Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

HYDRO 2000 INC.

EB-2007-0704

December 10, 2007

INTRODUCTION

Hydro 2000 Inc. (“Hydro 2000”) is the licensed distributor for the former villages of Alfred and Plantagenet. Hydro 2000 submitted an application for 2008 electricity distribution rates on September 13, 2007. The application was based on a future test year cost of service methodology. On November 19, 2007, Hydro 2000 submitted a revised application reflecting updates resulting from its responses to interrogatories.

The purpose of this document is to provide the Ontario Energy Board (the “Board”) with the submissions of Board staff after its review of the evidence submitted by Hydro 2000 in the November 19th filing.

THE APPLICATION

As reflected in its revised filing, Hydro 2000 requested a revenue requirement of $500,727 less an amount for the low voltage pass-through of $143,000 and revenue offsets of $35,980 for a total base revenue requirement of $321,747. This reflects the recovery of a revenue deficiency of $56,538. Hydro 2000 also requested to continue its smart meter rate adder, to establish a deferral account for future capital expenditures and to dispose of certain variance accounts over a three year period totalling $338,619. Hydro 2000 has addressed one outstanding matter from its 2006 rates case (RP-2005-0020/EB-2005-0380). In that decision, the Board directed Hydro 2000 to file a plan to reduce distribution losses.

OM&A

Background

Hydro 2000 is seeking an amount of $244,817 for OM&A for the 2008 test year. This is an increase of 18% from the reported 2006 actual costs of $218,509.

Discussion and Submission

<u>Incremental Billing System Costs</u>
It appears from its response to Board Staff interrogatory #1 c), that a large portion of the OM&A increase is attributable to an increase in on-going billing system costs totaling

$15,073. Hydro 2000 stated that in late 2006, its billing system provider (Advanced Infinity Company) was purchased by the Harris Co. Harris Co. indicated that it would not support the Advanced system going forward. Consequently, through its host provider (Ottawa River Power), Hydro 2000 replaced the Advanced system with Harris Co.'s NorthStar CIS version 6.2. Hydro 2000 stated that Harris Co. charged only the data conversion costs totaling $57,200 which Hydro 2000 is proposing to include in its 2008 rate base.

On the OM&A side, Hydro 2000 stated that it will now incur $15,073 more annually for licence and EBT costs. It remains unclear as to why these costs are incremental. Board staff invites Hydro 2000 to affirm that these costs are not in fact replacing other similar on-going costs related to the Advanced billing system that are currently embedded in Hydro 2000's revenue requirement. In so doing, Hydro 2000 should identify the amounts currently reflected in its rates for licensing and EBT costs and to demonstrate that the $15,073 applied for is truly incremental.

<u>Regulatory Costs</u>

In response to Board staff interrogatory #8, Hydro 2000 stated that it would remove $60,000 from its proposed OM&A expenses related to regulatory cost recoveries and transfer this amount to a deferral account.

Hydro 2000, in its original submission, requested $197,631 for Administrative and General Expenses in the 2008 test year (Exhibit 4, Tab 1, Schedule 2, Page 1). This represented an increase of $61,290, or 45% over the 2007 bridge year. Hydro 2000 identified that the company required a $60,000 increase relating to the preparation of their 2008 Cost of Service application to the Board and related costs. Hydro 2000's response to Board Staff interrogatories page 21 stated:

> Hydro 2000 Inc. is confirming that the 2008 amount for regulatory expenses included a one-time costs of $30,000 to Elenchus Research Associates and a one-time increase in 2008 of the annual costs paid to Deloitte of $19,000 and $11,000 for reserve for future expenditure for interveners fees and consultant fees to reply all interrogatives with help of lawyers and regulatory consultants.
>
> At this point Hydro 2000 Inc. is applying to have a sub-account in 1508 to track for regulatory expenses incurred. It will remove the $60,000 dollars expenses from its OM&A expenses and transfer-it in a deferral sub-

account 150800-03. Hydro 2000 Inc. will re-filed is application with this change.

Board staff notes that Hydro 2000's revised proposal for variance account disposition is based on recovery by way of a rate rider over a three year period ending April 30, 2010. However, the Board may wish to consider options with respect to the appropriate recovery methodology. Board staff also notes that although Hydro 2000 removed approximately $60,000 of regulatory costs from OM&A, it appears that it included only approximately $40,000 in account 1508. Board staff invites Hydro 2000 to clarify why it has not requested all of its originally stated costs in its revised filing.

COST ALLOCATION AND RATE DESIGN

LOW VOLTAGE

Background

Hydro 2000 is an embedded distributor, served by the host distributor Hydro One. The amount of Low Voltage ("LV") cost approved for inclusion in 2006 distribution rates was $106,241. The revenue requirement for distribution costs other than LV cost was $278,095. In accordance with the 2006 EDR model, the LV amount was allocated to the customer classes in proportion to the revenue from the Retail Transmission Rate – Connection, and the remaining larger part was allocated in proportion to average distribution revenue in the preceding three years.

Board staff notes that the Informational Filing of Hydro 2000's cost allocation model did not include the LV cost. Run 2 of the filing yields a revenue to cost ratio for each class, based on allocated costs net of the LV cost, together with revenue net of the pass-through amounts to cover the LV cost.

In its initial application, Hydro 2000 included an amount of $121,000 for the 2008 LV cost. In the revised application, this amount was increased to $143,000. Information was provided in response to interrogatories on how this amount would be allocated to the classes.

Discussion and submission

<u>LV Costs</u>

In response to Board staff interrogatory #5, Hydro 2000 provided a detailed billing history from Hydro One for the three shared line circuits and the three shared distribution stations, running from October 2006 to September 2007 inclusive. The total is slightly higher than $143,000. Given the evidence that normalized consumption forecast for 2008 is higher than 2006 actual consumption and 2007 projected consumption (Exhibit 3, Tab 3, Schedule 4,) it appears that the forecast amount is conservative.

Due to the significant size of Hydro 2000's annual LV costs relative to its total distribution expenses (approximately 25%) the Board may wish to consider that Hydro 2000 may need to file an updated rate order reflecting an updated LV cost forecast upon the Board's approval of Hydro One's 2008 distribution application and the corresponding LV component. While it is true that Hydro 2000 has the ability to track any variances in LV costs in account 1550, Hydro 2000's evidence at Exhibit 5, Tab 1, Schedule 3 shows that the forecasted accruals for 2007 alone total approximately $30,000 or 20% of the total variance account balances requested for disposition. Subject to the timing of the Board's approval of Hydro One's updated LV rates, the Board may wish to consider when Hydro 2000 should update its LV cost rate adders.

<u>Allocation of LV Cost</u>

Hydro 2000's proposed allocation of LV cost is found in the final table of the response to Board staff interrogatory # 39 c). The starting point for the proposed allocation is based on calculations in the response to interrogatory # 39 b). By contrasting the allocation of LV costs in the two tables (i.e. the 2006 EDR in the second table and the proposal in the third table) it can be seen that the proposed allocation differs somewhat from the approved allocation in 2006. From this starting point, the proposed allocation appears to be part-way toward the allocations that arise from the Informational Filing of the cost allocation model. LV costs are effectively allocated in the same proportions as other costs.

In the end, the proposal effectively is for an allocation of LV costs as follows: Residential 63.52% (60.11%); GS<50 23.89% (21.35%); GS>50 10.25% (17.65%); Streetlights 2.09% (0.82%); and Unmetered Scattered Load 0.25% (0.07%). The amounts in brackets are the proportions from Hydro 2000's approved 2006 model.

The approved allocation in 2006 was based on revenue from the Retail Transmission Rate – Connection, on the rationale that the service provided by the host distributor is similar in nature to the connection aspect of transmission. Board staff submits that Hydro 2000 has not provided a rationale for changing this method of allocating LV costs. Board staff invites Hydro 2000 to address this in its reply submission, and/or to provide revised class revenue requirements in which the LV component is calculated on the previously approved basis.

LINE LOSSES

Background

Board staff notes that the Board's decision on Hydro 2000's 2006 rate application (RP-2005-0020/EB-2005-0380) directed Hydro 2000 to file a plan to reduce distribution losses. Hydro 2000 filed a Utility Load Flow and Evaluation Study as part of the subject application.

The evidence in the subject application shows the calculation of a Distribution Loss Factor ("DLF") of 1.066 and Supply Facilities Loss Factor ("SFLF") of 1.0045, based on actual data from previous years. The application is for approval of a Total Loss Factor ("TLF") of 1.070, which is the product of these two factors (Exhibit 4, Tab 2, Schedule 9, pages 2 and 4). However, the proposed Tariff shows an amount of 1.066 for the TLF (Exhibit 9, Tab 1, Schedule 6, page 3). The currently approved TLF is 1.061.

Discussion and submission

In response to Board staff interrogatory #46 f), Hydro 2000 confirmed its requested DLF as 1.066. Hydro 2000 did not confirm its TLF. Board staff invites Hydro 2000 to confirm its requested TLF and if different than 1.07 to explain this difference.

The reference to Exhibit 4 above shows a steady increase in the DLF, with a slight downturn in 2006. The requested amount of 1.066 is a five-year average, which is lower than the record achieved during the most recent three years. This trend may be a matter of concern over the longer term. In response to Board staff interrogatory #46 e), Hydro 2000 indicated that the planned introduction of new technology, including smart meters, will be helpful in detecting losses in the future.

As per the response to Board staff interrogatory # 46 a), the requested TLF includes the losses of 3.4% in the LV system outside of the boundaries of the embedded distributor.

The line loss study submitted with the subject application outlined two recommendations for reducing losses in the near term. In response to Board staff interrogatory #48, Hydro 2000 stated that the first recommendation (to update the "system single lines to add further system information, including the ratings of all switches, the size of all conductors and other details" - with a budget of $6,000) would be accomplished in future years. Hydro 2000 justified this delay by stating that the load growth assumption used by the study was 3% over the next 10 years whereas Hydro 2000's actual load growth from 1999 to 2007 was only 0.89%.

With respect to the second recommendation, the study recommended the re-balancing and re-phasing of the Alfred and Plantagenet feeders. In response to Board staff interrogatory #48, Hydro 2000 stated that an analysis and re-balancing of the feeders is done every three years with the next work scheduled for January 2008.

The Board may wish to consider the appropriateness of Hydro 2000's proposed loss factor given their attempts at implementing the study's recommendations and the fact that a large portion of Hydro 2000's losses occur outside of its boundaries.

Board staff is concerned with the evidence that Hydro 2000's component of the DLF indicates a steady and continuous increase from 2002-2006 (i.e. from 1.80% to 3.91%). Hydro 2000 stated that it will be in a better position to develop a plan to reduce losses once it installs its own metering on its lines (i.e. to a specific transformer and feeder) whereby it would be able to accurately compare its purchases and sales by feeder. Hydro 2000 stated that it is not in a position to spend the $20,000 that this kind of project will cost at this time, especially given that its own metering may in fact be implemented as part of a smart meter project in 2008 or 2009. The Board may wish to consider if further direction should be provided to Hydro 2000 regarding the management of the DLF.

REVENUE TO COST RATIOS

Background

Hydro 2000 submitted its Informational Filing. The Run 2 yielded Revenue to Cost Ratios are found in the second column of the following table. The revenue requirement allocated in the filing did not include LV costs. The evidence submitted in response to VECC Interrogatory #22 is that the ratios flowing from the proposed rates are as found in the third column of the following table.

%	Informational Filing Run 2	Proposed Rates
Customer Class	**R/C**	**R/C**
Residential	115.0	108.8
GS < 50 kW	81.4	88.2
GS > 50 kW	94.5	108.4
Unmetered Scattered Load	10.4	11.3
Street lighting	50.3	71.8

Discussion and submission

The table above shows that, with the exception of the GS > 50 kW class, the proposed rates are designed to yield revenue to cost ratios that move closer to 100%. Board staff notes that with the one exception of the USL class, the ratios are within the range recommended in the Board's *Application of Cost Allocation for Electricity Distributors* issued on November 28, 2007.

However, it should be noted that the new values are not based on a forward year cost allocation study. Hydro 2000's intention, as stated in response to Board staff interrogatory #39 c) was to move approximately 30% to 40% of the distance from the existing ratios toward 100%. Board staff has been unable to replicate the new ratios precisely from the data available.

With that in mind, Board staff wishes to make two observations. First, staff notes that Hydro 2000 has moved the revenue to cost ratio for the GS > 50kW class from 94.5%

past the neutral point to 108.4%. Board staff invites Hydro 2000 to address this concern in its reply submission.

Second, Board staff notes that the new ratio for Unmetered Scattered Load (USL) remains very low. Further, staff notes that the proposed rate per kWh for this class is lower than the existing rate, and is considerably lower than the corresponding rate for the GS < 50 kW class, even though the two rates are equal in the existing Tariff shown at Exhibit 9, Tab 1, Schedule 4, Page 1. The Board should consider whether Hydro 2000 should adjust its USL rate to conform to the new Board policy.

FIXED CHARGES

Background

Hydro 2000's Informational filing includes a calculation of the floor and ceiling amounts based on 2004 costs adjusted per the EDR 2006 methodology. The proposed monthly fixed charges are near the ceiling values calculated in the cost allocation model.

Discussion and Submission

The proposed rates are not above the calculated ceiling for any class. Board staff notes that the calculated ceiling in a forward test year model would be higher, and notes further that Run 2 did not include LV costs. Nevertheless, the proposed monthly fixed service charges are in several instances more than double the existing approved rate.

It appears from its response to VECC interrogatory #20 that Hydro 2000 has made an explicit decision to increase its monthly fixed service charges relative to its volumetric charges, to achieve stability in its revenues.

Hydro 2000 acknowledges that it is unable to identify a Board policy that would support this approach. Further, it is clear in the evidence at Exhibit 9, Tab 1, Schedule 9 that the impact on smaller customers in each class is higher than on larger customers.

The Board is conducting a study of rate design principles at this time, with a general expectation that fundamental re-design will not be undertaken pending finalization of the study and a report. The Board should consider whether Hydro 2000's approach is premature.

DEFERRAL AND VARIANCE ACCOUNTS

DISPOSITION

Background

Hydro 2000 is requesting that the following accounts and balances be cleared for disposition as of April 30, 2008 as per Exhibit 5, Tab 1, Schedule 3 DVAD.v16.xls spreadsheet. The balances provided below include both an interest and principal forecast up to April 30, 2008:

1508 Other Regulatory Assets, $46,380 versus $6,607 in original application
1550 LV Variance Account, $65,106
1580 RSVA Wholesale Market Service Charge, $8,725
1588 RSVA – Power, $63,892
1590 Recovery of Regulatory Assets $103,700
1592 Deferred PILs Account, $50,817

The Hydro 2000 proposal is to collect these amounts from rate payers via rate riders as per Exhibit 5, Tab1, Schedule 3.

Hydro 2000 has other deferral and variance accounts that they are not asking to dispose of at this time. The following are the forecasted balances of these other accounts as of April 30, 2008:

1555 Smart Metering, ($2,547)
1562 Deferred Payments in Lieu of Taxes, ($103,118)
1563 PILS Contra Account $103,118
1565 CDM Expenditures and Recoveries, $3,043
1566 CDM Contra Account ($3,035)
1584 RSVA – Retail Transmission Network Charge, ($27,443)
1586 RSVA Retail Transmission Connection Charge, ($19,626)

Discussion and Submission

<u>Treatment of RSVAs</u>

Hydro 2000 is not applying for disposition of accounts 1584 RSVA – Retail Transmission Network Charge and 1586 RSVA Retail Transmission Connection Charge as per Exhibit 5, Tab 1, Schedule 3 DVAD.v16.xls. As of December 31, 2006 these balances were ($25,948.86) and ($18,245.08) respectively. The Board's usual practice in the electricity sector is to dispose of all RSVAs unless a reason is provided. Hydro 2000 has not provided a reason for these accounts not being cleared. Board staff notes that these balances represent an over-collection from ratepayers. It would be inconsistent with previous Board policy on the treatment of RSVA disposition if these accounts are not cleared at this time. Board staff has not identified any regulatory or financial hardship reasons for not disposing of these accounts in their entirety at this time.

Hydro 2000 is applying for disposition of 1588 RSVA Power. This account is reviewed quarterly for disposition by the Board as part of the Bill 23 process and the Board may wish to consider the impact of ordering disposition of this account upon the Bill 23 process.

<u>Forecasting Balances for Disposition</u>

Hydro 2000 is forecasting both principal and carrying charges for some of the deferral and variance accounts that it is proposing to clear. The accounts being forecasted are account 1508 Other Regulatory Assets, 1550 LV Charges, and 1592 Deferred PILs account. The remaining accounts being applied for disposition are using December 31, 2006 principal balances plus accrued interest to April 30, 2008.

Board staff notes that in the natural gas sector, utilities do forecast principal and interest on deferral and variance accounts for disposition to the end of the current test year. However, generally, these forecasts do not exceed two or three months once the applicant provides an update before the decision is released. The forecasted balances are then trued up to the actual and any differences are placed in a deferral account for disposition at the next rate case. This approach has not been used for electricity distributors.

In the electricity distribution sector, it has not been Board practice to order disposition of forecasted balances of principal transactions on deferral and variance accounts. Usual practice for disposing of variance and deferral accounts in the electricity sector is to use the most up-to-date audited balances, as supported by audited financial statements, plus forecasted carrying charges on those balances up to the start of the new rate year. The most recent Hydro 2000 balances that have been independently audited are the December 31, 2006 balances. It would be inconsistent with the Board's past uniform practice in this sector to dispose of forecasted principal balances.

Treatment of Account 1508 – "Other Regulatory Assets"

Hydro 2000 does not appear to be using account 1508 as defined in the Accounting Procedures Handbook ("APH"). There are two Board approved expenses that could potentially be booked into account 1508. One is the difference between the 1999 OEB cost assessment and the actually billed amounts to April 30, 2006. The other is the cash contribution paid to OMERS until April 30, 2006. Hydro 2000 has applied for the former but not the latter. The OEB cost assessment variance is discussed below.

In account 1508, Other Regulatory Assets, Hydro 2000 calculated and booked the difference between the OEB assessment costs in 1999 and current assessments levied on Hydro 2000 projected to April 30, 2008. According to the APH, account 1508 is to be used to record the difference between OEB cost assessments invoiced to the distributor for the Board's 2004/05 and 2005/06 (up to April 30, 2006) fiscal years and the 1999/2000 OEB cost assessment previously included in the distributor's rates. Since Hydro 2000 received new rates in the 2006 EDR, only balances associated with OEB assessments levied before April 30, 2006 would be consistent with the Board's directions in this matter.

As per Hydro 2000's response to Board Staff Interrogatory #35, Hydro 2000 identified the balances associated with OEB assessments before April 30, 2006 (that have not been dispositioned to date) as $2,369.25 for 2005 and $556.33 for 2006 (one third of the 2006 variance of $1,669) for a total of $2,925.58 plus associated interest. However, there is a total balance of $6,029 being requested for disposition. This difference appears to be due to the post April 30, 2006 amounts including the forecasted amounts to April 30, 2008. The Board may wish to consider that if it denies disposition of forecasted variance and deferral account balances generally (i.e. those amounts reflecting accruals post December 31, 2006), that only the $2,925.58 balance plus applicable interest to April 30, 2008 should be disposed at this time.

Hydro 2000 is deferring an additional element that has no prior approval from the Board. As noted earlier under OM&A, Hydro 2000 is recording expenses, such as overtime and external consultants, associated with the current 2008 rebasing application into account 1508 and requesting disposition of the balance as of April 30, 2008. Currently, the balance of this sub-account is $39,573 plus associated interest. These expenses are normally associated with account 5655, Regulatory Expenses. Article 220 of the APH states that for account 5655:

> This account shall include all expenses (except pay of regular employees only incidentally engaged in such work) applicable to utility operating expenses, incurred by the utility in connection with formal cases before the Board or other regulatory bodies, or cases in which such a body is a party, including payments made to a regulatory body for fees assessed against the utility for pay and expenses of such body, its officers, agents, and employees. Amounts of regulatory expenses that by approval or direction of the Board are to be spread over future periods shall be charged to account 1525, Miscellaneous Deferred Debits, and amortized by charges to this account.

Hydro 2000 states that it intends to continue to track expenses incurred related to the 2008 rebasing into 1508 (response to Board staff Interrogatory #35). Board staff has several concerns with the recovery of these amounts by way of deferral account disposition. First, the final amount of this deferred amount is unknown. Second, Hydro 2000 is not tracking these costs in the proper account as noted above. Board staff notes that the proper account to record such costs is account 1525, Miscellaneous Deferred Debits. Third, the Board has not given approval or direction to Hydro 2000 to defer expenses associated with the 2008 rebasing application into account 1525 as required by the APH.

<u>Treatment of Account 1590 – "Recovery of Regulatory Asset Balances"</u>
Hydro 2000 is requesting that the balances currently in 1590 be rolled into the current disposition of regulatory assets. In the Phase 2 decision for the Review and Recovery of Regulatory Assets for the five large distributors (RP-2004-0117, RP-2004-0118, RP-2004-0100, RP-2004-0069, RP-2004-0064) the Board stated that:

> Also as of April 30, 2005, all four Applicants shall debit the Regulatory Asset Recovery Account (1590, Recovery of Regulatory Asset Balance) by the approved total recovery amounts. Starting May 1, 2005, revenue from the monthly rate riders shall be credited to the Regulatory Asset

> Recovery Account (1590). Interest shall continue to apply to this account. (Section 9.018)
>
> At the end of the three year period, at April 30, 2008, as there will be a residual (positive or negative) balance in the Regulatory Asset Recovery Account (1590), this balance shall be disposed of to rate classes in proportion to the recovery share as established when rate riders were implemented. (Section 9.019)

Hydro 2000 has proposed to dispose of account 1590 before the final balance has been determined. The Board may wish to consider that this does not reflect a proper true-up. The Phase 2 decision quoted above suggests that the rate rider associated with 1590 be removed as of May 1, 2008. Once the residual balance in account 1590 is finalized, the residual balance is to be disposed at a future hearing. The final balance in account 1590 cannot be confirmed until after the current recovery period has expired, i.e. April 30, 2008.

<u>Treatment of Account 1592 – "PILS and Tax Variance for 2006 and Subsequent Years"</u>

The APH defines account 1592 to include the following balances:

> For the period starting May 1, 2006, the distributor shall use this account to record the tax impact of any of the following differences:
>
> 1. Any differences that result from a legislative or regulatory change to the tax rates or rules assumed in the 2006 OEB Tax Model.
>
> 2. Any differences that result from a change in, or a disclosure of, a new assessing or administrative policy that is published in the public tax administration or interpretation bulletins by relevant federal or provincial tax authorities.
>
> 3. Any differences in 2006 PILs that result in changes in a distributor's "opening" 2006 balances for tax accounts due to changes in debits and credits to those accounts arising from a tax re-assessment:
>   a) received by the distributor after its 2006 rate application is filed, and before May 1, 2007; or
>   b) relating to any tax year ending prior to May 1, 2006.

In Hydro 2000's 2007 IRM proceeding (EB-2007-0539), and by way of a letter dated March 10, 2007, Hydro 2000 requested that "the Board approve a special deferral account to capture the amounts of PILs paid by Hydro 2000 for the years 2007, 2008, 2009 or until the rebasing". Hydro 2000 submitted this request because they had a large loss in 2004 that resulted in no PILs proxy in its 2006 rates. This loss also resulted in a loss carry forward that was applied to reduce taxes/PILs paid for in the 2003, 2004, 2005, and 2006 tax years.

In its decision for Hydro 2000's 2007 IRM application, the Board allowed Hydro 2000 to use account 1592 to track a PILs deferral for review and disposition in a future rates case. However, the balance as of December 31, 2006, and as reported by Hydro 2000 in the subject proceeding is $10,211. The March 10, 2007 request did not include tracking PILs paid in 2006 in the deferral account. The Board should address the appropriateness of a balance in this account at the end of 2006.

Board staff also has concerns about the Hydro 2000 calculations of PILs values for 2007 and 2008 in account 1592, as the calculations do not appear to be consistent with the Board approved methodology of calculating PILs proxies. For example, it appears to include regulatory assets, which have been denied in various decisions such as the 2006 electricity distribution rate decision (RP-2005-0020/EB-2005-0412) for PUC Distribution Inc.

Finally, the Board may wish to consider that although Hydro 2000 has not applied for the disposition of account 1562 Deferred PILs at this time, the methodology used to finalize and dispose of this account may impact the final calculation of the 1592 account balance.

<u>Request for New Deferral Account</u>
Hydro 2000 is requesting a new deferral account to capture capital expenditures in future years 2009 and 2010 for planned disposition in 2011. The purpose of the deferral account is to capture the potential revenue from rate base that could be derived from planned capital expenditures in 2009 and 2010 that will not be included in the approved rate base for 2008. While Hydro 2000 did not fully explain, in its response to Board staff interrogatory #29, what this revenue would be composed of, normally revenue associated with capital in rate models includes depreciation, PILs, and return on rate base. According to Hydro 2000, if it does not achieve planned capital expenditures reflected in the approved revenue requirement for 2008, the deferral account would be adjusted to reflect this with a reduction to the amounts posted to this account. The Board may wish to consider that the request to establish this deferral account is analogous to including a capital investment factor in an IRM year.

There are four regulatory principles guiding the establishment and use of regulatory accounts; prudence, materiality, causality, and management ability to control. Capital investment is necessary to keep the business a going concern and to maintain necessary reliability; therefore a reasonable level of capital investments can be characterised as both prudent and outside management's ability to control. Rate base does impact revenue requirement, satisfying causality. In Hydro 2000's case, materiality is satisfied as the $40,000 of new capital proposed by Hydro 2000 would represent a 5% increase in rate base.

However, there are three reasons based on past regulatory requirements that do not appear to support the approval of this account.

First, in the electricity distribution sector, the Board has usually used the APH, the Uniform System of Accounts, and supporting letters of directions to allow the use of deferral and variance accounts by utilities. Deferral and variance accounts open to one utility, and the usage of those accounts, are usually open to all distributors. Therefore, creating a new deferral account for one distributor creates a precedent for other distributors.

Second, the Board Report[1] stated at page 37 that "The Board concludes that there is no need for a capital investment factor in this 2nd Generation IRM plan. Those distributors with an inordinate capital spending program can be accommodated through rebasing." The mechanistic calculation for 3rd Generation IRM has not been finalized, as it is currently before the Board, and may include a capital component.

Third, Hydro 2000 has not demonstrated that financial hardship will be achieved if the deferral account is not allowed. The company is forecasted to generate a fair profit in the test year, as per Hydro 2000's proforma income statements filed in the subject application.

The Board may wish to consider the above principles when deciding on Hydro 2000's request for the establishment of the deferral account.

All of which is respectfully submitted.

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[1] Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation Mechanism for Ontario's Electricity Distributors (the "Board Report"), issued December 20, 2006