

**Ontario Energy
Board**

**Commission de
l'énergie
de l'Ontario**



EB-2011-0335

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 West Coast
Huron Energy Inc. for an order approving the recovery of
costs caused by tornado damage to be effective October
1, 2011.

BEFORE: Ken Quesnelle
Presiding Member

Marika Hare
Member

DECISION WITH REASONS

January 31, 2012

INTRODUCTION

West Coast Huron Energy Inc. (“West Coast Huron” or the “Applicant”) filed an application with the Ontario Energy Board (the “Board”) on September 8, 2011 under section 78 of the Ontario Energy Board Act, 1998, S.O. 1998, c.15 (Schedule B). West Coast Huron requested approval to recover the costs caused by an F3 Tornado that occurred on August 21, 2011. The Applicant requested that the proposed rates be effective October 1, 2011 and remain in effect for a period of 63 months. The Board assigned the application file number EB-2011-0335.

On September 22, 2011 the Board issued a Notice of Application and Hearing. Vulnerable Energy Consumers Coalition (“VECC”), School Energy Coalition (“SEC”) and the Association of Major Power Consumers in Ontario (“AMPCO”) applied for intervenor status and cost eligibility. No objections were received. The Board granted VECC, SEC and AMPCO intervenor status and determined that each intervenor was eligible to apply for an award of costs under the Board’s *Practice and Direction on Cost Awards*. Two letters of comments were received.

In Procedural Order No. 1, issued on October 17, 2011, the Board declared West Coast Huron’s current rates interim as of November 1, 2011 and established a schedule for interrogatories and responses.

On October 24 and October 26, 2011, Board staff and intervenors respectively, filed interrogatories pursuant to Procedural Order No. 1. On November 10, 2011 West Coast Huron filed responses to Board staff and intervenor interrogatories.

Procedural Order No. 2, issued November 18, 2011, established a process for submissions and reply submissions. On December 5, 2011 Board staff and the intervenors filed their respective submissions.

On December 14, 2011 the Board issued a letter granting West Coast Huron’s request for an extension to the date for filing a reply submission from December 12, 2011 to December 19, 2011. On December 20, 2011 West Coast Huron filed its reply submission.

BACKGROUND

West Coast Huron’s distribution activity is in the Town of Goderich, Ontario. On August 21, 2011 Goderich was subject to a F3 Tornado that caused extensive damage to West Coast Huron’s electricity distribution system and building, and caused loss of revenue from impacted commercial and residential customers. In its application, West Coast Huron claimed that the utility’s financial position is in “dire straits” and that immediate financial relief was needed. It also sought to recover a total amount of \$1.99 million, as shown in table 1 below, through a Tornado Relief Funding Adder based on the costs allocated to all customer classes on the basis on 2010 distribution revenues. Table 2 below itemizes the infrastructure that was damaged during the storm and needed replacement.

Table 1 – Cost Claim

	Application	Initial Revised	Final Submission
Infrastructure Replacement	\$1,500,000	\$1,500,000	\$1,440,339 ²
Interest Cost	\$400,000	\$198,400	\$191,982
Loss In Revenue	\$500,000	\$130,000	\$130,000
NBV of Assets Destroyed		\$229,500	\$229,500
Total Amount of Recovery Sought	\$2,400,000	\$2,057,900	\$1,991,821

Table 2 – Summary of Damaged Distribution Infrastructure

Items	Extent
Poles	98
Polemount transformers	19
Service Wire	296 drops
4.16kV conductor	1,610.19 metres
Secondary Conductor	2,735.87 metres
Smart Meters	101
Switches	7
27.6kV Conductor	243.29 metres and 243.29 metres neutral
Total	

In its reply submission West Coast Huron noted that the revised infrastructure replacement costs claimed are final however additional cost claims are anticipated.

West Coast Huron proposed to allocate the tornado damage costs on the basis of distribution revenue and recover these costs by means of a fixed rate adder for each rate class over a 63 month period. Table 3 below depicts West Coast Huron's proposed rate adders. West Coast Huron submitted that the adder should be considered interim pending the finalization of costs and impact of revenue loss. It also proposed to true-up the costs and revenue loss as part of its 2013 cost of service application, expected to be filed in the second quarter of 2012.

Table 3

Rate Class	Updated Rate Adder
Residential	\$4.50
GS<50kW	\$10.50
GS>50kw and <499kW	\$108.37
GS>500 and <4,999	\$1,090.14
Large User	\$3,803.14
USL	\$13.32
Sentinel	\$1.74
Streetlighting	\$0.66

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 with Reasons:

1. Nature of the Application
2. Z-factor criteria
3. Other Issues

THE ISSUES

1. Nature of the Application

In response to VECC interrogatory #1a, West Coast Huron indicated that its application is not a typical Z-Factor application since a typical Z-Factor application would be made after all expenses have been recorded, vetted for incremental impact, and audited. Rather, it stated that it is proposing a new approach since it believes that its situation requires immediate financial attention and the mechanisms available for relief of this nature are currently not defined or available.

West Coast Huron stated that the storm damage put the company in dire financial straits and a cash flow of approximately \$38,000 per month as a result of the proposed rate adders would assist the utility to bear the costs of its increased line of credit (from \$1 million to \$2 million).

Board staff noted that the evidence makes no reference to the terms and conditions of the line of credit and the underlying financial obligations of West Coast Huron.

VECC, SEC and AMPCO submitted that West Coast Huron's application should not be approved as filed due to the lack of relevant and necessary financial information.

VECC noted that the shareholder equity far exceeds the 40% deemed amount for rate setting purposes, which should enable the Applicant to financially manage the storm damage recovery. VECC also noted that its concern regarding West Coast Huron's borrowing capacity lies in the fact that it is also planning to undertake a major capital program in the latter part of 2011 through 2012, which is estimated to cost \$2.8 million. VECC submitted that West Coast Huron did not present a compelling case regarding its claim of dire financial need. As a result, VECC submitted that there is no foundation for approving West Coast Huron's request for a rate adder at this time. Rather, West Coast Huron should be directed to file for a Z-Factor adjustment as part of its 2013 rebasing application (or before if possible).

Similarly, SEC argued that West Coast Huron is substantially overcapitalized and submitted that the Applicant has not demonstrated a need for the requested cash flow and therefore a rate adder is neither appropriate nor necessary in this case.

AMPCO took a similar position, and stated that West Coast Huron has not provided adequate financial information to support the need for additional cash flow and, in the absence of relevant and necessary financial information, there are too many unanswered questions for the Board to approve a rate adder for advance recovery of the restoration costs.

AMPCO submitted that West Coast Huron should file a Z-factor application as per the Board's Guidelines once its financial position is known to allow for a prudence review of restoration costs incurred to date. VECC and SEC added that West Coast Huron should track the storm related costs in a deferral account, which should be reviewed and cleared at the time of West Coast Huron's next rebasing application.

West Coast Huron acknowledged that its equity exceeded the 40% deemed equity, but noted that West Coast Huron's higher level of equity was used to fund the Smart Meter Program and that 2011 deferred capital projects will be partially funded through equity.

The Applicant noted that the issue West Coast Huron faces is the timing of the additional cash flow requirement for a capacity expansion project on top of the significant unanticipated expenditures related to the tornado. In its reply submission, West Coast Huron stated that reprioritizing of this capital project is not an option as it is required by the Distribution System Code to provide supply to meet its customers' needs and must move forward to make this capital infrastructure investment.

Board Findings

The Board agrees with VECC, SEC and AMPCO that West Coast Huron has not demonstrated it is in dire financial need and has not provided adequate financial information to support the need for additional and immediate cash flow.

The Board takes note that West Coast Huron also acknowledged that its line of credit is currently adequate to sustain the utility's operations.

The Board further notes that West Coast Huron originally applied for relief under the Board's Incremental Capital Module for a capacity extension project for West

Coast Huron's largest customer as part of its 2012 IRM application.(EB-2011-0203). In response to Board staff and VECC's interrogatories regarding the level of capital contribution from West Coast Huron's affected customer, West Coast Huron stated that it recently entered into an agreement whereby the affected customer will contribute to 100% of the cost. As a result, West Coast Huron requested to withdraw its cost claim to fund this project.

For these reasons the Board finds that the company should be in a position to finance the incremental costs of the tornado damage until such time that final actual costs are known and can be reviewed in a Z-factor adjustment application.

The Board expects that West Coast Huron will apply for a Z-factor adjustment in its next rebasing application. It is expected that actual incremental costs and lost revenues will have been clearly identified at that time.

2. Z-factor criteria

On September 17, 2008, the Board issued the *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Supplemental Report") (EB-2007-0063). In the Supplemental Report, the Board restated its approach for dealing with the costs of unforeseen events that are outside of management's control. The Board determined that in order for amounts to be considered for recovery by way of a Z-factor, the amounts must satisfy all three of the following eligibility criteria:

- | | |
|-------------|--|
| Causation | Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived. |
| Materiality | The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements. |
| Prudence | The amount must have been prudently incurred. This means that the distributor's decision to incur the amount must |

represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

In response to VECC interrogatory #1b, West Coast Huron stated that the amounts claimed satisfy all three Z-Factor eligibility criteria.

West Coast Huron noted that the expenses and revenue loss would not have occurred in the absence of the tornado and that such an event is beyond management's control and outside of the base upon which rates were derived. Further the cost included in the Z-Factor amount is incremental costs and that that all regular payroll costs (\$39,839) and the associated truck costs (\$9,492) were deducted from the total cost claim.

West Coast Huron noted that its distribution revenue for 2010 was \$2,214,838. The Board established a materiality threshold of \$50,000 for a distributor of that size. West Coast Huron stated that the total costs incurred by the utility exceed the threshold amount as set out by the Board.

West Coast Huron also indicated that its decision to incur expenses related to the tornado were made on the basis of the most cost-effective options balanced with the priority of restoring power to customers in a timely manner. It noted that although much of the physical labour was outsourced to other electricity distributors, work was done at normal billing rates by these third parties and that overtime was carefully considered and deemed necessary to restore the system as soon as possible. West Coast Huron further noted that materials were acquired at normal rates from regular suppliers.

Board staff submitted that while it agreed with West Coast Huron that its application is not a Z-Factor claim per se, the criteria of causation and materiality were met. With respect to the reasonableness of the costs claim, Board staff noted concerns with the inclusion of the net book value of infrastructure assets and the inclusion of lost revenue. Board staff also submitted that a sunset date of 63 months is not appropriate as funding adders are intended to provide advanced funding until such time that costs can be reviewed for prudence. Board staff argued that a rate adder should be in place until West Coast Huron's next rebasing application.

While VECC submitted that there is no foundation for approving West Coast Huron's request for a rate adder at this time, VECC also indicated that based on a preliminary review, West Coast Huron appears to have a justifiable case for its future Z-Factor application.

Likewise, SEC argued that the applicant did not demonstrate a need for the requested cash flow and therefore submitted that the application should not be approved as filed. SEC however indicated that the tornado event and its related costs appear to qualify for Z-Factor treatment.

AMPCO acknowledged that West Coast Huron has incurred significant costs for infrastructure restoration caused by a tornado and submitted that the utility is entitled to recover these costs. However, APMCO submitted that West Coast Huron should submit a Z-factor application as per the Board's guidelines once its financial position is known to allow for a prudence review of restoration costs incurred to date.

In its reply submission, West Coast Huron submitted that its proposal met the three eligibility criteria. West Coast Huron acknowledged that this application is not a typical Z-factor application in that costs were not completely known during this proceeding. As such a final decision regarding prudence can't be determined. West Coast Huron submitted that a final reconciliation should be performed during the 2013 cost of service application and that a final prudence review be performed at that time.

Board Findings

The Board is satisfied that a Z-factor event occurred when the F3 tornado destroyed a significant portion of West Coast Huron's distribution system and other assets. This event was genuinely external to the regulatory regime and beyond the control of management.

The Board notes that in order for a Z-Factor to be eligible for cost recovery, the amounts must satisfy the criteria of causation, materiality and prudence.

While the Board is not providing West Coast Huron with advanced funding at this time, the Board finds that West Coast Huron has demonstrated that the eligibility criteria of causation and materiality have been met. Since West Coast Huron's application is not a typical Z-factor application in that actual costs were not completely known during the proceeding, the Board finds that it is premature to assess prudence at this time.

As previously stated, the Board expects West Coast Huron to apply for a Z-factor adjustment in its next rebasing application when actual incremental costs and lost revenues have been clearly identified. The review would be limited to prudence, cost allocation and rate design matters since causation and materiality have been established in this Decision with Reason.

3. *Other Issues*

In its reply submission West Coast Huron noted that it has treated all expenditures as 'repair' costs, rather than capitalizing the expenditures and has foregone the ability to earn a return on equity on these costs. West Coast Huron noted that this was consistent with the outcome of the Combined Proceeding on Storm Damage Cost Claims (the "Combined Proceeding") (EB-2007-0514, EB-2007-0595, EB-2007-0571, EB-2007-0551).

West Coast Huron proposed to record all related recovery from the rate adder in USoA Account 1572 sub-ledger account "2011 Tornado Relief Funding Adder", and to record all related costs incurred net of recoveries from external parties as an offset to the above in USoA Account 1572 sub-ledger account "2011 Tornado Relief Costs" with simple interest applied monthly to opening account balances.

VECC took no issue with the approval of a "2011 Tornado Relief Costs" deferral account.

Similarly, SEC submitted that the Applicant should be directed to record its incremental costs (revenue requirement impact only) caused by the tornado in a deferral account.

APMCO and Board staff made no submission on these issues.

Board Findings

The Board is concerned with West Coast Huron's proposal to treat all expenditures as 'repair' costs rather than expensing some OM&A costs and capitalizing capital expenditures and associated OM&A costs. In the Board's Decision with Reasons in the Combined Proceeding, the Board noted that its finding to allow the subject claim to be recovered through OM&A, should not be construed as providing the Board's view on capitalization generally. The Board notes that in this particular case, the replacement of West Coast Huron's distribution assets due to the tornado constitutes a significant portion of its entire rate base. The Board believes that these assets should be treated as any other capital assets and be included in rate base, thereby reflecting the principle of matching costs with revenues. The Board expects that West Coast Huron will address this matter when it applies for a Z-factor adjustment in its next rebasing application. The Board also expects that West Coast Huron will apply MIFRS in its calculation of depreciation expense to be included as part of the revenue requirement.

The Board will approve West Coast Huron's request for a "Tornado Relief Costs" sub-account. West Coast Huron shall record eligible Z-Factor cost amounts in Account 1572, Extraordinary Event Costs, contained in the *Accounting Procedures Handbook* for electricity distributors. The Board notes that carrying charges ought to be calculated using simple interest applied to the monthly opening balances in the account and recorded in a separate sub-account of 1572. The rate of interest shall be the rate prescribed by the Board for deferral and variance accounts for the respective quarterly period published on the Board's web site.

The Board expects West Coast Huron to maintain records in a manner that will permit ready identification of each cost contained in this account, including the separate identification of any capital and non-capital cost components. The capital sub-account shall include capital assets that generally are included in the utility's rate base for rate making purposes while the non-capital sub-account record the related annual incremental depreciation expense, operating and maintenance costs.

COST AWARDS

The Board may grant cost awards to eligible parties 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.

1. Intervenors shall file with the Board and forward to West Coast Huron their respective cost claims within **14 days** from the issuance of this Decision with Reasons.
2. West Coast Huron shall file with the Board and forward to intervenors any objections to the claimed costs within **21 days** from the date of issuance of this Decision with Reasons. .
3. Intervenors shall file with the Board and forward to West Coast Huron any responses to any objections for cost claims within **28 days** of this Decision and Order.
4. West Coast Huron shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings with the Board must quote the file number EB-2011-0335, and 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 be received by the Board by 4:45 p.m. on the stated date. Parties should 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 e-mail their documents to the attention of the Board Secretary at BoardSec@ontarioenergyboard.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's *Practice Directions on Cost Awards*.

DATED at Toronto, January 31, 2012

ONTARIO ENERGY BOARD

Original Signed By

Ken Quesnelle
Presiding Member

Original Signed By

Marika Hare
Panel Member