



EB-2005-0243

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 Espanola Regional Hydro Distribution Corporation for an order or orders approving or fixing just and reasonable rates.

BEFORE: Paul Vlahos
Presiding Member

Pamela Nowina
Member

DECISION AND ORDER

The Application and Proceeding

Espanola Regional Hydro Distribution Corporation (“Espanola Hydro” or the “Applicant” or the “utility”) filed an application that was received by the Ontario Energy Board (the “Board”) on February 3, 2005 pursuant to section 78 of the *Ontario Energy Board Act, 1998* for an order or orders of the Board authorizing electricity distribution rates. The Board assigned the application Board file number EB-2005-0243.

The Board issued a Notice of Application on March 17, 2005 that the Applicant served and published in accordance with the Board’s Letter of Direction. A letter of intervention was received from the Rainbow District School Board on April 8, 2005. However, by letter dated May 1, 2005, the Rainbow District School Board advised that its letter of intervention had been sent in error, and that it no longer wished to intervene in the proceedings. Therefore, there were no intervenors in this matter. The Board received two letters of comment on this proceeding.

The Board issued a procedural order in connection with this application dated May 2, 2005. An oral hearing was held in the Board's hearing room on May 12, 2005. At the end of the oral portion of the evidence, the Board reserved its decision.

A copy of the full record adduced in the proceeding is available at the Board's offices. The Board has summarized the record to the extent it felt necessary to provide context to its findings.

Summary of the Application

Espanola Hydro distributes electricity to approximately 3,500 customers. According to the Applicant's evidence, costs exceeded revenues in 2002 and 2004. In order to ensure that revenues match or exceed costs in future rate years, Espanola Hydro applied to the Board for an increase in the variable component of the distribution rates to customers in its General Service >50 kW rate class. There are currently sixteen customers in this rate class. When the application was originally prepared, the variable component for the GS>50 kW class was \$0.7777 per kW. However, prior to the oral hearing on this matter, that rate was increased as a result of the Applicant's 2nd tranche of MARR application to \$1.2523 per kW. The Applicant sought through the current application to have the rate increased to \$3.12 per kW. If this rate increase were implemented, it would result in approximately \$71,803 in additional annual revenue for the utility. The Applicant did not propose to raise rates for any other rate class.

The Applicant requested that the Board approve the requested rate increase retroactively to March 1, 2003, which was the rate implementation date the Applicant sought leave from the Minister of Energy, unsuccessfully, to bring the rate increase application before the Board.

Summary of Espanola Hydro's Evidence

The Applicant was represented at the oral hearing by its General Manager, Mr. Gary Keith. Mr. Keith testified that, in order to fund the utility's operations, he found new revenue streams through contracting out line crew personnel to neighbouring utilities and undertook certain cost cutting initiatives. The utility also corrected certain misapplications of eligibility in its rate classifications. Mr. Keith testified that while the measures he has undertaken to improve revenue and cut costs helped to improve the financial position of the utility, he

believed it to be necessary to seek a rate increase to ensure Espanola Hydro's continued viability.

Financial Health of Espanola Hydro

Audited financial statements for Espanola Hydro were presented by Board Staff for the past four years. These statements showed a net income of \$115,705 in 2001, a net loss of \$294,749 in 2002, a net income of \$127,267 in 2003, and a net loss of \$93,055 in 2004.

When questioned as to why its finances showed a substantial annual swing between net income and net loss, Mr. Keith explained that the positive change between 2002 and 2003 was the result of the utility finding new revenue streams, such as contracting its line crews to other utilities. The change from net income to net loss between 2003 and 2004 was largely the result of a \$163,000 interest payment on a loan from the Applicant's shareholders. Mr. Keith indicated that this was a "paper entry" only, and had been entered in the financial statements to avoid paying income tax. Mr. Keith suggested that this "paper entry" did not in fact come out of the Applicant's revenues, and therefore a net income was actually realized for 2004.

Through a holding company, the Town of Espanola and the Township of Sables-Spanish River are the owners of Espanola Hydro and a services company (the "Services Company"), each a separate legal entity. Espanola Hydro and the Services Company share the same employees and equipment. Apparently, the equipment was actually sold by Espanola Hydro to the Services Company. According to Mr. Keith, Espanola Hydro actually earned approximately \$70,000 in 2004 if one excludes the purported interest payment to the shareholders of \$163,000. However, according to Mr. Keith, the Services Company lost approximately \$76,000 in the same year.

The evidence was unclear on how income is allocated between the Services Company and Espanola Hydro, or what work is conducted by the Services Company for Espanola Hydro.

The Rate Increase

It was the Applicant's evidence that it decided an increase to the variable component of the GS>50 kW rate was in order after examining comparable rates in neighbouring utilities. The Applicant observed that it charged a much lower rate in this class than many of its

neighbouring electricity distributors, and therefore decided that it was appropriate to raise the rates for this customer class.

Mr. Keith was questioned on a chart prepared by Board staff which showed the percentage increase the sixteen GS>50 kW customers could expect in their bills if the proposed increase was approved. Mr. Keith confirmed that the figures in the chart were correct. The chart showed annual bill impacts of between 5.08% and 11.92%. The overall average increase was 6.82%. The 11.92% impact was something of an anomaly, as the next highest impact was 9.62%. Mr. Keith could not say why this particular customer would see such a pronounced bill impact, but he indicated that the utility would be willing to work with the customer to try to reduce the amount of the increase. Mr. Keith also testified that by increasing the rates for the GS>50 kW customers would reduce the observed inequity of these larger customers paying less in delivery charges in absolute terms than their smaller sized competitors.

Mr. Keith indicated that he had discussed Espanola Hydro's financial situation with the sixteen GS>50 kW customers, and that most of them agreed that a rate increase was necessary and they were willing to pay prior to the increase being approved by the Board. Mr. Keith testified that it bills and receives additional revenues from these customers from what the authorized rates generate. It was not clear from the evidence as to the accounting and ratemaking treatment of the additional revenues. Mr. Keith conceded that not all of the customers were willing to pay retroactively, and in fact a letter of comment was filed with the Board from a customer specifically requesting that the rates not be applied retroactively.

Cost Allocation

Mr. Keith indicated that no formal cost allocation study had been conducted to justify raising the rates of only one rate class. Although evidence was presented by both the Applicant and Board staff comparing the Applicant's variable rate for GS>50 kW with neighbouring utilities, there was no filed evidence comparing the Applicant's other rate classes with those of other utilities. Mr. Keith did comment, however, that the Applicant's residential rates were also "on the low end of the scale" compared to neighbouring utilities.

Board Findings

The Panel cannot approve Espanola Hydro's application as presented. After hearing the Applicant's evidence, the Panel cannot determine from that evidence whether the current

rates result in a net deficiency or sufficiency from a revenue requirement perspective. The relationship between Espanola Hydro and the Services Company has not been sufficiently explained, and without reasonable clarity on how all utility costs and revenues are managed and presented between the two corporations, the Board cannot have confidence in the financial statements of Espanola Hydro.

Although the Panel is dismissing this application, Espanola Hydro may yet require some increase in its rates. It is not possible from the evidence presented to ascertain the true revenue requirement of the utility. The Board would be concerned if the utility itself may not be earning sufficient revenues to ensure its operational feasibility. The Panel encourages the Applicant to bring a fresh application to the Board, which better explains both the current financial situation of the utility and its projected revenue requirement. Such application should include a better rationale for allocating all of the proposed incremental revenue increase to a single rate class. It would not be a requirement in this case for Espanola Hydro to undertake a formal or complex cost allocation study, but it must provide a better rationale than simply to compare costs of the GS>50 kW rate class with neighbouring distribution systems. If it is the Applicant's position that the current rates for the GS>50 kW rate class have been incorrectly set since the rates were unbundled some years ago, a proposition that was not entirely clear from the record, then it must provide evidence in support of that proposition. Finally, the Applicant's evidence that its residential rates are low compared to neighbouring utilities suggests that it should have at least considered raising these rates as well.

The Board found Mr. Keith to be an open and forthright witness. However, for a proper assessment of the merits of an application for rate relief, the utility's evidence must be properly prepared from a revenue requirement perspective and contain sufficient cost allocation rationale. The allocation of any incremental revenue is especially important when the relief is targeted to a specific rate class. Espanola Hydro should consider retaining external assistance in bringing its application to the Board for rate relief and, in any event, consult with Board Staff for any assistance that it may require.

Mr. Keith testified that the Applicant had been charging some of its GS>50 kW customers rates in excess of the rates authorized in the current rate order on a voluntary basis by the customer. The Panel notes that section 78 of the *Ontario Energy Board Act* is quite clear in stating that a utility may only charge rates that have been approved by the Board. Espanola Hydro is therefore ordered to cease charging rates in excess of those that have been approved through the current rate order.

ISSUED at Toronto, May 31, 2005

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary