February 27, 2009

BY EMAIL & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

**Board File No. EB-2008-0234**
**Lakeland Power Distribution Ltd. – 2009 Rates Rebasing Application**
**Argument of Energy Probe**

Pursuant to Procedural Order #4, issued by the Board on February 6, 2009, please find two hard copies of the Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2008-0234 proceeding. An electronic version of this communication will be forwarded in PDF format.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc: Chris Litschko, Lakeland Power (By email)
Margaret Maw, Lakeland Power (By email)
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**EB-2008-0234**

**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 **Lakeland Power Distribution Ltd.** for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2009.

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# ENERGY PROBE RESEARCH FOUNDATION ("ENERGY PROBE")

## ARGUMENT

**February 27, 2009**

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**LAKELAND POWER DISTRIBUTION LTD.**
**2009 RATES**

**EB-2008-0234**

**ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION**

# INTRODUCTION

This is the Argument of the Energy Probe Research Foundation ("Energy Probe") related to the setting of 2009 rates for Lakeland Power Distribution Ltd. ("LPDL") effective May 1, 2009.

This Argument has been structured to reflect the major components of the LPDL evidence. Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of LPDL. However, in order to minimize intervenor time and costs, a comprehensive impact analysis has not been undertaken. If the Board accepts any or all of the Energy Probe submissions, it is assumed that the direct and indirect impacts will be determined by LPDL and reviewed by intervenors and Board Staff through the associated draft rate order. An example of a comprehensive impact analysis would include the direct impact on rate base of a reduction in $10,000 in OM&A expenses and a $25,000 reduction in capital expenditures. Depreciation expense would also be directly impacted by the capital expenditure change. The indirect impacts would include the change in total cost of capital and taxes (due to CCA, interest and OM&A expense changes).

LPDL is forecasting a significant deficiency. As shown in Exhibit 7, Tab 1, Schedule 1, the gross revenue deficiency is $991,889 on forecasted revenues of $4,373,411.79. The deficiency represents an increase in total revenues of nearly 23%.

## RATE BASE

### a) Working Capital

Energy Probe accepts the approach taken by LPDL to calculate the working capital allowance component of rate base, with the adjustments noted below. However, Energy Probe continues to believe that the 15% methodology may be overstating the required allowance for working capital and recommends that the Board direct LPDL to prepare a working cash (lead lag) study for its next rebasing application.

i) Cost of Power

Energy Probe submits that the cost of power component of the working capital allowance should be updated to reflect the most recent cost of power forecast presented to the Board. It should also be updated to reflect the forecast of network and connection transmission services provided by Hydro One Networks.

As shown in Exhibit 2, Tab 4, Schedule 1, the allowance for working capital associated with the cost of power (including transmission costs) represents more than $2.5 million of rate base, which in turn is more than 16% of the total forecasted rate base for the distributor. Given the magnitude of the influence of the cost of power on rate base and the resulting revenue requirement Energy Probe submits that the Board should direct LPDL to update the calculation based on the most recent information available to the Board at the time of its Decision.

Energy Probe does, however, have concerns over the methodology used to calculate the commodity component of the cost of power. It is not clear to Energy Probe if LPDL has used the Average Supply Cost for RPP Consumers and applied this forecast to all customers. If so, it is not clear to Energy Probe that this RPP price should be applied to all consumers. Energy Probe submits that the Board should direct LPDL to estimate the kWh's that are associated with RPP consumers and the kWh's associated with non-RPP consumers and then apply the appropriate price to these two different sets of volumes to calculate the cost of power component of the working capital allowance.

ii) Removal of Property Taxes

LPDL has included the cost of property taxes (account 6105 Taxes Other Than Income Taxes) in the calculation of the working capital allowance (Exhibit 2, tab 4, Schedule 1, page 3). A review of Appendix A in the 2006 EDR Handbook clearly shows that account 6105 is **NOT** included in the calculation of the working capital allowance. Energy Probe submits that the calculation of the working capital allowance should be adjusted by the removal of the property tax expense as this expense is not a controllable OM&A expense.

iii) Changes to Controllable Expenses

Energy Probe submits that if the Board makes any adjustments to the controllable OM&A expenses in its Decision, these changes should be reflected in the calculation of the working capital component of rate base.

**b) Capital Expenditures in 2008 & 2009**

Energy Probe notes that the correct forecast for the 2009 rate base is $14,499,710 (Energy Probe Interrogatory # 3).

LPDL has made significant changes to their forecast of capital expenditures in both 2008 and 2009 from that originally filed. The original forecast for 2008 was $975,000 and for 2009 was $1,685,000 (Exhibit 2, Tab 2, Schedule 1, Tables 3 and 4). Expenditures in 2006 and 2007 were approximately $844,000 each year.

The response to Energy Probe Interrogatory # 11 provides a more current projection for the 2008 and 2009 capital expenditures. The revised forecast for 2008 is $942,000 and for 2009 is $1,773,000. The decrease in expenditures in 2008 of approximately $33,000 reflects a number of significant changes. First, as shown in the response to Energy Probe Interrogatory # 11, the revised forecast for 2008 reflects contributed capital of $334,000 that was not forecast in the original evidence. Partially offsetting this is an increase of $192,000 related to transportation equipment for vehicles that were originally budgeted

for in 2009. Decreases in computer and software expenditures make up most of the remaining decline in 2008.

The revised forecast for 2009 is for an increase of $88,000 despite the reduction of $205,000 for transportation equipment that was moved from 2009 to 2008. Offsetting this decrease are increases of $173,000 for distribution stations and $120,000 for line transformers. The increased distribution station costs reflect the addition of another developer on the same substation (Energy Probe Interrogatory # 11d).

Energy Probe accepts the updated projection for the 2008 and 2009 capital expenditures with the following provisions.

First, it is not clear whether the increase in distribution station costs of $173,000 due to the addition of another developer on the same substation is net of the increase in the capital contribution related to this project. As per the discussion in Exhibit 2, Tab 3, Schedule 1, page 4, the original $500,000 cost for this station was a cost of $1,500,000 net of $1,000,000 in contributed capital. Energy Probe invites LPDL to clarify whether the $173,000 increase is the gross increase in the cost, with no additional contribution reflected, or whether it is the net increase, reflecting both a higher cost and a higher contributed capital amount. If no additional contributed capital is included in calculating the $173,000 increase, Energy Probe invites LPDL to explain why.

The increase in line transformers of $120,000 does not appear to be been explained or justified by LPDL. Energy Probe invites LPDL to explain the need to increase these expenditures by $120,000 in 2009.

Finally, Energy Probe submits that the Board should carefully review the additional expenditures related to the additional developer ($173,000 for the distribution station and possibly $120,000 for line transformers). The economic outlook and the fortunes of the housing sector, in particular, have declined substantially since the evidence and interrogatory responses were prepared by LPDL. Energy Probe submits that the

economic conditions have even thrown into doubt the need for the original net $500,000 expenditure for the distribution station that was based on the first developer. These expenditures may well be pushed back beyond the current 2009 test year. Energy Probe submits that the Board should allow these forecast expenditures into rate base, but given that the distribution station accounts for 38% of the total capital expenditures forecast for the test year, the Board should establish a variance account for the net expenditures that actually come into rate base associated with this expenditure. This allows LPDL to recover the return on capital and depreciation expenses associated with this project if it continues on schedule. The variance account would also provide ratepayer protection if the project is delayed due to the economic and housing downturn that is currently being experienced.

In accepting the updated capital expenditures for 2008 and 2009 as reflected in the response to Energy Probe Interrogatory # 11, Energy Probe submits that the Board should direct LPDL to reflect these changes in their revenue requirement calculations. These changes would include the calculation of rate base (with a lower 2009 opening balance along with the higher expenditures in 2009), depreciation expense (the level and mix of changes in capital expenditures) and the impact on the capital cost allowance (CCA) for tax purposes. As an illustration, the movement of the $205,000 expenditure for transportation equipment will increase the CCA available to reduce income taxes in 2009 from $30,750 (1/2 year rule @ 30%) to $52,275 (30% on the UCC from the end of 2008).

## OM&A EXPENSES

### a) Reallocation of Lakeland Holding Expenses

LPDL purchases a significant amount of services from the Lakeland Holding group of companies. In 2009 LPDL is forecasting the purchase of $557,277 from affiliated companies (Exhibit 4, Tab 2, Schedule 5, Table 2). The allocation of these costs to LPDL is based on a number of allocators which are shown in Table 1 of Exhibit 4, Tab 2, Schedule 5. As indicated in the response to Energy Probe Interrogatory # 47, the allocator for office supplies should be shown as % of time spent rather than # of

employees. However, the figures shown in Table 2 for this category have been calculated using the correct allocator.

The response to Energy Probe Interrogatory # 37 shows the data used to calculate the various allocators used. In particular, the response shows the derivation of the % of time spent allocator. Energy Probe submits that this calculation is allocating a significant expense to the regulated entity LPDL that should remain with the holding company.

The response indicates that Lakeland Holding employees submit daily timesheets which are consolidated to produce a cost allocation percentage. The payroll hours used to calculate the allocator are based on the 2007 daily timesheets, the last year of actual information that LPDL would have had when it submitted its application.

The allocation factor of 62.3% of time spent is based on an allocation of 5,327.74 hours out of the total of 8,546.50 hours. However, this allocation of hours includes a reallocation of 2,674.50 hours that is initially allocated to the holding company.

Energy Probe submits that it is not appropriate to "reallocate" any Holding Company hours to the regulated Power (LPDL). It is not appropriate for ratepayers to bear any of the costs of the parent company, Lakeland Holding. As the response to Energy Probe Interrogatory # 37 clearly demonstrates, 2,674.50 hours were directly allocated to the parent company in 2007. This represented more than 31% of the total hours to be allocated. To reallocate these hours and their associated costs to the regulated distribution company is contrary to regulatory principles.

Energy Probe submits that the proper allocation factor for % of time spent is calculated based on the hours before any reallocation takes place. As indicated in the response to Energy Probe Interrogatory # 37, the total hours allocated to LPDL is 3,660.50 hours. This represents 42.8% of the total hours of 8,546.50. This is the allocation factor, in the view of Energy Probe, that should be used to allocate the relevant costs.

The relevant costs, as identified in Table 2 of Exhibit 4, Tab 2, Schedule 5 are the executive services, management services, human resources, general financial services and office supplies. The total of these line items shown in Table 2 is $466,277. This total represents 62.3% of the total costs, so the total costs would be $748,438. Applying the appropriate factor of 42.8%, the costs allocated to LPDL would be $320,331. This represents a significant reduction of $145,946 in OM&A costs for these shared services. Based on the above analysis and the regulatory principle that ratepayers should not pay costs associated with the parent company, Energy Probe submits that this reduction in costs is reasonable.

**b) 2009 Rate Rebasing Costs**

LPDL is forecasting costs associated with the 2009 rates rebasing application of $124,000 (Exhibit 4, Tab 2, Schedule 3, page 6). Further, LPDL has indicated that it has spread these costs over three years. Energy Probe submits that the total cost figure needs to be adjusted and the period over which the costs are recovered should be adjusted as well.

The estimated $124,000 cost includes an amount of $40,000 for legal costs and $25,000 for consultant costs (Board Staff Interrogatory # 7a). Legal and consulting costs are heavily influenced by time spent preparing for and attending an oral technical conference and/or an oral hearing. The response to Board Staff Interrogatory # 8b shows that the $65,000 is costs noted above for legal/consultant costs associated with Borden, Ladner Gervais is for "rate application & oral component". Energy Probe notes that neither an oral technical conference nor an oral hearing was required for this hearing. As a result there should a reduction in the legal and consulting costs associated with the 2009 rates rebasing. Given that an oral component can add substantially to the costs of a proceeding for legal counsel and consultants, it would seem reasonable to reduce the costs from the forecasted level of $65,000 by approximately one-third or $20,000. This reduction of $20,000 would appear reasonable given the time involved for legal counsel and consultants in preparing for and attending a technical conference and an oral hearing.

Therefore, Energy Probe submits that the total rate rebasing costs should be reduced from $124,000 to $104,000.

In the July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, the Board determined that the plan term for the 3rd generation IR would be fixed as the rebasing year plus three years, for a total of four years. Energy Probe therefore submits that the rate rebasing costs included in the 2009 revenue requirement should be one-fourth of the total 2009 rates rebasing costs, rather than one-third as proposed by LPDL.

The net change in these costs, reflecting the reduction in costs and the extended period for recovery reduces the costs from $41,333 ($124,000 over three years) to $26,000 ($104,000 over 4 years recovered over four years, results in a reduction in the revenue requirement of $15,333 in the 2009 test year.

**c) Electrical Safety Authority Fees**

LPDL had forecast an increase in the EDA fees in 2008 to $47,129 from a level of $16,806 in 2007 (Exhibit 4, Tab 2, Schedule 2, page 3). The forecast for 2009 was the same as that for 2008. In the response to Energy Probe Interrogatory # 35b, LPDL indicated that the ESA fees are based on a calculation related to revenue. LPDL believed that the revenue figure to be used was gross revenues. However, it realized that this was in error, as it confirmed that distribution revenues only should be used to in calculating the ESA fees. In the response to Energy Probe Interrogatory # 45, LPDL indicated that that the ESA fees will be $7,300 instead of the $30,000 originally forecast. This results in a reduction in ESA costs of $22,700. Energy Probe submits that this reduction should be reflected in the revenue requirement.

**d) Bad Debt Expense**

LPDL is forecasting a bad debt expense in 2009 of $35,000, the same level as forecast for 2008 (Exhibit 4, Tab 2, Schedule 2, page 2). The 2008 forecast is an increase of nearly $21,000 or almost 150% from the level recorded in 2007.

Energy Probe submits that the forecast cost of bad debt should be reduced by $20,000 to $15,000. As shown in the response to Energy Probe Interrogatory # 34b, the year-to-date October 2008 bad debt expense is only $12,000. Prorated to a full annual figure, this would translate to $14,400 for 2008, similar to the $14,112 recorded in 2007.

The response to Board Staff Interrogatory #6g indicates that LPDL had recorded the $12,000 in bad debt expense in the first six months of 2008. Therefore, no more additional bad debt expense had been incurred in the first four months of the last half of 2008. Energy Probe also notes that there is no potential for bad debt associated with large customers (commercial & industrial) because LPDL has procured Credit Risk Insurance for these customers.

Energy Probe further notes that LPDL has hired a part time collections person to reduce the amount of customers that go into arrears and ultimately end up with disconnection/reconnection charges (Energy Probe Interrogatory # 23f). This should also help reduce the level of bad debt expenses.

Based on the evidence, Energy Probe submits that the bad debt expense should be reduced by $20,000.

**e) Office Supplies and Expenses**

LPDL is forecasting an increase in office supplies expenses of nearly $21,000 or more than 28% in 2009 as compared to 2008. In the response to Energy Probe Interrogatory # 35a, LPDL has used a simple average of the past three years to forecast the 2009 level of expenses. However, a review of the figures for 2006, 2007 and 2008 provided in Exhibit

4, Tab 2, Schedule 2, page 3 indicates that the average of the three figures provided is $89,996. This is $4,500 lower than the forecasted expense provided for 2009. The figures also show that the average is skewed by the large expense in 2007 relative the 2006 actual cost and the forecast for 2008.

Energy Probe submits that a more reasonable forecast for 2009 is to base it on the 2008 forecast. This is the approach that LPDL has taken for many of the accounts listed in the administrative and general expenses. For many of these categories, expenses have been forecast in 2009 at the same level as that for 2008.

Energy Probe submits that a generous forecast for the increase in office supply expenses would be a 10% increase over the 2008 forecast level. Applying this increase would result in a forecast $81,000 for 2009, a reduction of approximately $13,500 from that forecast by LPDL. Energy Probe submits that this reduction is appropriate.

**f) Overall Increase in OM&A Costs**

LPDL is proposing an increase in overall OM&A costs in 2009 of $151,786 or 5.6% over the 2008 forecasted levels. These figures can be determined from the figures provided in the response to Energy Prove Interrogatory # 32a.

The increase forecast for 2009 is on top of an increase forecast for 2008 of $390,515 or 16.8%. In aggregate, the increase in expenses between 2007 and 2009 is more than $540,000. In contrast, between 2003 and 2007, OM&A costs increased by a total of only $250,859 (Board Staff Interrogatory # 4). This increase represents an average annual compound increase over the 2003 to 2007 period of 2.9%. By way of comparison, the average annual compound increase over the 2007 through 2009 period is forecast to be more than 11%.

Another way of looking at the increase in costs is based on OM&A cost per customer. As shown in the response to AMPCO Interrogatory # 1, the OM&A cost per customer rose from $234 in 2003 to $255 in 2007. This represents an annual average compound

increase of 1.2% over this period. The increase from 2007 to 2009 is from $255 to $310. This is an annual average compound increase over this two year period of 10.3%.

Energy Probe submits that an increase in excess of 11% following the moderate increases for 2003 through 2007 is not reasonable, especially in times of low or no inflation.

Based on the submissions of Energy Probe above in (a), (b), (c), (d) and (e), there would be a reduction in the OM&A costs claimed for 2009 of approximately $217,479 ($145,946 + $15,333 + $22,700 + $20,000 + $ 13,400). This would result in a 2009 OM&A forecast of $2,647,539. The resulting increase over the 2007 level of actual expenditures would be approximately 6.8% on a compound annual basis. Energy Probe submits that while still high, this is a much more reasonable increase than the 11% requested by LPDL.

## DEPRECIATION & AMORTIZATION

**a) Depreciation Rates**

In the response to Energy Probe Interrogatory # 8, LPDL provided the years used for each account to depreciate its assets. According to LPDL, there are no differences between these years and their associated rates from those found in the 2006 EDR Handbook. Further LPDL indicated that it used the half year rule on new additions in the first year and then the full year until the asset is depreciated.

However, upon further review, and as confirmed in the response to Energy Probe Interrogatory # 39, LPDL has used significantly different rates from those in the 2006 EDR Handbook for a number of asset categories. These different rates are based on shorter life estimates related to when the 5 utilities were merged. At that time the opening balances of the new company were set up by account and a new determination of service life was determined for each account based on the asset age in each account.

Energy Probe has estimated that the impact of using the higher depreciation rates accounts for $162,444 of the $991,889 claimed by LPDL. In other words, the higher depreciation rates being used for the merged assets accounts for about 16% of the total deficiency. The calculation of the difference in depreciation costs is shown in Appendix A to this Argument. Appendix A takes the response provided to Energy Probe Interrogatory # 39 and replaces the depreciation period (years) used by LPDL for the merged assets with the same depreciation rates used for the assets since the merger.

Energy Probe submits that the Board should direct LPDL to use the standard depreciation rates for the merged assets and reduce the depreciation expense for 2009 by $162,444. LPDL has not provided any study to suggest that assets that went into service in 2000 or before have a shorter life than those acquired since 2000. If such a study was done, it may well find that assets acquired since 2000 are expected to have a longer life than those specified in the 2006 EDR Handbook. In the absence of such a study, there is no justification for the significant impact on the revenue requirement that has been created.

Energy Probe notes that if the depreciation expense is reduced as proposed above by Energy Probe, LPDL will not be any worse off. The lower depreciation will result in lower accumulated depreciation in the test year which will ultimately increase rate base and provide additional returns to the shareholder. The value of the assets will still be recovered from ratepayers, just over a longer period. In the meantime, however, ratepayers are paying a more appropriate amount associated with these assets.

If LPDL believes that some of its assets have a shorter life, it should bring forward a complete depreciation study at its next rates rebasing application with deals with all of its depreciable assets, not just those acquired pre-merger. At that time, the Board and intervenors can have a full discovery process to test the information being provided. That opportunity was not provided to the Board and intervenors in this application, as this information was not revealed until the answers to supplementary interrogatories were provided.

**b) Changes to Gross Assets**

LPDL has made significant changes to the capital expenditure forecast for both 2008 and 2009. These changes, along with any further changes that may result from the Board's Decision in this matter, should be reflected in changes to the depreciation expense calculated for the 2009 test year.

## TAXES

Energy Probe submits that LPDL should calculate its income and capital taxes using the most recent information available, including tax rates that are expected to be applicable to 2009. This would include any changes that have resulted from the recent federal budget. It would also include any other changes as the result of any provincial budget that is known to the Board and other parties when the Decision is issued.

**a) Capital Tax**

Energy Probe does not agree with the calculation used by LPDL to forecast the capital tax in 2009 (Exhibit 4, Tab 3, Schedule 1) of $10,499. In particular, Energy Probe does not agree with the exemption of $10,833,559 shown in this calculation.

In the response to Energy Probe Interrogatory #28e, LPDL indicates that the Ontario Capital Tax exemption (of $15 million) has been split amongst the other PILS paying affiliates of LPDL. LPDL provides the calculation of the $10,833,559 exemption in the response to Energy Probe Interrogatory # 42. In that response, LPDL also indicates that none of the affiliates are regulated entities.

At Section 7.2.2, part ii of the 2006 EDR Handbook, it was clearly stated that "Where the applicant is a member of a larger corporate group, the full provincial capital tax exemption will be prorated among the regulated entities in that group." Given that LPDL has no regulated entities (Bracebridge Generation is licensed, but not regulated by the OEB), Energy Probe submits that the full $15 million exemption should be used in the capital tax calculation. Based on the reply to part (c) of the response to Energy Probe Interrogatory # 42, the capital tax would decline from $10,499 to $1,124.

Energy Probe accepts the tax rate of 0.225% used by LPDL in this calculation for 2009.

Energy Probe submits that the rate base changes that result from the change in the forecasted capital expenditures, changes in the working capital allowance and any further changes in capital expenditures and/or OM&A costs as determined by the Board should also be reflected in the calculation of the capital tax since these changes will have an impact on the rate base calculation.

**b) Income Tax**

i) Tax Rates

LPDL used a total tax rate of 33.00% in the calculation of income taxes in 2009 (Exhibit 4, Tab 3, Schedule 1). This rate included a federal tax rate of 19.00% and a provincial tax rate of 14.00%. Energy Probe agrees with the federal tax rate, but not with the provincial tax rate.

The provincial rate used by LPDL is not appropriate because their forecasted regulatory taxable income is less than $1.5 million for the 2009 test year. Because the regulatory taxable income is less than $1.5 million the calculation should reflect the provincial small business income tax rates. Energy Probe submits that these rates are 5.50% applied to the first $500,000 of taxable income, with the general tax rate of 14.0% for taxable income in excess of $500,000 and the claw back rate of 4.25% that is applicable to taxable income above $500,000 up to $1,500,000. The response to Energy Probe Interrogatory # 28 shows that the total income tax calculated using the provincial small business income tax rates reduces the income tax from $379,633 shown in Exhibit 4, Tab 3, Schedule 1 to $364,776. Energy Probe submits that LPDL should use the above noted provincial income tax rates and associated taxable income thresholds in the calculation of income taxes.

ii) Changes to the Capital Cost Allowance

There are a number of changes to the capital cost allowance (CCA) that should be taken into account when calculating the regulatory taxable income.

The first of these is the change in the CCA associated with the change in the capital expenditure forecast for both 2008 and 2009 as updated by LPDL in the response to Energy Probe Interrogatory # 11. Changes in each of these years will have an impact on the 2009 CCA calculation.

The second change that should be taken into account is dealt with in the response to Energy Probe Interrogatory # 30 and 43. In the first of these responses, LPDL confirmed that it recorded costs associated with the distribution system acquired post February 22, 2005 in 2005 in Class 1 rather than in Class 47 in 2005, 2006 and 2007. In the first response, LPDL calculated that the CCA for the 2009 test year would increase to $1,005,932 from the amount calculated in the evidence of $924,904 (Exhibit 4, Tab 3, Schedule 3, page 2). The second response sought clarification of the calculation of the $1,005,932 amount. As part of this response, LPDL provided a total CCA figure for 2009 of $971,769. Based on the calculations provided in the response to Energy Probe Interrogatory # 43, the response appears to provide the 2009 CCA deduction available for Class 47 and Class 1 as if the additions had been posted correctly in 2005 through 2007, including the impact that would have on 2008 and 2009. Energy Probe believes that this approach is correct and accepts the increase of $46,865 in the allowable CCA for the 2009 test year.

Energy Probe notes that because LPDL did not take the full CCA deductions for 2005 through 2008, it has paid excess amounts of PILS in those years. For example, in 2008, the correct CCA would be approximately $80,000 more than that filed in evidence (Energy Probe Interrogatory # 43). At a marginal tax rate of about 32%, this results in an excess PILS payment of more than $25,000 for 2008 alone.

iii) Impact of the Federal Budget

The January 27, 2009 federal budget introduced two changes that may have an impact on the regulatory taxable income in 2009. The first of these is an increase in the federal small business limit. The budget increased the amount of business income earned by a small business that is taxed at the lower federal corporate tax rate of 11%, as compared to the general federal corporate rate of 19%, from $400,000 to $500,000. Given that the LPDL taxable capital (rate base) is in slightly in excess of $15 million, this change will not impact on LPDL unless the Board's Decision reduces the rate base to below this level.

However, the second tax change does have an impact on LPDL. This change increases the CCA deduction for computers and system software in Class 50 acquired after January 27, 2009 and before February, 2011 from 55% to 100%. It also eliminates the half-year rule. In other words, businesses can fully deduct the cost of these computers and systems software in 2009.

As shown in Exhibit 4, Tab 3, Schedule 3, Table 2, LPDL has forecast the addition of $35,000 to this Class in 2009 (LPDL has identified this Class as Class 45.1). This results in a deduction to taxable income of $9,625 ($35,000 x ½ x 55%). The allowable deduction is now the full $35,000, or a reduction in taxable income of $25,375. At a marginal tax rate of about 32%, this results in a reduction in the revenue requirement of more than $8,000.

iv) Update to Regulatory Taxable Income

Energy Probe submits that if the regulatory taxable income is changed as a result of the Board's Decision and/or adjustments that LPDL has proposed to make, then the income tax calculation should also be updated to reflect the revised level of regulatory taxable income.

## LOSS ADJUSTMENT FACTOR

LPDL has calculated the distribution loss factor of 1.0315 using a five year average using data from 2003 through 2007, as shown in Table 1 in Exhibit 4, Tab 2, Schedule 9. The response to Energy Probe Interrogatory # 27 indicates that the three year average for the supply facility loss is mislabeled. It is actually a five year average, consistent with the calculation of the distribution loss factor adjustment. LPDL is proposing to use a supply facility loss factor of 1.0290, as shown in Table 2. The resulting total loss factor of these proposals is 1.0614 for secondary metered customers and 1.0508 for primary metered customers.

Energy Probe submits that the methodology proposed by LPDL does not accurately reflect the most recent trends in loss factors. The use of a five year average for the supply facility loss factor appears to be reasonable as there is no discernible trend in these figures over the 2003 through 2007 period. However, the distribution loss factor adjustments show a significant decline from 2003 (104.26%) to 2004 (103.10%). This decline is more than one full percentage point. The figures for 2004 through 2007 show that the distribution losses are relatively constant, with a difference between the highest and lowest figures over this period of only 0.53% (2004 vs. 2006). Moreover, the level recorded over this period remains significantly below the 2003 level. In light of this change that occurred after 2003, Energy Probe submits that it is more reasonable to forecast the distribution loss factor based on an average of the 2004 through 2007 period. This would result in a distribution loss factor of 1.0287, rather than 1.0315. The resulting total loss factor for a secondary metered customer would decline from 1.0614 to 1.0586.

# REVENUES

## a) Forecast Methodology

### i) A Flawed Methodology

LPDL uses a combination of a top down and a bottom up approach to preparing a forecast of volumes by rate class. The top down methodology involves the use of an econometric model to forecast total system purchases. This forecast is a normalized forecast. Energy Probe has a number of submissions on the econometric equation used in this top down approach in section (ii) below. Energy Probe also has a number of adjustments that it believes should be made to arrive at the total energy billing forecast. These suggested adjustments are detailed in part (b) below.

The bottom up approach takes a projection of the number of customers by rate class and multiplies it by a projection of the average use by rate class to arrive at a non-normalized volume forecast. The weather sensitive rate classes (or portions thereof) are then adjusted so that the total bottom up forecast by rate class in aggregate equals the normalized total energy billing forecast from the top down approach.

Energy Probe has a number of concerns with this approach. Suggestions for future forecast methodologies are presented in section (iii) below. Please note that all references to the Exhibit 3, Tab 2, Schedule 2 evidence is to the revised December 18, 2008.

The major concerns with this methodology that forces the rate class non-normalized forecasts to add up to the normalized total energy billing forecast are summarized below.

- The weather adjustment shown in Table 14 of Exhibit 3, Tab 2, Schedule 2 is done to force the sum of the non-normalized forecasts to add up to the normalized total energy billing forecast that is derived through the use of the econometric equation. There are two flaws with the methodology used. The first flaw assumes that the weather adjustment is proportional to the weather sensitive kWh forecast for each of the rate classes. For example, in Table 14, for 2009, the residential class has 53% of the weather sensitive energy, so the weather adjustment assigned to the residential class is 53% of the total adjustment needed to bring the two forecasts into agreement (i.e. 2.7 GWh).

This adjustment is also shown in the response to VECC Interrogatory # 41. There is no reason to expect that residential customers have the same level of sensitivity to the weather as do GS < 50 kW or GS > 50 kW customers. Indeed, it would be expected that all three classes have different levels of sensitivity to the weather.

- Second, the use of non-normalized average use forecasts for the weather sensitive accounts will bias the forecast because the impact of weather on average use is different by rate class. A change of one degree day or heating degree days cannot be expected to have the same proportional impact on the average use of the weather sensitive customer classes. This bias can be seen by looking at the forecasts proposed by LPDL for the residential and GS < 50 kW classes. LPDL proposes to use a forecast of annual kWh usage per customer that is based on the growth rates in use over the 2001 through 2007 period. The average use for the GS < 50 kW class declined on average by 0.19% over this period, while the residential use increased on average by 0.82% over the same period (Table 9, Exhibit 3, Tab 2, Schedule 2). Yet both of these customer classes experienced the same weather conditions over this period. This illustrates that historically, the impact of weather on these two classes of customers, both of which are assumed to be 100% weather sensitive (Table 13, Exhibit 3, Tab 2, Schedule 2) is quite different from one another.

- If there is change in the average use for a class from that originally forecast, this change does not have an impact on the total energy billing forecast using the LPDL methodology. This is a perverse result. As an example, the response to Energy Probe Interrogatory # 20 illustrates this result. In this interrogatory response, an increase in the average use per customer in the GS > 50 to 999 kW class increases the weather normalized billed energy forecast in 2009 from 50.7 GWh (Table 14 of the Revised evidence) to 58.2 GWh (Table 14 in Energy Probe Interrogatory #20) for this rate class. However, because the total weather normalized billed energy forecast for all rate classes does not change under the forecasting methodology employed by LPDL, the volumes for the other weather sensitive accounts decline. In particular, the residential volumes fall from 87.0 GWh to 82.2 GWh and the GS < 50 kW volumes fall from 49.2 GWh to 46.5 GWh. Since the number of customers for both of these rate classes is unchanged, the underlying reduction in these volumes implies a reduction in the normalized average use for each of the customer groups. However, this has nothing to do with converting a non-normalized forecast to a normalized forecast. In fact, following the methodology as proposed has the perverse impact of changing normalized average use for all weather sensitive rate classes!

  Based on the weather normalized billed forecast for 2009 shown in the Revised Appendix A to Exhibit 3, Tab 2, Schedule 2, the normalized average use for the residential class is 11,509 kWh and for the GS < 50 kW class is 31,770 kWh.

The response to Energy Probe #20 shows the impact on volumes by rate class for a higher forecast of GS > 50 to 999 kW customers. The net impact on volumes is that there is a decline in the residential volumes and in the GS > 50 kW volumes, as noted above. This is necessary because of the methodology used. The total kWh's do not change; they remained fixed at 227,182,694, independent of the number of customers.

The impact is a reduction in weather normalized billed forecast volumes for the residential and GS > 50 kW rate classes, with no change in the number of customers in either of these classes. This means that there is a reduction in normalized average use for both of these weather sensitive customer classes. In particular, based on the response to Energy Probe #20, the normalized residential use per customer declines to 10.870 kWh and the GS < 50 kW class declines to 30,019 kWh. In other words, an increase in average use for one group of customers in one class has impacted on the normalized average use forecast for all the weather sensitive customers. This result is neither logical nor defensible.

- The econometric equation used to forecast the total system purchases cannot adequately and/or accurately reflect the relevant drivers when these drivers are different for different rate classes. Further details are provided in the following section.

ii) Econometric Equation

The econometric equation used to forecast the total system purchases suffers from a number of deficiencies. Each of these deficiencies is noted below.

- By aggregating all volumes into a single equation, the methodology assumes that all rate classes are affected by the same drivers such as heating degree days, cooling degree days and real GDP. This is most likely not true.

- By aggregating all volumes into a single equation, the methodology assumes that all rate classes are affected to the same degree for each driver included. It is unlikely that the weather, for example, has the same impact on residential customers as it does on large general service customers. Similarly, general service volumes are likely to be more influenced by changes in real GDP than are residential volumes.

- The equation does not reflect the relationship between the numbers of customers in different rate classes to the volumes forecast. The equation, shown on page 3 of 12 of Exhibit 3, Tab 2, Schedule 2 includes the total number of customers as an explanatory variable. This assumes that the addition of one residential customer would have the same impact on the total

volumes purchased as the addition of one GS > 50 to 999 kW customer, for example. This is not reasonable. The response to VECC Supplemental Interrogatory #1 shows that if the number of customers is replaced by the number of residential and GS < 50 kW customers, GS > 50 to 999 customers and GS > 1000 customers, the coefficients on the estimates are significantly different from one another, ranging from 0 to 4,576 to 8,104. This compares to the LPDL estimated coefficient based on total customers of 4,807. Moreover, as shown in the response to VECC Interrogatory # 4a, simply replacing the total number of customers as an explanatory variable with the 3 sets of customers noted above, the total predicted kWh purchases increase from 232,047,061 kWh to 235,143,110 kWh, or 1.33%. In short, it is not reasonable to expect that the total purchases are not driven in part by the number of new customer additions by rate class. The above analysis indicates that it has a significant impact.

- The equation implicitly assumes that the impact of weather (heating and cooling degree days) has the same impact across all months (or seasons) of a year. For example, 1 additional heating degree day in January has the same impact on total system purchases as one additional heating degree day in July. It is extremely doubtful that this is true. The impact of weather will be different by month.

- The data used is based on total system purchases. The resulting forecast is then adjusted for the distribution loss factor to arrive at total energy billed. This approach does not recognize the actual loss factors each month over the historical period. The data used should have been the actual total energy billed each month. No adjustment for losses would then be required and the equation would have been estimated based on the true figures. This is important as the loss factors used between 2002 and 2007 range from 1.3% to 7.3% (Exhibit 3, Tab 2, Schedule 3, Table 5). The loss factors within each year are also likely to vary significantly from month to month, reflecting different load profiles in the summer as compared to the winter.

- The model used does not include any type of variable to model conservation. The inclusion of a simple trend variable may capture both conservation (including naturally occurring conservation) and other trends in the use of electric appliances.

- The equation used includes the Ontario Real GDP as an explanatory variable even through the T-statistic for this variable was less than 2.00 (Board Staff Interrogatory # 24b). This means that this variable is statistically no different from zero at a 95% confidence interval.

Energy Probe submits that these are the major deficiencies of the current econometric equation and the forecast that results from its use. In the following section, suggestions are provided for improvements in the forecast methodology, including using a bottom up regression analysis by rate class that would eliminate or minimize most of the deficiencies noted above.

iii) Future Forecasts

Energy Probe recommends that the Board direct LPDL to develop a forecasting methodology that generates a forecast of billed energy on a bottom up basis. In other words, a forecast is developed for each rate class and these forecasts add up to the overall forecast, rather than the top down approach used by LPDL in this application.

The forecast for each rate class would be based on a forecast for the number of customers in each rate class and a forecast of normalized average use for each rate class. The latter would be based on an econometric estimation of average use based on a number of explanatory variables that could differ by rate class. The forecast of customers could be driven by economic activity and/or local developments.

Such a process would enable LPDL to distinguish between the drivers of volumes by rate class. The current methodology groups all volumes together and attempts to determine what the drivers are of the total. Energy Probe submits that this approach loses much of its explanatory power because different rate classes are driven by different factors. As well, different classes are driven to different degrees by the same factor. As noted earlier, the impact of weather on residential customers is likely to be different than the impact on large general service customers. The current methodology attempts to "average" these impacts across all customer classes.

**b) Adjustments to the Forecast**

Energy Probe submits that a number of adjustments should be made to the forecast as filed. The adjustments are listed below.

i) Loss Factor Adjustment

LPDL has converted the total system weather normalized purchases forecast by dividing this forecast by a loss factor of 1.027 to determine the weather normalized energy billing forecast (Exhibit 3, Tab 2, Schedule 3, page 5). The loss factor is the average over the 2001 through 2007 period. However, as indicated in the response to Board Staff Interrogatory # 25, LPDL has discovered that it made an error in calculating the billed kWh's by using an incorrect loss factor. The correct loss factor should have been 6.14% rather than 2.70%. LPDL supports continued use of the 2.70% incorrect loss factor as a "rate mitigation measure". Energy Probe submits that this is not appropriate. The correct loss factor should be applied. Based on the response to the Staff interrogatory, Energy Probe submits that a reduction in the billed kWh forecast from 225,921,346 kWh to 218,623,574 kWh is appropriate. This is a reduction of 7,297,772 kWh.

ii) GS > 50 to 999 kW Use Adjustment

LPDL uses a geometric mean of the growth rate for the average use per customer for a number of rate classes to forecast the 2008 and 2009 average uses. As shown in Table 10 of Exhibit 3, Tab 2, Schedule 2, the geometric mean is a reduction of 6.22% for the GS > 50 to 999 kW class over the period 2001 through 2007. Applying this decline in use results in the average use for the class of customers falling to 551,637 kWh's as shown in Table 11. This level is significantly lower than the actual average use figures shown in Table 9 for 2002 through 2007.

LPDL indicates that the data for this class of customers for 2001 "is not as reliable as the following years" (Energy Probe Interrogatory # 19b). There were at least two major changes that made the 2001 data less reliable.

Energy Probe submits that the decline in average use of more than 37% in 2002 as compared to 2001 should be disregarded for purposes of forecasting the average use in this category of customers. As shown in the response to Energy Probe Interrogatory # 20, removing this one year of less than reliable data and utilizing the data for 2002 through 2007 results in a geometric mean growth rate of 1.59%. The resulting 2009 average use forecast using this growth rate applied to the actual 2007 level of consumption results in an average use forecast for the test year of 647,371 (Table 11 in the Energy Probe interrogatory response). This figure is much more in line with the trend in recent history for this class of customers.

Energy Probe, therefore, submits that the volume forecast should be adjusted upwards to reflect the increase in the average use forecast as follows:

(647,371 kWh/cust – 551,637 kWh/cust) x 91 customers = 8,711,794 kWh.

As illustrated above under the forecast methodology discussion, Energy Probe believes that this addition of 8,711,794 kWh should be on top of the total forecast and not simply an increase for one rate class accompanied by a decrease in other rate classes to make totals fit the overall forecast total.

iii) Customer Forecast

Energy Probe submits that the customer forecast provided by LPDL at Exhibit 3, Tab 2, Schedule 3, Table 8 should not be accepted for the residential, GS < 50 kW or GS > 50 to 999 kW rate classes. In each of these rate classes, Energy Probe submits that these forecasts are too low.

As shown in the response to VECC Interrogatory #4i, the actual number customers as of October 2008 already exceeds the year end forecast for 2008 for the residential, GS < 50 kW and GS > 50 kW classes. In fact, the residential and GS > 50 kW actual number of customers as of October 2008 exceeds the forecast year end 2009 forecasts.

Assuming no further growth from the October level, the number of actual residential customers would be 79 more than forecast for 2008; the number of GS < 50 kW customers would be 5 higher than forecast for 2008 and the number of GS > 50 kW customers would be 3 higher than forecast for 2008. This latter comparison reflects the 100 customers shown in the VECC interrogatory response to the 91 GS > 50 to 999 kW and the 6 GS > 1000 to 4999 kW customers forecast for 2008 by LPDL.

Energy Probe submits that a conservative forecast for 2009 is to simply increase the forecast customers provided by LPDL by the increase in the 2008 customers over and above the 2008 forecast. The following table calculates the increase in billed kWh's associated with a higher customer forecast and utilizes the average use forecast for residential and GS < 50 kW customers found in Table 11 of Exhibit 3, Tab 2, Schedule 2. The additional GS > 50 kW customers have been included at the average use noted above in part (ii) of 647,371 kWh.

| Class | Incremental Customers | Average Use | Incremental Volumes |
|---|---|---|---|
| Residential | 79 | 11,320 | 894,280 |
| GS < 50 kW | 5 | 31,243 | 156,215 |
| GS > 50 kW | 3 | 647,371 | 1,942,113 |
| Total | | | 2,992,608 |

Energy Probe notes that the incremental volumes associated with the additional customers would be even higher if the average uses proposed in part (iv) below were to be utilized.

As illustrated above under the forecast methodology discussion, Energy Probe believes that this addition of 2,992,608 kWh should be on top of the total forecast and not simply an increase for some rate classes accompanied by a decrease in some rate classes to make the totals fit to the overall forecast total. This adjustment should be made to the overall forecast total because it is the result of additional customers that were not included in the original forecast. The incremental revenue generated would reflect both the increase in

volumes for all three rate classes and the increase in the annualized number of customers. It would also reflect a change in the forecast level of kW's for the GS > 50 kW class.

Energy Probe believes that in the future the customer forecast should be more sophisticated than simply using a geometric mean annual growth rate of past growth. More emphasis should be provided on local information specific to the distributor's area. This is especially important for small distributors like LPDL. Information from local planning departments should be used, as should local knowledge of subdivision and commercial development that is taking place, or forecast to take place.

iv) Average Use Changes

The average use figures calculated in Tables 9 and 10 of Exhibit 3, Tab 2, Schedule 2 are based on actual consumption, not normalized for weather. As a result the calculated changes in average use for the weather sensitive residential and GS < 50 kW customer classes are heavily influenced by the actual weather. Energy Probe submits that a more accurate way to forecast the volumes associated with these customers is to use the normalized average consumption figures for these customers as calculated by Hydro One based on 2004 data. While this approach is not perfect, it does reflect a true estimate of normalized use for these customer classes. LPDL acknowledges that CDM has only recently had an influence on their consumption and that the impact of their historical CDM activities would be minimal (Board Staff Interrogatory # 23).

As shown in the response to VECC Supplemental Interrogatory #4, the normalized average use calculated by Hydro One based on 2004 weather normalized data was 11,782 kWh for residential customers and 33,412 kWh for GS < 50 kW customers. Energy Probe submits that these figures should be used in the calculation of the volumes for these two customer classes. The following table shows the calculation of the incremental volumes associated with the incremental average use applied to the adjusted number of customers.

| Class | Average Use | Customers | Incremental Volumes |
|---|---|---|---|
| Residential | (11,782 – 11, 320) | (7562 + 79) | 3,530,142 |
| GS < 50 Kw | (33,412 – 31, 243) | (1549 + 5) | 3,370,626 |
| Total | | | 6,900,768 |

As noted above under the forecast methodology discussion, Energy Probe believes that this addition of 6,900,768 kWh should be on top of the total forecast and not simply an increase for some rate classes accompanied by a decrease in some rate classes to make the totals fit to the overall forecast total. This adjustment should be made to the overall forecast total because it is the result of higher normalized average uses that were not included in the original forecast.

v) Summary

In aggregate, the adjustments proposed by Energy Probe for 2009 total approximately 11,307,398 kWh ((7,297,772) kWh to reflect correction in loss factor; 8,711,794 kWh to reflect a more accurate forecast for GS > 50 to 999 kW use per customer; 2,992,608 kWh to reflect higher than forecast customers and 6,900,768 kWh to reflect adjustment for average use). This represents an overall increase in the billed kWh of approximately 5.0%. The increase in the number of customers in 2009 would also generate additional revenue, as would a higher kW forecast for the GS > 50 to 999 kW class.

**c) Other Distribution Revenue**

LPDL is forecasting a decrease in other distribution revenue from $508,125 in 2007 to $400,906 in 2008. This increase in 2008 is followed by a slight increase in 2009 to $407,336. These figures are provided in Exhibit 3, Tab 3, Schedule 1.

i) Interest and Dividend Income

As shown in the response to Energy Probe Interrogatory # 23, the year-to-date October 2008 actual revenues are below the corresponding period revenues in 2007 by just under 4.0%. However this decline is misleading. As shown in the response to Energy Probe Interrogatory # 23, this total includes an amount in the 2007 revenue of $46,037

associated with interest on regulatory assets, while 2008 includes net revenue of ($6,197) associated with regulatory assets. Excluding these amounts yields actual revenues in 2007 to October of $248,848 and in the same period for 2008 of $287,510. As a result, the change in revenues is actually an increase of 16.5%.

Energy Probe submits that the interest income or expense associated with deferral and variance accounts (including regulatory assets) should not be included in the calculation of the other distribution revenue offsets. This is because this interest income or cost will be cleared to customers at the time that the associated deferral and variance accounts are cleared to customers.

By including this interest cost in 2009, LPDL is effectively double counting the impact. LPDL will recover these costs when it clears the balances in the associated accounts, which will include the interest. At the same time, LPDL has reduced the level of other distribution revenues which are used to offset the revenue requirement that needs to be recovered through distribution rates. Ratepayers would be, therefore, effectively paying this interest cost twice. Energy Probe respectfully submits that the Board should direct LPDL to remove any interest expense included in the Other Distribution Revenue forecast in 2009 associated with deferral and variance accounts, including regulatory assets.

Interest and Dividend Income accounts for more than $94,000 of the reduction in 2008 (Exhibit 3, Tab 3, Schedule 1). Part of this decline is appropriate because the 2007 figure includes interest revenue associated with the regulatory assets which should not be shown as revenue in 2007 for regulatory purposes.

However, as shown in the response to Energy Probe Interrogatory # 23, year-to-date October 2008 already includes more than $57,000 in interest and dividend income, compared to the forecast of $0 in the evidence. Prorating this ten month period would suggest that interest and dividend income is likely to total about $68,000 more in 2008 than forecast. This increase should then be carried forward into 2009.

ii) All Other Distribution Revenue

Energy Probe submits that the Other Distribution Revenue forecast excluding Interest and Dividend Income should be increased. The current forecast for 2008 is $400,906, excluding account 4405. The actual levels recorded in 2007 were $413,662, again excluding account 4405. The year-to-date October levels are virtually the same when account 4405 is removed from the analysis. As a result, Energy Probe submits that the forecast for all of the other distribution revenues is appropriate for 2008 and is a good basis for the forecast of $407,336 for 2009.

iii) Summary

In summary, Energy Probe submits that the Other Distribution Revenue forecast is appropriate for all the components with the exception of Interest and Dividend Income. This is based on the 2009 forecast being driven by the levels forecast for 2008 and the year-to-date October 2008 levels being in line with the corresponding 2007 figures. Interest and Dividend Income should be increased by $68,000 to reflect actual interest to October and the removal of any interest expense related to deferral and variance accounts, including regulatory assets.

## DEFERRAL AND VARIANCE ACCOUNTS

LPDL is not proposing to recover the balances in any of the deferral and variance accounts as part of this application (Exhibit 5, Tab 1, Schedule 2).

If the Board determines that some or all of the deferral and variance accounts should be recovered as part of this application, then Energy Probe submits that the Board should ensure that the interest rates used by LPDL to calculate the interest on the balances reflect the most recent OEB prescribed interest rates available. In particular, based on the response to Board Staff Interrogatory # 38, it appears that interest after January 1, 2009 has been calculated using a rate of 3.35% which was the rate in effect for the third and fourth quarters of 2008. The prescribed interest rate for the first quarter of 2009 is 2.45%.

Further, should the Board determine that some or all of the accounts should be recovered as part of this application, Energy Probe submits that the recovery should be over a minimum two year period. This would help mitigate the impact on customers of the increase driven by the revenue deficiency and the recovery of the deferral and variance account amounts.

## COST OF CAPITAL

### a) Capital Structure

LPDL is requesting a deemed equity component of 43.3%, short term debt of 4.00% and long term debt of 52.7% Exhibit 6, Tab 1, Schedule 2). Energy Probe accepts this capital structure as it is in compliance with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006.

### b) Return on Equity

LPDL has requested a return on equity of 8.57% in the test year, reflecting the OEB's March 7, 2008 letter regarding the cost of capital updates for the 2008 cost of service applications (Exhibit 6, Tab 1, Schedules 1 & 4). LPDL also states that the OEB will update the return on equity rate in early 2009 for rates effective May 1, 2009. Energy Probe accepts this position as it is compliance with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006.

### c) Short Term Debt Rate

LPDL has requested a short term debt rate of 4.47% in the test year (Exhibit 6, Tab 1, Schedule 2). This reflects the OEB's March 7, 2008 letter regarding the cost of capital updates for the 2008 cost of service applications. LPDL does not address in their evidence on whether or not this short term debt rate should be updated by the Board in early 2009 for rates effective May 1, 2009. However, as indicated in the response to Energy Probe Interrogatory # 26c, LPDL confirmed that the OEB would finalize the short

term debt rate for 2009 using January 2009 market interest rate information and that the revised figure would be used to calculate the cost of short term debt. Energy Probe submits that the short term debt rate should be updated to be compliant with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006 and consistent with the approach taken related to the return on equity.

**d) Long Term Debt Rate**

All of the LPDL long term debt is held by non-affiliates (Exhibit 6, Tab 1, Schedule 3) at market rates. The overall cost of this debt for 2009 has been calculated to be 5.16% and LPDL has used this rate for the deemed long term debt component of its rate base.

Energy Probe submits that this rate is appropriate and should be applied to the deemed long term debt component of the rate base.

## COST ALLOCATION & RATE DESIGN

LPDL proposes to increase the revenue to cost ratio for the residential, GS < 50 kW, street lighting, sentinel lighting and unmetered scattered load customers, while decreasing the ratio for the GS > 50 kW class.

Based on the 2006 cost allocation informational filing, the unmetered scattered load, street lighting and sentinel lighting classes are below the revenue to cost range identified as appropriate in the Board's "Report on Application of Cost Allocation for Electricity Distributors" dated November 28, 2007. All of the remaining classes are all within the ranges identified as appropriate; there are no rate classes that are above the range.

LPDL has proposed to move the revenue to cost ratio for the street and sentinel lighting class part of the way from what the current ratio is to the bottom of the OEB proposed range of 70%. In particular, LPDL proposed to increase the ratio for street lighting from 16.95% to 50.24% and for sentinel lighting from 24.54% to 52.70%. Energy Probe supports this adjustment. However, LPDL does not propose to move the ratios for these

two customer classes closer to the 70% that is the bottom of the Board approved range for these classes. In particular, LPPD has indicated that they would prefer to wait until a new cost allocation filing is completed (response to Energy Probe Interrogatory # 31). Energy Probe submits that based on the best information available today, the Board should direct LPDL to increase the revenue to cost ratios for these two customer classes by 50% of the remaining difference to the bottom of the range in 2010 and then to 70% in 2011. Energy Probe believes this movement is appropriate given that in the various 2008 Decisions the Board expected the applicants to achieve the remaining 50% move to the bottom of the range in equal increments in the two years following the rebasing year. Energy Probe therefore recommends that the Board adopt this movement.

Energy Probe accepts the increase in the unmetered scattered load class from 67.27% to 81.25%. However, Energy Probe recognizes that this increase moves the ratio above the minimum for the range, which is 80%. Energy Probe would not object to a revenue to cost ratio of 80% for this class of customers.

On the other hand, Energy Probe submits that there is no reason to adjust the revenue to cost ratios for the residential or GS < 50 kW classes since the ratios for these classes are already within the ranges approved by the Board. This is based on the Decision and Order for Wellington North Power Inc. (EB-2007-0693), where the Board stated at page 29 that:

> "An important element in the Board's report on cost allocation was its express reservation about the quality of the data underpinning cost allocation work to date. The report frankly indicated that the Board did not consider all of the data underpinning the report to be so reliable as to justify the application of the report's findings directly into rate cases. For this reason, among others, the Board established the ranges depicted above and mandated the migration of revenue to cost ratios currently outside the ranges to points within the ranges, but not to unity. In short, the ranges reflect a margin of confidence with the data underpinning the report. No point within any of the ranges should be considered to be any more reliable than any other point within the range. Accordingly, there is no particular significance to the unity point in any of the ranges."

The revenue to cost ratio for the GS > 50 kW class is also within the range identified by the Board for the customers in this class, so there is no need to reduce the ratio for these customers. Energy Probe submits, however, that the additional revenue generated by increasing the revenue to cost ratio for the street lighting, sentinel lighting and unmetered scattered load classes should be used to reduce the corresponding ratio for the GS > 50 kW class. This is the only class of customers with a revenue to cost ratio in excess of 100% and, as such, any additional revenues generated by increasing the ratios for other classes should be used to reduce the ratio for this class. The incremental revenues generated in 2010 and 2011 of moving the street and sentinel lighting classes should also be used to reduce the ratio for the GS > 50 kW classes in those years.

## COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Recognizing the size of LPDL, Energy Probe has attempted to minimize its time on this application, while at the same time ensuring a thorough review.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

**February 27, 2009**

**Randy Aiken**

**Consultant to Energy Probe**