Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2009-0263

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Festival Hydro Inc. for an order approving or fixing just and reasonable rates and other charges for the distribution of electricity to be effective May 1, 2010.

BEFORE: Ken Quesnelle
Presiding Member

DECISION AND ORDER

April 1, 2010

BACKGROUND

Festival Hydro Inc. ("Festival Hydro" or the "Applicant") filed an application (the "Application") with the Ontario Energy Board (the "Board") on August 28, 2009. The Application was filed under section 78 of the *Ontario Energy Board Act, 1998*, S.O 1998, c. 15 (Sched. B) (the "Act"), seeking approval for changes to the rates that it charges for electricity distribution to be effective May 1, 2010. Festival Hydro 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. The Applicant purchased the assets of the Hensall Public Utilities Commission in 2000. As the rates are not yet harmonized, the Applicant has a regular residential and a Hensall residential customer class.

Festival Hydro is one of over 80 electricity distributors in Ontario regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document, as amended on May 27, 2009, outlines the filing requirements for cost of service rate applications based on a forward test year by electricity distributors.

On January 29, 2009, the Board indicated that Festival Hydro would be one of the electricity distributors to have its rates rebased for the 2010 rate year. Accordingly, Festival Hydro filed a cost of service application based on 2010 as the forward test year.

The Board assigned the Application file number EB-2009-0263 and issued a Notice of Application and Hearing dated September 11, 2009. The Board approved three interventions: the Vulnerable Energy Consumers Coalition ("VECC"), the School Energy Coalition ("SEC") and Energy Probe Research Foundation ("Energy Probe"). No letters of comment were received by the Board regarding the Application.

Procedural Order No.1 was issued on October 16, 2009. The Board made provision for written interrogatories. On December 7, 2009, the Board issued Procedural Order No. 2, which made provision for a supplemental round of interrogatories and provided dates for submissions. All intervenors filed interrogatories and made submissions in this proceeding. Board staff also posed interrogatories and made submissions. Festival Hydro's reply submission was filed on February 10, 2010.

Festival Hydro requested a revenue requirement of $9,852,131 to be recovered in new rates effective May 1, 2010. The Application indicated that the existing rates would produce a revenue deficiency of $979,468 for 2010. The resulting requested rate increase was estimated as 4.4% on the delivery component of the bill for a residential customer in the main service area consuming 800 kWh per month. Residential customers consuming 800 kWh per month in the Hensall service area would experience a 24.1% increase in their delivery charges. The total bill impact would be an increase of 7.5%. A GS<50 kW customer consuming 2,000 kWh per month would experience a 1.7% increase in their delivery charges and a 0.5% increase on the total bill.

In response to supplemental interrogatories, Festival Hydro revised the revenue requirement to $9,697,453, reflecting adjustments primarily to operating expenses and PILs. As part of its reply submission, Festival Hydro agreed to some further changes, however these changes were not quantified in relation to bill impacts and a decreased revenue deficiency.

The full record is available at the Board's offices. The Board has chosen to summarize the record to the extent necessary to provide context to its findings.

THE ISSUES

The following issues were raised in the submissions of Board staff and intervenors, and are addressed in this Decision:

- Load Forecast;
- Operating, Maintenance & Administrative Expenses;
- Payments in Lieu of Taxes;
- Rate Base and Capital Expenditures;
- Cost of Capital and Capital Structure;
- Cost Allocation and Rate Design;
- Introduction of microFIT Generator Service Classification;
- Deferral and Variance Accounts;
- Smart Meters; and
- Implementation.

LOAD FORECAST

Load Forecast Methodology

Festival Hydro's load forecast was developed in three steps:

- A total system weather normalized purchased energy forecast was developed based on a multifactor regression model that incorporated historical load, weather and economic data;
- The weather normalized purchased energy forecast was adjusted by a historical loss factor to produce a weather normalized billed energy forecast; and
- The total billed energy forecast was disaggregated into forecasts for the rate classes using forecasted customer numbers and historical usage patterns.

In its Application, Festival Hydro noted that the regression model coefficient for population was negative. The Application stated that this is a result of population growth in recent years increasing at a decreasing rate. 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 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 new two GS>50 customers coming to Stratford. Festival Hydro made a further adjustment to its load forecast in order to convert the system purchases to total billed load forecast by applying 2.58%, the average of annual loss factors for the period 2000 to 2008. The resulting 2009 load forecast was 589.8 GWh and the 2010 load forecast was 576.9 GWh.

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 as well as the IESO 18 month outlook. Festival Hydro developed a load forecast applying a demand decline of 4% in 2009 and decline of 0.3% in 2010 as reported in the May 25, 2009 IESO 18 month outlook. The data for these methodologies, as well as other data discussed on this issue are provided for reference in the following table:

	GWh	2009		2010	
		Purchased	**Billed**	**Purchased**	**Billed**
1	Actual purchases, Non-normalized	567.0			
2	Festival Proposal: Regression Analysis (including negative coefficient for population) and loss factor of 1.0258 (adj. R^2 – 0.776)	605.1	589.8	589.8 Plus 1.983 = 591.8	576.9
3	Staff Proposal: Normalized Average Consumption		596.8		600.3
4	IESO 18 month outlook (May 2009)		569.6		567.9
5	Regression Analysis (excluding population) (adj. R^2 – 0.723) and loss factor of 1.0258 Energy Probe IR 44	646.4		647.3	631.1
6	Energy Probe revision of IESO using normalized 2008 purchases	604.8		602.9	
7	Energy Probe Proposal: Average of 5 and 6 plus 1.983 GWh and loss factor of 1.0249			627.1	611.9
8	VECC Proposal: Average of 4 and 5 billed				600.0
9	Festival Revised Proposal: Applicant accepted loss factor of 1.025 in reply submission, applied to 2				577.3

Parties submitted that the regression model's negative coefficient for population is conceptually counter-intuitive; it implies that the load decreases as the population increases. Parties were also concerned with the general quality of the results produced by the regression model as measured by the adjusted R–squared of 0.776. This result is much lower than the typical 0.90 to 0.95 range.

In response to Energy Probe supplemental interrogatory #44, Festival Hydro provided the results of the regression model excluding the population variable. The predicted 2009 purchases were 646.4 GWh, the 2010 purchases were 647.3 GWh and the resulting adjusted R-squared was 0.723.

Board staff submitted that the regression model with its negative coefficient for population did not pass the test of reasonableness. Board staff recommended 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.

Energy Probe submitted that Festival Hydro's methodology is an improvement over the NAC methodology. The NAC method relies on average consumption in one year only and does not make adjustments for economic activity or changes in the weather. Energy Probe referred to degree day data and noted that 2008 was a year with a relatively warm winter and a cool summer.

Energy Probe stated that Festival Hydro applied the IESO demand decline to actual 2008 billed energy, but that the forecasts should have been applied to normalized 2008 purchases. An estimate of normalized purchase data was provided by Festival Hydro in response to a VECC interrogatory. Energy Probe applied the 4.0% reduction and the further reduction of 0.3% to these normalized data to yield a 2010 purchased energy forecast of 602.9 GWh. Energy Probe observed that the load forecast based on the IESO demand decline, 602.9 GWH, suffers from the assumption that change in electricity consumed by the Applicant mirrors the change for the province as a whole and should not be relied on solely. Energy Probe also observed that the regression model result without the population variable, 647.3 GWh, should not be relied on solely. Energy Probe submitted that an average of the two results plus the adjustment of 1.983 GWh to reflect the addition of new two GS > 50 customers, should be the total system weather normalized purchased energy forecast for 2010. Energy Probe's proposal is 627.1 GWh on a purchased basis.

Energy Probe also questioned the loss factor adjustment. The factor of 2.58% determined by Festival Hydro is based on the period 2000 to 2008, while the regression model is based on the period 1998 to 2008. As Festival Hydro provided the loss factors for 1998 and 1999 in response to an Energy Probe interrogatory, Energy Probe stated that the loss factor adjustment should be 2.49%. Accordingly, Energy Probe's billed energy forecast would be 611.9 GWh.

VECC observed that none of the forecasts are particularly robust, but that it would be reasonable to conclude that the 2010 forecast falls within the range of the results. VECC proposed a simple average of the lowest forecast, the IESO forecast provided by Festival Hydro, and the result of the regression model without the population variable adjusted by the loss factor of 2.58%, 631.1 GWh. VECC's proposal is 600.0 GWh on a billed basis.

The Applicant noted in its reply submission that other distributors, including Burlington Hydro and Cambridge North Dumfries ("Cambridge") experienced similar results with negative coefficients for population/customers. Festival Hydro noted that Cambridge, at VECC's request, produced a regression analysis with a CDM variable which moved the negative coefficient from the population variable to the CDM variable. The resulting forecast for Cambridge was lower than the forecast with the negative population coefficient. Festival Hydro stated that it would expect results similar to those of Cambridge.

The Applicant noted that parties have referred to various load forecasts and have made submissions in response to the negative population coefficient. The Applicant provided actual purchases for the past 5 years (non-normalized) as a guide for the determination of reasonableness. The Applicant stated that the data demonstrate erosion in purchases.

Year	Actual Purchases – GWh (Non-normalized)
2005	650.5
2006	635.4
2007	634.3
2008	611.7
2009	567.0

The regression model forecasts normalized 2010 system purchases of 589.8 GWh and billed energy forecast of 576.9 GWh. The Applicant stated that the Ontario economy is most recently projected to grow in 2010. However the Applicant believes that the harmonized sales tax, anticipated time of use pricing, conservation, 7.4% local unemployment rate and permanent load displacement will cause continued erosion of purchases. The Applicant did not comment on the adjusted R-squared of the regression model.

Festival Hydro believes that the forecast based on the IESO outlook of 567.9 GWh provided in response to the Board staff supplementary interrogatory presents a reasonable 2010 load forecast. Festival Hydro stated that 65% of its load is consumed by GS>50 and large use customers indicating a high level of manufacturing. The Applicant also referred to the IPSP breakdown of provincial demand (30% residential, 40% commercial and 30% industrial) and stated that the IPSP provincial perspective represents its situation. As noted above, Energy Probe stated that Festival Hydro should have applied the IESO demand decline to normalized 2008 purchases. In its reply submission, Festival Hydro submitted that the IESO forecast of 567.9 GWh is appropriate and that Festival Hydro's load is not highly weather sensitive.

Festival Hydro agreed with VECC that the NAC forecast is too high and recommended that Board staff's submission not be used.

Festival Hydro stated that Energy Probe's proposed 2010 load forecast of 627.1 GWh based on a version of IESO forecast and a regression analysis without a population variable is unreasonable. The forecast is significantly (60 GWh) higher than 2009 actual purchases, and given the erosion in load and the economic slowdown, the Energy Probe 2010 forecast is not reasonable.

Festival Hydro submitted that its original purchased energy forecast for 2010, 589.8 GWh, as documented in its Application should be accepted. As noted above, Energy Probe submitted that the loss factor adjustment should include 1998 and 1999 loss factors. The Applicant agreed with Energy Probe's submission and that the loss factor adjustment should be 2.50%. Accordingly, the Applicant has determined that the 2010 billed energy forecast will be 577.3 GWh and not 576.9 GWh.

Weather Normalization

Both Energy Probe and VECC noted concerns with Festival Hydro's assumption that the residential and GS<50 classes are 100% weather sensitive. VECC submitted that intuitively these classes are not 100% weather sensitive. VECC compared the 2004 weather normal use calculated by Hydro One for the cost allocation filing and the 2008 weather normalized average use using the same methodology[1], with the 2010 forecast.[2] The comparison indicates that Festival Hydro's load forecast for these customer classes is low. Energy Probe submitted that a more reasonable assumption is that 50% of the volumes consumed by residential and GS<50 classes are weather sensitive. In response to Energy Probe interrogatory #20 on this scenario, Festival Hydro stated that a change to 50% weather sensitivity would increase the volume of kWh/kW sold, which would decrease the overall revenue deficiency by $44,434. Festival Hydro submitted that it is prepared to accept the suggestion of Energy Probe and VECC to assume that 50% of the volumes consumed by residential and GS<50 customers are weather related. The Applicant did not provide a revised forecast by customer class or a revenue impact.

Energy Probe noted an additional concern with the kW forecast. Festival Hydro has used the average ratio for kW/kWh as calculated over 2000 to 2008 to forecast the kW billing determinant for 2010. Energy Probe submitted that GS>50 and large use class kW/kWh ratios have been rising and street light and sentinel light ratios have been declining and therefore the average should not be used. Energy Probe submitted that 2008 kW/kWh ratios should be used. Energy Probe submitted that the changes reduce the revenue deficiency by $137,710 from Festival Hydro's original proposal.

Festival Hydro submitted that Energy Probe's approach is inconsistent with its approach on loss factor adjustment, i.e. a longer period is more appropriate. Festival Hydro submitted that its original kW forecast should be approved.

Customer Forecast

There were no submissions from parties on customer forecast. Festival Hydro has forecasted 25,874 customers/connections for 2010 and submitted that the forecast is appropriate and should be approved by the Board.

Board Findings

The Board acknowledges Festival Hydro's work with the multifactor regression model. The Applicant has demonstrated responsiveness to Board direction in previous decisions. However, there are weaknesses in the regression model. The negative

[1] VECC Interrogatory #13(h)
[2] VECC Interrogatory #13(f)

population coefficient is counter-intuitive and casts doubt on the resulting load forecast. Festival Hydro referred to a Cambridge and North Dumfries forecast which included population and CDM variables. When the negative coefficient was moved from the population variable to the CDM variable, the resulting load forecast was lower than the forecast with the negative population coefficient. Festival Hydro suggested that it would expect similar results. However, as the forecast including CDM in the suite of variables was not produced, the suggestion of similar results is unsupported.

A number of load forecasts and averages have been suggested by parties for the test year. Each of the test year forecasts listed in the table above has some degree of deficiency. The Board will not endorse a specific forecasting methodology, but seeks best efforts and reasonable results.

The Board agrees with parties that the results of the regression analysis should be the starting point for determining the appropriate load forecast. The most appropriate final forecast likely lies within the range of forecasts suggested by the Applicant and by the parties. The Board notes that the average of the regression results stemming from scenario Nos. 2 and 5 above results in a billed energy forecast of approximately 600.0 GWh and the Board concludes that this is the test year forecast that will be adopted.

The Board observes that Festival Hydro commented on the effects of CDM and reduced manufacturing load in relation to the negative population coefficient. However, the Applicant failed to provide data to support their comments and failed to demonstrate efforts to include these factors and any other local factors in the regression model. Festival Hydro may wish to undertake further work in this area for its next cost of service application in order to better reflect the impacts of CDM and local economic factors.

The Board finds that it is appropriate to use the average ratio for kW/kWh for the period 2000 to 2008 to forecast the kW billing determinant for 2010. The trends cited by Energy Probe are not sufficiently strong to require Festival Hydro to use the 2008 kW/kWh ratios.

The Board will accept the forecast of customer/connection numbers.

The Board accepts the weather normalization agreed to by parties and the Applicant, i.e. 50% of the volumes consumed by residential and GS<50 customers are weather related.

OPERATING, MAINTENANCE AND ADMINSTRATIVE EXPENSES ("OM&A")

The table below presents the components of the proposed OM&A expenses for the 2010 Test Year and compares them with previous years.

	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%
Property Taxes	$129,853	$124,805	$59,500	$89,490	$50,317	-12.40%
Total Operating Expenses	**$ 5,948,853**	**$ 6,056,386**	**$ 6,146,338**	**$ 6,490,442**	**$ 6,674,423**	**2.93%**

For the 2010 test year, Festival Hydro requested approval of $3,968,610 in controllable OM&A expenses excluding taxes and amortization expenses. This represents a 2.73% increase over the 2009 Bridge year and a 7.45% increase over 2008 actuals. Total operating expenses (including depreciation/amortization and property taxes) for the 2010 test year are forecast at $6,674,423. This represents an increase of 2.83% over the 2009 bridge year and an 8.59% increase over Festival Hydro's 2008 actuals.

Intervenors and Board staff proposed reductions on both the basis of a line-by-line analysis and from the perspective of the reasonableness of the envelope of total costs. The submissions of intervenors and Board staff addressed issues in the following areas:

- Overall Increase in OM&A;
- Fuel Costs;
- Bad Debt Costs;
- Low Income Energy Assistance Program ("LEAP");
- International Financial Reporting Standards ("IFRS");
- Regulatory Costs;
- Wage Increases;
- Impact of Harmonized Sales Tax; and
- Depreciation

Overall Increase in OM&A

SEC believes generally that Festival Hydro has done a good job of keeping its OM&A cost increases to a reasonable level and VECC noted that increases in OM&A have been well controlled overall.

Energy Probe submitted that the increase of 2.7% forecast by Festival Hydro for 2010 expenses as compared to the forecast for 2009 is the maximum increase that the Board should allow given the slowdown in the rate of inflation during the recession. The average GDP-IPI for the first three quarters of 2009 was 1.7%. Energy Probe is also concerned with the increase of 4.6% that was forecast for 2009. Energy Probe stated that the 2009 increase is twice the 2.3% GDP-IPI allowed for distributors in 2009. Applying inflation rates that are 50% higher than 2.3% for 2009 and 1.7% for 2010 to 2008 actual OM&A, Energy Probe estimated that the 2010 OM&A expenses would be $50,000 lower than forecast by the Applicant. This envelope reduction and Energy Probe's proposed reduction related to the harmonized sales tax results in a total envelope reduction of $101,750.

The Applicant compared its OM&A costs with its cohort group of mid size medium-high undergrounding distributors. Festival Hydro's OM&A costs/customer are consistently below the average.

Festival Hydro submitted that if the Board proceeds by way of an OM&A envelope review, that the Board consider labour and non-labour expenses separately. Festival Hydro's Application applied inflationary factors of 3% to labour and 2.7% to non-labour expenses. If the Board accepts these factors, Festival Hydro would accept a further reduction of $38,000 in total, related to LEAP, regulatory costs, IFRS and bad debt.

Board Findings

In this particular decision the Board has made findings on the reasonableness of the individual cost drivers. The total amount of costs that have been determined to be reasonable equate to the allowable spending that can be recovered in rates. It is up to Festival Hydro to determine on an ongoing basis how to best prioritize its spending of its allowed revenues in order to meet its many obligations associated with its operation of the utility.

Fuel Costs

The year over year increase in fuel cost is summarized as follows:

	Annual Fuel Cost Increases
2006	$20,070
2007	$41,871
2008	$63,122
2009	$9,373
2010	$8,011

SEC, supported by VECC, submitted that the inflationary factor applied to fuel cost is unreasonable. The test year cost builds on 2008 fuel costs that were unusually high. SEC referred to the U.S. Department of Energy website tracking retail gasoline prices and stated that 2010 fuel costs are below the 2007 level. SEC submitted that the 2010 OM&A amount should be reduced by $63,122.

In reply, the Applicant stated that it approached the forecasting of OM&A using a constant inflation factor across all accounts. The Applicant disagreed with arbitrarily selecting a single account, i.e. fuel costs, for special consideration. The Applicant suggested that where one account may be slightly higher, other accounts may be slightly lower. The selection of fuel cost for special consideration should be rejected.

Board Findings

The Board accepts the Applicant's approach and agrees that in this case it is not reasonable to single out the fuel cost account. The Board will not require a reduction to revenue requirement based on a disallowance of test year fuel costs.

Bad Debt Costs

The bad debt expense for the 2010 test year is projected to be $121,395. Festival Hydro provided bad debt expense for the period 2006 to 2009 to support its determination for 2010. Festival Hydro stated that the bad debt cost driver peaked in 2006 and 2009, the years when two large industrial customers filed for credit protection. The 2010 projection included a partial allocation of $61,037 of 2009 bad debt related to a large customer who had filed for protection under the *Companies' Creditors Arrangement Act* ("CCAA").

	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	152,889.00	111,956.00	74,700.00	146,037.31	485,582.31	121,395.58
(2010 rate application - Four year average)						

Board staff invited the Applicant to comment on the use of a four year average for 2010 when the four year time frame includes data that reflects peaks. Similarly, SEC submitted that the data for two of the four years are anomalies and that the 2010 projection is 62% higher than 2008 data. SEC submitted that the 2010 forecast should be $90,000 which is 20% higher than 2008 to take into account that the current economic condition will likely result in higher bad debt costs. VECC supported SEC's position.

The Applicant advised, in its reply submission, that one of the large customers subject to creditor protection under CCAA paid amounts owing in full after the August 28, 2009 application filing date. Accordingly, the Applicant proposed a reduction in bad debt cost to $106,136, which is the average of the previous four years. Festival Hydro stated that the $90,000 recommended by SEC does not allow for the impact of bad debt associated with even a single GS>50 customer, and that this is unreasonable given current economic conditions and the local economy's dependence on the auto and tourism sector.

Board Findings

The Board finds that Festival Hydro has adequately justified its proposal. The Board accepts the reduction in bad debt cost to $106,136.

Low Income Energy Assistance Program ("LEAP")

Festival Hydro has included 0.12% of its distribution revenue requirement to fund LEAP. Festival Hydro stated 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.

Board staff submitted that the $7,600 relating to new LEAP programs 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. This position was supported by VECC and Energy Probe.

The Applicant acknowledged that $7,600 related to LEAP should be removed from OM&A. Festival Hydro submitted that should LEAP or similar programs be introduced that the distributor be allowed to establish a variance account to record any incremental costs.

Board Findings

The Board accepts the OM&A reduction of $7,600 related to LEAP. The Board notes that the policy framework related to this issue is a work in progress and it will address appropriate cost recovery if and when programs are introduced.

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. Through interrogatories, Board staff, Energy Probe and SEC 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.

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. Festival Hydro revised the one-time costs to $44,000 ($11,000 each year for four years) and estimated that the ongoing costs would be $14,000 annually.

Energy Probe accepted the reduction in revenue requirement. Energy Probe would not be opposed to the inclusion of the $11,000 in the 2010 revenue requirement assuming that the deferral account would be changed to a variance account to track differences between the forecasted amount and actual one-time transitional costs related to IFRS.

Board Findings

The Board notes that the Board established a deferral account for the tracking of one-time administrative costs in the October 2009 APH-FAQ which designated account 1508, Other Regulatory Assets, Sub-account Deferred IFRS Transition Costs. The Board notes that Festival should record the one-time incremental transition costs in this account for purposes of bringing these costs forward for review and disposition at a future proceeding.

The Board also considers the inclusion of $14,000 in OM&A for incurred incremental administrative costs directly related to the ongoing compliance with IFRS to be reasonable. This is a modest amount that the Board expects will be downward trending as experience is gained and processes streamlined. The more stable ongoing costs will be determined at the time of the next rebasing.

Regulatory Costs

The Applicant has included in 2010 and the subsequent three year period a $40,000 increase in annual regulatory costs. The Applicant stated that the increase is required to cover the expenses associated with the 2010 cost of service Application based on a written process, 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.

Board staff submitted that the $160,000 expense related to the 2010 cost of service Application and other regulatory related matters was reasonable. Energy Probe submitted that the cost was too high as the average approved regulatory cost for 2009 cost of service applications was $128,413. Energy Probe submitted that a 10% reduction to $144,000 ($4,000 reduction each year for four years) is appropriate and comparable to the Board’s decisions for Innisfil Hydro Distribution Systems Limited (EB-2008-0233) and COLLUS Power Corp. (EB-2008-0226).

The Applicant submitted that $144,000 over four years is not unreasonable, assuming that the next step for this Application is the draft Rate Order.

Board Findings

The Board finds it appropriate for the Applicant to recover the costs associated with the preparation of its 2010 rates case over the future period as these are one-time costs which will not be incurred again until the next rebasing. The Board finds that the amount of $144,000 over a four year period is reasonable.

Wage Increases

As documented in the Application, 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. The Application stated that the new position will be shared with the City of Stratford, and the City of Stratford will pay 40% of the salary and benefits. 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 sought further clarification on executive wages through interrogatories. A MEARIE salary survey of other LDCs in the southwestern region was provided by the Applicant to support that its executive wages were comparable to the survey mean. Board staff submitted that the Applicant had provided sufficient information in support of its compensation proposal.

Energy Probe noted inflation levels of 2.3% for 2009 and 1.7% for 2010 based on three quarters of data from Statistics Canada. Energy Probe submitted that a 2.0% increase for non-union employees in 2010 is appropriate for revenue requirement purposes. This amounts to a $40,000 reduction in OM&A.

The Applicant observed that Energy Probe did not provide compelling support for differentiating between union and non-union personnel. Matching increases has been the practice, and the Applicant states that this is fair and equitable to all staff. Differentiating between union and non-union staff could lead to morale related issues and has the potential to offset savings achieved through salary reductions.

Board Findings

The Board considers the increase in total compensation for the 2010 test year to be reasonable. As for the practice of applying increases evenly to union and non-union personnel groups; the Board does not consider the maintained spread between the two groups to be a determinative factor as to what is reasonable. The comparison of labour costs and executive salaries to comparable markets is the best indication of reasonableness as well as the entity's overall costs. The Board observes that the Applicant's overall OM&A per customer is consistently below the cohort average, and that the Applicant was able to demonstrate that executive salaries are comparable to the mean for the southwestern region.

The Board does, however, find that it is appropriate to report union and non union compensation separately for external comparison purposes.

The Board accepts the compensation costs as proposed for the test year by Festival Hydro.

Impact of Harmonized Sales Tax

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 Energy Probe interrogatory, 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. In response to the same interrogatory, Festival Hydro estimated that $11,500 of PST was paid in September 2009, of which 25% was capitalized.

Board staff submitted that 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.

Energy Probe and SEC submitted that it was appropriate to reduce OM&A by $51,750, i.e. 75% of $11,500 per month for a half year as the change will occur half way through the test year. VECC submitted that OM&A should be reduced by $103,000, the equivalent of a full year impact. Energy Probe and VECC submitted that a variance account should be established should the actual savings deviate significantly from the estimate.

Festival Hydro commented that actual savings may differ from projections because its suppliers may or may not pass through savings in their prices and therefore the amount of savings is speculative. Festival Hydro agreed with establishing a variance account to track the difference between the expenses incurred for which PST would have been paid and for which the distributor is now eligible for a Harmonized Sales Tax ("HST") Input Tax Credit ("ITC").

Board Findings

The Board finds that the revenue requirement for 2010 should reflect any savings arising from the implementation of the HST effective July 1, 2010. However, the Board notes that a projection of HST impact based on one month of data is insufficient to establish a forecast for the entire test period.

The Board finds that it would not be onerous for Festival Hydro to track the ITC amounts as Festival Hydro will need to file ITC information in GST/HST returns which will be subject to review by the tax authorities.

The Board directs the use of a deferral account, not a variance account as submitted by Board staff and the Applicant. There is no need to compare the ITC amounts with any PST amounts reflected in the current application. Festival Hydro will use deferral account 1592 PILS and Tax Variances, sub-account HST/OVAT Input Tax Credits (ITCs).

Festival Hydro will record the actual Ontario Value Added Tax ("OVAT") ITCs claimed after June 30, 2010 on those costs and expenses that would normally be considered for inclusion in rate base or revenue requirement in a cost of service application. Festival Hydro will retain copies of their GST / HST returns as part of RRR and for evidence in future rates proceedings.

Depreciation

Buildings and Fixtures

Appendix B of the *2006 Electricity Distribution Rate Handbook* provides for a 50 year amortization period for buildings & fixtures. Festival Hydro has amortized physical buildings over 50 years, but fixtures such as HVAC systems are amortized over 30 years. Board staff submitted that fixtures should also be amortized over 50 years in accordance with the EDR Handbook. VECC supported this view.

In response to an Energy Probe interrogatory, Festival Hydro estimated that the impact of the 30 year depreciation period on fixtures was $7,000. Given the Applicant's rationale and the limited impact of the deviation, Energy Probe submitted that the Applicant's proposal should be approved.

The Applicant submitted that the amortization period for fixtures should remain at 30 years. Festival Hydro stated that, based on its experience, the useful life of roofs and HVAC equipment is 20 to 30 years, and that the auditor accepted this practice. Festival Hydro also noted that the Board permitted two deviations from the 2006 EDR Handbook's amortization rates in the Peterborough Distribution Inc. proceeding (EB-2008-0241).

Board Findings

The Board finds that the amortization period that the Applicant has applied to fixtures is in keeping with the life cycle of those assets and is reasonable. The Board finds that the additional granularity on this matter is appropriate and consistent with Board efforts to accurately reflect asset life cycles.

<u>Half Year Rule</u>

Energy Probe has reviewed the test year calculations and confirms that Festival Hydro has calculated a full year of depreciation on 2010 capital additions. Energy Probe submitted that the Applicant has failed to follow the Board's policy that has established the use of the half year rule for calculating the depreciation expense in the test year and has overstated the 2010 depreciation expense by approximately $94,000.

Festival Hydro replied that it has not historically applied the half year rule. Its depreciation policy has been to take a full year of depreciation in the year of purchase and none in the year of disposal. This practice has been accepted by the auditors. Festival Hydro also noted that it was unable to reproduce Energy Probe's calculation of $94,000 and determined the amount to be $85,000. The Applicant noted that the Board permitted deviations from the half year rule in the COLLUS Power Corp. proceeding (EB-2008-0226) and that the circumstances are similar.

Festival Hydro submitted that there should be no change from its current depreciation practice for this proceeding, but that it will update its practice to reflect the half year rule in the next rebasing application.

Parties also noted that depreciation expenses will need to be adjusted to reflect any changes in capital additions for 2009 or 2010 from those provided in the updated revenue requirement.

Board Findings

The half-year rule is used by most electricity distributors. Conceptually, this approach aligns the straight-line depreciation with the addition of assets to rate base. Assuming no retirements, averaging the opening and closing Net Fixed Assets amount equates to assuming that new assets enter service mid-year. The half-year rule for calculating depreciation expense thereby calculates the appropriate straight-line depreciation expense for those assets entered mid-year.

As noted in the capital expenditures section, Festival Hydro's capital spending is stable for the test year and future years. As the trend is stable, Festival Hydro is not advantaged or disadvantaged by the half year rule over time. Therefore, the Board directs Festival Hydro to apply the half year rule for test year capital additions.

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.

Board staff submitted 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. The Applicant agreed in its reply submission.

Energy Probe observed that Festival Hydro added an amount of $3,900 to the accounting income for interest and penalties on taxes, which Energy Probe submitted should be disallowed. The Applicant agreed and stated in its reply submission that the amount will be removed from the PILs calculation.

The Applicant provided a detailed tax summary indicating calculations to reflect the changes noted below.

Provincial Tax Rate

Festival Hydro's Application used a provincial tax rate of 14.0%. In response to supplementary interrogatories, Festival Hydro confirmed that the provincial tax rate will decline to 12% effective July 1, 2010, and updated the revenue requirement to reflect 13.0% for 2010.

Small Business Tax

Effective July 1, 2010, the small business tax rate is reduced from 5.5% to 4.5% on the first $500,000 of taxable income. Also effective July 1, 2010, the surtax of 4.25% on taxable income between $500,000 and $1.5 million will be eliminated. Energy Probe has estimated that the impact of the rate and surtax changes will be a $18,750 reduction in taxes. In response to Energy Probe supplementary interrogatories, Festival Hydro has updated the revenue requirement to reflect the small business tax rate change.

Tax Credits

Energy Probe noted that Festival Hydro had not made any tax deductions for the Apprenticeship Training Tax Credit, the Co-operative Education Tax Credit or the Investment Tax Credit. In response to an interrogatory, Festival Hydro has determined the provincial apprenticeship tax credit to be $10,000 and the federal training tax credit to be $2,000. In response to supplemental interrogatories and confirmed in its reply submission, Festival Hydro also added $4,000 to 2010 income to reflect the 2009 federal apprenticeship tax credit.

FMV Reduction in CCA

The Application noted a fair market value ("FMV") bump of $1,847,262 in the determination of the 2009 capital cost allowance.[3] Energy Probe interrogatories #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. Parties submitted that the correction is appropriate.

[3] Exhibit 4/ Tab 3/ Schedule 2

Board Findings

The Board accepts the Applicant's observations and its recalculation of PILs in response to the interrogatories and submission of parties. The draft Rate Order should reflect these adjustments.

RATE BASE AND CAPITAL EXPENDITURES

Festival Hydro requested approval of a rate base of $39,583,651 in its Application, composed of $32,247,928 average net book value and $7,335,724 working capital allowance. In response to supplemental interrogatories, Festival Hydro reduced its requested rate base due to minor adjustments related to IFRS and PILs to $39,581,974. This is an increase of 5.4% over 2008 actuals and 13.1% over 2006 Board approved rate base.

Capital Expenditures

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 the test year rate base. The following table summarizes capital additions to Festival Hydro's fixed assets for the period 2006 to 2010.

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 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. The Applicant also 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. After normalizing for unusual capital additions in 2008, Board staff observed that capital additions are stable in the period 2008 to 2010 and that similar levels of capital additions are budgeted for 2011 and 2012.

VECC's view is that Festival Hydro's approach to capital planning is appropriately documented and supported, but provided a submission on harmonized tax. Energy

Probe accepted the capital expenditure forecast as appropriate with exceptions on harmonized sales tax and asset disposal.

Board Findings

The Board accepts the level of capital expenditures proposed by Festival Hydro in its Application.

Impact of Harmonized Sales Tax

As noted in the OM&A section of this Decision, Festival Hydro estimated that $11,500 of PST was paid in September 2009, of which 25% was capitalized. VECC submitted that capital expenditures should be reduced by $34,500, i.e. 25% of $11,500 per month for a full year. VECC also submitted that a variance account should be established to track any difference between the savings embedded in rates and actual savings. If the Board deemed that a variance account was not warranted, VECC submitted that the 2010 rate base should still be reduced by the forecasted impact of the introduction of the harmonized tax.

Similar to its submission on OM&A, Energy Probe submitted that a capital expenditure reduction of $17,250, i.e. 25% of $11,500 per month for a half year, was acceptable as long as a variance accounts was established. In the absence of a variance account, Energy Probe submitted that that capital expenditure should be reduced by $67,000. Energy Probe is concerned that Festival Hydro's estimate of $11,500 per month is too low and prorated comparable Burlington Hydro data (EB-2009-0259) to determine the $67,000 reduction for Festival Hydro.

In reply submission, Festival Hydro noted that the reductions proposed by VECC and Energy Probe are based on a one month review of PST savings and the evidence of Burlington Hydro. Festival Hydro believes that the September 2009 data is representative of normal monthly spending, but that "there is room for variation in spending patterns throughout the year." The Applicant also submitted that it has not been demonstrated that it and Burlington Hydro have similar spending patterns. While Festival Hydro expressed some doubt that savings will actually be realized, the Applicant submitted that the Board should not reduce capital expenditures, but should require Festival Hydro to establish a variance account to track the difference between any capital expenditures incurred for which PST would have been paid and for which the distributor is now eligible for an HST input tax credit. Festival Hydro stated that a variance account would hold parties harmless and would eliminate speculation regarding the potential amount to be saved.

Board Findings

As noted in the OM&A findings, the Board finds that a projection of HST impact based on one month of data is insufficiently supported.

The Board approves the use of a deferral account, 1592 PILS and Tax Variances, sub-account HST/OVAT Input Tax Credits (ITCs), to track the incremental change due to the shift from PST to the HST and the amounts Festival Hydro receives through the incremental ITC. Tracking of these amounts will continue in the deferral account until Festival Hydro's next cost of service application is determined by the Board or until the Board provides guidance on this matter, whichever occurs first.

Asset Disposal Reclassification

As noted above, the Applicant also transferred $968,310 from the non depreciable asset disposal cost account to the respective property, plant and equipment accounts in 2008. Festival Hydro has not restated its financial results retrospectively, and Energy Probe submitted that rate base is $94,613 higher than it should be in 2010. Energy Probe submitted that rate payers should not provide a return on assets that should have been depreciated in prior years.

The Applicant submitted that the accounting treatment is consistent with the recommendation from their auditors. The Applicant also noted that depreciation was not charged in prior years and that rate payers had the benefit of this omission from rates.

Board Findings

The Board finds that rate base should not be reduced by $94,613. The Board agrees with the Applicant that rate payers had benefitted from the omission of depreciation in prior years.

Working Capital Allowance ("WCA")

Festival Hydro used 15% of OM&A and cost of power in the calculation of 2010 WCA. The WCA 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.

Board staff submitted 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, and updates to reflect current retail transmission prices. Board staff also submitted 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 evolution of the industry and current initiatives, such as smart metering and Time-of-Use pricing, and renewable generation contracts, have had and will continue to have impacts on cash working capital requirements for all distributors. Board Staff noted 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. Energy Probe and VECC's submission were consistent with that of Board staff.

The Applicant submitted that its approach to WCA is correct and that a lead/lag study is not required for its next rebasing application. In support of its position the Applicant noted the following:

- The Board's filing requirements indicated that distributors could calculate WCA by the 15% approach or a lead/lag study. The filing requirements did not provide a threshold test that would trigger a lead/lag study.
- Several larger utilities are not conducting lead/lag studies because these utilities have not been able to justify such expenditures.
- For small working capital requirement, the cost of the lead/lag study is likely to exceed any adjustment that might result. Festival Hydro referred to the Board's decision for Welland Hydro Electric System Corp (EB-2008-0247) which stated, "The Board will also not require Welland to conduct a lead lag study for its next rebasing application. The Board concludes that it would not be cost effective for utilities such as Welland to undertake individual lead lag studies."

Festival Hydro suggested that the Board may wish to consider a more generic review of lead/lag studies to ensure a cost effective consistent approach. Festival Hydro submitted that if the Board requires a lead/lag study for the next rebasing application that the Applicant would request the establishment of a deferral account to capture the cost of the study.

Energy Probe does not support the methodology used by Festival Hydro to calculate the commodity component of the cost of power. Energy Probe submitted that the use of separate prices for RPP and non-RPP volumes provides a more accurate estimate of the commodity cost of power. Based on responses to interrogatories, Energy Probe estimated that the commodity cost of power drops by $1.6 million which translates into a reduction of $250,000 in rate base.

Festival Hydro submitted that the RPP is intended to capture the approximate cost of power over the long term and its use for determining the cost of power is a reasonable approximation of the future cost of power. The Applicant submitted that it is appropriate to use RPP prices for the calculation of WCA.

Board Findings

The Board agrees that further work on the formulaic WCA approach is warranted. The Board expects to initiate a generic proceeding / consultation on determining a new working capital methodology in advance of Festival Hydro's next cost of service filing. The Board will not direct Festival Hydro to conduct an independent lead/lag study at this time.

The Board acknowledges that Energy Probe's proposed cost of power methodology better reflects reality, but also notes that the determination of the WCA is a proxy at this time. Further, with the implementation of smart metering and TOU pricing, further adaptation will be required to accurately estimate the cost of power for estimating working capital requirements. The Board will not require Festival to adopt Energy Probe's alternative approach at this time.

COST OF CAPITAL and CAPITAL STRUCTURE

On December 20, 2006, the Board issued the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*. This report provides the Board's policy guidelines for determining the capitalization and cost of capital to be used for electricity rate-setting.

Festival Hydro noted in its Application that its requested cost of capital, summarized in the table below, was without prejudice to ROE that may be adopted by the Board in early 2010.

Cost of Capital Parameter	Festival Hydro's 2010 Proposal As filed on August 28, 2009
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%
Long-Term Debt	7.40% - based on the assignment of the deemed rate of 7.62% to Festival Hydro's promissory notes due to the City of Stratford, its municipal shareholder, and a 2010 loan from Infrastructure Ontario to fund the smart meter program for which a rate of 6% was assumed
Return on Equity	8.01%
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital (WACC)	7.40%

In 2009, the Board conducted a consultative process to review the Cost of Capital for all rate regulated entities in the Ontario energy sector under its jurisdiction. Based on its findings arising from that consultative process, on December 11, 2009, the Board issued the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the "2009 Report").

On February 24, 2010, the Board issued a letter documenting the updated Cost of Capital parameters to be used in determining distribution rates for 2010 cost of service applications, based on the methodologies documented in the Board's 2009 Report. These are summarized in the following table:

Cost of Capital Parameter	Updated Value for 2010 Cost of Service Applications
Return on Equity	9.85%
Deemed Long-term Debt Rate	5.87%
Deemed Short-term Debt Rate	2.07%

The following issues were raised in submissions:

- Long-Term Debt Rate
- Short-Term Debt Rate
- Return on Equity
- Capital Structure

Long Term Debt Rate

As noted above, Festival Hydro had applied the deemed rate of 7.62% to its affiliate debt. Section 4.4.1 of the 2009 Report states that, “The Board will primarily rely on the embedded or actual cost of existing long-term debt instruments.” Board staff and VECC submitted that Festival Hydro’s debt should be recalculated to reflect the lower of the actual rate of 7.25% for the affiliated debt instrument ($15.6 million) and the Board’s deemed rate. SEC also submitted that Festival Hydro’s debt should be recalculated to use the lower of the actual debt rates for its promissory notes and the Board’s deemed rate. Energy Probe submitted that the affiliate long term debt is callable within the test year and that the deemed rate should apply, referring to Appendix C of the Board Report.

All parties submitted that the recent Infrastructure Ontario interest rates for 15 year loans should be used for the loan to fund the smart meter program ($2.5 million). All parties submitted that 6.0% for the Infrastructure Ontario loan was too high and the recommendations ranged from 4.25% to 4.72%.

Board staff noted that its submission was subject to the determination of the deemed long term debt rate as the Board’s 2009 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.”

Festival Hydro submitted in its reply that the 7.25% actual debt rate should be applicable to the promissory notes (totalling $15.6 million) held by the City of Stratford. The Board approved the 7.25% debt rate in prior rate proceedings and reliance upon actual cost of debt is in keeping with the Board’s 2009 Report. Festival Hydro also submitted that the rate applicable on the Infrastructure Ontario loan be determined as the rate posted on the Infrastructure Ontario website concurrent with the day the Board announces the deemed rates applicable for the 2010 calendar year.

Board Findings

The Board notes that Board staff, VECC and SEC have agreed that the lower of the actual debt rate and the Board’s deemed rate should be applicable to the promissory notes held by the City of Stratford. The Board agrees that the rate to be applied to long term affiliate debt will be the lower of 7.25% and the Board’s deemed long-term debt rate, i.e. 5.87%, as determined in accordance with the 2009 Report.

All parties have agreed that the rate applied to the Infrastructure Ontario loan should reflect a real rate, either at the time of the application or the interrogatory responses or the day the Board announces the deemed rates applicable for the 2010 calendar year. The Board finds that the rate that will be applied to the Infrastructure Ontario loan is the rate on the Infrastructure Ontario website on February 24, 2010.

Short Term Debt Rate

Energy Probe submitted that the short term debt rate should be updated to reflect the methodology outlined in Appendix D of the Board Report. Festival Hydro submitted that this is reasonable.

Board Findings

The Board agrees with the position of the parties.

Return on Equity

The 2009 Report determined that the initial ROE to be embedded in the Board's refined formula would be 9.75%. This assumed a forecast long term government of Canada bond yield of 4.25% and an initial equity risk premium of 550 points. The equity premium includes 50 basis points for transactional/flotation costs.

Energy Probe stated that flotation costs of capital are applicable in cases where a distributor releases some new stocks in the market or it issues debt. Energy Probe submitted that the inclusion of the 50 basis points for transactional costs is not appropriate for Festival Hydro as there is no evidence that the costs will be incurred in 2010.

The Applicant stated that Energy Probe's submission in the current Application is inconsistent with its written comments in the Consultation on the Cost of Capital, which referred to the 50 basis points for flotation costs and use of formulaic approaches. Festival Hydro is concerned that Energy Probe's proposal creates a double standard for return on equity based on utility size. Festival Hydro submitted that Energy Probe has failed to provide evidence to deviate from Board policy.

Board Findings

The Board will make not make the adjustment to the method of determining the ROE proposed by Energy Probe. The Board notes the following from page 63 of the 2009 Report:

> The Board will apply the methods set out in this report annually to derive the values for the ROE and the deemed long-term and short-term debt rates for use in cost of service applications.

This approach is qualified by the Board at page 13 of the 2009 Report:

> The final “product” of this process, of course, is a Board policy. This was not a hearing process, and it does not – indeed cannot – set rates. The Board’s refreshed cost of capital policies will be considered through rate hearings for the individual utilities, at which it is possible that specific evidence may be proffered and tested before the Board. Board panels assigned to these cases will look to the report for guidance in how the cost of capital should be determined. Board panels considering individual rate applications, however, are not bound by the Board’s policy, and where justified by specific circumstances, may choose not to apply the policy (or a part of the policy).

The issue is whether the Board should apply the policy or whether it should adjust the application of the policy for the specific circumstances of Festival Hydro. The Board concludes that the policy should be applied unadjusted.

The Board notes that the argument advanced by Energy Probe, namely the removal of 50 basis points from the ROE on the basis that Festival Hydro does not issue equity in the market, is the same as that advanced by Energy Probe in Burlington Hydro Inc.’s 2010 Cost of Service application. The Board in fact notes that Festival Hydro’s situation exactly corresponds with that of Burlington Hydro in that application. And for the same reasons as articulated by the Board in its decision on Burlington Hydro’s 2010 distribution rates application[4], the Board finds that Festival Hydro has complied with the requirements of the 2009 Report and of the Board’s filing requirements, and that no adjustment to the ROE is warranted or supported.

The Board finds that it would be inappropriate to adjust the operation of the formula without evidence as to the appropriateness of such an adjustment in terms of the overall

[4] Decision with Reasons, Burlington Hydro Inc., [EB-2009-0259], pp. 25-28

methodology in the context of Festival Hydro's circumstances. This evidence would need to address, for example, whether such an adjustment for Festival Hydro is appropriate under the "stand alone" utility principle and whether the allowance is related only to specific transactional costs or whether it has broader application, and that no adjustment to the ROE is warranted or supported.

The emphasis in the 2009 Report regarding the need to support an application refers particularly to long-term debt and the proper application of the Board's policy, an area which has drawn considerable attention in several Cost of Service applications in the past few years. With respect to adjustments to the ROE, such as that proposed by Energy Probe, the Board finds that the evidentiary burden rests with the party proposing a departure from the policy. Depending upon the circumstances this could be either the applicant or an intervenor.

Capital Structure

Energy Probe submitted that the Board should adjust the deemed capital structure for the Applicant. Energy Probe submitted that the Board did not explicitly state that the 60% debt component should remain at 56% long term debt and 4% short term debt. Energy Probe stated that it agreed with the December 20, *2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation (the "2006 Report")*, and that "the term of the debt should mirror the life of the assets the debt is used to finance."

Energy Probe submitted that there is a mismatch between the level of deemed short-term debt and the working capital level included in rate base. Energy Probe submitted that the shortfall in short term debt is $5.7 million, which is based on the difference between 2010 working capital of $7.3 million and deemed short term debt of $1.6 million. Energy Probe also noted that Festival Hydro's actual long term debt is $18.1 million, while the deemed long term debt for 2010 is $22.2 million. If the difference of $4.1 million was classified as short term debt, the short term debt component of rate base would increase to 14%.

The Applicant stated that it knows of no basis upon which a direct relationship can be made between working capital allowance and short term debt. The Applicant argued that Energy Probe has not provided sufficient justification to depart from existing Board policy. There have been no changes to the actual equity share structure since the 2006 EDR application and the Applicant submits that its requested deemed capital structure is appropriate.

Board Findings

The Board will make no adjustment to the deemed capital structure of 56% long-term debt and 4% short-term debt. As acknowledged by all parties, the Board's uniform deemed capital structure and uniform approach to setting the WCA have both been in place for considerable time. The Board is not prepared to depart from these policies on the basis of the record in this proceeding. Energy Probe has asserted that the WCA should align to short-term debt in the capital structure, but it has not provided any evidence to support this contention, theoretically or practically; nor has Festival Hydro had the opportunity to respond with rebuttal evidence. However, as indicated earlier, the Board may review the formula approach to determining the WCA. In the context of that review it may be appropriate to examine the levels of WCA across utilities and consider whether any refinement to the deemed capital structure is warranted.

In summary, the Board finds that the weighted average cost of capital for Festival Hydro will be 7.31%. The table below sets out the Board's conclusions for Festival Hydro's deemed capital structure and cost of capital. It incorporates the Board's recent updated cost of capital parameters and assumes a rate of 5.87% for the Infrastructure Ontario loan. The Applicant will update the data to reflect the actual rate for the Infrastructure Ontario debt as of February 24, 2010.

Capital Component	% of Total Capital Structure	Cost Rate
Long-Term Debt	56%	5.87%
Short-Term Debt	4%	2.07%
Equity	40%	9.85%
Weighted average cost of capital		7.31%

COST ALLOCATION AND RATE DESIGN

The following issues are addressed in this section:

- Loss Factors;
- Revenue to Cost Ratios;
- Rate Design;
- Other Distribution Revenue;
- Low Voltage Charges; and
- Retail Transmission Rates.

Loss Factors

Festival Hydro applied for a total loss factor (“TLF”) of 1.0307 for secondary metered customers < 5,000 kW. The request 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 Applicant provided loss factor data for the five year period 2004 to 2008 in support of its request.

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 a SFLF of 1.0045, the provincial wide SFLF, which Festival Hydro adopted in 2001. In the 2006 cost of service proceeding, 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 stated that this was an over sight in 2006.

Parties were silent on the matter or stated that the TLF request of 1.0307 and SFLF request of 1.0075 was reasonable.

Board Findings

The Board will accept the TLFs as proposed by Festival Hydro. The TLFs are set out in the table below.

Total Loss Factors

Secondary metered < 5000 kW	1.0307
Primary metered < 5000 kW	1.0204
Secondary metered ≥ 5000 kW	1.0176
Primary metered ≥ 5000 kW	1.0075

Customer Classes

The Applicant revised rate class descriptions from those that appear in the Tariff of Rates and Charges effective May 1, 2009. The Applicant explained, in response to an interrogatory, that the revisions are in relation to the rules for the process and frequency of reclassification in accordance with amendments to the DSC. Board staff submitted that the changes should correspond to those in the Applicant's conditions of service. The Applicant submitted that the conditions of service will be updated upon final approval of the 2010 application.

Revenue-to-Cost Ratios

The following table sets out Festival Hydro's 2006, current and proposed revenue-to-cost ratios and the Board's target ranges, as established in the Board's *Application of Cost Allocation for Electricity Distributors EB-2007-0667*.

	2006 Informational Filing** Column 1	2010 Informational Filing** Column 2	Proposed Ratio (Aug. 28, 2009) Column 3	Board Target Range Column 5
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's Application requested approval of the ratios in column 3. The Applicant proposed to move in the direction of 100% for all classes. Festival Hydro proposed to move the ratio for street lighting and sentinel lighting halfway to 70%, the lower limit of the Board's Target Range. The proposed change for residential Hensall moved the ratio beyond the 80% lower limit. The Application stated that it is Festival Hydro's desire to move the residential 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 413 residential Hensall customers will experience a greater than 10% total bill impact based on the revenue to cost ratio proposed for 2010. The increase will be approximately 14% on total bill and will represent a dollar increase of $4.88 per month. While the increase for these 42 customers exceeds 10%, Board staff submitted that the increase is reasonable as it will facilitate the movement towards harmonization and eventually simplify Festival Hydro's billing and customer care operations.

Board staff submitted 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 observed that the proposed 2010 ratios, with the exception of street lighting and sentinel lighting, are within the Board's target range and reasonable.

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." Revenue to cost ratios for the period up to 2013 were provided in response to a supplementary interrogatory.

While the Applicant has not requested revenue to cost ratio approval beyond the test year, Board staff noted 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 submitted that the 3 year process is more appropriate to address issues related to cross subsidization.

SEC submitted that there is no reason to wait until 2013. SEC submitted that the street light, sentinel light and USL customer classes should move to the minimum levels by 2011.

Energy Probe submitted that the Board should direct Festival Hydro to reduce the USL ratio to 120% in 2010 and to move the street light and sentinel light ratios half of the way to 70% in 2010. Energy Probe submitted that the street light revenue to cost ratio should increase to 70% in the following two years. Energy Probe does not support the movement of ratios that are already within the Board's target range to unity unless the movement is to reduce the ratio.

VECC agreed with Festival Hydro's proposal regarding street light and sentinel light and with the plans for the IRM period.

Festival Hydro agreed with the suggestion of parties except for SEC's suggestion to move to minimum levels by 2011. The Applicant's opinion is that the change would be too aggressive. The following was provided with the reply submission.

Customer Class	2010 Cost Allocation Study	2010 Proposed Rev Cost Ratio	2011 Proposed Rev Cost Ratio	2012 Proposed Rev Cost Ratio	2013 Proposed Rev Cost Ratio
Residential	108.44%	108.14%	107.90%	107.68%	107.48%
Residential - Hensall	71.52%	82.65%	91.10%	99.55%	107.48%
GS < 50 kW	116.03%	114.00%	113.00%	111.87%	111.87%
GS >50	79.93%	80.00%	80.00%	80.00%	80.00%
Large Use	114.10%	114.00%	113.00%	111.87%	111.87%
Sentinel Lights	31.40%	50.70%	60.35%	70.00%	70.00%
Street Lighting	32.88%	49.90%	59.95%	70.00%	70.00%
USL	143.83%	120.00%	113.00%	110.00%	110.00%

<u>Residential Hensall</u>

Energy Probe submitted that the increase proposed by Festival Hydro in 2010 is too high, and that the increase should not be 91.21% as originally proposed but should be 82.65% or whatever level results in a 10% total bill impact for the smallest customers. Increases in future rate years should also result in no more than 10% total bill impact for the smallest customers. Any additional revenue should be allocated entirely to reducing the residential revenue to cost ratio.

In order to ameliorate bill impact considerations, VECC submitted that the 2010 adjustment to the residential Hensall class should be no more than half of the way to 85%. VECC supported Festival Hydro's long term goal of harmonizing its residential rates, but submitted that increasing revenue to cost ratios for the residential Hensall class was not the correct way to achieve the goal. VECC submitted that the two residential customer classes should be combined for 2010, a revenue to cost ratio for the combined class should be established, and rates for residential Hensall increased with the aim of eventually harmonizing.

The Applicant proposed to achieve the same revenue to cost ratio for regular residential and residential Hensall rates over a four year period. Revenue from increases in Hensall rates would be applied as a reduction to regular residential rates. The Applicant revised the revenue to cost ratio originally proposed in the Application, 91.21%, to the 82.65% proposed by Energy Probe. The new ratio results in a total bill impact of 12.85% or $4.77 per month for the 250 kWh customers. The proposed ratio changes in the three subsequent years result in bill impacts of less than 10% for the 250 kWh customers.

Board Findings

The Board has reviewed the revenue to cost ratios proposed in Festival Hydro's reply submission. The Board accepts the proposal to:

- Move the ratio for the street light and sentinel light classes half way to the Board's lower target of 70%, and to move these classes to ratios of 70% by 2012. This three year approach differs from the Applicant's original four year approach, but is more consistent with a number of other Board decisions;
- Move the ratio for GS>50 customers to 80%; and
- Move the ratio for USL customers to 120%.

The Board accepts the proposed revenue to cost ratio of 82.65% for residential Hensall customers in 2010. The Board also accepts the ratios proposed for residential Hensall customers for 2011, 2012 and 2013, noting the Applicant's submission that rate impacts for 250 kWh customers will not exceed 10% in these three years.

Rate Design

Fixed/Variable Split

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. The table below identifies the Monthly Service Charges ("MSC"):

	Ceiling	Current	Proposed
Residential	$16.80	$14.09	$15.53
Residential Hensall	$17.13	$9.03	$13.06
GS < 50	$28.03	$28.11	$30.15
GS > 50	$151.80	$209.76	$238.49
Large Use	$1,390.03	$10,447.04	$10,977.20
Streetlight	$9.31	$0.45	$0.81
Sentinel Light	$9.24	$0.79	$1.47
USL	$6.96	$14.06	$12.91

The Board has noted that it will not require that an existing MSC above the ceiling must be brought down to or below the ceiling[5]. Board staff noted in submission that Festival Hydro's proposal was consistent with previous Board decisions for other distributors.

VECC submitted that for customer classes where the MSC is below the ceiling, it is the Board's expectation that the MSC will remain below the MSC. VECC also submitted that where the MSC is above the ceiling, the distributor should not increase them further.

Festival Hydro submitted that it has followed a structured approach consistent with previous years. For the customer classes with proposed MSC above the ceiling, the total bill impacts are well within the Board's thresholds. The Applicant submitted that its proposal to maintain fixed/variable splits be accepted by the Board.

Board Findings

The Board accepts Festival Hydro's proposals regarding the fixed/variable ratios, namely that the ratios remain unchanged. The Board agrees with Board staff and the Applicant, that previous Board decisions have approved maintaining fixed/variable ratios even where the MSC is greater than the ceiling. The Board intends to continue its consideration of cost allocation and rate design matters at a later date. Until that time it is preferable to maintain the same fixed/variable ratios irrespective of the ceiling so as not to distort the status of the ratio for reasons that are not ultimately supported by a yet to be developed guiding principle.

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

Other Distribution Revenue

Festival Hydro supplies street lighting installation and repair services, as well as waste and sewage billing services for the City of Stratford. The City of Stratford provides tree trimming services to Festival Hydro within the City of Stratford. Through the interrogatory process, Energy Probe 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. 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 included this addition to revenue offsets. In response to a VECC supplemental interrogatory, Festival Hydro indicated the potential for other distribution revenue to increase by a total of $36,336, which included the margin on street lighting services.

VECC and Energy Probe observed that the 2010 forecast revenue for street lighting capital and maintenance is less than cost due to a timing issue. Both parties submitted that timing issues should not result in higher rates. Festival Hydro, in its reply submission, provided an update on its non-utility operations. The update reflected the increase of $14,985 related to the margin on street lighting maintenance and an increase of $16,081 related to the timing difference. The update also reflected a decrease of $33,951 related to margins and returns earned on street lighting and water and sewage billing on behalf of the city. Festival Hydro submitted that the net change for non-utility operations should be a decrease of $2,885.

The net impact of Festival Hydro’s response to the VECC supplemental interrogatory and the review on non utility operations is an increase in other distribution revenue of $18,466 from the original amount of $659,450 to $677,916.

Board Findings

The Board approves the adjustment to other distribution revenue for rate setting purposes. This is not an approval of the activities of Festival Hydro that apparently garner the reported other distribution revenues.

Low Voltage Charges

In its application, Festival Hydro determined that 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 a Board staff interrogatory, Festival Hydro revised the charges to $103,917.68 to reflect the limited period of rider #4 on the Hydro One rates.

Both Board staff and VECC submitted that allocation of ST charges on the basis of 2010 retail transmission connection would be more appropriate than allocating based on historical numbers.

The Applicant agreed with the ST amount of $103,918.68 and allocation on the basis of 2010 retail transmission connection in its reply submission.

Board Findings

The Board finds that the ST amount of $103,918.68 is reasonable and that allocation on the basis of 2010 retail transmission connection is appropriate.

Retail Transmission Service ("RTS") Rates

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 RTS rates to reflect changes in the Ontario Uniform Transmission Rates ("UTR") as of July 1, 2009, 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 indicated 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.

VECC submitted that the adjustment to RTS rates should be based on a combination of the percentage over/under payment over the first six months of 2009 in combination with the percentage change in UTR as of July 1, 2009. In its reply submission, Festival Hydro completed the analysis suggested by VECC and determined that it was over collecting network charges by 12.58% and under collecting connection charges by

3.32%. Festival Hydro also provided the results of the impact of the UTR effective July 1, 2009.

Board Findings

The Board finds that Festival Hydro's analysis of its historical charges is reasonable.

The Board notes that a decision and order was issued on December 16, 2009 and a rate order was issued on January 21, 2010 regarding an application by Hydro One Networks Inc. that requested changes to the uniform provincial transmission rates. The changes in the UTRs on July 1, 2009 and January 1, 2010 are shown in the following table.

Uniform Transmission Rates

	Effective on July 1, 2009	Effective on January 1, 2010
	($/kW/month)	($/kW/month)
Network Service Rate	2.66	2.97
Line Connection Service Rate	0.70	0.73
Transformation Connection Service Rate	1.57	1.71

The Board orders Festival Hydro to update its RTS rates accordingly.

INTRODUCTION OF MICROFIT GENERATOR SERVICE CLASSIFICATION AND RATE

Ontario's Feed-In Tariff (FIT) program for renewable energy generation is a cornerstone of the province's *Green Energy and Green Economy Act, 2009*. The program was launched in September 2009, and the Ontario Power Authority ("OPA") started accepting applications on October 1, 2009.

The program includes a stream called microFIT, which is designed to encourage homeowners, businesses and others to generate renewable energy with projects of 10 kilowatts (kW) or less. Participants in the microFIT program are guaranteed a certain rate for the power they produce and feed into the Ontario grid.

On September 21, 2009, in anticipation of the initiation of the OPA's microFIT program, the Board issued a Notice of a Proceeding and Procedural Order No. 1 to commence a proceeding on its own motion to determine a just and reasonable rate to be charged by an electricity distributor for the recovery of costs associated with an embedded generator account having a nameplate capacity of 10 kW or less (embedded micro generator) that meets the eligibility requirements of the OPA's microFIT program. The Board assigned file number EB-2009-0326 to this proceeding.

The Board recognized the need for an appropriate cost recovery mechanism for the distributors, and the need to support the implementation of the microFIT initiative. The Board intended that the new micro generator service classification and associated rates were to be added to the rate tariffs of every distributor.

In its EB-2009-0326 Decision and Order, issued February 23, 2010, the Board approved the following service classification definition, which is to be used by all licensed distributors:

microFIT Generator

> *"This classification applies to an electricity generation facility contracted under the Ontario Power Authority's microFIT program and connected to the distributor's distribution system."*

On March 17, 2010, the Board approved a province-wide fixed service charge of $5.25 per month for all electricity distributors effective September 21, 2009.

As part of its draft Rate Order material, Festival Hydro shall identify the microFIT Generator service classification and include the approved service charge in the Tariff of Rates and Charges.

DEFERRAL AND VARIANCE ACCOUNTS

In its Application, Festival Hydro provided the account balances representing principal balances to December 31, 2008 and projected interest to April 30, 2010. The Applicant provided the audited Financial Statements as of December 31, 2008, which include an itemization of Regulatory Assets and Liabilities at a lesser level of detail.

The 2008 year end balances plus projected interest to April 30, 2010 are shown in the following table.

Account Number	Account Description	Total ($)
1508	Other Regulatory Assets – Sub-Account – OEB Cost Assessments	97,265
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	**-2,568,583**
	TOTAL	**-2,149,357**

The table above was prepared by Board staff and was reproduced in the Applicant's reply submission. The Board notes that the data were not reproduced correctly in the reply submission as there are sign errors in the Applicant's version. However, the Board is able to identify that the errors are simply related to data transfer as the subtotals and totals match those in the Board staff table.

Festival Hydro has proposed to dispose of the balances over a 4 year period. Energy Probe submitted that the 4 year period was acceptable and VECC submitted that Festival Hydro's proposal for clearing its deferral and variance accounts was consistent with the Board's EDDVAR (EB-2008-0046) report.

Energy Probe submitted that Festival Hydro has not used the prescribed interest rates for the entire period. In its reply submission, Festival Hydro has determined that the difference between its application and use of the prescribed interest rates is $289, and submitted that the Board should accept the interest calculation it has provided in the application.

<u>Account 1588 – Global Adjustment Sub Account</u>
Festival Hydro provided a calculation of the separate rate rider to dispose of just the Global Adjustment sub-account. Festival Hydro determined the separate rate rider based on 2008 non-RPP kWh sold allocated amounts applied to the 2010 non-RPP consumption data.

Energy Probe submitted that the Board should adopt a separate rate rider for the recovery of the Global Adjustment whenever the distributor is able to apply different rate riders to different customers within a class. In its reply submission, Festival Hydro stated that it is not able to apply the rate rider specifically to non-RPP customers. Festival Hydro submitted that it is prepared to establish a rate rider for Global Adjustment and a rate rider excluding Global Adjustment with the understanding that the riders will be applied to all customers within a rate class. Festival Hydro does not know how much it would cost to make computer changes to apply a rate rider to a select group of customers within a rate class.

GS>50 and large user customers were allocated 88.9% of the total Global Adjustment variance. Festival Hydro stated that virtually all the customers in these classes are on non-RPP pricing, so cost causality is closely met. Festival Hydro is of the opinion that the sub-account rate rider should apply to Municipalities, Universities, Schools and Hospitals (“MUSH”) accounts. Most of the MUSH sector were with energy retailers in 2008 and are currently with retailers.

Festival Hydro has determined that a residential customer with average monthly consumption of 800 kWh would see a bill impact of $0.96 per year. The Applicant submitted that any cost of system enhancement is not justified.

Board Findings

The Board approves the deferral and variance account balances as presented by Festival Hydro and approves a disposition period of four years as proposed by the Applicant. The Board notes that Energy Probe is correct in its submission that distributors should apply the Board's prescribed interest rates. However, as the difference is small, the Board will allow the Applicant's interest determination to stand.

Festival Hydro noted that the impact of its Global Adjustment sub-account proposal on residential customers is not material. While it is imperfect to recover the global adjustment from all customers, Festival Hydro made a reasonable observation that the cost of system enhancement to apply the rate rider only to non- RPP customers is not justified at this time. However, Festival Hydro should make efforts to determine the cost of system enhancement and provide this information in a future rate application.

The Board finds that a separate rate rider is not required for the disposition of the Global Adjustment sub-account.

The Board reminds Festival Hydro that the necessary accounting entries to reflect the Board's Decision and Order in this proceeding on the disposition of deferral and variance accounts should be recorded as soon as possible, and certainly no later than June for RRR purposes as at June 30, 2010.

SMART METERS

Festival Hydro requested that the standard $1.00 smart meter funding adder be approved as part of the 2010 cost of service rate application. The request reflects no change from the current funding adder of $1.00 which was approved as part of Festival Hydro's 2009 IRM rate application (EB-2008-0175). The rate adder will continue to be applicable to residential, residential Hensall, GS<50, GS>50 and large use customer classes.

The Application states that Festival Hydro has not begun the process of installing smart meters as part of the province's smart meter initiative. However, Festival Hydro plans to have all smart meters deployed by December 31, 2010. The total capital cost is estimated to be $2.5 million. The cost of smart meters has not been included in the revenue requirement in the current application. Smart meter funding adders, and capital and operating costs related to smart meters, will continue to be recorded in established deferral accounts 1555 and 1556, for review and disposition in a future application.

The smart meter funding adder of $1.00 was supported by Energy Probe. All other parties were silent on the matter.

Board Findings

The Board approves continuation of the $1.00 smart meter funding adder.

IMPLEMENTATION

The Board has made findings in this Decision which change the 2010 revenue requirement and, as a result, the distribution rates from those proposed by Festival Hydro. In filing its draft Rate Order, it is the Board's expectation is that Festival Hydro will not use a calculation of the revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects Festival Hydro to file detailed supporting material, including all relevant calculations showing the impact of this Decision on Festival Hydro's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Supporting documentation shall include, but not be limited to, filing a completed version of the Revenue Requirement Work Form excel spreadsheet, which can be found on the Board's website. Festival Hydro should also show detailed calculations of the revised retail transmission service rates and variance account rate riders reflecting this Decision.

Festival Hydro applied for rates May 1, 2010. In the event that the Board could not issue a Decision and Rate Order by that time, 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 Board approves a May 1 effective date and notes that there is sufficient time to implement the rates on May 1, 2010 as well.

RATE ORDER

A Rate Order decision will be issued after the processes set out below are completed.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. The Board will determine eligibility for costs in accordance with its *Practice Direction on Cost Awards*. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's *Practice Direction on Cost Awards*. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

All filings with the Board must quote the file number EB-2009-0263, and be made through the Board's web portal at www.errr.oeb.gov.on.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must be received by the Board by 4:45 p.m. on the stated date. Parties should use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.oeb.gov.on.ca. If the web portal is not available, parties may e-mail their documents to the attention of the Board Secretary at BoardSec@oeb.gov.on.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's *Practice Directions on Cost Awards*.

THE BOARD DIRECTS THAT:

1. Festival Hydro shall file with the Board, and shall also forward to intervenors, a draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates including the Revenue Requirement Work Form in Microsoft Excel format.

2. Intervenors shall file any comments on the draft Rate Order with the Board and forward to Festival Hydro within 7 days of the date of filing of the draft Rate Order.

3. Festival Hydro shall file with the Board and forward to intervenors responses to any comments on its draft Rate Order within 7 days of the date of receipt of intervenor submissions.

4. Intervenors shall file with the Board and forward to Festival Hydro their respective cost claims within 30 days from the date of this Decision.

5. Festival Hydro shall file with the Board and forward to intervenors any objections to the claimed costs within 44 days from the date of this Decision.

6. Intervenors shall file with the Board and forward to Festival Hydro any responses to any objections for cost claims within 51 days of the date of this Decision.

7. Festival Hydro shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto**,** April 1, 2010

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary