to its net income and distribution revenue.
- Details on the intended use of the funds and the concomitant benefits to its customers.

North Bay also noted that due to its stable population base there is little risk of intergeneration cross subsidy.

On the issue of the correction of the account balances, the Board accepts that certain account balances submitted for the purpose of establishing the 2006 rates were incorrect. The record is clear that errors in accounting were made and that a substantial effort has been made to establish accurate balances, based on the correct accounting methodologies and entries. The applicant appears to have taken due care and effort to reform certain accounting procedures to be compliant with the Accounting Procedures Handbook.

As to the significance of the balances, North Bay contends both in its original application and in its reply submission that the money it proposes to collect by way of rate riders is to be applied to needed capital projects within the applicant's service area. At paragraph four of its reply submission North Bay states the following:

"To be clear, the money recovered is not being used to enrich the utility or its shareholder – it is being put back into the system that serves the Applicant's customers."

The Board agrees that the amount proposed to be collected is significant. However, the applicant's position on this point is not clear to the Board. The applicant submits that the

Board should consider the negative impact on the financial status of the utility and at the same time submits that the recovery sought is not to be used to enrich the utility.

These seemingly contradictory contentions may arise from the applicant's understanding, as it is characterized in the application that the corrected account balances represent monies currently owed to the utility.

While no party took issue with the intended use of the sought after money, for reasons that follow the Board will not opine on the appropriateness of the applicant's proposed spending in the context of this application.

The main area contested in the application is the issue of retroactivity. Board staff submitted that the Board may wish to consider the retroactive nature of North Bay's request and cited recent Board decisions where the Board denied requests similar to North Bay's. North Bay responded by noting that the "pass through" nature of the accounts in its application should be considered and that the balances represent its true costs.

In the normal course a utility need not concern itself with the fluctuations in RSVA account balances driven by timing differentials between the incurrence of costs and the collection of offsetting revenues. The purpose of the account is to track the variance with the intent to dispose of the balances in a manner that keeps the applicant whole. However, once the rates, including any associated riders from the clearance of the RSVAs or any other account, have been determined to be final the Board has little, if any, power to alter these rates retroactively.

The applicant has not demonstrated any financial hardship that may have been as a result of the incorrect balances being cleared. The applicant submits that the rationale for allowing the prior period adjustment is that RSVA balances are intended to be a "pass trough" and essentially immune from any retroactivity concern. The Board does not differentiate its treatment of the RSVA accounts from any other component of the approved rates in its consideration of retroactivity. The reasonable rate-payer confidence in the continuation of rates deemed final are diminished equally irrespective of the impetus of the retro-activity.

In support of its request the applicant submits that the intended use of the recovered amounts will be of benefit to the customer due to system improvements. The Board does not consider the establishment of a future need to be sufficient grounds to warrant a prior period adjustment. There are other more appropriate processes to establish the revenues required for future spending.

A central function of cost of service rate making is the matching of future revenues with anticipated reasonably incurred future costs. In a typical rate setting exercise an applicant determines what its reasonably incurred costs will be in the future period for which the applied for rate will be charged. The applicant provides its rationale for the level of spending that underpins its revenue requirement and the Board sets rates in accordance with what it considers to be just and reasonable. It is a holistic process that considers all expected revenues and all expected costs to determine the appropriate rates.

North Bay's 2006 rates were established on the basis of what was thought to be a true account of its expected future costs and revenues. The fact that for 2006 rates North Bay chose to use a historic test year as a proxy for future costs does not alter the concept that rates were established on a prospective basis to match future revenues against future reasonably incurred costs.

North Bay cited the Board's desire to maintain the use of deferral accounts in support of its claims. It is not rational to conclude that the Board's desire to maintain the use of deferral accounts suggests that the final disposition of deferral accounts is anything less than final.

The Board notes that the 2007 rate setting process was a mechanical process that continued the 2006 rates with some inflation related adjustments. The Board initiated a rate setting framework for the electricity distribution sector that provided an opportunity to distribution companies to apply for rates on a cost of service basis for the 2008 rate year or any subsequent year. North Bay did not elect to seek increases to its rates in 2008 or 2009 to cover the costs of these activities but does intend to apply for new rates for 2010 on a cost of service basis. There is no evidence that North Bay was forced to delay capital spending due to lack of revenue or any evidence as to why North Bay did not apply for a rate increase earlier if it saw a need to increase its spending.

The Board expects North Bay to establish its stated needs in the context of its overall spending in its 2010 cost of service rate application. The disposition of the account balances for the time period January 1, 2005 to December 31, 2008 would also more appropriately be done in the context of that rate setting proceeding.

As Board staff noted, a decision to allow North Bay's RSVA balances to be disposed for the period January 1, 2005 to December 31, 2008 only would result in North Bay refunding the amount of $503,506.69 plus interest to its customers.

North Bay submitted that a finding of the Board that disallowed the prior period adjustment but required North Bay to dispose of the corrected balance would penalize North Bay for its efforts to correct its account practices. The Board does not agree with North Bay's characterization. The application of sound rate setting principles results in a fair and transparent process that protects the interests of both ratepayers and the utility alike. While North Bay is to be commended for its efforts, there is a basic expectation that a licensed franchise holder will provide the Board with an accurate account of its financial affairs for rate setting purposes.

The Board is not driven by a need for a symmetrical treatment of ratepayers and utilities in situations where correction of utility mistakes is required. The utility has control of its books and records and has the responsibility to ensure mistakes do not occur. For this reason the Board could find in favour of the ratepayer in certain situations and not find in favour of the utility if the utility was in the same situation.

The Board notes that North Bay has identified spending requirements to maintain service to its customers. The Board further notes that North Bay has not considered it necessary to apply for a cost of service rate increase to provide the funds for these requirements before now. The filing of its rate application for 2010 rates provides the appropriate and timely opportunity to seek the revenues it claims are required. In this way North Bay's ratepayers will be afforded the opportunity to provide comments that are informed by North Bay's total spending plan.

North Bay's request to clear the RSVAs using corrected balances for the period prior to January 1, 2005 is therefore denied. The Board has already issued a final decision related to these balances, and it will not retroactively alter these balances. The Board also chooses to not clear the RSVA balances from January 1, 2005 forward at this time. The Board will consider the disposition of these balances either through its quarterly review of commodity deferral accounts pursuant to s. 78(6.1) of the Act, or in North Bay's next rates case. The request for the disposition of the carrying charges associated with the balances from January 1, 2009 to June 30, 2009 is therefore also denied at this time.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the Ontario Energy Board Act, 1998. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

THE BOARD DIRECTS THAT:

1. VECC shall file with the Board and forward to North Bay its cost claim within 26 days from the date of this Decision.

2. North Bay shall file with the Board and forward to VECC any objections to the claimed cost within 40 days from the date of this Decision.

3. VECC shall file with the Board and forward to North Bay any responses to any objections for cost claims within 47 days of the date of this Decision.

4. North Bay shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, September 8, 2009

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary