



ONTARIO ENERGY BOARD

STAFF SUBMISSION

TILLSONBURG HYDRO INC.

2009 ELECTRICITY DISTRIBUTION RATES

EB-2008-0246

May 26, 2009

Introduction

Tillsonburg Hydro Inc. (THI) is an Ontario business corporation, 100% owned by the Town of Tillsonburg (Town). THI is a “virtual” utility. It has no employees and does not own all of the assets required to provide distribution service on a “stand alone” commercial basis. The Town makes several of its employees and many of its assets available to THI. In 2008 the Town provided 9.6 FTE technical employees dedicated to THI and 7.45 FTE employees to provide other aspects of service to THI and there are no proposed changes for 2009. The arrangement is governed by a Master Service Agreement (MSA) under which THI pays fixed charges that recover the Town’s directly incurred costs (operating and capital) and a Management Fee that supports the recovery of indirectly incurred costs and contributes towards the recovery of the cost of capital. THI owns and is responsible for assets that are unique to the provision of electricity distribution services.

In 2008, THI provided service to approximately 6,715 customers (5,900 residential (87.8%), 640 energy billed General Service (9.5%), 85 demand billed General Service (1.3%), 19 USL (0.3%), 80 Sentinel Lighting accounts (1.2%) and Street Lighting (1 customer). Its service territory includes the Town of Tillsonburg as of November 7, 1998.

THI is embedded within Hydro One Networks and is not a host distributor.

The intervenors of record for this application include: the Association of Major Power Consumers in Ontario (“AMPCO”), Energy Probe Research Foundation (“EP”), the School Energy Coalition (“SEC”), the Vulnerable Energy Consumers Coalition (“VECC”) and Ms. K. Englander, a resident of Tillsonburg. AMPCO and Ms. Englander have not been active participants in the review of the application.

The Application

In its original application filed with the Board on August 22, 2008, THI sought approval of \$3,312,930 as the 2009 revenue requirement it requires to provide electricity distribution services. On an equivalent basis, this compares with a Board-approved level of \$2,406,000 for 2006, the last year the rates were reviewed on a cost of service basis. During the interim period, the Board has approved adjustments to distribution rates

effective May 1, 2007 and May 1, 2008 through an Incentive Regulation Mechanism (IRM) process.

The application also sought approval to eliminate the current General Service 500 – 5,000 kW class and to re-classify the customers in that class to either a new General Service 500 – 1,499 kW class or a new General Service 1,500 – 5,000 kW class. In addition, the application sought approval to eliminate the current Sentinel Lighting class and to re-classify the existing customers in that class to the Unmetered Scattered Load (USL) class. THI also sought approval to implement rate riders that recover the balances recorded in certain variance and deferral accounts as of December 31, 2007 and the associated carrying charges as of April 30, 2009 and to recover THI's Lost Revenue Adjustment Mechanism and Shared Savings Mechanism awards, and charge a revised Smart Meter Rate Adder of \$1.00/metered customer per month. There is also a reference to THI's proposed standby service rate.

On October 24, 2008, THI advised the Board that it would be filing an update to its evidence to reflect changing demand and energy consumption forecasts as a result of prevailing economic conditions, as well as changes to transmission rates and Regulated Price Plan prices. On December 15, 2008 the applicant filed its updated evidence with the Board and the intervenors of record.

The Applicant stated that the update:

- Reflected revisions to its 2009 capital budget and 2009 OM&A budget;
- Reflected its 2008 3rd quarter financial results and revised 4th quarter projection;
- Reflected changes to the load forecast for 2008 and 2009;
- Reflected the impact of the OEB's recently announced changes to Regulated Price Plan prices and to Uniform Transmission Rates;
- Incorporated better estimates of coincident peak and non-coincident peak data that result in more accurate revenue to cost ratios;
- Reflected the findings of the independent third party review of its CDM program results; and
- Corrected errors in its August 22nd filing.

As a result of the update, THI proposed to increase its 2009 Service Revenue Requirement from \$3,312,930 to \$3,325,415.

The Applicant provided the following table showing the estimated percentage change in total bills for average customers within each class:

	August 22 nd Submission - Original	August 22 nd Submission - Corrected	December 15 th Updated Submission
Residential @ 1,000 kWh/month	5.66%	5.66%	6.76%
GS < 50 kW @ 2,000 kWh/month	6.37%	6.37%	13.32%
GS 50-499 kW @ 125 kW/month	2.64%	2.64%	11.39%
GS 500-1,499 kW @ 1,000 kW/month	13.61%	1.09%	9.74%
GS ≥ 1,500 kW @ 2,500 kW/month	18.64%	3.86%	13.42%
USL @ 2,225 kWh/month	-2.62%	-2.62%	-2.68%
Street Lighting @ 320 kW/month	-5.18%	-5.18%	-4.51%

THI indicated that if the updated application is approved as filed, a residential customer consuming 1,000 kWh per month would experience an approximate 20.4% increase in the current delivery charges. This is a \$7.48 per month increase on the bill. A general service customer consuming 2,000 kWh per month and having a monthly demand of less than 50 kW would experience an approximate 25.0% increase in the current delivery charges. This is a \$15.45 per month increase on the bill.

In its initial application, THI requested that the Board order its current rates effective May 1, 2009 on an interim basis if the Board had not authorized final rates on or before that date. On April 13, 2009 the Board received a request from THI and on April 15, 2009 supporting rationale relating to that request that the Board declare the rates, as proposed in the evidence, interim effective May 1, 2009.

The Board indicated that it would not be able to conclude its review of the application in order to set rates to be implemented May 1, 2009 and that it would not approve the THI's request for the proposed rates to be declared interim. However, pending the issuance of final rates for 2009, the Board declared the current rates interim, effective May 1, 2009.

In declaring the current rates interim, the Board emphasized that this interim rate order should not be construed as predictive, in any way whatsoever, of the final determination of this application with regards to the effective date.

The Board also noted that the material that was received on April 15, 2009 in regards to the interim rate application contained amendments to the evidence, further to the updates of December 15, 2008. The Board understood that THI intended that this

revised material would be included in the rate application, notwithstanding the interim rates decision. The Board accepted the amended material for that purpose.

The evidentiary phase of the application closed with the responses by THI to clarification questions that related to the interrogatory responses.

THI filed an Argument-in-Chief (AIC) on May 15, 2009.

Outstanding Issues from Previous Board Decisions

2006 Rate Application (RP-2005-0020/EB-2005-0420)

In its 2006 Rate application, THI proposed a new Large User rate for application to an existing customer in its GG > 50 TOU class and a potential new customer in the service territory. In its Decision, the Board stated that:

“The Board is concerned that the introduction of a new class, as distinct from the re-setting of rates for an existing class, would invariably have effects on cost allocation for the entire customer base which are not sufficiently documented, and may be changed in the near term through the Board’s cost allocation review. Therefore, the Board does not approve the proposed Large User rate at this time. It is open to Tillsonburg Hydro to propose such a rate in future rate filings, and it is the expectation of the Board that a detailed cost allocation will be required.”

This current application does not propose the introduction of a Large User class, but it does propose to split the existing demand billed General Service class into two classes based on a load determination (50 to 1,499 kW and 1,500 to 5,000 kW).

2007 Rate Application (EB-2007-0581) and 2008 Rate Application (EB-2007-0860)

The Decisions regarding the applicant’s 2007 and 2008 rates had no outstanding issues.

General

This submission reflects observations and concerns which arise from Board staff’s review of the pre-filed evidence as updated on December 15, 2008, both rounds of interrogatory responses, the material included as part of its interim rate proposal received on April 15, 2009 and THI’s AIC dated May 15, 2009. It is intended to assist the Board in evaluating THI’s application and in setting just and reasonable rates.

Board staff acknowledges the fact that the downturn in the economic situation in Tillsonburg since the original rate application was filed last August and the resulting implications on THI's forecasted operations that were reflected in the updates and revisions to the data have created a more complex application than might be expected for a distributor of this size. Rather than simply carrying on with the original application's forecast assumptions knowing they were unrealistic, these revisions have provided a more up to date indication of what THI might experience in the way of load and energy forecasts and also the modifications to its operation.

At times the added material has caused added complexity in the understanding and review of the application. For example, the lack of equivalent justification of the revised forecast data filed on May 13 as compared to the December 15 update of the original application is of concern to Board staff. This is discussed further in the appropriate section of the submission.

Board staff is also concerned that while the Board accepted the material from THI's April 14th interim rate application into evidence, and despite the fact that the changes reflect the best information available, the revised cost and other data, particularly the "correcting errors in the December 2008 Update" portion, have not been subject to testing.

Despite these concerns, on balance Board staff submits that the probable reduction in the forecasting error will result in rates that will be more reflective of the actual situation. Board staff submits that this is sufficient justification for the delay in the final approval of just and reasonable rates and charges.

Rate Base

General

Background

THI has documented its rate base in Exhibit 2. This is summarized in the following table, which also includes working capital and average net fixed assets.

Summary of THI's Rate Base, Net Fixed Assets and Working Capital Allowance

Test Year Rate Base

	August 22, 2008 Application	December 15, 2008 Revised Application	May 15, 2009 Argument-in_Chief
Net Fixed Assets in Service			
Opening Balance	\$ 6,234,879	\$ 6,149,499	\$ 6,149,499
Closing Balance	\$ 6,289,357	\$ 6,335,744	\$ 6,335,744
Average In-service Balance	\$ 6,262,118	\$ 6,242,622	\$ 6,242,622
Working Capital Allowance	\$ 2,684,962	\$ 2,750,214	\$ 2,471,140
Total Rate Base	\$ 8,947,080	\$ 8,992,836	\$ 8,713,762

Source: December 15, 2008 Application, E1/T1/S3 - U1, Argument-in-Chief, May 15, 2009, Appendix C.3

In its AIC, THI has stated that the proposed rate base for the 2009 test year is \$8,714,000, composed of \$6,243,000 of net distribution assets and \$2,471,000 of Working Capital Allowance.

Board staff has also prepared the following table of THI's net book value capital assets by year:

Net Book Value of Capital Assets over Time

Year	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 Bridge	2009 Test
Capital Assets - Net Book Value	\$ 5,338,170	\$ 5,254,908	\$ 5,555,197	\$ 5,917,911	\$ 6,149,499	\$ 6,335,744
Annual % Change		-1.6%	5.7%	6.5%	3.9%	3.0%

Average annual % change (geometric mean) -2004 to 2009

3.5%

Source: December 15, 2008 Revised Application, E1/T1/S3 - U1, Board staff IR #1

Board staff's comments on the Working Capital Allowance are addressed elsewhere in this submission.

Discussion and Submission

THI's rate base shows only small increases, averaging 3.50% per annum from 2004 to 2009 test year.

THI is proposing increases to capital expenditures to rehabilitate parts of its network. Board staff submits that the record supports THI's proposal. Board staff observes that THI's capital assets consist exclusively of land and land rights, poles, wires, transformers, conduits and meters directly used for the distribution of electricity. Other assets, such a buildings, furniture, vehicles, equipment, and computer hardware and

software, are assets of the Town, for which cost recovery is recovered as THI's expenses under the MSA.

Beyond the comments made above and elsewhere in this submission, Board staff takes no issue with THI's proposed rate base.

2009 Capital Expenditures

Background

THI has documented its capital expenditures in Exhibit 2. Clarification on certain capital expenditures was sought through interrogatory responses by Board staff and intervenors. Board staff has summarized THI's historical and forecasted capital expenditures in the following table:

Capital Expenditures by Year						
	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 Bridge	2009 Test
Capital Expenditures (excluding Smart Meters)	\$ 924,694	\$ 757,445	\$ 936,299	\$ 941,518	\$ 822,253	\$ 736,512

Source: Response to Board staff IR #1

Discussion and Submission

Board staff does not take issue with THI's proposed capital expenditures of \$736,512 for 2009. Board staff views that THI has adequately documented the need for proposed capital projects. It has explained also deferments of certain projects. Board staff also views that the proposed level of capital expenditures is reasonable, in light of historical expenditures. As noted above under Rate Base, THI is a virtual utility and capital expenditures are restricted to physical assets of the electricity distribution network owned by THI; assets of the Town, such as buildings, computer hardware and software, and vehicles are not included.

Asset Management

Background

THI did not file any information on Asset Management. However, in the application, it is stated that the Town expects to hire an Asset Manager to assist THI in conducting more

rigorous asset condition assessment and asset planning. This Town employee would also carry out other activities for THI and for the Town. In response to interrogatories, it was stated that the Asset Manager has not yet been hired.

Discussion and Submission

Board staff notes that intervenors have questioned THI's ongoing Voltage Conversion program. Intervenors appear to be concerned that THI does not have a rigorous plan for completing this long-term project and that, due to delays, the benefits of such a system upgrade may be delayed and diminished. Board staff understands the long-term nature of such a project (which has been or is being done by other distributors), but is also sympathetic to the intervenor's concerns. Board staff acknowledges that system upgrading such as Voltage Conversion may require reprioritization in light of emergencies or may have to be coordinated with other projects. However, Board staff submits that THI should have a more rigorous plan to complete this project within a reasonable time horizon and should be ensuring that the project is proceeding. The recruitment of an Asset Manager should provide THI with improved competencies in this regard.

Board staff submits that THI should provide improved evidence of asset condition assessment and Asset Management, and of how these are reflected in its capital planning, in THI's next cost of service based rate application.

Working Capital Allowance

Background

THI provided its proposed Working Capital Allowance (WCA) and derivation in E2/T1/S2/Attachment A, E2/T4/S1 and E2/T4/S2, with a proposed WCA for 2009 of \$2,750,244. THI is using the standard Board methodology of 15% of the forecasted 2009 cost of power of \$16,210,735, (based on the November 2008 forecasted RPP price of \$0.0603/kWh and existing retail transmission rates) and the forecasted controllable expenses of \$2,124,024.

In its AIC, THI has documented a WCA of \$2,471,140, calculated as 15% of the sum of controllable expenses of \$2,135,524 and Cost of Power of \$14,338,742.

Discussion and Submission

Board staff takes no issue with THI's methodology for calculating the WCA. However, Board staff submits that THI should update the WCA in determining the revenue requirement and associated distribution rates to recover it in preparing its draft Rate Order, to reflect any changes in controllable expenses of load forecasts as determined by the Board in its Decision, as well as to reflect the most current estimate of the RPP commodity price of \$0.06072/kWh, from the Board RPP Report of April 15, 2009, as well as updates to reflect current retail transmission prices.

While some details are provided in Appendix C,3 of the AIC, Board staff is unable to confirm the numbers provided or the commodity price, RTS and wholesale market prices used. Board staff invites THI to provide sufficient detail and discussion to aid other parties in better understanding the numbers provided and their derivation.

Service Quality and Reliability

Background

In response to Board staff IR # 5, THI provided information on its actual service quality and reliability performance for the period 2003 to 2007. This included discussion of below-standard reliability, with respect to CAIDI in 2007. Further information on the reliability degradation was sought by staff in supplemental IR #36. While THI had noted that an outage at Hydro One's TS was a cause for increased outages in 2007, THI noted that severe weather and equipment failures also contributed to worsening performance.

Discussion and Submission

Board staff submits that THI has provided adequate explanation of its service quality and reliability on the record through the responses to the interrogatories. Board staff notes that equipment failures on THI's distribution network, along with severe weather and outages at Hydro One's TS accounted for deteriorating performance. Board staff submits that THI should undertake to improve its performance, and expects that recruitment of an Asset Manager would assist in accomplishing this.

Operating Revenue

Load and Revenue Forecast

Background

In Exhibit 3 of its August 22, 2008 filing, THI discussed the development of its load forecast. It determined the 2008 Bridge Year and 2009 Test Year customer/connection count. THI also determined the kWh forecast – and the kW forecast for appropriate classes – by customer class.

On December 15, 2008, as part of the revised filing, THI filed a new load forecast. THI also provided additional information in response to two rounds of forecasting interrogatories.

Discussion and Submission

Methodology and Model

For the Residential and GS<50 kW customer classes, the annual average growth in the number of customers during the 2003-2007 period was, with one adjustment, forecasted to continue for 2008 and 2009. No growth was included in any of the other classes; a small reduction was made in the GS 50 – 499 kW class.

For the weather sensitive classes (i.e. Residential, GS<50 kW and GS 50 – 499 kW), THI developed a multivariate model that describes the relationship between the monthly wholesale weather-sensitive purchases and three independent variables: weather (i.e. heating and cooling degree days as recorded by Environment Canada at Hamilton Airport), economic factors (i.e. monthly employment levels for London) and peak day consumption (i.e. the number of non-holiday weekdays). Changes due to announced shutdowns and layoffs were incorporated into the model. The “weather-sensitive purchases” approach was taken since less than 50% of the utility’s load is weather sensitive. Five years of historical data were used (only 2003-2007 were available) and a 10-year period chosen (with some justification provided) as the definition of normal weather.

The resulting energy forecast for weather-sensitive wholesale purchases was converted to a billing level forecast and allocated to the three weather-sensitive classes based on their 2007 class shares. The forecast for each of the non-weather sensitive classes was developed based on historical trends and taking into account the effect of the economy on the applicant's small number of (but large load) automotive and other industrial customers. Finally, by incorporating the OPA's CDM targets, the charge determinants for all classes were developed.

Results

The December 15, 2008 load forecast, which took into account the worsening economic conditions, was 6.6% lower than the August 22, 2008 forecast. (Exhibit 1, Tab 1, Schedule 3 – U1, page 5, Table 7)

The historical change in number of customers/connections was +0.9% p.a.; the forecasted change is +0.8% p.a. The 2009 forecasted customer/connection count is 9,130. The historical kWh change was +1.3% p.a.; the forecasted kWh change is *negative* 4.3% p.a. The 2009 forecasted load is 206.3 GWh. (N.B. The December 15, 2008 forecast is the source for the 2009 values.)

Analysis

THI has developed a sophisticated load forecasting model. Backcasting tests showed that the model has the potential to produce a very accurate load forecast for the weather-sensitive classes. However, Board staff experienced difficulty in understanding the *application* of the model.

A number of the interrogatories sought correction to erroneous references in the filing or sought a more complete understanding of the filing. Brief and/or incomplete responses to a number of the initial interrogatories required the same questions to be re-asked as supplemental interrogatories.

One aspect of the application of the model that was the focus of a number of interrogatories (e.g. Board staff interrogatories #14 and #39, EP interrogatory #18, VECC interrogatory #21) was the issue as to how the applicant accounted for system losses in converting from wholesale purchased load to billed load. It seems to Board staff that all the system losses were assumed to be associated with the weather-sensitive classes

and no losses associated with the remaining classes. While, undoubtedly, insufficient data would exist to precisely associate the losses with specific classes, a reasonable basis could be found to make a credible split. Board staff invites THI to clarify how it handled system losses in the conversion process and explain why it chose this specific method. It would be useful to include an estimate of the maximum error that may have been introduced as a result of the method used in the application.

In its responses to numerous interrogatories, the THI resolved concerns regarding weather normalization, CDM assumptions, changes in the load of some of its major customers, 2008 actual vs. forecasted load, etc. Thus, notwithstanding the lack of clarity regarding the conversion from wholesale purchased load to billing load, Board staff would have no significant reservation recommending the Board accept the applicant's December 15, 2008 forecast of 206.3 GWh, subject to any sizeable corrections that may be necessary due to the applicant's use of system losses.

However, as part of its May 13, 2009 filing providing answers to the supplemental interrogatories, the Applicant filed a revised load forecast of 181.7 GWh (in response to Board staff interrogatory #37) that "corrects" previously filed evidence. No details are provided regarding this correction that results in a forecast that is 12% lower than the December 15, 2008 forecast. In the same filing in response to VECC interrogatory #28, the Applicant provides a table "that reflects the proposed changes to the load forecast for 2009" and shows a load forecast value of 179.6 GWh. Again no details for the change are provided. On May 20, 2009, the Applicant filed, in confidence, supplementary information regarding Board staff interrogatory #37 that showed a change in the forecasted load for two customer classes but, again, no details or rationale were provided.

Despite the fact that Board staff acknowledges that a revision to the forecasts to reflect the changed circumstances is a good thing, in the absence of any explanation and supporting rationale for the April 14/May 20 changes, Board staff is unable to comment on the reasonableness of the newly filed forecast. Indeed, Board staff is unclear regarding the kWh value of the proposed new forecast.

In its AIC, the Applicant notes that it has adjusted its load forecast due to changes in the load of its largest customer. However, no data is provided that would permit Board staff to conclude the new load forecast is reasonable or otherwise.

On the understanding that no new evidence can be introduced in its Reply Argument, Board staff would invite THI to assist the Board in providing a more complete explanation.

Operating Costs

THI has applied for OM&A expenses excluding depreciation, and property and other taxes for 2009 of \$2,124,025 which is \$497,058 or 30.6% greater than for the 2008 bridge year, and \$502,679 or 31% greater than for the 2006 actuals. THI's 3 year average for Total OM&A is \$236 per customer which is less than the cohort average of \$259, as found in the PEG Report EB-2006-0268 and displayed on the Board's Website [http://www.oeb.gov.on.ca/OEB/ Documents/EB-2006-0268/Comparison of Distributors 20081203.xls](http://www.oeb.gov.on.ca/OEB/Documents/EB-2006-0268/Comparison_of_Distributors_20081203.xls). These numbers were revised in THI's interim rate application on April 14, 2009. Board staff submits that the April revision are untested costs. As a result, the following submissions are based on the December 15, 2008 revised filing, which was subject to full review through the interrogatory process.

The following table from Board Staff Interrogatory 18 tracks the changes from 2006.

Tillsonburg Hydro Inc.											
	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9	Col. 11	
Line	2006 Board Approved	Variance 2006/2006	2006 Actual	Variance 2007/2006	2007 Actual	Variance 2008/2007	2008 Bridge	Variance 2009/2008	2009 Test	Variance 2009/2006	
1	Operation	403,209	256,119	659,328	-42,696	616,632	-3,247	613,385	269,907	883,292	223,964
2			63.5%	-6.5%		-0.5%		44.0%			34.0%
3	Maintenance	145,599	36,753	182,352	-2,844	179,508	-16,753	162,755	23,337	186,092	3,740
4			25.2%	-1.6%		-9.3%		14.3%			2.1%
5	Billing & Collections	327,045	50,438	377,483	17,285	394,768	31,340	426,108	117,339	543,447	165,964
6			15.4%	4.6%		7.9%		27.5%			44.0%
7	Community Relations	0	25,863	25,863	-19,405	6,458	-6,458	0	0	0	-25,863
8				-75.0%		-100.0%					-100.0%
9	Administrative and General Expenses	466,193	-89,873	376,320	46,584	422,904	1,815	424,719	86,475	511,194	134,874
10			-19.3%	12.4%		0.4%		20.4%			35.8%
11	Total OM&A Expenses	1,342,046	279,300	1,621,346	-1,076	1,620,270	6,697	1,626,967	497,058	2,124,025	502,679
12			20.81%	-0.07%		0.41%		30.55%			31.00%

Board Staff requested the identification of the cost drivers underpinning these year over year changes in Board Staff Interrogatory 18. The following were identified as the major cost drivers and the changes from 2006 to 2009:

Cost Driver	Change (\$)
FTE & Board of Directors	162,000
Cost of Living	27,000
Paper & Postage	30,000
New CIS	101,000
Regulatory Costs	62,000
Total	532,000

Labour

THI is a virtual utility with its labour related costs sourced from the Town through the MSA. The cost of living Test Year forecast for labour is 2% or about \$27,000 as stated in the response to EP Interrogatory 26.

As indicated in EP Interrogatory 2, THI has forecast for 19 FTE's in 2009. Included in the 19 FTE's are 2 apprentice Linesmen and an Operations Regulatory Affairs Manager. THI pointed out that the apprentice Linesmen were hired to replace expected retirements. When asked in SEC Interrogatory 13 d) how long the 2 new Linesmen would be working doubled-up with those expected to retire, THI said that they did not know how long they would work that way.

According to EP Interrogatory 26 c), THI stated that it did not expect the Operations Regulatory Affairs Manager to provide relief from the costs allocated from the Finance Regulatory Affairs Manager in 2009, for the Operations Manager will require development into the position.

Discussion and Submission

Board staff submits that without knowledge of retirement dates, the hiring of apprentice Linesmen might be premature. While it is difficult to predict when someone might retire, there needs to be compelling evidence for the Board to accept the inclusion into rates for the next four years the costs for twice the necessary FTE's in a particular area of the company. The same point can be made for the allocations from the Finance Regulatory Affairs Manager. Board staff submits that it should not take four years to train a manager. One would expect that, given the specialty nature of the position, a hire would be familiar with the regulatory process, and most training might be on the in-house

systems and reporting, which would not be any different than the training to everyone which would happen when a new system is rolled out. As a result Board staff would expect less of the Finance Regulatory Affairs Manager's time being allocated.

In addition, Board staff would like to point out that THI pays for 9 Board Directors for a total cost of \$83,000 as shown in EP Interrogatory 37. THI states in SEC Interrogatory 13 that they increased the number of Directors from 7 to 9 to comply with the Affiliate Relationships Code ("ARC"). Board staff submits that a nine-member Board of Directors is a heavy burden for a company having a rate base of \$9 million and 19 FTE's. The ARC requires that a minimum of one-third of the Board of Directors be independent. Board staff submits that THI should have seen this as a cost cutting opportunity and reduced the size of the Board from 7 to 6 and change the member mix to comply with the ARC.

Paper & Postage

THI state that up to and including 2008, THI was not charged for the paper and postage consumed to operate the company. The situation has changed and THI has forecast \$30,000 for paper and postage in 2009.

Discussion and Submission

Board staff submits that in the MSA found in Exhibit 1/Tab 2/Schedule 1 Attachment A between the Town and THI (in Appendix A, section A.6.5 (a) Billing Design, Printing, Inserting and Mailing Invoices) it states that the Town will provide services for "Printing of all monthly bills and notices for existing customer base of +/- 6,000 customers" and "Inserting and preparing bills/notices for mailing including up to 3 additional inserts and business return envelopes and delivery to post office, **including postal charges**, at current rates" [emphasis added]. For these services and all other customer services, the Town extracts a fee of \$152,657 from THI. While the MSA does not address consumables other than postage as being included in the fee, Board staff points out that consumables are part of the MSA for they are also mentioned in A1 (a) Hydro Operations for Vehicles and Fleet. In that section it specifically states maintaining and fuelling vehicles. In the spirit of the MSA, Board staff submits that the \$30,000 for these consumables should be disallowed. As pointed out in EP Interrogatory 29 the postage costs, which are included in the MSA, are \$21,840 of the \$30,000.

New CIS

THI has undertaken to acquire a new CIS at a cost of \$308,475, as stated in EP Interrogatory 27, to replace the existing system. The existing system will no longer be supported by its vendor, as pointed out in Board staff Interrogatory 22 a). The assets, however, will not be in rate base, but owned by the Town. The Town in turn will charge the related total capital costs to THI over the three year period of 2009-2011. As pointed out in EP Supplemental Interrogatory 36, the system will be also used for billing water and sewage customers for those non THI services.

In EP Interrogatory 27, THI states that the Town has included a 5% management fee in the \$308,475 purchase price.

Discussion and Submission

It appears to Board staff that the capital costs of the entire system will be charged to THI and thus the costs borne by its customers. THI states that the Town considers that the need for smart meter billing is the driver for the new system and consequently the electricity utility pays for the entire system. THI further points out in the Interrogatory response that there are benefits for the Town of not having to print and mail two bills and of not owning the billing system.

It is a generally accepted regulatory practice that customers share the costs of facilities over their useful life and that there are no free riders. Good costing should be able to identify incremental costs associated with the increased functionality for smart meters, and all users of the system would receive the average capital costs for the aspect not associated with smart meters. The incremental costs for smart meters would appropriately be allocated to THI. Board staff submits that to charge the entire capital cost of the CIS system to THI is inappropriate.

Board staff also is concerned over the accelerated period of write-off; namely, three years. A tenet of the regulatory paradigm is that the costs of assets are charged to operations over an estimate of their expected useful life. To accelerate the write-off results in intergenerational subsidization with the associated free rides. Board staff submits that a more appropriate period would be the one used for the amortization of computer hardware and software; namely, 5 years.

Finally, Board staff has concerns regarding the Management Fee levy for the purchase. Through the MSA, the Town provides billing and customer services to THI. As stated above, the Town owns the facilities for the provision of these services. Specified fees are extracted from THI for these services. Board staff submits that it is inappropriate for the Town to levy a 5% fee on the purchase of their facility and then extract fees, which again include the 5% Management Fee from THI for providing services that uses that facility. In reply to Board staff Interrogatory 26, THI stated that the Management Fee, which represents an added charge to the basic service charges, is properly applied to:

- Recover costs eligible for recovery but not previously identified; and
- Collect funds to offset the indirect costs incurred by the Town in providing service to THI.

The Management Fee recognizes that the basic MSA charges to THI are not fully burdened with an allocation of common or indirect costs such as IT and telecommunications, and the costs of capital for the Town.

In other words, it appears to Board staff that all non specified costs in the MSA are collected in the Management Fee. It appears that the purchasing costs, indirect costs, and the costs of capital are considered in the 5% Management Fee and are collected when services are rendered through the burdened service fee of the MSA. Board staff submits that the 5% fee on the purchase is double dipping.

Regulatory Costs

THI have submitted for the following total regulatory costs to be amortized over four years:

Consultants	\$175,000
Intervenors	\$31,000
OEB Sec. 30	\$25,000
Management Fee 5%	\$11,550

Discussion and Submission

Board staff has concerns about some of these costs. Even considering the fact that the application has been updated and amended since the initial filing, the \$175,000 for consulting is significantly higher than other distributors' claims in the 2009 EDR

applications. While THI did not have an Operations Regulatory Affairs Manager, the \$175,000 is more than the budget for the manager which is estimated in Exhibit 4/Tab 2/Schedule 2, page 9 Updated December 15, 2009 as \$102,000. In addition, the Finance Regulatory Affairs Manager was involved in the application preparation, and so the consultants would not have preformed all the tasks of the operations manager. Board staff has observed that in other distributor cost of service based rate applications one time consulting fees are typically in the \$50,000 range. Adding this amount to the manager's salary of \$102,000 results in just over \$150,000, indicating that the claim for consultants is still high. Board staff invites THI to address this in its Reply.

Board Staff submits that the application of the 5% Management Fee is inappropriate on regulatory costs. These costs are incremental. If under business as usual the 5% fee keeps the Town "whole", then Board staff submits that the rate payers should not be burdened with a windfall for the Town when there are incremental costs.

Management Fee

The MSA provides the means for the Town to collect a 5% Management Fee. While Board staff has little concern about the level, based on the evidence, it does have a concern about using a percentage fee instead of a flat fee.

Discussion and Submission

THI points out in response to Board staff Interrogatories 25 and 26 that the fees compare favourably with other utilities and generate approximately \$145,000 for the Town to cover the non-specified expenses it was designed to collect. According to THI in its response to Board staff Interrogatory 27, the current MSA expires on June 30, 2009 and the Town and THI are actively negotiating a new agreement.

However, it appears to Board staff that by levying 5% on everything, untoward windfalls arise, as demonstrated above. Board staff submits that it would be more appropriate to have a flat charge of \$145,000 and therefore submits that the revised agreement should dispense with the percentage fee and replace it with a flat fee.

Depreciation

Background

THI has documented its accumulated depreciation expense in E2/T2/S4 (and Attachment A), E2/T3/S6, and E4/T1/S2. In E2/T3/S5, THI states that it applies a 4% (25 year expected life) straight line depreciation/amortization rate, in accordance with the 2006 *Electricity Distribution Rate Handbook*. Board staff has summarized THI's actual and proposed annual depreciation expense below:

Year	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 Bridge	2009 Test
Depreciation Expense	\$ 284,258	\$ 384,320	\$ 409,940	\$ 440,419	\$ 462,589	\$ 491,357
Annual percentage change		35.2%	6.7%	7.4%	5.0%	6.2%

Source: Board staff IR #1

Discussion and Submission

Board staff observes that recent changes (since 2005) in THI's annual depreciation expense are directly relatable to rate base and capital additions. THI adheres to the Board's policy with respect to depreciation/amortization rates, as documented in Appendix B of the 2006 *Electricity Distribution Rate Handbook*. Board staff takes no issue with THI's methodology for the determination of the depreciation expense and proposed depreciation expense level.

Loss Adjustment Factors

Background

THI proposed a Total Loss Factor (TLF) for 2009 of 1.0388 based on an average of the historic TLFs for 2005 to 2007. In response to Board staff interrogatory #30, THI provided a revised set of historic TLFs for 2005 to 2007, but did not provide a revised proposed TLF for 2009. In their AIC, THI affirmed that based on a similar averaging methodology, the proposed TLF for 2009 is 1.0420. The dual sets of TLFs are tabulated below. The approved TLF for 2008 was 1.0422.

Historic TLFs and 3-year Average				
Year	2005	2006	2007	3-year Average
Application	1.0381	1.0391	1.0392	1.0388
Updated in Interrogatory Response	1.0427	1.0416	1.0417	1.0420

The underlying historic Distribution Loss Factors (DLF) and Supply Facilities Loss Factors (SFLF) provided in the interrogatory response are tabulated below. Board staff has included a column showing the 3-year average.

Historic DLF and SFLF Values				
Year	2005	2006	2007	3-year Average
DLF	1.0407	1.0388	1.0388	1.0394
SFLF	1.0019	1.0027	1.0028	1.0025

Board staff notes that the SFLF is quite different from the industry standard value of 1.0045 for distributors directly connected to the IESO grid.

Discussion and submission

Board staff submits that the 3-year average TLF of 1.0420 based on the average of the historic TLFs for 2005 to 2007 provided in the argument-in-chief is acceptable.

Payments in Lieu of Taxes (PILs): Calculation of PILs

Background

THI provided its proposed PILs allowance in E4/T3/S1 and E4/T3/S2. It stated that its proposed 2009 test year PILs expense is forecasted to be \$59K (grossed up for recovery to \$71K), compared to forecasted 2008 bridge years PILs expenses of \$81K and 2007 actual PILs of \$187K. Further explanation of PILs was provided in response to SEC IR #10 and Energy Probe IR #24.

Discussion and Submission

As with other areas, THI's PILs is affected in 2008 bridge and 2009 test years by recent changes in THI's rate base and operations. However, based on the record, Board staff takes no issue with the methodology by which THI has estimated its PILs allowance that should be recoverable in its 2009 distribution rates.

Board staff notes that other changes to THI's revenue requirement will be required, due to updating of the Cost of Capital parameters and the Board's decision on rate base, and capital and operating expenditures, and that these will have a flow-through effect of the PILs allowance that should be recoverable in rates. In addition, the recently-passed Federal Budget has provisions which may impact on a corporation's tax liability for 2009. Board staff submits that THI should flow through applicable changes and update the PILs allowance to determine the revenue requirement and rates resulting from the Board's Decision.

Smart Meters

Background

THI is not a distributor explicitly or implicitly named in regulation as being previously authorized to deploy smart meters. However, on June 25, 2008, the Government enacted O. Reg. 238/08 amending O. Reg. 427/06.

On October 22, 2008, the Board issued *Guideline G-2008-0002: Smart Meter Funding and Cost Recovery* (the "Smart Meter Guideline") to establish guideline policies and filing requirements on cost tracking and applications for cost recovery in light of the amended regulations.

THI has proposed to increase the smart meter funding adder, currently approved at \$0.26 per month per metered customer to \$1.00. THI has stated that it was becoming authorized under the amended regulation pursuant to and in compliance with the London Hydro RFP process, and intends to deploy smart meters in 2009.

THI is not seeking approval for capital and operating costs incurred to date or in 2009, but will track actual costs, and revenues received by way of the funding adder, in established deferral accounts for review and disposition in a subsequent application.

Discussion and Submission

Proposed smart meter funding adder of \$1.00

Through interrogatories¹, THI was requested to provide supporting documentation in accordance with section 1.4 of the Smart Meter Guideline. THI has not done so. While it has filed copies of certain correspondence received from the Fairness Commissioner, Board staff submits that this information is not definitive. THI has consistently stated that it will file the information when its plan is authorized by its Board of Directors, but has not done so to date.

In response to Board staff supplemental IR #43, THI stated that it is actively seeking approval from its Board of Directors and that all other required approvals and authorizations have been obtained.

Board staff submits that THI has not complied with the Board's Smart Meter Guideline to support an increase of the smart meter funding adder to \$1.00 per month per metered customer. The Smart Meter Guideline was issued in October 2008, more than seven months ago. Other distributors, whether filing Cost of Service or IRM applications, have been able to easily and adequately meet the filing requirements in support for an increase to \$1.00. THI has not provided adequate documentation on the record to show that it is authorized and is planning deployment activities beginning in 2009, as evidenced by several interrogatories posed by Board staff and intervenors in two rounds of discovery. Board staff submits that THI's explanation that it has not received authorization from its Board of Directors is inadequate.

In light of this, Board staff submits that the Board may wish to consider two options:

- Deny THI's request for the increased smart meter funding adder of \$1.00 per month per metered customer; or
- Approve the increase of the smart meter funding adder to \$1.00, but require that THI file necessary information.

Denying the increase to the smart meter funding adder would be a strict application of the Smart Meter Guideline, and be consistent with the Board's practice in other Cost of Service and IRM applications in 2008 and 2009. In other rate applications, the Board

¹ Responses to Board IR #7, 22 c), SEC IR #5, Energy Probe IR #13. See also responses to Board staff supplemental IR #43 and SEC supplemental IR #22.

approved the increased smart meter funding if there was a demonstrated and realistic expectation or maintained the existing funding adder in the absence of such evidence.

However, Board staff recognizes both the seed funding and rate mitigation purposes of the smart meter funding adder. Denying the increase could lead to delays in smart meter deployment by THI as it becomes authorized and could result in more significant rate increases in subsequent years as full deployment is achieved. Board staff submits that both outcomes are less than desirable.

Should the Board decide to approve the increased smart meter funding, Board staff submits that THI be required to file the requested information in compliance with the Smart Meter Guideline within a stated period (e.g. within 3 months from the Board's Decision). The increase in the smart meter funding adder could be made conditional upon filing adequate information in accordance with the Smart Meter Guideline.

Wide Area Network and ancillary equipment

THI is a virtual utility. Its physical assets consist of the poles, wires, conduit, transformers and the meters used for the physical distribution of electricity through its network to serve its customers. Other assets used to operate THI's distribution system, such as vehicles, office space and equipment and computer hardware and software, are owned by the Town. Recovery of the costs of these assets is reflected in the prices pursuant to the MSA.

In response to Board staff IR #2 a) i), THI stated that the Wide Area Network ("WAN") and other assets (collectors and repeaters) directly related to proper operation of smart meters will be purchased by the Town but owned by THI. In Board staff supplemental IR # 35, Board staff sought clarification of this statement. THI responded that the Town will purchase the equipment on behalf of THI pursuant to the MSA. THI will then make a one-time payment to the Town, and then include the assets in rate base and amortize the cost recovery over the expected life.

Board staff interprets THI's evidence as saying that, ultimately, THI is the end purchaser and owner of the WAN and ancillary equipment necessary to operationalize smart meter technology. Staff, however, is concerned that purchasing these assets first through the Town, pursuant to the MSA, will result in the Town applying its standard 5% Management Fee. In Board staff's submission, the purchase price with the vendor is the

appropriate market price for the WAN and ancillary smart meter-related equipment, and applying a 5% overhead would increase the cost borne ultimately by ratepayers. Board staff also fails to see what “added value” is provided by the Town through this two-step process, for these THI assets directly related to the smart meter-enabled distribution network, keeping in mind THI’s explanation of the justification of the 5% Management Fee as documented in VECC supplemental IR # 14 e).

Board staff notes that these costs related to smart meters are being recorded in the established deferral accounts 1555 and 1556, and do not affect THI’s proposed distribution rates for 2009. However, Board staff submits that smart meter capital costs recorded for disposition in a subsequent application, for assets owned or to be owned by THI as part of its distribution rate base should not incorporate any mark-up over the third-party vendor prices.

Deferral and Variance Accounts

Background

THI is requesting only the disposition of the following Deferral and Variance accounts:

- 1508 - Other Regulatory Assets;
- 1525 – Miscellaneous Deferred Debits; and
- 2425 – Other Deferred Credits.

This encompasses disposal of \$157,402 which includes the December 31, 2007 balance plus interest up to April 30, 2009. THI provided associated rate riders proposed to be in effect for two years. In their AIC, THI provided an updated set of rate riders. Both sets are provided in the table below.

Deferral and Variance Account Rate Riders Disposition of account 1508, 1525 and 2425							
	Residential (\$/kWh)	GS<50kW (\$/kWh)	GS>50kW< 500kW (\$/kW)	Street Lighting (\$/kW)	USL (\$/kWh)	GS>500kW <1500kW (\$/kW)	GS>1500k W (\$/kW)
Application	0.0012	0.0003	0.0327	0.1564	0.0009	0.0364	0.0167
Argument- in-chief	0.0012	0.0004	0.0327	0.1585	0.0009	0.0468	0.0173

Board staff notes that award amounts totalling \$52,500 attributable to LRAM and SSM awards have been included in account 2425. Board staff further notes that in other distributors’ applications LRAM and SSM amounts are accounted for through a separate

rate rider and not included with the rate riders associated with the disposition of deferral and variance accounts.

In response to Board staff interrogatory #49 parts (c) and (p), THI provided information on a selected group of its deferral and variance accounts (1505, 1525, 2425, 1580, 1582, 1584, 1586, 1588, 1590) that have account balances as of December 31, 2007. With respect to RSVA accounts 1580, 1582, 1584, 1586, 1588, Board staff wishes to confirm if the disposal amounts provided in the interrogatory response (shown in the table below) include the December 31, 2007 balance plus interest up to April 30, 2009.

Disposal Amounts related to RSVA accounts	
Account	Amount to be disposed
1580	(\$415,458)
1582	\$161
1584	(\$130,076)
1586	(\$10,245)
1588	(\$469,188)

The total disposal amount is (\$824,169) and the associated rate riders for respectively two and three years are provided in the table below.

Deferral and Variance Account Rate Riders							
Disposition of account 1505, 1525, 2425, 1580, 1582, 1584, 1586, 1588, 1590							
Recovery Period	Residential (\$/kWh)	GS<50kW (\$/kWh)	GS>50kW<500kW (\$/kW)	Street Lighting (\$/kW)	USL (\$/kWh)	GS>500kW <1500kW (\$/kW)	GS>1500kW (\$/kW)
2 years	(\$0.0014)	(\$0.0024)	(\$0.9331)	(\$0.8074)	(\$0.0018)	(\$1.2521)	(\$1.4457)
3 years	(\$0.0009)	(\$0.0016)	(\$0.6221)	(\$0.5383)	(\$0.0012)	(\$0.8348)	(\$0.9638)

Board staff notes that a separate initiative that the Board will undertake for the disposition of commodity account 1588 (RSVA power) and other related RSVAs has not yet been finalized. In this regard however, Board Staff Discussion Paper “Electricity Distributors’ Deferral and Variance Account Review Initiative” (EB-2008-0046) issued on April 1, 2009, proposes that distributors be required to file an application to dispose of all account balances (with a few exceptions such as PILs, CDM, smart meters and account 1590) as part of their cost-of-service application.

Discussion and submission

Board staff invites THI to confirm that the rate riders provided in its AIC replace those provided in the application. Board staff further invites THI to isolate the amounts attributable to LRAM and SSM awards from account 2425, re-calculate and provide:

- rate riders required to dispose of deferral and variance accounts, and
- separate rate riders (appropriate to the rate classes that benefited from the programs) required to recover amounts attributable to LRAM and SSM awards.

In isolating the LRAM and SSM claim, Board staff submits that THI should provide the detailed calculations of the application of interest to the LRAM/SSM savings that are being claimed, with detailed explanations of the application of the interest to the balances. A detailed reconciliation of this amount to the calculation of the remaining balances in Account 2425 – Other Deferred Credits should also be provided to clarify the record.

Board staff notes that the RSVA Power account 1588 comprises Cost of Power and the Global Adjustment sub-account and further that the Cost of Power balance is attributable to all customers, whereas the Global Adjustment balance is attributable to only non-RPP customers. In this regard, Board staff invites THI to provide:

- the closing balances corresponding to RSVA - Cost of Power account (excluding the global adjustment balance) and the Global Adjustment sub-account, and
- updated rate riders to reflect the allocation treatment discussed above (i.e. Cost of Power balance is attributable to all customers, whereas the Global Adjustment balance is attributable to only non-RPP customers). As a simplifying methodology, Board staff suggests that GS 50 – 499 kW, GS 500kW – 1,499 kW and GS>1500 kW rate classes be considered to comprise non-RPP customers, and the other rate classes be considered to comprise RPP customers.

Despite the fact that THI has requested disposition only of accounts 1508, 1525 and 2425, Board staff submits that, notwithstanding the fact that the staff proposal mentioned above is not yet confirmed Board policy, the Board should order the disposition of all of the above stated deferral and variance account balances that have account balances as of December 31, 2007. Board staff submits that a three-year recovery period to mitigate the impact of disposition is reasonable.

Cost of Capital and Capital Structure

Background

The Cost of Capital pertains to cost to compensate investors and lenders for the monies provided to fund the assets that the firm uses to produce the goods and services to its customers. It compensates for the opportunity cost for the time that the money is invested until recovery as well as relating to risk of recovering their investments, based on the business risk of the firm in its market(s) relative to the risks of investing elsewhere. The Cost of Capital relates to the return on the rate base of the regulated firm. There are several parameters that comprise the cost of capital for the Board's rate-making purposes:

- 1) Capital structure (the proportion of rate base financing through debt (long- or short-term) or equity (common shares or preferred shares);
- 2) Long-term debt rate;
- 3) Short-term debt rate;
- 4) Return on Equity ("ROE"); and
- 5) Return on preferred shares.

These components combine together to determine the weighted average cost of capital ("WACC"). Multiplied by the rate base, this produces the net income, relating to the expected profitability of the firm, and also influences directly the tax or PILs expense borne by the firm and to be recovered in rates.

The Board has documented its guideline Cost of Capital methodology in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Board Report"), issued December 20, 2006. The Board Report is a guideline, but departures from the methodology in the Board Report are expected to be adequately supported.

In Section 6 of its Application, THI has proposed its requested Cost of Capital. This is summarized in the following table.

Cost of Capital Parameter	THI's Proposal
Capital Structure	56.7% debt (composed of 52.7% long-term debt and 4.0% short-term debt) and 43.3% equity
Short-Term Debt	4.47%, but to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	6.10%, corresponding to the Board's deemed long-term debt rate for 2008. However, this would be updated with the deemed long-term debt rate based on January 2009 Bank of Canada, TSX, and Consensus Forecasts data.
Return on Equity	8.57%, but to be updated in accordance with the methodology documented in Appendix B of the Board Report.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	7.06% as proposed, but subject to change due to updates to the Cost of Capital parameters per the Board Report, at the time of the Board's Decision. THI's updates to its actual and forecasted long-term debt also affects the WACC.

As noted, THI has affirmed that the deemed Short-term and Long-term Debt Rates and the ROE would be updated based on Bank of Canada, *Consensus Forecasts*, and TSX data for January 2009 in accordance with the methodologies documented in the Board Report.

On February 24, 2009, the Board issued a letter to all distributors announcing the updated Cost of Capital parameters to be used for rate-setting in 2009 Cost of Service electricity distribution rate applications. These updated parameters are:

Return on Equity:	8.01%
Deemed Long-term Debt Rate:	7.62%
Deemed Short-term Debt Rate:	1.33%

In responses to SEC IR #15, THI indicated that it would update its cost of capital to correspond to the updated parameters.

Discussion and Submission

Board staff observes that THI is a virtual utility and is 100% equity financed by the Town. This may not be the most efficient means of structuring the capital financing of the utility. However, THI has, in the past and proposes to use in the current proceeding, the deemed capital structure established by the Board for rate-setting purposes. Also, Board staff considers that the increased equity financing – essentially under-leveraging – does not, based on the evidence, pose a financial risk to the utility.

As noted by THI in its application, and supported by Notes to Audited Financial Statements, THI does not have any history of debt financing. In the absence of any other information, application of the guidelines in the Board Report would suggest that the updated deemed long-term debt rate of 7.62% would apply.

Board staff has summarized THI's weighted average cost of capital, based on the updated cost of capital parameters in the following table.

Component	Capitalization (%)	Rate (%)	
Long-term Debt	52.70%	7.62%	4.02%
Short-term Debt	4%	1.33%	0.05%
Total Debt	56.70%	7.18%	4.07%
Common Equity	43.30%	8.01%	3.47%
Preferred Shares	0%		0.00%
Total Equity	43.30%	8.01%	3.47%
Total	100.00%	7.54%	7.54%

Board staff submits that THI's proposal for Cost of Capital complies with the guidelines documented in the Board Report.

Cost Allocation and Rate Design

Revenue to Cost Ratios

THI's proposed resulting revenue to cost ratios for each rate class for 2009 as shown on page 2 of Appendix C.6 of its AIC are shown in the table below. The table also shows revenue to cost ratios per the updated informational filing, the updated informational filing as shown in the AIC, the Board policy range and the halfway point to the nearest policy target.

Rate Class	Revenue to Cost Ratio				
	Updated Informational Filing	Updated Informational Filing as shown in AIC	Proposed 2009 as shown in AIC	Halfway point to policy target	Board Policy Range
Residential	123.47%	124%	118%	120%	85% - 115%
GS < 50 kW	115.14%	111%	108%		80% - 120%
GS 50–499 kW	63.35%	59%	70%	70%	80% - 180%
GS 500–1,499 kW	59.80%	54%	62%	67%	80% - 180%
GS 1,500-5,000 kW	33.39%	35%	57%	57%	80% - 180%
Street Lights	348.85%	317%	218%	218%	70% - 120%
USL + Sentinel	75.35%	75%	85%		80% - 120%
GS 500-5,000 kW	42.59%				80% - 180%
Sentinel Lighting	130.28				70% - 120%
USL	78.24				80% - 120%

The proposed resulting revenue to cost ratios for all rate classes except GS<50 kW and USL+Sentinel are outside the Board policy range. The resulting ratios for the GS 50 – 499 kW, GS 1,500 – 5,000 kW and Street Light classes have moved towards the range by half of the difference between the updated informational filing value from the AIC and the low/high end of the Board’s range ratios. The ratio for the Residential rate class has moved more than halfway. The resulting ratio for the GS 500 – 1,499 kW has moved by less than half.

Discussion and submission

As noted in EP Interrogatory 40, the levels of the revenue to cost ratio for the Street Lights at 342% are significantly higher than the ratios of other distributors. Board staff notes that all other distributors that have had their rates based on a cost of service review in 2008 and 2009 have these ratios significantly less than 100% (typically less than 30%). THI’s response indicates that it reran the model based on the suggestions of EP and provided the results of that analysis, which Board staff understands to significantly reduce the revenue to cost ratio. Therefore while the level of the ratio appears to be abnormally high, based on the revised analysis, Board staff submits that the proposed rates seem reasonable. Board staff invites THI to either confirm our understanding or provide a clearer explanation of the situation.

On page 11 of its AIC, THI provides its rationale for the resulting revenue to cost ratios. Board staff supports THI's proposal to reduce cross-subsidization among the rate classes by re-aligning the revenue-to-cost ratios in accordance with the Board's policy. The schedule for the implementation of the changes in the ratios has been set out in previous decisions for other distributors and Board staff submits that such a schedule is desirable in this application with a possible exception to accommodate any mitigation to address a high bill impact. Board staff assumes that this may explain the resulting ratio for the GS 500 – 1,499 kW class, and would invite THI to confirm this.

Monthly Fixed Charges

In determining the basis for the revenue to be recovered through the monthly fixed charges, THI has stated in its AIC that it "proposes to charge the maximum fixed monthly charge permitted by Board policy". It goes on to justify the levels of the fixed charge "to promote rate stability for most customer classes and not unduly increase its risk that it will not recover the authorized revenue requirement".

Discussion and submission

Board staff assumes that THI's reference to "Board policy" on this matter is the Report of the Board entitled "Application of Cost Allocation for Electricity Distributors" issued on November 28, 2007. Section 4.2.2 of that Report discusses the upper bound for the Monthly Service Charge and includes the following:

"The Methodology set a ceiling for the MSC based on the avoided costs plus the allocated customer costs. The Discussion Paper proposed that the ceiling for the MSC be 120% of this level. Some participants believed that the results of the sensitivity analysis were not an appropriate basis for setting an upper bound.

The Board considers it to be inappropriate to make significant changes to the ceiling for the MSC at this time, given the number of issues that remain to be examined. The appropriateness of the methodologies cited above, used to set the MSC is an issue that will be examined within the scope of the Rate Review. The Rate Review will also examine the role of rate design in achieving various objectives, including conservation of energy. Both of these undertakings will have determinative impacts on the fixed/variable ratio policy.

In the interim, the Board does not expect distributors to make changes to the MSC that result in a charge that is greater than the ceiling as defined in the Methodology for the MSC. Distributors that are currently above this value are not required to make changes to their current MSC to bring it to or below this level at this time.”

Board staff notes that this Report did not establish an upper bound or maximum level of fixed charge, but merely identified that additional review is required to examine this matter. Therefore, Board staff submits that there is no “Board policy” on which THI can justify the changes it proposes to the levels of the monthly service charges. Board staff admits, however, that there is nothing in the Report that prohibits a distributor from increasing its monthly service charges to levels that correspond to a methodology suggested in a previous Staff Discussion Paper, as it appears that THI has proposed.

Board staff submits that the rationale for the approval of the proposed changes comes down to THI’s last part of its justification; namely, the mitigation of the risks associated with recovering part of the revenue through the variable component versus the more certain recovery of some part of the revenue through the fixed component.

Volumetric rates

Board staff notes that the 2009 test year revenue requirement provided in the AIC (\$3,240,000) is lower than what was provided in the application (\$3,325,000). Board staff further notes that the volumetric rates provided by THI in its AIC are higher than what was provided in the application in all cases except for the GS 500–1,499 kW rate class. The two sets of rates are shown in the table below.

Rate Class	Volumetric rates per Application	Volumetric rates per Argument-in-chief
Residential	\$0.0188/kWh	\$0.0203/kWh
GS < 50 kW	\$0.0147/kWh	\$0.0148/kWh
GS 50–499 kW	\$1.8687/kW	\$1.9763/kW
GS 500–1,499 kW	\$2.4238/kW	\$2.4209/kW
GS 1500-5000 kW	\$1.5564/kW	\$1.8983/kW
Street Lights	\$3.0283/kW	\$4.1125/kW
USL + Sentinel	\$0.0026/kWh	\$0.0027/kWh

Discussion and submission

Board staff's calculation of the revenue generated using the volumetric rates provided in the AIC and the volumes provided in the application indicates that the revenue generated exceeds the revenue requirement by approximately \$168,000. Board staff invites THI to provide a detailed calculation of revenue generated from its proposed rates and demonstrate its correlation with the revenue requirement. Board staff also invites THI to provide an explanation and justification as to why the rates have changed between its application and its AIC.

Reclassification of rate classes

THI proposes to partition its existing GS 500 – 4,999 kW rate class into GS 500 – 1,499 kW and GS 1,500 – 5,000 kW rate classes to overcome an existing intra-class subsidy and to improve the homogeneity of its customer classes. THI also proposes to eliminate its Sentinel Lighting rate class by merging it with the existing Unmetered Scattered Load (USL) rate class. As a result, the billing determinant for the Sentinel Lighting accounts will be changed from kW to kWh. A comparison between the existing 2008 and the proposed 2009 rates is provided in the following table.

Rate Class	2008 Monthly Service Charge	2009 Monthly Service Charge	2008 Distribution Volumetric Rate	2009 Distribution Volumetric Rate
GS 500–1,499 kW		\$751.00		\$1.8983/kW
GS 1,500-5,000 kW		\$1,151.00		\$2.2409/kW
GS 500-5000 kW	\$1,158.42		\$0.4773/kW	
Sentinel Lighting	\$1.18		\$7.3155/kW	
USL	\$12.38		\$0.0100/kWh	
USL + Sentinel		\$20.00		\$0.0027/kWh

Discussion and submission

With respect to the partitioning of the GS 500 – 4,999 kW rate class into GS 500 – 1,499 kW and GS 1,500 – 5,000 kW rate classes, Board staff supports the proposal, but notes that the AIC indicates total bill increases from 2008 to 2009 exceeding 10% for the both newly created rate classes, particularly the latter.

Board staff submits that these increases are triggered by a combination of:

- the revenue to cost ratios moving from the original 43% to respectively 70% and 62%; and
- an increase in the volumetric rate from 2008 to 2009 as shown in the table.

Board staff invites THI to confirm the above and comment with respect to the resulting bill impacts.

With respect to the merger of the Sentinel Lighting and USL rate classes into a single rate class, Board staff notes that the justification for combining these two classes appears to be that they both are unmetered and the classes are relatively small. Board staff is concerned that the load profile of the current USL and the current Sentinel Lighting connections could be significantly different. Also going from a per kW to a per kWh billing determinant for the Sentinel Lighting accounts, the basis the estimation of the kWh usage is not explained.

Board staff notes that the AIC indicates a total bill increase from 2008 to 2009 for the USL rate class to be 10.4%. It appears that this increase is triggered by the increase in the monthly service charge from 2008 to 2009 as shown in the table.

Board staff invites THI to provide an explanation of the estimated consumption it will use for the Sentinel Lights and bill impact analysis for the current Sentinel Lighting rate class resulting from its merger with the USL rate class. Board staff further suggests that THI clarify whether the monthly service charge in the new USL + Sentinel rate class is on a per connection basis or on a per customer basis.

Standby Service Rate

THI makes reference to a proposed Standby Service rate in its original application and its AIC.

Discussion and submission

Board staff notes that currently THI does not have an approved Standby Service rate and could not find any supporting material in the evidence regarding a proposed Standby

Service rate. Board staff invites THI to indicate where in its evidence it has provided the details on the proposed standby rate.

Transformer Ownership Allowance

THI has applied to continue its currently approved allowance of \$0.60 per kW for those customers in the General Service classes that provide their own transformation. The costs associated with this allowance have been allocated to reflect the current Board treatment that has been used in other distributor's applications.

Discussion and submission

Board staff submits that the approach taken and the resulting allocations appear to be reasonable.

Retail Transmission Service Rates

In a decision rendered on March 14, 2008, for the 2008 rates, the Board directed THI to decrease its retail transmission network service rates and line and transformation connection service rates by 18% and 5% respectively. This was against a backdrop of an 18% decrease and 5% decrease respectively in the uniform transmission rates for Ontario transmitters effective November 1, 2007. Hence, THI's decrease of these rates was in concert with the wholesale decrease.

In its 2009 application, THI has proposed an increase of approximately 11.3% in the network rates and an increase of approximately 5.5% in the connection rates, both in concert with the increase in the uniform transmission rates for Ontario transmitters effective January 1, 2009.

In response to Board staff interrogatory #34, TH provided monthly balances for 2006 and 2007 in its deferral accounts related to retail transmission network charge (#1584) and retail transmission connection charge (#1586). The balances in both accounts have fluctuated over the two year period.

Discussion and submission

In the absence of deferral account balances for 2008 related to accounts #1584 and #1586, Board staff submits that THI's proposed increase related to the network and connection rates in concert with the increase in the uniform transmission rates for Ontario transmitters effective January 1, 2009 is acceptable.

Specific Service Charges

THI has proposed to continue with all of its currently approved Specific Service Charges.

Discussion and submission

Board staff submits that these charges are reasonable.

Rate Mitigation

In its AIC, THI states the following:

"THI proposes to adjust rates so that over a two year period all its rates achieve Revenue:Cost ratios consistent with the Board approved ranges as per established Board practice. THI acknowledges that for some customer classes this adjustment, independent of the proposed recovery of the claimed revenue deficiency, will result in large rate changes. This is further exacerbated for the customer classes that are eligible for Transformer Ownership Allowance; previously, THI's General Service 500 – 4,999 kW variable distribution rates were less than the authorized Transformer Ownership Allowance. THI's proposed recovery of its computed 2009 Test Year gross revenue deficiency in combination with changes to move this customer class towards the lower end of the Board's authorized Revenue:Cost ratio results in a significant bill impact.

THI did not propose to mitigate rates further out of concern for the associated undesirable consequences to other customer classes that would be required so that THI could recover its proposed 2009 Test Year revenue requirement. THI notes that its distribution rates have chronically under earned versus the Board authorized maximum Allowed Rate of Return. THI submits that its customers have enjoyed rate mitigation in those years when THI incurred the ongoing costs

to provide an appropriate quality of service and its shareholder was not afforded an opportunity to earn a fair rate of return on invested capital.”

Discussion and submission

Typically, in rate applications before the Board, a resultant bill impact greater than 10% has caused the Board to consider the need for a rate mitigation aspect to its decision on just and reasonable rates. As noted above, for the reasons stated, THI does not propose to include any specific rate mitigation measures. Board staff acknowledges the conflict between establishing the appropriate cost allocation and rate design amongst the rate classes and the impacts that causes while at the same time allowing the distributor to recover its determined revenue requirement and trying to keep the resulting bill impacts within a 10% level. The question becomes which criterion dominates.

Board staff submits that there can be no fixed answer and that it must be addressed on a case by case basis. In this particular application, Board staff submits that the desire for revisions to the cost allocation and the rate design proposals ought to be considered above the resultant bill impact threshold issue and that subject to an examination of the requested impacts to the former Sentinel Lighting accounts, there is no need to introduce specific rate mitigation measures. While this will result in bill impacts greater than 10%, it appears that THI is prepared to accept the consequences and any resultant customer questions.

Summary

THI filed its AIC on May 15, 2009. At the conclusion of that document, THI provided a list of specific approvals it requested that were in addition to the determination of the total revenue requirement. In reference to those specific approvals requested, Board staff submits the following summary:

- Establish General Service >500 kW, <1,500 kW and General Service >1,500 kW customer classes. Board staff supports this re-classification.
- Eliminate its existing General Service 500 – 4,999 kW customer class. Board staff supports this re-classification.
- Include the customers in THI’s existing Sentinel Lighting customer class into its Unmetered Scattered Load customer class and to eliminate the Sentinel Lighting

customer class. Subject to the requested further explanations and bill impacts, Board staff supports this re-classification.

- Charge revised distribution rates, both fixed in the period and varying based on the level of service. In general, Board staff supports this request.
- Charge rate riders that recover the balances recorded in certain variance and deferral accounts as of December 31, 2007 and the associated carrying charges as of April 30, 2009 and to recover THI's Lost Revenue Adjustment Mechanism and Shared Savings Mechanism awards. In general, Board staff supports this request, but has submitted an alternative option.
- Charge a revised Smart Meter Rate Adder. See the submission in the previous Smart Meter section, but conditional upon THI complying with section 1.4 of the Smart Meter Guideline. In the alternative, the Board may consider retaining the existing smart meter funding adder.
- Charge a rate rider to recover the full 2009 revenue deficiency since rates will not be approved until after May 1, 2009. Board staff supports the approach to apply a rate rider, probably in effect until April 30, 2010, to recover the incremental foregone distribution revenue for the period from May 1, 2009 to the implementation date as a result of billing the customers at the current rates.
- Apply its proposed method for charging for the provision of Standby service. Board staff can find no evidence in the application relating to this issue and therefore submit it should be denied.
- Apply revised distribution loss factors. Board staff supports level of the TLF value as proposed.

All of which is respectfully submitted