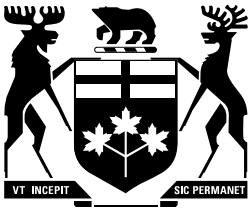

ONTARIO ENERGY BOARD

STAFF SUBMISSION

CANADIAN NIAGARA POWER INC. – EASTERN ONTARIO POWER (EB-2008-0222)

AND

CANADIAN NIAGARA POWER INC. – FORT ERIE (EB-2008-0222)

2009 ELECTRICITY DISTRIBUTION RATES

May 29, 2009

Introduction

Canadian Niagara Power Inc. (CNPI or the Applicant) is an Ontario corporation and is a wholly-owned subsidiary of FortisOntario Inc. Among other things, the applicant carries on the business of owning and operating electricity distribution facilities within Ontario. It carries on its distribution business in the following three territories; Fort Erie, Port Colborne and Gananoque.

CNPI submitted simultaneously a separate rate application for each of these service territories and the Board gave them file numbers as follows:

- CNPI – Eastern Ontario Power (Gananoque) EB-2008-0222,
- CNPI – Fort Erie EB-2008-0223, and
- CNPI – Port Colborne EB-2008-0224.

While the applications are separate, because they have been prepared by CNPI, contain some common elements and the intervenors are the same, the Board decided to deal with all three applications at the same time. However, as the evidentiary phase for the CNPI – Port Colborne application has not concluded, this submission will pertain to only the CNPI – Eastern Ontario Power (CNPI – EOP) and CNPI – Fort Erie (CNPI – FE) applications. The Board staff submission for the CNPI – Port Colborne application will be made at a later date.

The intervenors of record for all three applications include: the Association of Major Power Consumers in Ontario ("AMPCO"), Energy Probe Research Foundation ("EP"), the School Energy Coalition ("SEC") and the Vulnerable Energy Consumers Coalition ("VECC"). AMPCO has not been an active participant in the review of the application.

CNPI – EOP supplies electricity to approximately 3,650 customers (3,100 residential (85%), 415 energy billed General Service (11%), 35 demand billed General Service (1%), and 100 other (USL, Sentinel Lighting and Street Lighting)). Its service territory includes the Town of Gananoque and some parts of the Township of Leeds and the Thousand Islands, of the Township of Frontenac Islands and of the City of Kingston.

CNPI – Ft. Erie supplies electricity to approximately 16,000 customers (13,750 residential (86%), 1,150 energy billed General Service (7%), 135 demand billed General Service (1%), 110 USL (1%), 862 Sentinel Lighting accounts (5%) and Street Lighting (1

customer with 3,000 lights). Its service territory includes the Town of Fort Erie as of December 31, 1990 as per the *Regional Municipality of Niagara Act* and a customer in Niagara Falls.

The Applications

The CNPI – EOP application is seeking approval of $2,359,739 as the 2009 revenue requirement it requires to provide electricity distribution services. On an equivalent basis, this compares with a Board-approved level of $1,909,143 for 2006 (a 23.6% increase), 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 IRM process.

The application also seeks approval to eliminate the current General Service 50 to 4,999 kW – Time of Use class, in accordance with a previous Board decision (EB-2007-0594), and to re-classify any customers in that class to the General Service 50 to 4,999 kW class.

The CNPI – FE application is seeking approval of $9,827,418 as the 2009 revenue requirement it requires to provide electricity distribution services. On an equivalent basis, this compares with a Board-approved level of $8,386,930 for 2006 (a 17.2% increase), 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 IRM process.

Both applications also include a proposed harmonization of rates for the CNPI – FE and the CNPI – EOP service areas with the exception of certain aspects that are specific to each service area, such as loss adjustment factors, transmission service rates and low voltage costs recovery.

The evidentiary phase of these two applications concluded at the end of the oral hearing on April 23, 2009 and the filing of undertakings on April 30, 2009.

CNPI filed an Argument-in-Chief (AIC) on these two applications on May 14, 2009.

Outstanding Issues from Previous Board Decisions For CNPI – EOP

2006 Rate Application (RP-2005-0020/EB-2005-0346)

Corporate and Shared Costs Allocation Study

CNPI – EOP applied to reflect the outcome of a study that allocates corporate and shared costs within its cost of service. At that time the Board accepted the resulting cost consequences for the determination of the 2006 revenue requirement and resulting rates. The Decision went on to state that "the study has not been sufficiently tested in this hearing for the Board to endorse its methodology beyond accepting the cost consequences for setting 2006 rates". This matter is included in this 2009 rate application.

General Service Rates

CNPI – EOP applied to change the name of the GS> 50 TOU class to GS> 50 Legacy and close the class to new customers. The decision noted that the proposed Legacy rate is more advantageous for a customer with higher demands. The Board was concerned that by closing the rate there may be customers with similar load characteristics to those in the class that would not have access to the rate. For that reason the request to close the class was denied.

However, the Board accepted the rate levels for the GS> 50 TOU class on a temporary basis and directed the applicant "to develop a rate design proposal, within 90 days of the issuance of the Decision, for a revised general service rate that treats all qualifying customers fairly and equally, based on load characteristics".

2007 Rate Application (EB-2007-0594)

Elimination of TOU General Service rates

On July 27, 2006, CNPI – EOP submitted its rate design proposal in accordance with the April 28, 2006 order. However, in light of certain economic developments in its service area, CNPI – EOP withdrew its proposal on September 6, 2006 and stated that it will file a more comprehensive proposal in the 4th quarter of 2006.

The Board noted that no revised proposal had been filed and that it applied to continue both its TOU and conventional GS >50 kW classes for its 2007 IRM adjustment.

On March 5, 2007, CNPI – EOP filed a clarification letter with the Board providing an update on the status of the rate design proposal. In that communication, it notified the Board that two of the six consumers in the TOU class had disappeared, a third indicated that it would cease operations by early 2007 and a fourth may follow suit. The Applicant requested additional time to re-evaluate its approach to the elimination of the TOU class. The Applicant explained that rather than impair the Board's IRM process, it elected to proceed with its 2007 application based on the 2006 EDR decision including maintaining the temporary TOU class.

In light of the information submitted by CNPI - EOP regarding the changing economic conditions in its service territory, the Board found that CNPI – EOP's request to extend the period for filing a revised rate design proposal reasonable. The Board therefore allowed CNPI – EOP to temporarily maintain the TOU rate class as revised by the IRM adjustments approved in the 2007 rate decision.

The Board stated that it will expect CNPI – EOP to file a revised rate design proposal as part of its next cost of service application. The proposal should conform to the conditions and specifications outlined in the April 28, 2006 decision. This matter is included in this 2009 rate application.

For CNPI – FE

2006 Rate Application (RP-2005-0020/EB-2005-0344)

Corporate and Shared Costs Allocation Study

In the same way as with CNPI – EOP, as part of its 2006 application, CNPI – Ft. Erie applied to reflect the outcome of a study that allocates corporate and shared costs within its cost of service. At that time the Board accepted the resulting cost consequences for the determination of the 2006 revenue requirement and resulting rates. The Decision went on to state that "the study has not been sufficiently tested in this hearing for the Board to endorse its methodology beyond accepting the cost consequences for setting 2006 rates". This matter is included in this 2009 rate application.

2007 Rate Application (EB-2007-0514)

Except for the review of storm damage that was dealt with as part of a combined hearing that subsequently approved the recovery of those costs through rate riders effective September 2007 through August 31, 2009, the applicant's 2007 rate application had no outstanding issues.

General

This submission reflects observations and concerns which arise from Board staff's review of the pre-filed evidence, both rounds of interrogatory responses, the material included as part of the Technical Conference, the Oral Hearing and the applicant's AIC. It is intended to assist the Board in evaluating these applications and in setting just and reasonable rates.

Rate Base

Background

CNPI has documented its rate base in E2/T1/S1 in each application. In its AIC, CNPI has documented the rate base and component parts (average in-service Net Fixed Assets and Working Capital Allowance ("WCA")). In the AIC, CNPI has summarized the Rate Base for CNPI – FE in Table 3-1.[1] CNPI is proposing a 2009 Rate Base $37,463,907, consisting of $34,159,409 for average net fixed assets and a WCA of $3,844,883.

Similarly, CNPI has summarized, in the AIC, the Rate Base for CNPI – EOP in Table 3-3.[2] CNPI is proposing a 2009 Rate Base of $7,756,830, consisting of $6,908,041 for average net fixed assets and a WCA of $848,789.

Numerous interrogatories were posed by Board staff and intervenors to better understand CNPI's recent and proposed capital projects for each of the service areas. As was documented in the applications, and explored through interrogatories and the oral hearing, CNPI has different legacy systems in the three service areas, and must

[1] CNPI Argument-in-Chief, page 11, May 14, 2009
[2] *ibid.*, page 12, May 14, 2009

address and prioritize projects to ensure effective and efficient electricity distribution service in each service territory.

In CNPI – FE, CNPI has noted that its legacy network design is based on a different engineering architecture that is common in New York but not used elsewhere in Ontario. CNPI is upgrading its network to be more compatible with engineering standards used throughout Ontario. Such upgrading will allow CNPI to improve losses and reliability; further adoption of Ontario standards will ensure access to components for builds and replacements.

Fort Erie is also CNPI's "home" territory, and where central office functions are performed. It also serves as the operations centre for operations in the contiguous Port Colborne service area.

In CNPI – EOP, CNPI acquired a system that it now finds necessary to upgrade. Limited capacity put reliable supply in various parts of the service area at risk. CNPI has also documented that there is no SCADA system. The legacy engineering design of CNPI – EOP is also uncommon (now) in Ontario, and CNPI has undertaken capital projects for a new Main substation and infrastructure upgrading to improve both network efficiency and system reliability. SCADA capability is built into new infrastructure.

Discussion and Submission

CNPI is proposing increases to capital expenditures to rehabilitate parts of its network. Board staff submits that CNPI has adequately supported its recent historical and proposed rate base, including capital projects discussed below, with respect to a need for, prioritization and prudence of the rate base in each of the CNPI – FE and CNPI – EOP applications. As such, Board staff takes no issue with CNPI's proposed rate base for these two service area applications.

2009 Capital Expenditures

Background

CNPI has documented its capital expenditures in E2/T3/S2 and provided further explanation of capital projects in E2/T3/S3 in each application. Clarification of certain

capital expenditures was sought through interrogatory responses by Board staff and intervenors. In its AIC, CNPI has summarized the capital expenditures in each of the service areas. Board staff has reproduced these in combined form below:

Capital Expenditures (excluding Smart Meters)[3]

	2006 Actual	2007 Actual	2008 Bridge	2009 Test
CNPI – FE	$3,949,000	$4,501,000	$4,139,000	$4,110,000
CNPI – EOP	$264,000	$2,798,000	$967,000	$868,000

Discussion and Submission

As discussed under Rate Base above, CNPI's capital projects were explored through interrogatories and during the oral hearing, in addition to the evidence documented in the applications. CNPI has different capital projects in the different service areas, which are necessitated by the different legacy systems and associated matters. Based on the evidence on the record, Board staff considers that CNPI has supported the need for, prioritization and prudence of its capital projects in each of the CNPI – FE and CNPI – EOP applications. As a result, Board staff does not take issue with CNPI's proposed capital expenditures for 2009 in each of the service areas.

Asset Management

Background

CNPI provided documentation on its current Asset Management process in E2/T1/S1/Appendix D. Board staff also considers that CNPI's Information Technology Capital Strategy documented in E2/T1/S1/Appendix C as being directly related to CNPI's asset management strategy.

Discussion and Submission

Board staff views the above documentation on CNPI's Asset Management approach as useful evidence with respect to CNPI's processes. As noted elsewhere in this submission, Board takes no issue generally with CNPI's proposals for its rate base and capital and operating expenditures in these applications. Board staff considers that CNPI has taken into account customer expectations, service reliability, safety and productivity

[3] *ibid.*, Table 3-2, page 11 and Table 3-4, page 13

improvements, and has justified the need for, priorities and prudence of capital projects in recent years and for the test year. However, Board staff submits that more formal asset management practices, undertaken with regard to CNPI's needs and capabilities, would be beneficial. CNPI should be encouraged to undertake and provide improved documentation on asset condition and Asset Management in its next Cost of Service rates application.

Working Capital Allowance

Background

CNPI provided its proposed WCA and derivation in E2/T4/S1 and E2/T4/S2 in each application. As noted above, under Rate Base, CNPI has proposed a WCA of $3,844,883 for CNPI – FE and $848,789 for CNPI – EOP. CNPI has used the standard methodology of calculating the WCA as 15% of the sum of controllable expenses and the cost of power. CNPI has documented that the WCA differs for all three of the service area applications depending on circumstances. For example, CNPI – FE is not embedded to Hydro One Networks, and so LV charges do not factor into the determination of its WCA. CNPI has noted that it used the RPP price of $0.0545/kWh from the April 11, 2008 Regulated Price Plan Report of the Board to proxy the commodity price, and used RTS and Wholesale Market Charges from the Board's April 21, 2008 Rate Order, in determining the Cost of Power.

Discussion and Submission

Board staff takes no issue with CNPI's methodology for calculating the WCA. However, Board staff submits that CNPI should update the WCA in each application 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 approved retail transmission prices. The RRRP and Wholesale Market Service Charges should also be updated as applicable.

Service Quality and Reliability

Background

In E2/T1/S1/Appendix B of both applications, CNPI provided information on its service reliability performance, for the years 2005 to 2007 for CNPI – EOP and the years 2003 to 2007 for CNPI – FE. CNPI reported the standard reliability indicators of SAIDI, SAIFI and CAIDI as well as ASAI (Average System Availability Index). In the oral hearing, CNPI filed undertakings to update the results with 2008 actuals. CNPI's reliability performance in each of CNPI – EOP and CNPI – FE service areas is summarized in the following tables

System Reliability - CNPI - EOP

	2003	2004	2005	2006	2007	2008
SAIDI	3.16	1.1	4.07	7.43	5.18	0.85
SAIFI	1.1	1.54	1.05	2.47	3.82	0.55
CAIDI	2.87	1.04	3.89	3.01	1.36	1.55
ASAI			99.954	99.915	99.924	

System Reliability - CNPI - FE

	2003	2004	2005	2006	2007	2008
SAIDI	4.17	4.9	2.67	61.68	3.95	3.38
SAIFI	3.66	2.92	3.10	12.06	3.13	3.18
CAIDI	1.14	1.68	0.86	5.11	1.26	1.06
ASAI	99.952	99.944	99.970	99.948	99.955	

Sources: E2/T1/S1/Appendix B, Board staff IRs #9 and 16, Undertakings JT1.9 and JT1.14

Board staff posed interrogatories[4] to seek further clarification of CNPI's evidence of its system reliability.

Discussion and Submission

Board staff observes that CNPI's service quality and reliability, as reported to the Board in accordance with section 2.1.5 of the Reporting and Record-keeping Requirements, are consistent with the evidence on the record in this application. Board staff observes that system reliability appears to be worse in CNPI – EOP. However, Board staff considers that the reliability performance is consistent with CNPI's documentation of the physical network in each service area and of associated issues. Board staff considers that CNPI is taking adequate efforts to maintain and operate its network in each service area, and that capital projects, both undertaken and planned for system rebuild and conversions, should result in improved system reliability. Overall, Board staff takes no issue with the

[4] Board staff (EOP) IR #9, Board staff (Fort Erie) IR #16.

evidence provided on CNPI's reliability performance in the two service areas, but submits that CNPI needs to continue to focus its efforts on improving service quality and reliability.

Operating Revenue

Load and Revenue Forecast

Background

For each service area in the respective Exhibit 3 of its August 15, 2008 filings, the Applicant discussed the development of its forecasts. It determined the 2008 Bridge Year and 2009 Test Year customer/connection count forecasts. It also determined the kWh forecasts – and the kW forecasts for appropriate classes – by customer class and presented variance analyses in support of the forecasts.

The Applicant provided additional information in response to two rounds of forecasting interrogatories. At the Oral Hearing, the Applicant provided further information.

Discussion and Submission

Methodology and Model

In the respective Exhibit 3, Tab 2 of each application, CNPI provided a detailed description of its customer count forecast and load forecast for both service areas.

The Applicant noted that population historical growth for CNPI – EOP had been almost stagnant. For CNPI – Fort Erie, there had been only modest growth. For both service areas, it was stated that the historical situation is expected to continue into the future. Consequently, the Applicant stated that for both service areas it expected little change in customer count for most classes. For the Residential, GS<50kW and GS>50kW classes, it stated that the customer counts were expected to be at the historical levels or slightly lower. For CNPI – EOP, it also noted that the GS>50kW TOU class had been decimated by the downturn in the automotive sector and that only the two remaining customers were expected to continue into 2009. In both service areas, the customer count forecast

for these classes reflected these expectations. Virtually no change was forecasted for the remaining classes.

The weather-normalized load forecasts were developed using a variation of the established Normalized Average Consumption (NAC) approach. For each of the weather sensitive classes (i.e. Residential, GS<50kW and GS>50kW and, in addition for the CNPI – EOP service area, GS>50kW TOU), the Applicant weather-corrected *each* of the 2005 to 2007 kWh loads.

The Applicant's weather-normalization factors were substantially based on the Province-wide weather-normalization factors available from the IESO website, but subsequently modified by the Applicant using its "uplift factors". The uplift factors were introduced by the Applicant to adjust the IESO Province-wide weather-correction factors in an attempt to obtain weather-correction factors that better represented the Applicant's historical local weather conditions. The uplift factors were service area specific.

For each customer class and for each year, the weather-corrected load was divided by the respective number of customers to determine an NAC (i.e. kWh per customer) value. Depending on the inherent trend in the NAC values, either the 2007 NAC value was deemed as applicable for 2008 and 2009, or the three NAC values for each class were averaged over the 2005-2007 period and that average value assumed for 2008 and 2009. The forecast loads for 2008 and 2009 were determined by multiplying the applicable NAC value by the forecasted number of customers in that class. A somewhat similar but non-weather normalization approach was used for the other classes. The kW demand forecast for those classes that use the kW determinant was established by utilizing the class load factor.

Results

For CNPI – EOP:

- The historical customer/connection count growth was +0.7% p.a.; the forecasted count growth is +0.5% p.a. The 2009 forecasted count is 4,269.
- The historical kWh change was *negative* 4.5% p.a.; the forecasted kWh change is *negative* 2.4% p.a. The 2009 forecasted energy is 63.0 GWh.

For CNPI – FE:

- The historical customer/connection count growth was +1.0% p.a.; the forecasted count growth is +0.8% p.a. The 2009 forecasted count is 19,821.
- The historical kWh growth was +0.7% p.a.; the forecasted kWh growth is +1.2% p.a. The 2009 forecasted energy is 304.2 GWh.

Analysis

While there were numerous interrogatories from Board staff and intervenors, the majority of these questions were aimed at correcting errors and clarifying ambiguities.

In response to Board staff interrogatory #22, the Applicant stated that CDM effects have been taken into account in both service areas. While Board staff agrees that historical CDM initiatives have been taken into account, staff submits that incremental CDM improvements have been omitted from the forecast.

In Board staff interrogatory #20, the Applicant was asked to rationalize how its weather normalization factors (which are based on the IESO's average weather-normalization for the *entire* Province) were used to represent conditions in each of its *local* service areas. The Applicant asserted that there are insufficient data available at the localized level and thus basing its approach on the Province-wide IESO data is an acceptable method to developing a local load forecast. It was noted that the Applicant had, in any case, incorporated its uplift factors. As the pre-filed evidence shows (Exhibit 3, Tab 2, Schedule 1, Page 4 - both service areas), the Applicant's modification had the effect of producing larger weather-correction factors; i.e. the Applicant's approach included *more* weather-normalization than using only the basic IESO values.

In Board staff interrogatory #21 (together with #25 for CNPI – EOP, #30 for CNPI – FE), staff questioned further the reasonableness of the Applicant's weather normalization factors and, specifically, how these factors were supported by the Degree Days evidence the Applicant had presented. The Applicant replied that the information was only for illustrative purposes and variances between the Applicant's factors and Degree Days may be attributed to temperature being only one of the variables used in developing a load forecast.

In reply to a VECC interrogatory (#2 for CNPI – EOP, #8 for CNPI – FE), the Applicant provided a table comparing the effect of the Applicant's weather normalization factors and those developed by Hydro One when it prepared year-2004 custom-built factors for the Applicant's Cost Allocation Informational Filing. The table showed the factors developed by Hydro One to be *many* times larger than the Applicant's factors; i.e. even though the Applicant's weather-normalization factors are larger than the basic IESO values, they are still much smaller than the values specifically developed for the utility in the past. Therefore, the Applicant's current values result in significantly less weather correction taking place than when the earlier values developed by Hydro One for the Applicant are used. The Applicant continued that, despite the large difference in the size of the factors, the Applicant's factors provide "a reasonable proxy to use in the Application."

VECC, in a Supplementary interrogatory (#26 for CNPI – EOP, #29 for CNPI – FE), pursued the large difference in the size of the Applicant's IESO-based factors and the Hydro One-based factors. The Applicant defended its position by stating that the volatility inherent in the Hydro One-based factors had not been evident in recent sales.

At the Oral Hearing, the Applicant provided further information (Transcript, Volume 1, pages 31-48) about the "uplift factors" it had developed. Under cross examination, the Applicant acknowledged (page 47, lines 20-25) that the methodology used to develop the uplift factors does not make sense although it asserted the results seem to intuitively match what has been seen historically.

Board staff submits that the foregoing clearly shows that using either the IESO-weather correction factors or the Applicant's discredited variant of these, would result in substantial under-correction for weather in a local service area. This, in turn could introduce a significant load forecasting error.

Because the Applicant's historical load in both service areas has been almost flat, even the substantial under-correction made would have minimal effect on the resulting load forecast *in this particular case*. Board staff therefore submits that in spite of its weather correction factor reservations and to a lesser extent the Applicant's failure to include future CDM effects, the Board should accept the load forecast as reasonable and appropriate for rate setting purposes. Moreover, Board staff acknowledges that the Applicant likely used the best weather-normalization information readily available to it

when it developed its load forecast. Using a more solid weather-normalization methodology in future would likely result in the load forecast being accepted with greater confidence.

Operating Costs

Corporate Cost Allocation

Background

In CNPI's 2006 EDR RP-2005-0020/EB-2005-0344/0345/0346, the Board found that the corporate cost allocations had not been sufficiently tested. CNPI has brought forward its cost allocation in this case to be tested. The study was conducted by BDR NorthAmerica Inc. (BDR). In all areas within its review, BDR found the methods for allocation of the various cost centres to be reasonable and consistent with acceptable methods of distribution cost allocation. In addition, in some aspects, such as General Plant and Property and Procurement, BDR found an improvement in methodology over the prior approach.

Board staff in Interrogatory 42, asked CNPI to comment on the five principles that the Board established in Enbridge Gas EB-2005-0001. CNPI's response indicated that the transfer costs meet the five criteria.

Discussion and Submission

Board staff reviewed the study and the comments of the consultant. Board staff submits that the study is appropriate for its purpose.

For CNPI – EOP

Background

CNPI – EOP has applied for OM&A expenses excluding depreciation, and property and other taxes for 2009 of $1,191,875 which is $30,030 or 2.6% greater than for the 2008 bridge year, and $192,637 or 13.9% less than for the 2006 actuals. CNPI – EOP's 3 year average for Total OM&A is $380 per customer which is greater than the cohort

average of $279, 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. CNPI – EOP addressed this concern in evidence at Exhibit 1/Tab 1/Schedule 6, Page 2 and Exhibit 1/Tab 2/Schedule 1, Page 2. CNPI – EOP pointed out the uniqueness of the distribution company and differences in the nature of works that are charged to capital or to operations between utilities which was evidenced in the Combined proceeding on Extraordinary Event Storm Damage Costs Claims (EB-2007-0514/0595/0571/0551).

The following table summarizes the material from Board staff's Interrogatory 48:

Eastern Ontario Power (CNP)

		Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9	Col. 10
		2006		2006		2007		2008		2009	
		Board Approved	Variance 2006/2006	Actual	Variance 2007/2006	Actual	Variance 2008/2007	Bridge	Variance 2009/2008	Test	Variance 2009/2006
1	Operation	257,502	29,041	286,543	-75,182	211,361	23,057	234,418	16,337	250,755	-35,788
2			*11.3%*		*-26.2%*		*10.9%*		*7.0%*		***-12.5%***
3	Maintenance	173,348	-18,322	155,026	37,782	192,808	49,342	242,150	-36,580	205,570	50,544
4			*-10.6%*		*24.4%*		*25.6%*		*-15.1%*		***32.6%***
5	Billing & Collections	310,698	-24,419	286,279	-18,293	267,986	-9,567	258,419	10,662	269,081	-17,198
6			*-7.9%*		*-6.4%*		*-3.6%*		*4.1%*		***-6.0%***
7	Community Relations	2,160	-2,160	0	951	951	1,499	2,450	1,550	4,000	4,000
8			*-100.0%*		*#DIV/0!*		*157.6%*		*63.3%*		***#DIV/0!***
9	Administrative and General Expenses	575,355	81,309	656,664	-141,771	514,893	-90,485	424,408	38,061	462,469	-194,195
10			*14.1%*		*-21.6%*		*-17.6%*		*9.0%*		***-29.6%***
11	Total OM&A Expenses	**1,319,063**	**65,449**	**1,384,512**	**-196,513**	**1,187,999**	**-26,154**	**1,161,845**	**30,030**	**1,191,875**	**-192,637**
12			4.96%		-14.19%		-2.20%		2.58%		***-13.91%***

Discussion and Submission

Board staff has some concerns about operating costs per customer being higher than most of CNPI – EOP's cohorts. However, Board staff notes that costs have come down since 2006, which indicates an effort to reduce the cost per customer metric.

Board staff examined the cost drivers in Board staff Interrogatory #48 and found that Vegetation Management increased in 2006 by $40,900 and in 2007 by $33,100 for a total increase going forward of $74,000. Examining the evidence on Vegetation Management found in Exhibit 4/Tab 2/Schedule 3, Appendix A, Page 2, it appears that $86,343 is forecast for 2009. This approximates to 7.2% of the forecast OM&A costs. When asked in Board staff's Interrogatory 43 to comment on its three year cycle when compared to Hydro One Network's claim that their optimum cycle is 8 years as stated in EB-2007-0681, CNPI stated that three years is reasonable and appropriate based on experience. Board staff submits that it seems inconsistent that Hydro One Networks, a neighbouring

distributor and CNPI – EOP have such diverse cycles, and requests that CNPI address this in their Reply.

Board staff has reviewed the evidence on the other operating costs issues and has no comments.

For CNPI – FE

Background

CNPI – FE has applied for OM&A expenses excluding depreciation, and property and other taxes for 2009 of $4,489,990 which is $58,200 or 1.3% greater than for the 2008 bridge year, and $54,405 or 1.2% less than for the 2006 actuals. CNPI – FE's 3 year average for Total OM&A is $297 per customer, which is greater than the cohort average of $260, as found in the PEG Report EB-2006-0268 and displayed on the Board's Website. CNPI – FE addressed this concern at Exhibit 1/Tab 1/Schedule 6, Page 2 and Exhibit 1/Tab 2/Schedule 1, Page 2. CNPI – FE pointed out the uniqueness of the distribution company and differences in the nature of works that are charged to capital or to operations between utilities, which was evidenced in the Combined proceeding on Extraordinary Event Storm Damage Costs Claims (EB-2007-0514/0595/0571/0551).

The following table summarizes the material from Board staff's Interrogatory 51:

Fort Erie (CNP)

		Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9	Col. 11
		2006		2006		2007		2008		2009	
		Board Approved	Variance 2006/2006	Actual	Variance 2007/2006	Actual	Variance 2008/2007	Bridge	Variance 2009/2008	Test	Variance 2009/2006
1	Operation	714,745	641,760	1,356,505	-442,102	914,403	-122,641	791,762	49,648	841,410	-515,095
2			*89.8%*		*-32.6%*		*-13.4%*		*6.3%*		***-38.0%***
3	Maintenance	934,204	-247,892	686,312	334,713	1,021,025	-5,291	1,015,734	-2,318	1,013,416	327,104
4			*-26.5%*		*48.8%*		*-0.5%*		*-0.2%*		***47.7%***
5	Billing & Collections	796,730	237,386	1,034,116	-14,787	1,019,329	1,922	1,021,251	-75,091	946,160	-87,956
6			*29.8%*		*-1.4%*		*0.2%*		*-7.4%*		***-8.5%***
7	Community Relations	4,234	-1,573	2,661	4,127	6,788	7,712	14,500	29,330	43,830	41,169
8			*-37.2%*		*155.1%*		*113.6%*		*202.3%*		***1547.1%***
9	Administrative and General Expenses	1,869,376	-404,575	1,464,801	407,929	1,872,730	-284,187	1,588,543	56,631	1,645,174	180,373
10			*-21.6%*		*27.8%*		*-15.2%*		*3.6%*		***12.3%***
11	Total OM&A Expenses	**4,319,289**	**225,106**	**4,544,395**	**289,880**	**4,834,275**	**-402,485**	**4,431,790**	**58,200**	**4,489,990**	**-54,405**
12			5.21%		6.38%		-8.33%		1.31%		***-1.20%***

Discussion and Submission

Board staff has some concerns about operating costs per customer being higher than CNPI – FE's cohorts. However, Board staff note that costs have come down since 2006, which indicates an effort to reduce the cost per customer metric.

Board staff examined the cost drivers in Board staff Interrogatory 51 and has concerns about Maintenance of Meters and Property Maintenance. Meter Maintenance is increased $59,800 in 2006 and $83,000 in 2007 for a total of $142,800. No offsets are indicated for 2008 and 2009. Therefore the $142,800 is built into the revenue requirement. In Exhibit 4/Tab 2/Schedule 3, Appendix A, Page 3 CNPI – FE explain that the 2007 increase was due to addressing a backlog of meter reverifications. It further states that future replacement for reverifications will be made with smart meters.

Board staff submits that it appears that no replacements are planned for 2009 and yet the OM&A costs include $142,800 for replacements. Board staff invites the Applicant to clarify the matter in its reply argument and direct Board staff to material already filed with the Board in its application, if any, in support of such clarification.

Property Maintenance increased $56,700 in 2007, $46,000 in 2008 and $112,400 in 2009 for a total of $215,100. Board staff submits that these are significant increases and invites the Applicant to account for the increases in its Reply Argument.

Board staff has reviewed the evidence on the other operating costs issues and has no comments.

Depreciation

Background

CNPI has documented its accumulated depreciation expense in E2/T2/S4, E2/T2/S5 and E4/T2/S7 in each application. Board staff has summarized the annual depreciation expense as shown in E4/T2/S7 for CNPI – FE and CNPI – EOP in the following table.

Depreciation Expense

	2006 Actual	2007 Actual	2008 Bridge	2009 Test
CNPI – FE	$1,965,950	$1,862,300	$1,882,884	$1,987,933
CNPI – EOP	$298,940	$356,862	$452,930	$480,538

Source: E4/T2/S7

In response to a Board staff interrogatory[5], CNPI provided further information on CNPI's depreciation rates.

Discussion and Submission

In general, Board staff observes that changes in CNPI's annual depreciation are directly related to rate base and capital additions. Further, Board staff acknowledges that CNPI has, or has inherited, three different systems in the CNPI – FE and CNPI – EOP service areas. The ownership and even the regulatory oversight were different for the two service areas historically. Board staff observed that there were some differences documented for the depreciation of asset classes in the two service areas, for which the different histories were a key factor.

It is preferable that CNPI adopt a more common approach that addresses any legacy inconsistencies. Board staff submits that this is a necessary condition for CNPI's proposed harmonization of CNPI – FE and CNPI – EOP for rate-setting purposes. To this end, Board staff takes no issue with CNPI's evidence provided in the response to Board staff IR #5, where CNPI shows that it is now applying its documented depreciation rates commonly to its capital assets in the three service areas. While CNPI does in fact use depreciation or amortization rates that differ from those documented in Appendix B of the 2006 *Electricity Distribution Rate Handbook* (the "2006 EDRH"), these are for relatively few asset classes. Further, the deviations are not one-sided – in some asset classes CNPI's expected life is slightly longer than the Board guideline, and in other cases it is shorter. Board staff considers that any overall differences are, in all likelihood, small in magnitude. Board staff also acknowledges that the grandfathering of its legacy depreciation/amortization rates is consistent with the Board's policy as documented in the 2006 EDRH.

[5] Response to Board staff IR #15

In summary, Board staff takes no issue with CNPI's methodology for calculating and its proposed depreciation expense.

Loss Adjustment Factors

For CNPI – EOP

Background

In response to Board staff interrogatory #57, CNPI – EOP reaffirmed that the proposed Total Loss Factor (TLF) for 2009 is based on an averaging of actual TLFs for the 3-year period 2005 to 2007 and is 1.0719. The Board approved TLF in the 2006 EDR was 1.0715. CNPI – EOP is a fully embedded distributor within the service territory of host distributor Hydro One. The Applicant has further affirmed that the proposed Supply Facilities Loss Factor (SFLF) of 1.0340 is inclusive of losses incurred within Hydro One's distribution system. After factoring in embedded generation within the service territory, the proposed effective SFLF is 1.0272.

The proposed underlying distribution loss factor (DLF) is 1.0438. CNPI – EOP's actual DLF has increased during the 3-year period from 2005 to 2007 as shown in the following table:

	2005	**2006**	**2007**	**Average 2005 - 2007**
Actual DLF	1.0093	1.0350	1.0870	1.0438

CNPI – EOP believes that its actual DLF for 2005 is incorrect owing to anomalies with its unbilled revenue program at the end of 2005. Both in the application and interrogatory response, CNPI – EOP put forth several reasons for the sharp increase in its actual DLF for 2007. Included in these reasons are:

- Bi-directional metering to measure reverse power flow was not installed until March 3, 2008. Thus any unmetered energy flow of this nature would result in increased distribution losses.
- With respect to the mix of loads serviced from its 44 kV, 27 kV and 4 kV distribution systems, by the end of 2007 CNPI – EOP had lost a significant percentage of industrial load serviced from its 44 kV and 27 kV distribution

systems. Loads serviced from higher voltage distribution systems will inherently have lower loss percentages associated with them compared to the same load serviced from lower voltage distribution systems.

CNPI – EOP has not yet evaluated any possible reconfiguration of the distribution system as a result of these customer reductions.

Discussion and submission

The record suggests that CNPI – EOP's DLF is on an upward trend. Previously, the Board has generally expressed concern over the level of distributors' DLF and required those with levels greater than 5% to provide an explanation and plan to get the value below the 5% level.

Board staff submits that once the reconfiguration of the distribution system is completed, CNPI – EOP should provide detailed information about the DLF and what attempts it is making to reduce the level.

Board staff submits that despite the wide variations in the yearly DLF, the method of averaging actual TLFs for the 2005-2007 period to obtain the proposed TLF for 2009 provides a result that is consistent with the value approved by the Board in 2006 and is acceptable for 2009 rates.

For CNPI – FE

Background

In response to Board staff interrogatory #58, CNPI – FE reaffirmed that the proposed Total Loss Factor (TLF) for 2009 is based on an averaging of actual TLFs for the 3-yr period 2005 to 2007 and is 1.0391. The Board approved TLF in the 2006 EDR was 1.0479. CNPI – FE is fully supplied from the IESO-controlled grid. It has further affirmed that the proposed Supply Facilities Loss Factor (SFLF) of 1.0033 (as compared to the industry standard of 1.0045 for directly connected distributors) is based on an averaging of actual SFLFs for the 3-yr period 2005 to 2007.

The proposed underlying distribution loss factor (DLF) is 1.0357. CNPI-FE's actual DLF has fluctuated during the 3-yr period from 2005 to 2007 as shown in the following table:

	2005	2006	2007	Average 2005 - 2007
Actual DLF	1.0289	1.0418	1.0363	1.0357

CNPI – FE believes that its actual DLF for 2005 shown in the table is incorrect owing to anomalies with its unbilled revenue program at the end of 2005. In the application, CNPI – FE stated that it has made modifications and upgrades to its distribution system that has yielded an enduring reduction in its DLF.

Discussion and submission

Board staff submits that CNPI – FE's proposed TLF for the test year 2009 is acceptable.

Taxes

Background

CNPI is an investor-owned corporation that pays Federal and provincial taxes, in contrast to PILs (Payments In Lieu of taxes) that municipally-owned or provincially-owned distributors are subject to. In each of the applications, CNPI has documented its proposed expense allowance for taxes in E4/T3/S1 to E4/T3/S7.

CNPI is subject to taxes as a corporate entity. It has documented the allocation of taxes in a top-down method, allocating between transmission and distribution and then, within distribution, between the three service areas.

CNPI's proposed tax expense is summarized below.

Summary of Actual and Proposed taxes

CNPI Taxes (actual and forecasted) - per Exhibit 4 / Tab 3 / Schedule 2

Net Income (before addbacks and deductions)	2006 Actual	2007 Actual	2008 Bridge	2009 Test
All Operations	$ 2,141,257	$ 3,529,198	$ 348,000	$ 3,927,823
Transmission	$ 1,348,153	$ 3,178,959	-$ 181,000	$ 1,802,000
Distribution	$ 793,104	$ 350,239	$ 529,000	$ 2,125,823

Note: 2006, 2007, 2008 per financial statements; 2009 is regulated utility income.

Taxable Income	2006 Actual	2007 Actual	2008 Bridge	2009 Test
All Operations	$ 3,276,718	$ 5,344,019	$ 398,768	$ 3,953,457
Transmission	$ 2,874,196	$ 5,350,488	$ 347,993	$ 2,500,577
Distribution	$ 402,522	-$ 6,469	$ 50,795	$ 1,452,880

Taxes (Actual / Forecasted)	2006 Actual	2007 Actual	2008 Bridge	2009 Test
All Operations	$ 1,331,418	$ 2,098,652	$ 331,956	$ 1,710,151
Transmission	$ 1,044,060	$ 1,956,504	$ 163,484	$ 869,592
Distribution	$ 287,358	$ 142,148	$ 168,472	$ 840,559
CNPI - FE	$ 201,233	$ 95,244	$ 109,723	$ 538,151
CNPI - EOP	$ 29,478	$ 15,586	$ 22,024	$ 111,423
CNPI - PC	$ 56,647	$ 31,319	$ 36,724	$ 190,985

Distribution of Tax Payments (Actual and Forecasted)	2006 Actual	2007 Actual	2008 Bridge	2009 Test
Transmission	78.42%	93.23%	49.25%	50.85%
Distribution	21.58%	6.77%	50.75%	49.15%
Percentage of Distribution				
CNPI - FE	70.03%	67.00%	65.13%	64.02%
CNPI - EOP	10.26%	10.96%	13.07%	13.26%
CNPI - PC	19.71%	22.03%	21.80%	22.72%

Further clarifying information on taxes was sought through discovery[6], and CNPI provided, in Board staff's submission, satisfactory explanations.

Discussion and Submission

As with other areas, CNPI's taxes are affected in 2008 bridge and 2009 test years by recent changes in CNPI's rate base and operations. Further, the actual tax expense attributable to distribution and transmission and to each service area within the distribution business has historically been affected by the realized net income. This resulted in bridge and test year forecasted tax expenses, based on forecasted income

[6] Responses to Board staff IR #60, VECC (Port Colborne) IR #26 and #27.

and allocated on a top-down process, varying significantly from historical actuals for the distribution service areas.

However, based on the record, Board staff takes no issue with the methodology, including the approach for allocating on a top-down basis between transmission and distribution and then within distribution to the three service areas, by which CNPI has estimated its tax allowance that should be recoverable in its 2009 distribution rates.

Board staff notes that other changes to CNPI'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 tax 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 CNPI should flow through applicable changes and update the tax allowance to determine the revenue requirement and rates resulting from the Board's Decision.

Smart Meters

Background

CNPI 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.

In its original applications, and clarified in response to Board staff IR #10, CNPI has proposed to retain its existing smart meter funding adder, currently approved at $0.27 per month per metered customer in CNPI – FE and $0.26 in CNPI – EOP. Further, conditional on the proposed harmonization of distribution rates of the two service areas, CNPI has proposed to harmonize the smart meter funding adder at $0.27 per month per metered customer. CNPI has stated that it is becoming authorized under the amended regulation pursuant to and in compliance with the London Hydro RFP process, and that it expects to begin smart meter deployment in 2009.[7]

[7] E2/T1/S1. See also the responses to Board staff (EOP) IR #7 and Board staff (Fort Erie) IR #14

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.

CNPI is also 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

Board staff submits that CNPI has complied with the policies and filing requirements of the Smart Meter Guideline. While CNPI has documented that it is becoming authorized under regulation and intends on deploying smart meters beginning in 2009, it is not seeking an increase in the smart meter funding adder. It could have done so. However, Board staff observes that the Smart Meter Guideline is not obligatory. Increasing the funding adder to $1.00 may help to mitigate future rate impacts when smart meters are fully deployed and the costs recoverable in rates, but CNPI may be choosing to not increase the smart meter funding adder to mitigate rate impacts of this current application.

Further, CNPI is not seeking recovery of amounts invested in or expensed with respect to smart meter implementation in this application; all such costs will be reviewed and disposed of for recovery in a future application, in accordance with the Smart Meter Guideline.

Board staff submits that CNPI's proposal to retain the existing smart meter funding adder is reasonable. Board staff also takes no issue with CNPI's proposal to harmonize the smart meter funding adder at $0.27 per month per metered customer.

Deferral and Variance Accounts

For CNPI – EOP

Background

CNPI – EOP is requesting only the disposition of account 1508 - Other Regulatory assets. This encompasses disposal of the December 31, 2007 balance including interest

up to April 30, 2009. The balance in this account including interest up to December 31, 2007 is $12,149. The associated rate riders assumed to be in effect for one year are provided in the table below.

Deferral and Variance Account Rate Riders Disposition of account 1508					
Residential ($/kWh)	GS<50kW ($/kWh)	GS>50kW ($/kW)	USL ($/kWh)	Sentinel Lighting ($/kW)	Street Lighting ($/kW)
0.0002	0.0002	0.0656	0.0003	0.0727	0.0687

In response to Board staff interrogatory #61 part (c), CNPI provided information on a selected group of its deferral and variance accounts that have account balances as of December 31, 2007. This information is provided in the following table. The balances shown include interest up to December 31, 2007.

Regulatory Asset Account Balances at December 31, 2007		
Account Description	Account #	Total ($)
Other Regulatory Assets - OEB Cost Assessments	1508	11,680
Recovery of Regulatory Asset Balances	1590	(16,176)
Total		**(4,496)**

Discussion and submission

Board staff notes that the 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. In the oral hearing (Volume 2, p. 9-12), and in its AIC, CNP stated its acceptance to dispose of all accounts if the Board so directs. As part of Undertaking # JT2.2, CNPI provided the balances in accounts 1508, 1580, 1584, 1586 and 1588. This encompasses disposal of the December 31, 2007 balance including interest up to April 30, 2009. The balances in these accounts including interest up to April 30, 2009 are provided in the following table.

Regulatory Asset Account Balances at December 31, 2007 (including interest up to April 30, 2009)		
Account Description	Account #	Total ($)
Other Regulatory Assets - OEB Cost Assessments	1508	12,171
RSVA – Wholesale Market Service Charge	1580	(282,563)
RSVA – One-time Wholesale Market Service	1582	
RSVA – Retail Transmission Network Charge	1584	(159,249)
RSVA – Retail Transmission Connection Charge	1586	(5,990)
RSVA – Power	1588	659,159
Total		**223,528**

The associated rate riders prepared by CNPI assumed to be in effect for three years are provided in the following table.

Deferral and Variance Account Rate Riders Disposition of accounts 1508, 1580, 1582, 1586, 1588					
Residential ($/kWh)	GS<50kW ($/kWh)	GS>50kW ($/kW)	USL ($/kWh)	Sentinel Lighting ($/kW)	Street Lighting ($/kW)
0.0012	0.0012	0.03700	0.0012	0.4054	0.3003

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 submits that CNPI – EOP provide:

- the closing balances corresponding to RSVA - Cost of Power account (excluding the global adjustment) 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).

Board staff submits that notwithstanding the fact that the staff proposal mentioned above is not yet confirmed Board policy, the Board should order disposition of all of the above stated deferral and variance account balances and not just the disposition of account 1508.

For CNPI – FE

Background

CNPI – FE is requesting only the disposition of account 1508 - Other Regulatory assets. This encompasses disposal of the December 31, 2007 balance including interest up to April 30, 2009. The balance in this account including interest up to December 31, 2007 is $42,927. The associated rate riders assumed to be in effect for one year are provided in the following table.

Deferral and Variance Account Rate Riders Disposition of account 1508					
Residential ($/kWh)	GS<50kW ($/kWh)	GS>50kW ($/kW)	USL ($/kWh)	Sentinel Lighting ($/kW)	Street Lighting ($/kW)
0.0002	0.0001	0.0391	0.0003	0.0574	0.0445

In response to Board staff interrogatory #62 part (c), CNPI provided information on a selected group of its deferral and variance accounts that have account balances as of December 31, 2007. This information is provided in the table below. The balances shown include interest up to December 31, 2007.

Regulatory Asset Account Balances at December 31, 2007		
Account Description	Account #	Total ($)
Other Regulatory Assets - OEB Cost Assessments	1508	41,270
Extraordinary Event Costs	1572	1,415,298
One-time Wholesale Market Service	1582	40,245
Recovery of Regulatory Asset Balances	1590	(231,544)
Total		**1,265,269**

The associated rate riders prepared by CNPI assumed to be in effect for one year are provided in the following table.

Deferral and Variance Account Rate Riders Disposition of account 1508					
Residential ($/kWh)	GS<50kW ($/kWh)	GS>50kW ($/kW)	USL ($/kWh)	Sentinel Lighting ($/kW)	Street Lighting ($/kW)
0.0003	0.0003	0.0899	0.0004	0.1026	0.0897

Discussion and submission

Board staff notes that the 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. In the oral hearing (Volume 2, p. 9-12) and in its AIC, CNPI stated its acceptance to dispose of all accounts if the Board so directs. As part of Undertaking # JT2.2, CNPI provided balances in accounts 1508, 1580, 1582, 1584, 1586 and 1588. This encompasses disposal of the December 31, 2007 balance including interest up to April 30, 2009. The balances in these accounts including interest up to April 30, 2009 are provided in the following table.

Regulatory Asset Account Balances at December 31, 2007 (including interest up to April 30, 2009)		
Account Description	Account #	Total ($)
Other Regulatory Assets - OEB Cost Assessments	1508	43,004
RSVA – Wholesale Market Service Charge	1580	(591,650)
RSVA – One-time Wholesale Market Service	1582	41,864
RSVA – Retail Transmission Network Charge	1584	98,795
RSVA – Retail Transmission Connection Charge	1586	97,446
RSVA – Power	1588	1,108,288
Total		**797,747**

The associated rate riders prepared by CNPI assumed to be in effect for 3.89 years are provided in the table below.

Deferral and Variance Account Rate Riders Disposition of accounts 1508, 1580, 1582, 1586, 1588					
Residential ($/kWh)	GS<50kW ($/kWh)	GS>50kW ($/kW)	USL ($/kWh)	Sentinel Lighting ($/kW)	Street Lighting ($/kW)
0.0000	0.0000	0.3170	0.0000	0.2087	0.2015

Board staff invites CNPI to clarify in its Reply submission the rationale behind zero rate riders for the residential, GS<50kW and USL rate classes and the mechanism through which CNPI – FE would recover the total balance of $408,378 attributable to these three rate classes with a zero rate rider.

The "Balance to be collected or refunded in the next 3 years" of $797,747 and the "Balance to be collected or refunded per year" of $205,012 (both shown in Undertaking # JT2.2) imply a disposition period of 3.89 years. Board staff invites CNPI to clarify why the disposition period is not an integer such as 3 years or 4 years.

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 submits that CNPI – FE provide:

- the closing balances corresponding to RSVA - Cost of Power account (excluding the global adjustment) 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).

Board staff submits that notwithstanding the fact that the staff proposal mentioned above is not yet confirmed Board policy, the Board should order disposition of all of the above stated deferral and variance account balances and not just the disposition of account 1508.

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 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 Exhibit 6 of its applications, CNPI has proposed its requested Cost of Capital. The Cost of Capital is common to the CNPI –FE and CNPI – EOP applications (as well as to the CNPI – Port Colborne application). Board staff has summarized CNPI's proposed common Cost of Capital in the following table.

Cost of Capital Parameter	CNPI'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	3.38% based on May 2008 Bank of Canada data on 3-month Bankers' Acceptance rates, but to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	6.82%, as a weighted average of third party debt of $30,000,000 at 7.092% (plus amortized transaction costs) and affiliated debt of $15,000,000, increasing to $21,000,000 at 6.13%. However, CNPI states that the affiliated long-term debt should attract the Board's deemed debt rate.
Return on Equity	8.39% based on May 2008 *Consensus Forecasts*, 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	7.36% 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.

As noted, CNPI 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%

Discussion and Submission

Board staff submits that CNPI's proposed Cost of Capital methodology, covering capitalization and the cost of short-term debt and equity financing, complies with the policies of the Board Report.

The only issue that emerged and was explored through interrogatory responses and the oral hearing, pertains to the affiliated debt. CNPI notes that the affiliated debt is a promissory note owed to FortisOntario. In the oral proceeding, CNPI explained that a promissory note for $15 million was issued in August 2008. In 2009, although the exact timing is not clear, CNPI expects to incur $6 million in additional debt. CNPI stated that its approach is to obtain financing through the parent until there is an amount that is sufficient to go to market.[8] In its AIC, CNPI has reiterated that the $21 million is affiliated debt that is callable on demand, and hence that the current deemed debt long-term debt rate of 7.62% should apply. Responses to undertakings also provided further information on this affiliated debt.[9]

While CNPI proposes that the 7.62% updated deemed debt rate should apply to the $21 million for the affiliated debt, in compliance with the Board Report guidelines, Board staff submits that the situation is less than clear about what rate should apply. Board staff submits that the CNPI/FortisOntario approach is more complicated than the scenarios contemplated in the Board Report.

Firstly, as documented in Undertaking JT2.6, the $21 million promissory note is expected to be issued in 2009 Q4, and would replace the existing note of $15 million, issued in 2008, as well as covering new debt of $6 million. In response to Undertaking JT2.6,

[8] Transcript, Vol. 2, p. 41 l. 7 to p. 44 l. 5, April 21, 2009
[9] Undertakings JT1.6 and JT2.6

CNPI states that: "The 2008 $15 million promissory note bears a debt rate of 6.13%, which was set by FortisOntario to match the Board's deemed long-term debt rate." Board staff notes that the Board's deemed long-term debt rate in 2008 was 6.10%, as announced in the Board's letter of March 7, 2008 on the 2008 Cost of Capital parameters. It is not clear on what the 6.13% rate is based or how it relates to the methodology for the long-term debt rate as documented in Appendix A of the Board Report.

Board staff is also concerned about the terms and conditions of the affiliated debt. In Undertaking JT2.6, CNPI states: "Similar to the existing $15 million promissory note, the new $21 million promissory note will be both: (i) "affiliate debt that is callable on demand" …; and (ii) new affiliated debt with a contracted rate that is the same as the deemed long-term debt rate… the debt rate of 7.62% should apply." Further, in undertaking JT1.6, CNPI affirms that, while FortisOntario can call the promissory note, CNPI can not pay the note prior to the end of the term (even though Board staff is not clear as to what the term of the note is, based on the evidence).

Board staff's concern is that the debt arrangements between FortisOntario and CNPI, until such time as they determine to go to market for third-party financing, are not at an arm's length. It is not clear how the arrangements, which seem to be asymmetrical, balance both consumers' and shareholders' interest. This is exacerbated at this time because of the increased deemed long-term debt rate of 7.62%, particularly when CNPI's evidence is that it expects that the $15 million note will be replaced, and solely upon FortisOntario's call, by the $21 million note at, based on current macroeconomic conditions, a higher cost of debt. There does not appear to be any way or intent for CNPI to maintain the $15 million note at its existing rate.

Board staff submits that one option could be to treat the affiliated debt as two instruments; such that,

- $15 million at the 6.10% deemed debt rate for 2008, for the promissory note issued in 2008; and
- $6 million new (incremental) debt for 2009 at the updated deemed long-term debt rate of 7.62%.

Subject to the comments above, Board staff submits that CNPI's proposal for Cost of Capital, as amended through discovery, complies with the guidelines documented in the Board Report.

Cost Allocation and Rate Design

Revenue to Cost Ratios

Background

The proposed revenue to cost ratios in the CNPI – EOP and CNPI – FE harmonized rate proposal for each rate class for 2009 are shown in column 5 of the following table. The table also shows revenue to cost ratios per the informational filing on a separate and combined basis (columns 1, 2, 3) and the Board policy range (column 6).

	Revenue to Cost Ratio					
	1	2	3	4	5	6
	Info. Filing CNPI – EOP	**Info. Filing – CNPI-FE**	**Info. Filing Combined**	**Transformer Ownership Allowance Adjusted Combined**	**Proposed 2009 Harmonized Rate Design**	**Board Policy Range**
Residential	73.02%	82.69%	80.52%	82.03%	82.88%	85% - 115%
GS < 50 kW	142.48%	129.81%	133.51%	134.23%	120.00%	80% - 120%
GS > 50 kW	158.23%	151.44%	154.80%	148.91%	152.66%	80% - 180%
USL	65.94%	56.76%	57.76%	57.39%	44.69%	80% - 120%
Sentinel Lights	31.77%	37.35%	37.46%	37.78%	54.61%	70% - 120%
Street Lights	27.64%	19.16%	19.51%	20.58%	23.91%	70% - 120%

- Residential: The proposed ratio is outside the policy range. The application states that it was necessary to stay below the 85% threshold in order to limit bill impact in CNPI-G.
- GS < 50 kW: The proposed ratio is within the policy range. The application states that the threshold is reached while not exerting undue rate pressures on the other rate classes.
- GS > 50 kW: The proposed ratio is within the policy range. The application states that the proposed ratio represents a reduction of the allocation to this rate class while not exerting undue rate pressures on the other rate classes.
- USL: The proposed ratio is outside the policy range. The application states that the proposed ratio is an attempt to not exert undue rate pressures on this rate class. In

the AIC, CNPI has stated that it has pushed the revenue-to-cost ratio to the maximum but are limited by the notional 10% total bill impact. Additionally the application states that CNPI – FE will implement billing on a per customer basis as opposed to the current practice of per connection basis. In response to Board staff interrogatory #69, CNPI has explained that this move is driven by the need to be consistent with existing practice at the other two service areas.

- Sentinel Lights: The proposed ratio is outside the policy range. The application states that the proposed ratio is an attempt to gradually move towards 100% and further to not exert undue rate pressures on this rate class. In the AIC, CNPI has stated that it has pushed the revenue-to-cost ratio to the maximum but are limited by the notional 10% total bill impact.
- Street Lights: The proposed ratio is outside the policy range. The application states that the proposed ratio is an attempt to gradually move towards 100% and further to not exert undue rate pressures on this rate class. In the AIC, CNPI has stated that it has pushed the revenue-to-cost ratio to the maximum but are limited by the notional 10% total bill impact.

Discussion and submission

In response to VECC interrogatories #6 and #20, CNPI provided an alternative cost allocation run including revenue to cost ratios under conditions of revenues by rate class reduced by the transformer ownership allowance (TOA) and allocated costs excluding the cost of transformer ownership. Board staff notes there is a mismatch between "Total Revenue" and "Revenue Requirement" resulting in overall revenue to cost ratios of 102.65% and 101.27% (rather than 100%) for CNPI – EOP and CNPI – FE respectively, apparently because revenue was not adjusted from gross to net of TOA. Assuming that this is the problem, Board staff has recalculated the ratios on a combined basis as shown in column 4 of the table. Board staff notes that after factoring in the impact of the TOA, the ratio would increase from 80.52% to 82.03% for the residential class and decrease from 154.80% to 148.91% for the GS > 50 kW class.

Board staff submits:

- The TOA adjusted revenue to cost ratios in column 4 should be the starting point rather than the combined informational filing ratios in column 3.
- CNPI should rebalance rates such that revenue to cost ratios that are outside the Board policy range move to the closest boundary of the range. CNPI should assess

the rate impact resulting from this action, particularly for residential customers in CNPI – EOP. For those rate classes, where the rate impact:

- is not excessive, the movement of the ratio should be in one step in the first year; and
- is excessive, the movement of the ratio should be in multiple steps, halfway to the closest boundary of the range in the first year, and in equal steps in the subsequent two years.

Retail Transmission Service Rates

For CNPI – EOP

Background

CNPI –EOP is an embedded distributor, embedded in the distribution system of Hydro One Networks Inc. (HONI). In response to Board staff interrogatory #66, CNPI-G stated that an analysis of the relationship between the transmission service charges from HONI and the revenue associated with retail transmission through distribution rates for the years 2006 and 2007 indicates revenue exceeded charges by an average of 15% in both network service and connection service.

HONI has proposed an increase of 11.44% and 5.85% (2009 vs. 2008) in its retail transmission rate for sub-transmission customers for transmission network service and line and transformation connection service respectively.

For 2009, CNPI – EOP is proposing a 15% decrease from its 2008 tariff in both its transmission network service rates and line and transformation connection service rates.

These rate movements are tabulated below.

Rate Movements			
	Average percentage spread between revenues and charges 2006-2007	Proposed change in HONI's transmission rates for sub-transmission customers from 2008 to 2009	Proposed change in CNPI – EOP's retail transmission rates from 2008 to 2009
Network	15%	11.44% increase	15% decrease
Connection	15%	5.85% increase	15% decrease

Discussion and submission

Board staff submits that it would be reasonable for CNPI – EOP to calculate revised network and connection rates which would capture both:

- the spread between historical transmission charges and revenue, and
- HONI's proposed 2009 over 2008 increase in its retail transmission rate for sub-transmission customers.

For CNPI – FE

Background

CNPI – FE is directly connected to the Hydro One Networks Inc. (HONI) transmission grid. In response to Board staff interrogatory #68, CNPI – FE stated that an analysis of the relationship between the transmission service charges from HONI and the revenue associated with retail transmission through distribution rates for the years 2006 and 2007 indicates charges exceeded revenues by an average of 3% in network service and 5% in connection service.

The HONI uniform transmission rate is higher by approximately 11.26% and 5.45% (2009 vs. 2008) respectively for transmission network service and line and transformation connection service.

For 2009, CNPI – FE is proposing a 14.26% and 10.45% increase from its 2008 tariff in its transmission network service rates and line and transformation connection service rates respectively.

These rate movements are tabulated below.

Rate Movements			
	Average percentage spread between revenues and charges 2006-2007	Proposed change in HONI's uniform transmission rates from 2008 to 2009	Proposed change in CNPI – FE's retail transmission rates from 2008 to 2009
Network	-3%	11.26% increase	14.26% increase
Connection	-5%	5.45% increase	10.45% increase

Discussion and submission

Board staff submits that CNPI – FE's proposed increase (network and connection rates) which captures both the spread between historical transmission charges and revenue and the 2009 over 2008 HONI uniform transmission rate increase is acceptable.

Specific Service Charges

Background

CNPI states that it will continue with all of its currently approved Specific Service Charges in both applications.

Discussion and submission

Board staff submits that these charges are reasonable.

Rate Harmonizartion and Bill Impacts

Background

Both applications include a proposed harmonization of rates for the CNPI – FE and the CNPI – EOP service areas with the exception of certain aspects that are specific to each service area, such as loss adjustment factors, transmission service rates and low voltage costs recovery.

In the event that the Board does not approve the rate harmonization proposal, the Applicant has also provided a set of "stand alone" rates for each service area, maintaining the relativecost allocations.

Discussion and submission

Board staff has reviewed and supports the methodology that CNPI has used in developing its proposed harmonization of rates. Board staff submits that the maintenance of unique charges associated with specific service area expenses such as the transmission and low voltage costs is appropriate. Because of the different

distribution systems, Board staff also supports the continuation of separate loss adjustment factors, as proposed by the applicant.

Board staff submits that, 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 earlier in the section on the revenue to cost ratios, CNPI has adopted this bill impact threshold in its development of the amount of movement towards the Board's established ranges. The additional impact resulting from the harmonization of the rates also adds to the overall bill impacts.

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 these particular applications, Board staff submits that the proposals put forward by the Applicant are a reasonable blend of meeting the sometimes opposing objectives.

All of which is respectfully submitted