ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES
Festival Hydro Inc.
EB-2009-0263

January 22, 2010

INTRODUCTION

Festival Hydro Inc. (“Festival Hydro” or the “Applicant”) is a licensed electricity distributor serving approximately 19,700 customers within the City of Stratford, and the towns of Seaforth, Brussels, Hensall, Zurich, Dashwood and St. Marys. Festival Hydro is wholly owned by the City of Stratford. The Applicant purchased the assets of the Hensall Public Utilities Commission in 2000. The rates are not yet harmonized, therefore the Applicant has two residential customer classes.

The Applicant filed its 2010 rebasing application (the “Application”) on August 28, 2009. Festival Hydro requested approval of its proposed distribution rates and other charges effective May 1, 2010. If a final rate order is not issued in time for a May 1, 2010 effective date, Festival Hydro requested that the Board allow it to use account 1574, Deferred Rate Impact Amounts, to record the difference between the revised rates and actual rates for the period May 1, 2010 to the date on which the final 2010 rates are effective. The Application was based on a future test year cost of service methodology.

The Vulnerable Energy Consumers’ Coalition (“VECC”), the School Energy Coalition (“SEC”) and Energy Probe Research Foundation (“Energy Probe”) were granted intervenor status in this proceeding. No letters of comment were received.[1] The proceeding has been conducted through written discovery, with two rounds of written interrogatories.

This submission reflects observations and concerns which arise from Board staff’s review of the pre-filed evidence and interrogatory responses made by Festival Hydro, and are intended to assist the Board in evaluating Festival Hydro’s application and in setting just and reasonable rates. Staff has determined that comments on the issues of smart meter funding and specific service charges are not necessary.

THE APPLICATION

In its original application, Festival Hydro requested a base revenue requirement of $9,852,131 to be recovered in rates effective May 1, 2010[2]. Festival Hydro has provided a breakdown of its revenue requirement confirming changes proposed between the time

[1] Response to Board Staff Supplemental IR#49
[2] Exhibit 8/ Tab 1/ Schedule 1

it filed the original application and the closing of the interrogatory stage of this proceeding. The updated revenue requirement is $9,697,453.[3] The following is a breakdown of Festival Hydro's revenue requirement:

Table 1
2010 Test Year Revenue Requirement

	As Filed August 28, 2009		As Updated January 7, 2010	
OM&A Expenses & Taxes	$	4,018,664	$	4,007,486
Depreciation/ Amortization	$	2,655,496	$	2,655,496
Return on Rate Base	$	2,928,832	$	2,928,708
Low Voltage	$		$	
PILS	$	908,589	$	780,198
Transformer Allowance	$		$	
Service Revenue Requirement	$	10,511,581	$	10,371,887
Revenue Offset	$	659,450	$	674,435
Base Revenue Requirement	**$**	**9,852,131**	**$**	**9,697,453**

The Applicant has calculated the following bill impacts if the application as updated on January 7, 2010 is approved.

Table 2
Bill Impacts

	Delivery (%)	**Delivery ($)**	**Total Bill (%)**
Res @ 800 kWh	3.1	1.10	1.3
GS<50kW @ 2,000 kWh	4.1	3.07	1.5

LOAD FORECAST

Exhibit 3 of the application discusses how the load forecast and customer count are developed. Festival Hydro is requesting Board approval for a 2010 forecast of

[3] Board Staff Supplemental IR#48

576,872,024 kWh.[4] This represents a 2.9% decrease from 2008 actual load. Festival Hydro states that the overall decline is due to the success of CDM programs, a struggling tourist industry and overall shrinkage in Ontario's manufacturing sector.

Festival Hydro's weather normalized load forecast was developed using a four step process:

1. A total system wide weather normalized energy forecast was developed using a multifactor regression model that incorporated the following independent variables: weather, economic output, population and calendar variables.
2. The energy forecast was adjusted by a historical loss factor to derive the system-wide billed energy forecast.
3. The forecast of billed energy by rate class was developed based on a forecast of customer numbers and historical usage patterns per customer class.
4. For the weather sensitive rate classes, the non-normalized billed energy forecast (from Step 3) was adjusted to ensure that the total non-normalized billed forecast by rate class was equivalent to the total weather normalized billed energy forecast (from Step 2) determined by the regression model.

To develop its load forecast, Festival Hydro used a multifactor regression model to determine the relationship between historical purchases and weather data, calendar factors and socio-economic data. The Applicant provided a comparison of the results of the model with actual system load purchases for the period from 1998 to 2008 in its application. The evidence indicates that the difference between the load estimated by the model and the actual load ranged from -1.54% to +2.50%.

The following were used as the inputs for the model to generate the weather normalized system purchases for the 2009 bridge year and 2010 test year:

- Monthly heating degree day ("HDD") and cooling degree day ("CDD") data as measured by Environment Canada at Stratford;
- Ontario real GDP monthly index derived from 2003, 2008 and 2009 Ontario Economic Outlooks as prepared by the Ontario Ministry of Finance;
- Population data was based on Census data for the City of Stratford and the Town of St. Marys from the 1998, 2001 and 2006 Census data. Population statistics for the smaller towns in the Applicant's service territory were obtained from the respective municipal offices; and

[4] Exhibit 3/ Tab 3/ Schedule 1

- Calendar information related to the number of days in a month and the spring/fall flag.

Board staff notes that the model chosen as the best predictor of kWh purchases by Festival Hydro included a negative coefficient for population. In its application, Festival Hydro stated that the negative coefficient is a result of population growth in recent years increasing at a decreasing rate.

The regression model predicted system purchases of 605.1 GWh for 2009 and 589.8 GWh for 2010. Festival Hydro applied an adjustment to increase the 2010 system purchase by 1.983 GWh to reflect the addition of two GS > 50 operations coming to Stratford. In response to Board staff interrogatory #9, Festival Hydro replied that the two operations (a satellite site of a university and a financial institution) are progressing as expected.

Festival Hydro made a further adjustment to its load forecast in order to convert the system purchases to total billed load forecast by applying an average of historical annual loss factors. The average loss factor of 2.58% was calculated for the period 2000 to 2008. By applying the average loss factor, the 2009 load forecast was reduced to 589.8 GWh and the 2010 load forecast was reduced to 576.9 GWh.

Customer Forecast

Festival Hydro is seeking Board approval for a test year customer forecast of 25,874 customers/connections. The test year forecast is 1.8%, or 469 customers/connections higher than the 2008 actuals. The bridge year and test year customer forecast were derived by extrapolating the 2008 actuals by the historical geometric class specific mean from 2001 to 2008. The class specific forecasts as proposed in the application are summarized in the following table:

Table 3
2010 Customer Count Forecast

Rate Classes	No. of Customers	Proportion of Total
Residential	17,115	66.1%
Residential Hensall	413	1.6%
GS<50 kW	1,968	7.6%

GS>50 kW	221	0.9%
Large Use	2	0.0%
Streetlights	5,916	22.9%
Sentinel Lights	83	0.3%
Unmetered Loads	156	0.6%
TOTAL	**25,874**	**100%**

Class Specific Load Forecasts

In calculating the customer class specific load forecasts, Festival Hydro determined the growth rate related to the annual kWh usage per customer/connection from 2000 to 2008. Reliable historical billed energy data by rate class is not available for the period prior to amalgamation in 2000. Subsequently, Festival Hydro determined the historical geometric mean for each class and applied it to determine the 2009 and 2010 class specific forecasts. The resulting non-normalized weather billed energy forecast was 592.9 GWh for 2009 and 592.5 GWh for 2010.

The difference between non-normalized weather billed energy forecast and the total weather normalized billed forecast was assigned to those rate classes that are weather sensitive – both residential classes, GS<50 and GS>50. The weather sensitivity factor for all classes was 100% except GS>50 which was assigned a factor of 24%. Festival Hydro aligned the non-normalized forecast using 11 year HDD and CDD. Festival Hydro states that the purchase data correlates better with the 11 year HDD and CDD data than the 20 year HDD and CDD data.

Through supplemental interrogatory #39, Board staff requested that Festival Hydro provide a load forecast for 2009 and 2010 using the normalized average consumption ("NAC") approach.

Board staff also requested a load forecast using the IESO 18 month outlook. Festival Hydro developed a load forecast applying electricity decline of 4% in 2009 and decline of 0.3% in 2010 as reported in the May 25, 2009 IESO 18 month outlook. The 2010 data for all three approaches are provided in the following table.

Table 4
2010 Load Forecast (kWh)

Comparison of Methods

Rate Classes	As Filed Aug 28	NAC	IESO
Residential	129,737,473	140,313,581	131,097,385
Residential Hensall	3,808,598	4,035,190	3,844,289
GS<50 kW	62,021,896	67,164,064	64,399,611
GS>50 kW	310,990,652	316,569,689	299,528,947
Large Use	65,544,852	67,424,347	64,533,191
Streetlights	3,904,130	3,881,508	3,677,472
Sentinel Lights	234,690	223,093	209,619
Unmetered Loads	629,732	678,377	652,487
TOTAL	**576,872,023**	**600,289,849**	**567,943,001**

Board staff has concerns with the multifactor regression model that Festival Hydro has used to generate its test year forecast. Festival Hydro, along with other distributors that have filed cost of service applications for 2010 distribution rates, used econometric multifactor regression modeling to attempt to improve the load forecast.

The Board accepted simplified load forecasting relying on the NAC approach for 2008 cost of service applications, but the Board stated its expectations for improvement. In 2009, some cost of service applicants attempted to improve on techniques and introduced more sophisticated econometric methods.

Board staff views the use of econometric methods for the 2009 cost of service applications as a positive step. It is also staff's view that multifactor regression modeling is not simply a mechanical process. The model should also pass the test of reasonableness. Are the coefficients or variables plausible in sign and significance? Is the functional form appropriate? Are there signs of model misspecification, such as auto-correlated errors, or implausible coefficients? Do the predicted values forecasted by the model seem reasonable?

Board staff submit that the econometric model used by Festival Hydro does not pass such reasonableness tests and should not be used. Principally, Board staff is concerned that the negative coefficient for population is conceptually counter-intuitive; it implies that the load decreases as the population increases. Board staff is also concerned with the general quality of the results produced by the regression model as measured by the R - squared.

In response to a Board staff interrogatory relating to the negative population coefficient, and similar interrogatories from VECC and SEC, Festival Hydro stated that, “The load increase from the modest customer growth is less than the reduction in load resulting from reduced average consumption across the entire customer population. This reduction across the entire consumer population is primarily the result of two factors: conservation and reduced manufacturing demand related to plant closures. Over the past five years, residential sales per customer (i.e. population) have been on the decline.” The Applicant provided no quantitative support with its explanation.

The adjusted R - squared of the multifactor regression model, as reported in the application, is 0.776. This result is much lower than the normal 0.90 to 0.95 acceptance range. In response to VECC interrogatory #10, the Applicant reported that the adjusted R - squared was worse, at 0.723, when population was removed as a factor.

The NAC approach determined loads that were 1.2% higher than the regression model for 2009 and 4.1% higher for 2010. The IESO approach determined loads that were 3.4% lower than the regression model for 2009 and 1.5% lower for 2010. Board staff recommends that the NAC approach be accepted for 2010 as it is more utility specific in comparison with the IESO approach, which has a provincial perspective and is perhaps more suited for application to a utility with more manufacturing in its service area.

OPERATIONS, MAINTENANCE AND ADMINISTRATION

Background

For the 2010 test year, Festival Hydro is requesting approval of $3,968,610 in OM&A expenses excluding taxes and amortization expenses. This request is documented in the application as filed on August 28, 2009.[5] This represents a 2.73% increase over the 2009 Bridge year and a 7.45% increase over 2008 actuals. Total operating expenses

[5] Exhibit 4/ Tab 1/ Schedule 1

(including depreciation/amortization) for the 2010 test year are forecast at $6,624,106. This represents an increase of 3.49% over the 2009 bridge year and an 8.83% increase over Festival Hydro's 2008 actuals. The following table summarizes Festival Hydro's OM&A and operating expenses by year.

Table 5
OM&A and Operating Expenses

	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test	Average Annual Variance
						2006 to 2010
Operation	$528,712	$522,506	$623,913	$640,791	$658,190	5.91%
Maintenance	$674,908	$835,083	$745,455	$766,335	$787,807	4.65%
Billing and Collection	$962,636	$921,773	$928,131	$1,022,792	$1,020,272	1.60%
Community Relations	$113,313	$157,301	$12,067	$22,374	$42,930	30.95%
Administrative and General Expenses	$1,348,736	$1,250,082	$1,384,019	$1,410,880	$1,459,411	2.20%
Sub-Total OM&A	**$ 3,628,305**	**$ 3,686,745**	**$ 3,693,585**	**$ 3,863,172**	**$ 3,968,610**	**2.28%**
Amortization	$2,190,695	$2,244,836	$2,393,253	$2,537,780	$2,655,496	4.94%
Total Operating Expenses	**$ 5,819,000**	**$ 5,931,581**	**$ 6,086,838**	**$ 6,400,952**	**$ 6,624,106**	**3.30%**

Over the 2006 to 2008 period, Festival Hydro's actual OM&A expenses increased by approximately 0.90% annually. The Applicant has also provided a table indicating the drivers of the OM&A increases year over year in Exhibit 4, Tab 2, Schedule 3, page 1. The table is replicated below.

Table 6
Drivers of OM&A Increases

	2006	2007	2008	2009	2010
Opening Balances	3,402,114	3,758,158	3,811,551	3,753,085	3,952,662
Labour	84,183	21,133	35,002	50,405	51,918
Materials	(121,780)	15,862	(26,303)	2,072	1,770
Outside services	49,131	(75,698)	90,312	8,387	15,150
Office supplies	14,152	5,665	22,947	6,091	5,206
Fuel	20,070	41,871	63,122	9,373	8,011
Other	23,057	51,411	4,044	11,921	27,784
Adjustments or writeoffs	92,073	(40,933)	(37,256)	71,337	(24,641)
PIL Property tax	97,797	(5,048)	(65,305)	29,990	(39,173)
Energy Conservation	97,360	39,129	(145,029)	10,000	20,241
Total	3,758,158	3,811,551	3,753,085	3,952,662	4,018,927

Board staff notes that the majority of the increases in 2010 OM&A expenses compared with 2008 actuals is a result of inflation, labour, other expenses and energy conservation.

Inflation

The Applicant states in its application that for both the 2009 and 2010 budget processes, each general ledger account was reviewed and increased by 3.0% for the labour and benefit components and 2.3% for other components to allow for inflationary costs. The accounts were then increased/decreased for any other additional costs or savings.

In response to Board staff interrogatory #13 relating to compensation, Festival Hydro stated that the inflationary increases of 3% on average are based on the union contract, most recently signed in 2008 and in effect until May 2011.

Board staff has no concerns with the inflationary increases applied by Festival Hydro.

Labour

As documented in the application[6] and in response to an interrogatory[7], total compensation increased by 3% for each of the historical year 2008 and the bridge year 2009.

Total compensation for the 2010 test year will increase by 4.1%. Festival Hydro is in the process of hiring an Energy Conservation Officer to aid in the implementation of various conservation programs[8]. The application stated that the new position with be shared with the City of Stratford, with the City of Stratford paying 40% of the salary and benefits. In response to Board staff interrogatory #13, the Applicant confirmed that the greater than 3% increase in 2010 over 2009 does relate to the addition of the Energy Conservation Officer.

Board Staff supplemental IR #41sought further clarification on executive wages and the Applicant's statement that in "2007 and 2008 executive wage increases were greater than 3% to reflect pay amounts that are competitive with other LDC's in the Southwestern Region."[9] In response to IR#41, Festival Hydro provided the results of the

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[6] Exhibit 4/ Tab 2/ Schedule 6

[7] Board Staff Interrogatory #13

[8] Exhibit 4/ Tab 2/ Schedule 6/ Page 3

[9] Response to Board staff interrogatory #13

MEARIE salary survey and compared those to actual Festival Hydro data. The following table compares the MEARIE mean with the actual Festival Hydro data for the three executive positions of President, VP Engineering & Operations and Secretary Treasurer, before and after executive wage increases.

Table 7
Total Executive Compensation

	2007	2008
Comparison with MEARIE mean before increase	$(12,817)	$(17,944)
Comparison with MEARIE mean after increase	$6,054	$(3,193)

Board staff submits that the Applicant has provided sufficient information in support of its compensation proposal.

Other Expenses

Other expenses include service charges, safety equipment, small tools and municipal taxes[10]. To explain the trends, the applicant states that this cost driver was at its lowest in 2008 due to the fact that 2007 included one-time costs that were not in 2008. In addition, regulatory expenses were over-accrued in 2007 and the over-accrual was cleared out in 2008. Board staff submits that the Applicant has sufficiently explained the trends for this driver.

Energy Conservation

The Applicant reports that the decrease in account 5415 in 2008 is due to the change in practice from placing CDM cost and recoveries in a balance sheet variance account to the income statement. The income was collected in 2005-2006 but the expenses were incurred into 2007. The 2008 cost driver was decreased significantly as conservation expenses booked in 2007 were not incurred in 2008. Board staff submits that the Applicant has sufficiently explained the trends for this driver.

Board staff also wishes to comment on several other OM&A related matters as follows.

[10] Exhibit 4/ Tab 2/ Schedule 3

Depreciation Rates

The application provides a list of depreciation rates which the Applicant states are in line with the rates set out in the APH. Board staff interrogatory #15 noted that the life years are consistent with those listed in Appendix B of the 2006 Electricity Distribution Rate Handbook except for buildings & fixtures. Festival Hydro replied that the physical buildings are amortized over 50 years in accordance with the EDR Handbook. Festival Hydro feels that fixtures such as HVAC systems are more justifiably amortized over 30 years as they are not expected to have the same useful life as physical buildings; however no supporting documentation was provided.

Energy Probe IR#39 sought the impact on the depreciation expense of using a 50 year life in place of 30 years for account 1908 buildings & fixtures. The Applicant replied that depreciation expense would decrease by approximately $7,000.

Board staff submits that buildings & fixtures should be amortized over 50 years in accordance with the EDR Handbook.

International Financial Reporting Standards ("IFRS")

In its application, Festival Hydro included $25,000 in administration costs to cover the transition costs to IFRS in each of the four years starting in 2010, for a total of $100,000. These costs were included in administration costs[11]. Board staff interrogatory #12 asked the applicant to explain how the request complied with section 8.2 of the July 28, 2009 Board Report, *Transition to International Financial Reporting Standards*. This section states that a deferral account will be set up to record the incremental one-time conversion costs to IFRS, and is not to include ongoing compliance costs. Similar interrogatories were posed by Energy Probe and SEC.

Festival Hydro stated that it anticipates using the deferral account for one-time conversion costs but that significant ongoing compliance costs should be considered and that it has applied for such costs. In response to Board staff interrogatory #12, Festival Hydro estimated the ongoing costs to be $14,000 each year for four years. In response to Board staff supplemental interrogatory #40, Festival Hydro provided specific examples of activities related to ongoing IFRS compliance.

[11] Exhibit 4/ Tab 2/Schedule 3/ Page 17

Festival Hydro has reduced OM&A by $11,000 in the updated test year revenue requirement in Table 1 of this submission to reflect the change in IFRS costs from $25,000 to $14,000.

Section 8.1 of the Board Report on the transition to IFRS states that, “Prudently incurred incremental administrative costs directly related to the ongoing compliance with IFRS will be recovered from ratepayers on the same basis as other current operating costs.” Board staff submits that the Applicant has appropriately implemented sections 8.1 and 8.2 of the report.

Low Income Energy Assistance Program (“LEAP”)

Festival Hydro has included 0.12% of its distribution revenue requirement to fund LEAP.[12] Board staff interrogatory #11 queried whether the amount related to existing programs. Festival Hydro replied that $4,400 relates to existing programs, and $7,600 relates to the new LEAP programs. Festival Hydro acknowledged that the Board’s letter dated September 28, 2009 indicated that the Board was deferring further work on LEAP as a result of a request from the Ministry of Energy and Infrastructure. However, Festival Hydro stated that it expected to incur costs associated with the development of the Ministry’s integrated program.

In its September 28, 2009 letter the Board indicated that the Minister of Energy and Infrastructure had requested that the Board not proceed to implement new support programs for low-income energy consumers in advance of a ministerial direction. Board staff submits that the costs relating to new LEAP programs, $7,600, should be removed at this time, as the Board has not yet received further guidance from the Ministry regarding a program for low-income energy consumers. As a result, any costs to be recovered by Festival Hydro in relation to such a program are not yet known.

Regulatory Costs

The Applicant has included in 2010 and the subsequent three year period a $40,000 increase in annual regulatory costs.[13] The Applicant states that the increase is required to cover the expenses associated with the 2010 cost of service application, and future workload associated with other regulatory related matters. The $40,000 is comprised of $14,000 for legal costs, $14,000 for consulting costs, $6,000 for incremental staff costs and $6,000 for intervenor costs.

[12] Exhibit 4/ Tab 3/ Schedule 3

[13] Exhibit 4/ Tab 2/ Schedule 3/ Page 4

Energy Probe interrogatory # 23 queried the expected cost reduction if the current application does not require an oral component. Festival Hydro responded that its forecast was based on a written process and that it cannot reduce the projection.

Board staff submit that the $160,000 expense related to the 2010 cost of service application and other regulatory related matters is reasonable. Staff note that similar amounts were approved for written proceedings in 2009, i.e. COLLUS Power Corp. (EB-2008-0226).

Adjustments or Writeoffs

Adjustments or writeoffs as noted in the table summarizing drivers of OM&A increases, represent bad debt expense. The Applicant projected that bad debt expense would increase in 2009 by $71,337 and decrease in 2010 by $24,641. The bad debt expense for the period 2006 to 2010 is summarized in the following table.

Table 8

	Bad Debt Expense for 2010 Test year					
	2006	2007	2008	2009	Four Year Total	Test Year 2010
Acutal & BridgeBad Debt expense	152,889.00	111,956.00	74,700.00	85,000.00	424,545.00	
Add: Large customer CCAA filing (allow 50%) increase to original 2009 budget				61,037.31	61,037.31	
Total bad debt expense (2010 rate application - Four year average)	152,889.00	111,956.00	74,700.00	146,037.31	485,582.31	121,395.58

Festival Hydro states that the bad debt cost driver peaked in 2006 and 2008, the years when two large industrial customers filed for credit protection[14]. The cost driver is reduced in the years when large customer write-offs did not occur.

Board staff invite the Applicant to clarify the years when the bad debt cost driver peaked. The data provided in Exhibit 4/ Tab 2/ Schedule 3 suggest 2006 and 2009 and not 2006 and 2008. Board staff invites the Applicant to comment on the use of a 4 year average for 2010 when the 4 year time frame includes data that reflects peaks.

[14] Exhibit 4/ Tab 2/ Schedule 3/ Page 3

Payments in Lieu of Taxes ("PILs")

In its application, Festival Hydro requested a PILs allowance of $928,906 composed of $908,589 for grossed-up income taxes and $20,317 for capital taxes.[15]

Table 9
PILs Summary

Description	2006 Board Approved	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test
Income Taxes	$1,252,551	$1,131,505	$1,303,245	$1,097,568	$753,906	$908,589
Ontario Capital Tax	$87,022	$92,296	$86,067	$64,059	$59,490	$20,317
Total Taxes	**$1,339,573**	**$1,223,801**	**$1,389,312**	**$1,161,627**	**$813,396**	**$928,906**
Year-over-Year Variance			13.52%	-16.39%	-29.98%	14.20%

The application noted a fair market value ("FMV") bump of $1,847,262 in the determination of the 2009 capital cost allowance.[16] Energy Probe interrogatory #32 and #50 queried the treatment and timing of the FMV bump and the impact on undepreciated capital cost ("UCC"), making reference to the 2006 Electricity Distribution Rate Handbook. In response, the Applicant stated that, as per section 7.2.4 of the handbook, the $1,847,262 FMV bump should not reduce the UCC balance in calculating the CCA used for tax purposes. Accordingly, the Applicant added the entire FMV bump back into the UCC balance. Board staff submits that the correction is appropriate.

The Applicant provided a correction to the PILs determination with its second round interrogatory responses. The correction reflects the inclusion in UCC of the FMV bump, the Ontario corporate income tax rate change from 14% to 12% and a correction for application software. The change reduces the 2010 PILs from $908,589 to $780,198.

[15] Exhibit 4/ Tab 1/ Schedule 1
[16] Exhibit 4/ Tab 3/ Schedule 2

Board staff notes that other changes to Festival Hydro's revenue requirement are possible, due to the Board's decision on Festival Hydro's rate base, capital and operating expenditures. These changes also have a flow-through effect on the PILs allowance which should be recoverable in rates. Board staff submits that Festival Hydro should flow through applicable changes in operating and capital costs, and update the PILs allowance to determine the revenue requirement and rates resulting from the Board's Decision in its draft Rate Order filing.

RATE BASE

Background

Festival Hydro has calculated its 2010 rate base to be $39,583,651. The proposed 2010 rate base is 5.4% or $2.0 M higher than 2008 actuals. In comparison with the 2006 Board Approved rate base, the proposed 2010 rate base is 13.1% or $4.6 M higher. The rate base for the period 2006 to 2010, as documented in Exhibit 2/ Tab 2/ Schedule 1 – Rate Base Overview, is summarized in the following table.

Table 10

Description	2006 Board Approved	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test
Gross Fixed Assets	$56,920,451	$62,593,542	$65,198,393	$70,067,244	$73,469,244	$76,826,244
Accumulated Depreciation	$28,828,157	$33,562,551	$35,520,874	$38,726,543	$41,462,401	$44,337,232
Net Book Value	$28,092,294	$29,030,991	$29,677,519	$31,340,701	$32,006,843	$32,489,012
Average Net Book Value	$28,421,346	$28,890,694	$29,354,255	$30,509,110	$31,673,772	$32,247,928
Working Capital	$46,050,224	$47,968,053	$48,360,788	$47,080,155	$50,100,520	$48,904,825
Working Capital Allowance	$6,907,534	$7,195,208	$7,254,118	$7,062,023	$7,515,078	$7,335,724
Rate Base	**$34,999,828**	**$36,085,902**	**$36,608,373**	**$37,571,133**	**$39,188,850**	**$39,583,651**
Year-over-Year Variance			1.45%	2.63%	4.31%	1.01%

Board staff observe that the total 2006 Board approved rate base as reported by the Applicant, $34,999,828, is not the sum of the average net book value and working capital allowance in the column, i.e. $35,328,880. Board staff invite the Applicant to confirm the data.

Capital Expenditures

Festival Hydro documented its capital expenditures in Exhibit 2/ Tab 3/ Schedule 1 – Capital Budget – Capital Project Description. The application states that Festival Hydro has not begun the process of installing smart meters and the cost of smart meters has not been included in this application. The following table summarizes capital additions to Festival Hydro's fixed assets for the period 2006 to 2010.

Table 11

Description	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test
Capital Additions	$2,399,343	$2,822,415	$5,063,167	$3,402,000	$3,357,000
Year-over-Year Variance		17.63%	79.39%	-32.81%	-1.32%
CICA Handbook –Spare Parts and Disposals to Capital			$1,616,563		
Capital Additions	$2,399,343	$2,822,415	$3,446,604	$3,402,000	$3,357,000
Year-over-Year Variance		17.63%	22.12%	-1.29%	-1.32%

In 2008, Festival Hydro adopted CICA Handbook Section 3031 and reclassified spare parts totaling $648,253 from inventory to capital assets. Board staff interrogatory #1 sought clarification on the change in accounting policy and the reasons why the change was not applied on a retrospective basis. The Applicant replied that the adjustment at December 31, 2008 was a reclass entry to ensure that financial statements were accurate. The Applicant stated that the adjustment did not impact the profit and loss statement as depreciation was not taken on the amount adjusted to capital. In response to SEC interrogatory #3, Festival Hydro stated that prior to the reclassification, major spare parts were treated as an inventory item and therefore not included in rate base.

In 2008, Festival Hydro transferred $968,310 from the non depreciable asset disposal cost account to the respective property, plant and equipment accounts. The application states that this transfer was done following the 2008 audit. Interrogatories from Board staff, SEC and Energy Probe sought details of the accumulation of the $968,310, as well as supporting documentation from the auditor. In response, the Applicant provided the details of accumulation year by year for the period 2002 to 2008 and an excerpt from KPMG's audit report.

After normalizing for unusual capital additions in 2008, staff observe that capital additions are stable in the period 2008 to 2010. Similar levels of capital additions are budgeted for 2011 and 2012.[17]

[17] Exhibit 2/ Tab 3/ Schedule 1/ Page 22

Major capital projects for 2010 include:

- Stratford MS#1 Conversion – 2010 will be the fifth year of this 5 year project to replace 4 kV infrastructure with 27.6 kV. In addition to replacing aging infrastructure, there will be a reduction in system losses and the elimination of the municipal substation. The 2010 cost is estimated to be $328,000. In response to SEC interrogatory #5, the Applicant stated that the total cost of the project is $1,249,271.
- Stratford – Delamere Rebuild – The scope of this project is to replace 35-45 year old poles, wooden crossarms, porcelain insulators and transformers. The estimated 2010 cost is $224,000.
- The applicant estimates that $450,000 is required for new transformers based on known projects and expected customer driven projects based on previous years.
- Forty small customer driven projects are expected in 2010, including new commercial and industrial connections. Festival Hydro estimates that 2010 costs will be $455,000.
- The applicant plans to replace 3 vehicles, for a total cost of $300,000. In response to interrogatories from VECC and EP, the Applicant provided more detailed information on the cost of vehicles and stated that the vehicles to be replaced are fully depreciated.

Board staff does not take issue with the proposed 2010 capital additions.

Service Quality and Reliability

Festival Hydro provided the following service reliability indices with its application[18].

Table 12
Service Reliability Indices

YEAR	SAIDI – Annual	SAIFI – Annual	CAIDI - Annual
2004	1.91	1.82	1.05
2005	2.35	2.49	0.94
2006	3.07	3.43	0.89
2007	4.18	4.82	0.87
2008	1.73	1.86	0.93
AVG	2.65	2.88	0.94

[18] Exhibit 2/ Tab 3/ Schedule 2/ Appendix A

In response to Board staff interrogatory #4, Festival Hydro noted that a major storm in 2007 caused numerous outages related to broken tree limbs. The single storm increased SAIDI by 1.14 and SAIFI by 0.29. The Applicant noted that it has implemented improvements in tree trimming and relay settings, as well it is installing automated switches and insulated brackets. Reliability indices for 2008 are generally lower than the previous three years.

Board staff submits that Festival Hydro has adequately documented the reasons for the trends in service reliability. The Applicant has also documented how it plans to maintain and improve the level of reliability of the distribution system in its Asset Management Plan. The stability of CAIDI does not point to any concerns with Festival Hydro's efforts to manage outages when they occur or for the need for increased capital expenditures.

Working Capital Allowance

Festival Hydro has used 15% of OM&A and cost of power in the calculation of working capital. No lead/lag study was provided. Festival Hydro has requested a working capital allowance of $7.3 million for the 2010 test year. Working capital has increased by approximately 0.5% annually from 2006 actual to 2010. The largest increase occurred in 2009 (6.4%) which correlates with a large increase in power supply expense during that time period.

Using information provided in its original application on WCA, Board staff has compiled the following summary table:[19]

[19] Exhibit 2 / Tab 1/ Schedule 1

Table 13

Description	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test
Operation	$528,712	$522,506	$623,913	$640,791	$658,190
Maintenance	$674,908	$835,083	$745,455	$766,335	$787,807
Billing and Collecting	$962,636	$921,773	$928,131	$1,022,792	$1,020,272
Community Relations	$113,313	$157,301	$12,067	$22,374	$42,930
Administrative and General	$ 1,348,436	$ 1,249,982	$ 1,383,769	$ 1,410,622	$ 1,459,147
Taxes and Income Taxes	$ 129,853	$ 124,805	$ 59,500	$ 89,490	$ 50,317
Power Supply Expense	$44,210,195	$44,549,337	$43,327,319	$46,148,116	$44,886,161
Working Capital	**$ 47,968,053**	**$ 48,360,788**	**$ 47,080,155**	**$ 50,100,520**	**$ 48,904,825**
Working Capital Allowance	**$ 7,195,208**	**$ 7,254,118**	**$ 7,062,023**	**$ 7,515,078**	**$ 7,335,724**
Year-over-Year Variance		0.82%	-2.65%	6.42%	-2.39%

Board staff takes no issue with Festival Hydro's methodology for calculating the WCA. Board staff submits that Festival Hydro should update the WCA to reflect any changes in controllable expenses and load forecasts as determined by the Board in its Decision, as well as the most current estimate of the RPP commodity price, as well as updates to reflect current retail transmission prices. Further, Board staff submits that Festival Hydro should provide sufficient detail and discussion in its draft Rate Order to aid other parties in understanding the numbers provided and their derivation.

In response to VECC interrogatory #2 relating to a lead-lag study, Festival Hydro states that Board's Filing Requirements for Transmission and Distribution Applications provides for two approaches, the 15% allowance approach and the lead-lag study. Festival Hydro chose the first option and stated that it does not plan to complete a lead-lag study at this time. As lead-lag studies can be costly for individual utilities, Festival Hydro recommended that if the Board considered such a study a requirement that the Board conduct the study on a generic basis across the province through a consultation process.

Board staff submits that there have generally been concerns about the appropriateness of the standard 15% formulaic approach, which dates back to the prior regulation of the municipal utilities by the former Ontario Hydro. The restructuring of the industry, unbundling of rates, introduction of competition in generation and marketing, and the corporatization of distributors as commercial, profit-seeking entities have altered the business environment and the distributors themselves. Current initiatives, such as smart metering and Time-of-Use pricing, and renewable generation contracts, will have further impacts on cash working capital requirements for all distributors.

Board Staff notes that 15% may be appropriate at this time, but that new evidence should be required at Festival Hydro's next rebasing application to support the requested working capital allowance.

Cost of Capital

The Board has revised and documented its approach to determine the cost of capital in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the "Board Report"), issued December 11, 2009, under Board File No. EB-2009-0084. The Board Report is a guideline, but departures from the methodology in the Board Report are expected to be adequately supported. While the Board Report was issued subsequent to this Application, the Board Report states that the revised guidelines apply to applications for rates effective in 2010 or later and determined through review of Cost of Service applications. Thus the Board Report supersedes the guidelines documented in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* issued December 20, 2006, and is applicable to Festival Hydro's Application.

In Exhibit 5 of its Application, Festival Hydro has proposed its test year Cost of Capital. This is summarized in the following table.

Table 14

Cost of Capital Parameter	Festival Hydro's 2010 Proposal
Capital Structure	60.0% debt (composed of 56.0% long-term debt and 4.0% short-term debt) and 40.0% equity
Short-Term Debt	1.33%, but to be updated in accordance with Appendix D of the Board Report.
Long-Term Debt	7.40% reflecting the rate of Festival Hydro's only promissory note due to the City of Stratford, its municipal shareholder, and a 2010 loan from Infrastructure Ontario to fund the smart meter program.
Return on Equity	8.01%, Festival Hydro states that its use of an ROE of 8.01% is without prejudice and is subject to any revised ROE that the Board may adopt in 2010. The ROE will be updated in accordance with the methodology in Appendix B of the Board Report.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital (WACC)	7.40% as proposed, but subject to change as the short-term and long-term debt rates and ROE are updated per the Board Report

Long Term Debt

Festival Hydro has its original debt, a promissory note held by its shareholder, the City of Stratford. While the documentation, dated August 18, 2009[20], indicates that the current rate is 7.25%, the Applicant stated in response to Energy Probe IR#36 it used the Board's deemed debt rate of 7.62% in calculations as this is consistent with the procedures that were followed in previous COS filings. Festival Hydro stated that the note is payable on demand at any time to the City of Stratford.

In addition to the promissory note, Festival Hydro will borrow $2.5 M from Infrastructure Ontario to fund the smart meter program. Festival Hydro applied an interest rate of 6.0% to the Infrastructure Ontario loan to determine the 7.4% long term debt rate as follows.

Table 15

Description	Amount	Interest	Rate
City of Stratford Demand Note	$15,600,000	$1,188,720	7.62%
Infrastructure Ontario Loan	$2,500,000	$150,000	6.00%
Total	$18,100,000	$1,338,720	7.40%

In its application Festival Hydro noted that the Infrastructure Ontario interest rate was 5.04% on June 16, 2009. The Applicant used 6.00% to allow for interest rate volatility. In response to Energy Probe IR#36 on November 23, 2009, the Applicant stated that the most recent interest rate on the Infrastructure Ontario website quoted for a 15 year loan was 4.72%.

Board Staff submits that Festival Hydro should use the latest information available on the record of this proceeding with respect to the level of the actual rate for its third party debt. Accordingly, staff submits that the rate of 4.72% should be used for the Infrastructure Ontario loan instrument.

Section 4.4.1 of the Board Report states that, "The Board will primarily rely on the embedded or actual cost of existing long-term debt instruments." Staff notes that there is no persuasive evidence provided by Festival Hydro for deviating from the Board's policy of using the actual debt rates for known debt. Accordingly, staff submits that the actual rate of 7.25% be used for the affiliated debt instrument to determine the long term debt

[20] Exhibit 5/ Tab 1/ Schedule 3

rate in the current application. This submission is subject to the determination of the deemed long term debt rate as the Board report states that, “The deemed long-term debt rate will act as a proxy or ceiling for what would be considered to be a market-based rate by the Board in certain circumstances.”

COST ALLOCATION AND RATE DESIGN

Loss Factors

Festival Hydro has applied for a total loss factor (“TLF”) of 1.0307 for secondary metered customers < 5,000 kW. This is based on a distribution loss factor (“DLF”) of 1.0230 and a supply facility loss factor (“SFLF”) of 1.0075. The 2010 TLF request represents a small increase over the current TLF of 1.0281. The request is based on loss factor data for the five year period 2004 to 2008, as illustrated in the following table[21].

Table16

Description	2004	2005	2006	2007	2008	5 Year Average
Loss Factor in Distributor's System	1.0204	1.0234	1.0221	1.0245	1.0248	1.02304
Supply Facility Loss Factor	1.0075	1.0071	1.0076	1.0075	1.0075	1.00744
Total Loss Factor						1.0307

Festival Hydro is a partially embedded distributor. Metering points in the City of Stratford and the Town of St. Marys are directly connected to the IESO controlled grid. Festival Hydro is embedded within Hydro One for the smaller towns in the Applicant’s service territory. The current TLF of 1.0281 is based on the current SFLF of 1.0045. In response to Board staff interrogatory #25, the Applicant stated that, in 2001, Festival Hydro adopted the provincial wide SFLF loss factor of 1.0045. In the 2006 COS, the SFLF amount was left at 1.0045 and not properly adjusted to equal the weighted average of the IESO directly connected points (SFLF of 1.0045) and the Hydro One embedded points (SFLF of 1.0340). Festival Hydro states that this was an over sight in the 2006 COS.

[21] Exhibit 8/ Tab 1/ Schedule 1

Board staff has no concerns with the provision made for the test year DLF, SFLF and TLF. The SFLF increase reflects the partially embedded nature of the Applicant's distribution system. The increase in TLF is a result of the increase in the SFLF.

Customer Classes

As noted in the introduction, in 2000, Festival Hydro purchased the assets of the Hensall Public Utilities Commission. These assets serve 413 residential customers. Because of the large difference in residential rates, the rates were not harmonized at that time. As part of the 2006 rate application process and previous RAM models, Festival Hydro took steps to harmonize these rates through direct mitigation. There has been no further direct mitigation since 2006. As a consequence, Festival Hydro still has two residential customer classes.

In total, Festival Hydro has eight customer classes. They are Residential, Residential Hensall, GS<50, GS>50, large use, sentinel lights, street lighting and USL. Festival Hydro has not proposed any changes to customer classes for the test year.

The Applicant has, however, revised the rate class descriptions from those documented in their Tariff of Rates and Charges effective May 1, 2009.[22] The Applicant reported in response to Board staff Interrogatory #29 that the revisions, generally relating to process and frequency of reclassification, are in accordance with the Distribution System Code as amended in proceeding EB-2007-0722. Board staff submit that the rate class descriptions provided in tariff sheets should correspond to those provided in the Applicant's Conditions of Service. Board staff invite the Applicant to confirm that this is the case.

Revenue to Cost Ratios

Festival Hydro revised its 2006 Cost Allocation Information Filing by removing the transformer ownership allowance of $446,944[23]. Board staff and VECC observed discrepancies in the reduction in revenues related to the transformer ownership allowance. The Applicant revised the 2006 model run and provided the revenue to cost ratio revisions with first round interrogatory responses. These revised 2006 revenue to

[22] Exhibit 8/ Tab 1/ Schedule 4
[23] Exhibit 7/ Tab 1/ Schedule 2

cost ratios are listed in column 1 of the table below. The cost allocation to reflect the 2010 load forecast, corrected for transformer ownership allowance is listed in column 2 of the table. The Board's target ranges, as established in the Board's *Application of Cost Allocation for Electricity Distributors EB-2007-0667*, are set out in column 4.

Table 17
Revenue to Cost Ratios

	2006 Informational Filing Col 1**	**2010 Informational Filing** Col 2**	**Proposed Ratio Col 3**	**Board Target Col 4**
Residential	105.11 %	108.44%	107.70%	85-115
Residential Hensall	60.51%	71.52%	91.21%	85-115
GS < 50	101.13 %	116.03%	112.28%	80-120
GS > 50	92.30 %	79.93%	81.85%	80-180
Large Use	148.97%	114.10%	108.13%	85-115
Streetlight	28.94 %	31.40%	50.70%	70-120
Sentinel Light	24.62%	32.88%	51.52%	70-120
USL	62.73%	143.83%	120.30%	80-120

(** Transformer Ownership Allowance Removed)

The contribution from USL in 2010 appears to have doubled when compared with the 2006 ratio, however, Festival Hydro submitted that this is due to a data error for USL revenue reported in 2006.

Festival Hydro is requesting approval of the ratios in column 3. The Applicant is proposing to move in the direction of 100% for all classes. Festival Hydro proposes to move the ratio for street lighting and sentinel lighting halfway to 70%, the lower band of the Board's Target Range. The proposed change for Residential Hensall moves the ratio beyond the 80% lower band. The application states that it is Festival Hydro's desire to move the Hensall rates closer to the regular residential rates and to eventually harmonize these rates. In response to Board staff supplementary interrogatory #42, Festival Hydro confirmed that 42 of the of the 413 Residential Hensall customers will experience a greater than 10% bill impact based on the revenue to cost ratio proposed for 2010. The increase will be approximately 14% and the total bill will increase by $4.88 per month. While the increase for these 42 customers exceeds 10%, staff submits that the increase is reasonable as it will facilitate the movement towards harmonization and eventually simplify Festival Hydro's billing and customer care operations.

The 2010 Test Year Revenue Impact is summarized in the following table from Exhibit 7/ Tab 1/ Schedule 2:

Table 18

Cost Allocation - Test Year Revenue Impacts

Class	Current Revenue (i.e. 2006 model revenue to cost ratios with TA removed	Test Year Revenue using 2010 model revenue to cost ratios	Test Year Revenue assuming Proposed revenue to cost ratios
Residential	5,034,449.38	5,870,412.79	5,830,423.31
Residential - Hensall	78,271.59	99,742.26	127,203.47
GS < 50 kW	1,675,383.69	1,798,111.34	1,739,984.60
GS >50	2,228,954.17	2,289,157.16	2,344,010.83
Large Use	385,581.05	341,906.71	324,011.09
Sentinel Lights	2,724.82	4,409.24	7,120.04
Street Lighting	54,161.32	66,582.91	104,317.84
USL	19,847.20	41,259.32	34,510.51
TOTAL	9,479,373.23	10,511,581.71	10,511,581.71

In response to Board Staff supplementary interrogatory #42, the Applicant provided its revenue to cost ratio proposal through to the year 2013.

Table 19

Customer Class	2010 Proposed Rev Cost Ratio	2011 Proposed Rev Cost Ratio	2012 Proposed Rev Cost Ratio	2013 Proposed Rev Cost Ratio
Residential	107.70%	107.37%	107.34%	107.28%
Residential - Hensall	91.21%	94.10%	97.10%	100.00%
GS < 50 kW	112.28%	111.00%	110.10%	109.30%
GS >50	81.85%	81.85%	81.85%	81.85%
Large Use	108.13%	108.13%	108.13%	108.13%
Sentinel Lights	50.70%	57.20%	63.80%	70.00%
Street Lighting	51.52%	58.00%	64.00%	70.00%
USL	120.30%	116.00%	110.00%	105.00%
TOTAL				

The Applicant did not request approval for 2011-2013 revenue to cost ratios in the current application. The Applicant stated that, "The Board's Filing Instructions for the 2010 Generation Incentive Regulation Mechanism (IRM3) dated August 24, 2009 under

Section SD1.2 allows for the adjustment if so ordered by the Board. If not ordered by the Board, Festival Hydro will consider requesting the Board to allow Festival Hydro, as part of the 2011, 2012 and 2013 3rd generation IRM filing to adjust each of the [two] classes (streetlights and sentinel lights) below their ranges to bring the revenue to cost ratios within the target ranges by the 2013 rate year."

Board staff submits that the adjustment to the informational filing model to report cost and revenues net of transformer ownership allowance removes an inconsistency that biased the ratios in the original model. Board staff observes that the proposed 2010 ratios, with the exception of street lighting and sentinel lighting, are within the Board's target range and reasonable.

While the Applicant has not requested revenue to cost ratio approval beyond the test year, Board staff notes that the Applicant's plans to implement a 4 year process (test year plus 3 years) to move streetlight and sentinel light customers to the minimum of the target range differs from the 3 year process (test year plus 2 years) proposed by distributors in 2008 and 2009 applications and approved by the Board. Board staff submits that the 3 year process is more appropriate to address issues related to cross subsidization.

Monthly Fixed Charges

In its application, Festival Hydro stated that it is appropriate to maintain the same fixed/variable proportions assumed in the current rates for all customer classifications in the test year[24]. Board staff supplemental IR #44 queried the large difference in % impact for fixed and variable charges for the GS>50 and large user customer classes, indicating that fixed/variable proportions had not been maintained.

In response, the Applicant noted that the impact of the transformer allowance was not properly reflected in the original calculations, causing the fixed component to be understated and the variable component to be overstated for these two customer classes. Festival Hydro has recalculated the fixed/variable ratios to properly reflect the transformer allowance and asked that the Board accept the revised monthly fixed charges noted in the following table in place of the original application.

[24] Exhibit 8/ Tab 1/ Schedule 1

Table 20

Correction of Fixed/Variable split for G.S. > 50 KW and Large use				
Table of Rates	Monthly Service Charge G.S. > 50 kW	kW Variable Rate G.S. > 50 kW	Monthly Service Charge Large User	kW Variable Rate Large User
2009 Current Rates	209.76	2.2603	10,447.04	1.0931
2010 Original COS apllication	206.40	2.5255	8,730.51	1.4217
2010 Revised COS apllication	238.49	2.4135	10,977.20	1.0026

The calculation of floor and ceiling for monthly fixed charges for all customer classes are available in worksheet O2 of the updated cost allocation study. The proposed monthly fixed charges for four customer classes, GS<50, GS>50, large user and USL, are above the ceiling.

The Board has noted that it will not require that an existing Monthly Service Charge above the ceiling must be brought down to or below the ceiling[25]. Festival Hydro's proposed monthly fixed charges, described in the application and in the table above, are consistent with previous Board decisions for other distributors.

Low Voltage Rates

In its application, Festival Hydro determined that test year low voltage, now sub transmission ("ST"), charges for the test year would be $81,436.76, based on the Hydro One rates effective May 1, 2009. The Applicant allocated the ST charges to each class based on historical amounts collected from each class over the period 2006 to 2008.
In response to Board staff interrogatory #24, Festival Hydro provided an allocation of ST charges on the basis of 2010 Retail Transmission Connection Costs.

Board staff supplemental interrogatory #43 observed that ST charges used by Festival Hydro were adjusted to implement Hydro One's rate rider #4, which is only in effect until April 30, 2011. The interrogatory asked the Applicant to recalculate the ST charges (1) assuming no rate rider and (2) assuming the rate rider is only in place for one year and not in place for 3 years, i.e. simulating the situation where Festival Hydro's next cost of service will be 2014. The Applicant determined that ST charges would be $111,411.32 for scenario 1 and $103,917.68 for scenario 2.

[25] *Application of Cost Allocation for Electricity Distributors*, November 28, 2007, EB-2007-0667, p.12-13

Festival Hydro noted in its response to the interrogatory that a June 8, 2009 letter from Hydro One confirmed that the rate riders are in effect for an 11 month period starting June 2009. As such, Festival Hydro believes the weightings used in scenario 2 are reasonable.

Board staff agree that the ST charge determined for scenario 2 is reasonable. The approach is similar to that taken by COLLUS Power Corp. in the 2009 cost of service application (EB-2009-0226) and subsequently approved by the Board. Board staff also submits that allocation of ST charges on the basis of 2010 Retail transmission connection is appropriate.

Retail Transmission Service Rates (“RTSR”)

The Board’s revision of the guideline *Electricity Distribution Retail Transmission Service Rates [G-2008-0001]* was issued on July 22, 2009. The guideline is used to adjust RTSRs to reflect changes in the Ontario Uniform Transmission Rates, namely an increase in the network rate of 3.5% and a decrease in the connection rate of 2.16%.

Festival Hydro reviewed amounts paid to the IESO and Hydro One over the past two and one half years. The analysis indicates that Festival Hydro has over-collected network charges annually. A reduction in the network rate was implemented as part of the 2008 rate application, but the reduction was not sufficient and the Applicant has continued to overcharge. The historical analysis of connection charges indicates an overcharge in 2008 and an undercharge in 2009.

In the application, Festival Hydro proposed different percentage changes to network and connection charges by customer class. VECC interrogatory #20 queried the use of historical proportions paid by class to allocate the new RTSR. The Applicant replied that the methodology used to allocate the new RTSR charges is the same approach used as part of the 2009 IRM model when RTSR rates were last changed. VECC interrogatory #20 also asked the Applicant to recalculate network and connection charges such that the same percentage adjustment is made for all customer classes. Festival Hydro’s response assumed that variances prior to January 1, 2009 would be disposed of in the current proceeding. The Applicant extrapolated charges to year end 2009 and determined the rates which would have been needed in 2008 to achieve the 2009 extrapolated charges. The Applicant then used the 2010 projected load forecast to determine the RTSRs requested by VECC. Festival Hydro determined that network charges would decrease by 4.1% and connection charges would increase by 0.4%.

Board staff notes that in 2009 IRM, Festival Hydro proposed and received an 11.3% network rate increase for all classes and a 5.5% connection rate increase for all classes. Staff suggests that it is appropriate to apply the same adjustment for all customer classes in 2010, that being a network charge decrease of 4.1% and connection charge increase of 0.4%. Staff notes that an analysis of Festival Hydro's RTS variance account balances (1584 and 1586) suggest that these adjustments would offset the observed overcharging and undercharging respectively.

Other Distribution Revenue

Energy Probe has queried why Festival Hydro has no margin on street lighting maintenance, but does appear to have a positive margin associated with administration fees for the City of Stratford water billing and collections[26]. In response, Festival Hydro stated that it has not historically charged a margin on street lighting services provided, but that it will do so going forward. Festival Hydro will collect $14,985 in 2010 and have included this addition to revenue offsets. Staff notes that Festival Hydro provided a rationale for this level of forecasted revenue and therefore has no concerns with this revision.

Deferral and Variance Accounts

Festival Hydro provided the account balances representing principal balances to December 31, 2008 and projected interest to April 30, 2010 in its application. It also submitted its Audited Financial Statements as of December 31, 2008. The 2008 year end balances plus projected interest to April 30, 2010 are shown in the following table.

Table 21

Account Number	**Account Description**	**Total ($)**
1508	Other Regulatory Assets – Sub-Account – OEB Cost Assessments	97,265

[26] Energy Probe Supplemental Interrogatory #45

1508	Other Regulatory Assets – Sub-Account – Pension Contributions	277,090
1518	Retail Cost Variance Account – Retail	-59,934
1525	Misc. Deferred Debits – incl Rebate Cheques	0
1548	Retail Cost Variance Account – STR	27,232
1550	Low Voltage	77,573
	Sub-Total	**419,226**
1580	RSVA – Wholesale Market Service Charge	-1,486,026
1582	RSVA – One time Wholesale Market Service Charge	40,192
1584	RSVA – Retail Transmission Network Charge	-982,096
1586	RSVA – Retail Transmission Connection Charges	-1,027,267
1588	RSVA – Power (excluding Global Adjustment)	311,144
1588	RSVA – Power (Global Adjustment)	575,470
	Sub-Total **TOTAL**	**-2,568,583** **-2,149,357**

Festival Hydro has proposed to dispose of the balances over a 4 year period.

Account 1588 – Global Adjustment Sub-Account

Festival Hydro has appropriately used the kWh for non-RPP customers as the allocator for the Global Adjustment sub-account of 1588. In response to Board staff supplemental interrogatory #46, Festival Hydro provided the calculations of the separate rate rider to dispose of the Global Adjustment sub-account balance using 2008 non-RPP kWh sales to determine the allocator for each class. Festival Hydro is of the opinion that the sub-account rate rider should apply to Municipalities, Universities, Schools and Hospitals (“MUSH”) accounts. The Applicant notes that most of the MUSH customers had contracts with energy retailers in 2008 and are currently with retailers.

Board staff notes that Festival Hydro has proposed new rate riders to dispose of the deferral and variance account balances, excluding the Global Adjustment sub-account and separate rate riders to dispose of just the Global Adjustment sub-account. The

Applicant has not provided the details of its calculations to determine the new rate riders and staff invites the Applicant to provide the details with its reply submission.

Harmonized Sales Tax

Staff notes that the provincial sales tax (“PST”) and goods and services tax (“GST”) will be harmonized effective July 1, 2010 pursuant to Bill 218 which received Royal Assent on December 15, 2009. Unlike the GST, the PST is currently included as an OM&A expense and is also included in capital expenditures. When the PST and GST are harmonized, corporations will realize a reduction in OM&A expenses and capital expenditures that has not been reflected in the current application for 2010 rates. In response to an interrogatory,[27] Festival Hydro stated that it has not made any adjustments to its 2010 OM&A and capital expenditure forecasts to reflect the elimination of the 8% PST costs starting on July 1, 2010. Festival Hydro did not provide a response estimating costs related to PST that are included in 2010 OM&A and capital expenditures for the period July 1 to December 31, 2010. In response to a Board staff supplementary interrogatory #47, Festival Hydro stated that in principle, it accepted the use of deferral accounts to protect both consumers and utilities in case of changes to external items such as tax rates. The Applicant stated that the cost impact could be offset to some degree if suppliers pass through reductions related to harmonization in their prices. Festival Hydro does not accept that accurate entries could be made in a deferral account if one were to be established. It is the Applicant’s expectation that the Board will provide direction to distributors to ensure a consistent and fair policy.

Notwithstanding the fact that the Applicant did not respond to staff’s query regarding the quantifying of any potential savings, staff submits that the amounts associated with PST costs could be significant. Accordingly, the Board may wish to consider establishing a variance account to track any savings that may arise. The Board could determine the materiality of the savings when it reviews the variance account at the time of disposition.

CDM Expenditures and Recoveries and CDM Contra Account (1565 and 1566)

Festival Hydro’s application stated that accounts 1565 and 1566 are equal and offsetting at an amount of $670,023. Although Festival Hydro did not request disposition of these

[27] Response to Energy Probe IR #1

accounts per se, the Applicant did request that the balances “be removed from the accounts.”

Board staff supplemental interrogatory #45 queried (1) the difference in quantum with respect to the $661,623 provided in the 2008 Annual Report, CDM Third Tranche MARR Funding for Festival Hydro Inc., dated December 31, 2008, (2) the difference in the quantum with respect to the Final Board Order for file RP-2004-0203/EB-2004-0520 approving a total budget of $660,343, the exact amount of Festival Hydro’s incremental MARR and (3) an explanation why the amounts in account 1565 and 1566 are not zero.

With respect to the first item, Festival Hydro notes that $9,000 was approved in the 2006 cost of service application for distribution of LED lights to residential customers, and that this amount is reported separately from the $661,623 in the 2008 Annual Report, CDM Third Tranche MARR Funding.

With respect to the second item, Festival Hydro is not aware why there is a difference of $1,280 between the reported amount and the approved amount. To achieve agreement, Festival Hydro noted in its reply that it will charge $1,280 against 2009 operations.

With respect to the third item, Festival Hydro reported that all CDM funding received was spent in its entirety. The Applicant also reported that its accounting practices did not directly follow Article 220 of the Accounting Procedures Handbook. In its interrogatory response, Festival Hydro requested retroactive treatment to clear both accounts 1565 and 1566 to zero.

Staff notes that clearing the accounts to zero is an accounting exercise and has no rate consequences. Accounts 1565 and 1566 are tracking accounts and are not intended to be disposed. Board approval is not required for addressing accounting deficiencies of this nature.

\- All of which is respectfully submitted -