

Hearst Power Distribution Company Limited
EB-2009-0266
Board Staff Submission

INTRODUCTION

The Applicant

Hearst Power Distribution Company Limited (“Hearst Power” or the “Applicant”) is a small (six staff, \$1.2 million Revenue Requirement) licensed electricity distributor serving the Town of Hearst (population 5,520) in Northern Ontario. Hearst Power has a customer base of approximately 2,750 and is embedded within Hydro One Networks Inc. (“Hydro One”); it is not a host distributor to any utility. All the power that the Applicant distributes is obtained from the Hydro One system.

The Corporation of the Town of Hearst is the parent company and owns 100% of both the Applicant and its affiliate, Hearst Power Sales and Services Company Limited. A number of the members of Hearst Power’s Board of Directors are also members of the Town Council. Hearst Power leases space from the Town Office and, in turn, provides some billing/management/maintenance services to the Town.

The Application

Hearst Power filed an application with the Ontario Energy Board (the “Board”) on April 28, 2010 (amended on May 21, 2010), under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that Hearst Power charges for electricity distribution, to be effective May 1, 2010. The Board assigned the File Number EB-2009-0266 to this application.

In the application, the impact of the requested rate increase on the total bill for a Residential customer using 800 kWh per month is a 2.73% increase (i.e. \$2.33 per month).

The Process

In its application, Hearst Power requested that the Board issue an interim Order approving its proposed distribution rates and other charges effective May 1, 2010, which may be subject to adjustments based on the Board’s final Decision and Order.

In its Decision and Order on Interim Rates, dated June 24, 2010, the Board did not approve Hearst Power's proposed rates on an interim basis as of May 1, 2010. The Decision and Order stated that were such approval granted, it may be perceived as pre-empting the outcome of the Board's review of Hearst Power's application and would likely result in implementing additional rate changes since the elements of the application had not been tested for prudence.

The Board determined that Hearst Power's current distribution rates should be declared interim as of May 1, 2010. The Board also stated that it would determine at a later date, if those new rates should be effective as of May 1, 2010, or as of a later date. By granting rates interim as of May 1, 2010, the Board noted, it had retained the authority to make the final rates effective as of that date, but that it is not required to do so.

In Procedural Order No.1, issued on July 9, 2010, the Board made provision for the filing of preliminary interrogatories due by July 16, 2010, to clarify certain pre-filed evidence and for Hearst Power to file complete responses by August 6, 2010. The Procedural Order indicated that after review of the responses to the interrogatories, it would determine the next steps. The approved intervenor – the Vulnerable Energy Consumers Coalition ("VECC") – and Board staff filed interrogatories on July 16, 2010. On August 25, 2010, Hearst Power requested an extension to respond to the interrogatories. Hearst Power filed its responses to the interrogatories on September 15, 2010, and October 1, 2010.

In Procedural Order No.2, issued on October 6, 2010, the Board determined that it would proceed by way of a written hearing and made provision for a round of written supplemental interrogatories due by October 15, 2010, with responses from Hearst Power due by October 29, 2010. The Procedural order also set out that submissions from Board staff and VECC were due by November 19, 2010, and a reply submission from Hearst Power by December 3, 2010. VECC and Board staff filed supplemental interrogatories on October 14, 2010, and October 13, 2010 respectively. On October 28, 2010, Hearst Power requested an extension to file their responses to the supplemental interrogatories and on November 15, 2010, requested a further extension. Hearst Power filed responses to the supplemental interrogatories on November 22, 2010.

In Procedural Order No.3, issued November 24, 2010, the Board noted that due to the late filing of interrogatory responses, it was necessary to modify the dates set out in

Procedural Order No.2. Submissions from Board staff and VECC were reset as due by December 13, 2010, and a reply submission from Hearst Power by January 4, 2011.

In response to Board staff supplemental interrogatory #1, Hearst Power confirmed that it is relying on the updated values it provided through the interrogatory process and requests approval on that basis.

Effective Date of Rate Change

As noted earlier, Hearst Power requested that its Rate Order be made effective May 1, 2010.

Discussion and Submission

Board staff supplemental interrogatory #3 referenced the Board's March 5, 2009, letter which advised all electricity distributors that "Applicants are encouraged to file applications for 2010 as soon as possible, and no later than August 29, 2009 for rates to become effective May 1, 2010." Hearst Power was asked in the interrogatory to explain the reasons for the late filing of its 2010 rate application. Hearst Power explained that it had advised the Board that it would be unable to meet the August 15, 2009, filing deadline because of the necessity to address OEB mandated programs and local issues. Moreover, as a small and first time cost of service applicant, it had not expected the exercise to be as time consuming for its internal resources.

Hearst Power was advised in the Board's April 20, 2010, letter that if it did not file its cost of service application by April 30, 2010, then its application should be filed as a 2nd generation IRM application. Board staff notes that by not filing a complete application until May 21, 2010, Hearst's application was almost nine months late and, had Hearst Power complied with the directions in the Board's April 20, 2010, letter it should have filed a 2nd generation IRM application.

Board staff also notes that the processing of the application by Board staff and VECC was unnecessarily delayed by Hearst Power's inability to meet the filing dates prescribed in the procedural orders and also its inability to file consistent information.

Board staff submits that when a utility fails to file a complete and accurate application by the required deadline, it forfeits its right to expect its new rates to be effective by May 1 of the following year. Board staff submits that consistent with the Renfrew (EB-2009-

0146) Decision, the effective date should be the beginning of the month after the issuance of the Decision in this current case.

RATE BASE

Overview

In Exhibit 2, Tab 1, Schedules 1-3, the Applicant requested approval of \$2,355,582 as the 2010 Rate Base. This amount was made up of net fixed assets (i.e. Average Net Book Value) of \$1,295,485 and a Working Capital Allowance of \$1,060,098.

Discussion and Submission

In response to Board staff interrogatory #2, the 2010 Rate Base value was modified to \$2,944,609; most of the increase was attributable to an increase in power supply expenses. Other changes were filed in response to VECC interrogatory #6. Further minor revisions to this value were made as individual components of the Rate Base were updated through the discovery process.

Rate base values from 2006 to 2010 are shown in Table 1 below. The \$2.945 million amount is a 25.1% per annum increase from the 2008 actual. Viewed over the longer term (2006 to 2010) the year-over-year increase in rate base is 7.1% per annum.

Table 1 – Rate Base Trend (\$ million)

Year	2006 Actual	2007 Actual	2008 Actual	2009 Projection	2010 Forecast
Total Rate Base	\$2.295m	\$2.210m	\$1.961m	2.164m	\$2.945m*

* Updated in response to Board staff interrogatory #2 and understood to be latest value on record

Board staff notes that the Applicant's treatment of Smart Meter-related capital expenditures in its pre-filed evidence is unclear (Exhibit 2, Tab1, Schedule 3, page 2). Smart Meters and their supporting communication systems appear to have been

included into the Applicant's rate base in a manner that is not consistent with the Board's G-2008-0002 Guideline: Smart Meter Funding and Cost Recovery, October 22, 2008 (the "Guideline") since, among other factors, the cost information was not audited in the manner required by section 1.5 of the Guideline. In Board staff interrogatory # 4, further clarification was sought but the only clarification that was provided was: "Hearst determined that since 100% of its smart meters would be installed by end of 2010, it was eligible to recover its costs through its Rate Base and regular OM&A expenses." Additional clarification was obtained through Board staff supplemental interrogatory #36.

Board staff is of the view that it would be appropriate for Hearst Power to include in the rate base the audited costs of the smart meters installed in 2009. Similarly, the residual balances associated with the 2009 smart meter installations captured in deferral accounts 1555 and 1556 should be disposed of by means of a disposition rate order. With respect to smart meters installed in 2010, Board staff disagrees that they should be included in the rate base since the cost information is not audited and doing so would be counter to the Board's Guideline referenced above. Pursuant to section 1.6 of the Guideline, Hearst Power may apply to seek recovery of smart meters installed in 2010 (once the financial information has been audited) by means of a smart meter disposition rider. (Please see Board staff's specific submission on this matter in the Smart Meter Riders sub-section in the Deferral and Variance Accounts section later in this submission.)

Capital Policies and Plan

In Exhibit 2, Tab 5, Schedules 1, Hearst Power proposed a capital expenditure of \$248,696 in 2010. A summary of Hearst Power's capital expenditures is shown in Table 2 below.

Table 2 – Capital Expenditures (\$k)

Year	2006	2007	2008	2009	2010
Capital Expenditures	58	52	115	463	249

In the same exhibit, Hearst Power showed it had included its smart meter spending in its 2009 and 2010 capital expenditures; the smart meter components included were stated to be \$437k (2009) and \$115k (2010). The rest of the 2010 expenditures focus on replacing poles, transformers and installing transformer pads for underground

distribution; no expenditure is included in this application in support of the government's Green Energy initiative.

Discussion and Submission

Board staff notes that the 2010 capital expenditure proposed in the application represents a 47% decrease from 2009 which, in turn, was a 310% increase from 2008; the wild fluctuations are primarily a result of the inclusion of smart meter costs in 2009 and 2010.

In response to Board staff interrogatory #5, Hearst Power clarified that the actual 2009 smart meter expenditures were \$424k; the 2010 predicted value remained at \$115k. In response to Board staff interrogatory #6, Hearst Power modified its total 2009 additions to \$469k. Appendix H which was provided in response to VECC interrogatory #8 provided additional updated data.

In order to provide focus for discussion on the non-smart meter capital expenditures, the expenditure data were updated and the smart meter items excluded (i.e. those items specifically identified by Hearst as smart meter related) as reported in the foregoing interrogatory responses. This resulted in Table 3 below.

Table 3 – Capital Expenditures Excluding Smart Meters (\$k)

Year	2006	2007	2008	2009	2010
Capital Expenditures excluding smart meters	58	52	115	45	134

In response to Board staff supplemental interrogatory #15, Hearst stated in part: "Hearst offers the following additional information on capital expenditures that are slightly higher than usual yet still fall below the materiality threshold.

- The \$13,000 in Buildings and Fixtures related to the warehouse roof to be replaced,
- The \$25,000 spending on Office Furniture and Equipment – folding machine,
- The \$25,000 spending on Software – Smart Meter related software (MDMR), and
- The \$12,500 spending on Transportation Equipment – Maintenance on trucks."

Board staff does not have an issue with the necessity of any of the 2010 proposed expenditures even though the 2010 expenditure is a significant increase from the historical norm. However, Board staff notes that the \$25k software is "smart meter-

related” and the \$12.5k amount is for truck “maintenance”. Thus, Board staff invites Hearst to verify that:

- the “smart meter software” is for the processing of data (e.g. billing) *after* the data have been received by the utility (otherwise the software should be considered a true smart meter expenditure and accounted for in a similar manner to smart meters), and
- the “maintenance” performed on the trucks is a betterment that increases the resale value of the trucks and not regular maintenance which merely keeps the vehicles in running order (and would therefore be an OM&A cost).

Accumulated Amortization

In response to Board staff interrogatory #7, Hearst Power confirmed that it had not consistently applied the half year rule throughout the historical years but has updated its depreciation as directed in the minimum filing guidelines.

Discussion and Submission

In response to VECC interrogatory #19, Hearst Power updated its evidence with respect to depreciation charges for 2010 and prior years. Concerning the half year rule, Hearst Power is invited to confirm that its rate base reflects the proper application of the rule.

In response to Board staff interrogatory #13, Hearst Power provided Appendix 2IR_D which corrected various errors and updated depreciation expenses.

Working Capital Allowance

Hearst Power’s proposed Working Capital for the 2010 Test Year (Exhibit 2, Tab 1, Schedule 2, page 2 and Exhibit 2, Tab 4, Schedule 1) is \$7,067,318 which translates to a Working Capital Allowance (“WCA”) of \$1,060,098. The WCA appears to have been calculated at 15% of the forecast cost of power and controllable distribution expenses (excluding amortization and PILs).

Discussion and Submission

In response to Board staff supplemental interrogatory #9, Hearst reduced the cost of power to \$5,409,909 (the magnitude of which changed with filing iterations) and hence a corresponding reduction in WCA resulted. Hearst showed that a 15% factor had been correctly applied. Board staff submits that it has no issue with the WCA provided it is calculated on the basis of the latest-filed load forecast in Appendix 2IR_C filed on November 22, 2010. However, the resulting value of the WCA calculated on this basis is

unclear; the most up-to-date filed value appears to be \$1,165,797 which is provided in response to VECC supplemental interrogatory #38. Hearst Power is invited to confirm that the WCA value it is relying on is \$1,165,797; if it is a different value, calculations determining the WCA number should be filed.

Service Quality and Reliability Performance

Hearst Power shows (Exhibit 2, Tab 7, Schedules 1-2) that its Service Quality Indicators exceed SQI standards. Hearst Power's service reliability statistics (SAIDI: System Average Interruption Duration Index and SAIFI: System Average Interruption Frequency Index) paint a picture where the frequent and long-duration outages in the service area are substantially the result of Hydro One outages while Hearst Power's own performance in this regard is satisfactory. Details are provided in Table 4 below.

Table 4 – Reliability Statistics (*including* Hydro One effect)

YEAR	SAIDI -Annual	SAIFI - Annual	CAIDI - Annual
2005	10.73	5.79	1.90
2006	11.73	5.91	1.98
2007	1.20	0.95	1.26
AVG	7.89	4.22	1.71

Discussion and Submission

In response to Board staff supplemental interrogatory #11, Hearst provided statistics which exclude the Hydro One influence. These data are shown below in Table 5.

Table 5 – Reliability Statistics (*excluding* Hydro One effect)

YEAR	SAIDI -Annual	SAIFI - Annual	CAIDI - Annual
2006	1.6	0.98	1.64
2007	0.65	0.92	0.71
2008	1.2	0.95	1.26
2009	5.67	3.45	1.64

It should be noted that there is a significant increase in both outage duration (SAIDI) and outage frequency (SAIFI) values for 2009. No evidence was provided to explain the sudden large increase and thus questions arise regarding the soundness of Hearst's distribution system and the ability of Hearst's field resources to rectify outages. In response to Board staff supplemental interrogatory #34, the 2005-2008 Total Loss Factor which averaged 1.0443, increased to 1.0563 in 2009. Board staff submits that

the Applicant has not provided a full explanation of the apparent diminishing health of its distribution system in determining its capital expenditures and OM&A.

REVENUE

Overview

Hearst Power proposes in its application, a 2010 Revenue Requirement of \$1,184,796 which includes a reduction in the Low Voltage charges. Table 6 provides Hearst Power's own summary of its 2010 revenue requirements.

Table 6

Revenue Requirement	2010 Test
OM&A	\$867,878
Amortization	145,659
Return on Capital	172,193
PILs	14,479
Service Revenue Requirement	\$1,200,209
Low Voltage Charges	-\$15,413
Revenue Requirement	\$1,184,796

While not evident from the Applicant's summary above, Revenue Offsets do appear to have been already included. Board staff notes that Low Voltage charges are not a distribution expense but are considered to be an "other power supply expense".

Customer and Load Forecast

In its application (Exhibit 3, Tab 2, Schedules 1-4), Hearst Power used a variation of the Normalized Average Consumption (NAC) approach to develop its 2010 load forecast. It was not clearly stated if the methodology used included any weather normalization or if the forecast was based on actual unmodified data.

Based on its NAC model, Hearst Power determined (Exhibit 3, Tab 2, Schedule 3, page 4) a test year customers/connections forecast of 3,503.

Also based on its NAC model, Hearst Power developed (Exhibit 3, Tab 2, Schedule 1 and 3) its 2010 load forecast. The load was variously expressed in Exhibit 3, Tab 2, Schedule 3, page 4 as a "2010 Test Year Forecast" of 86,167,555 kWh and a "2010 Test Year Weather Normalized (forecast)" of 116,205,364 kWh.

Discussion and Submission

In response to Board staff interrogatory #8, Hearst Power confirmed that it was relying on the second of the forecasts filed in the application; i.e. a customers/connections forecast of 3,503 and a load forecast 116,205,364 kWh.

On October 1, 2010, Hearst Power filed its “Addendum to Cost of Service Application EB-2009-0266” that contained “an alternate load forecast” of 3,693 customers/connections and 77,787,715 kWh.

In response to Board staff supplemental interrogatory #18, Hearst filed a further modified forecast of 3,686 customers/connections and 77,587,715 kWh. Hearst confirmed in its response to Board staff supplemental interrogatory #1 that this is the load forecast on which it is ultimately relying; hence, Board staff’s comments and submissions are made in relation to that forecast.

Despite Hearst Power’s repeated statements that it has produced a weather normalized forecast, there is no supporting evidence. Most utilities that develop a weather normalized load forecast achieve this by incorporating heating degree days and cooling degree days – no mention is made in the evidence of this technique. A simpler attempt at weather normalization that is often used by those utilities that use the NAC approach is to use historical weather normalization conversion data provided by Hydro One. At first, in response to VECC interrogatory #10g, Hearst Power seemed to imply it had made use of Hydro One weather-normalized kWh data. However, subsequently in Board staff supplemental interrogatory #17, Board staff detailed its understanding of the methodology that Hearst Power had used in developing its so-called “NAC” load forecast and included the part-question: “For greater certainty: It is understood that weather normalization based on the Hydro One data developed for the 2006 Informational Filing was NOT used.” Hearst Power confirmed *all* aspects of Board staff’s understanding. Board staff submits that the evidence is clear that Hearst Power did not include any weather normalization in the development of its load forecast and is likely relying on the notion that by calculating the average consumption over a five year period, the variable effects of weather have somehow been accounted for. Board staff submits that while a NAC-based forecast is simplistic, a version of this method that does not use any weather normalization and, like Hearst Power, does not consider trends in usage, is not sound.

While Board staff has no confidence in the methodology employed by Hearst Power in developing its load forecast, the reasonableness of the filed forecast values may be judged by comparing the historical and forecasted data.

As shown in Appendix 2IR_F, the number of customers/connections has remained virtually constant at 3,705 over the 2006-2008 period, dropping to 3,680 in 2009 and increasing to 3,686 in the 2010 forecast. Additional information on customer numbers was provided in response to VECC interrogatory #10. Considering that Hearst Power serves a low growth area and that a slightly higher forecast does not disadvantage the utility's customers, Board staff finds the proposed customers/connections forecast reasonable and submits that the Board should accept it.

Also as shown in Appendix 2IR_F (and utilizing the actual results displayed), the kWh load has decreased over the 2006-2008 period by 8.3% per annum, decreased a further 9.1% from 2008 to 2009, and is forecast to increase by 0.2% from 2009 to 2010. In response to Board staff supplemental interrogatory #19 which sought a comparison of the 2010 kWh forecast and the 2010 kWh actual usage to date, Board staff concluded that on a proportional basis, the forecast value is just slightly higher than the trending actual. This observation together with the explanation provided by Hearst that there appears to be little chance that the recently shut-down businesses will re-open in the foreseeable future, causes Board staff to conclude that the proposed load forecast result is reasonable. Board staff therefore submits that the 77,587,715 kWh load forecast should be approved by the Board.

Hearst Power is forecasting (Exhibit 3, Tab 3, Schedule 1) Other Revenues (i.e. Revenue Offsets) for 2010 of \$118,930. Most of the components of Other Revenues are reasonably stable over the historical and forecast periods, or have intuitive explanations (e.g. low interest rates for investments). The response to Board staff supplemental interrogatory #21 supports the reasonableness of the proposed amount. Board staff does not have an issue with the proposed amount.

OPERATING COSTS

Overview

In its application (Exhibit 4, Tab 2, Schedule 1, page 1), for the 2010 test year Hearst Power requested approval of \$867,878 for total OM&A expenses.

Hearst Power explained that the additional costs it will incur in 2010 include the meter reading program in support of Smart Meters, an additional employee in preparation for a planned retirement and the increased costs resulting from a negotiated labour strike. Hearst Power included no provision for LEAP, is not seeking recovery of any cost associated with the Green Energy Act, and makes no charitable donations.

Hearst Power noted that it leases office space from the Town of Hearst and the utility provides water meter reading and billing services, street light maintenance and related services to the Town. Hearst provided details of the monetary value of a number of its Purchased Services.

Discussion and Submission

In response to Board staff interrogatory #10 and VECC interrogatory #13, Hearst Power clarified certain ambiguities and provided a consistent set of historical and forecast OM&A details. Hearst Power revised its OM&A forecast to \$935,399. A summary of the data filed in Appendix BS-G is shown in Table 7; the 2009 Actual value is in response to Board staff supplemental interrogatory #23.

Table 7 – Summary of OM&A Expenses

	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Forecast
OM&A Expenses	\$641,459	\$665,483	\$695,799	\$802,639	\$935,399

Board staff notes that OM&A during the 2006-2008 period, increased by 4.2 % per annum, from 2008 to 2009 OM&A increased by 15.4%, and from 2009 to 2010 OM&A is forecast to increase by 16.5 %. Measured over the 2006-2010 period, the average increase was 11.5 % per annum.

In Board staff interrogatory #23, Hearst Power's 2010 year-to-date OM&A expenses were requested. In response, Hearst Power provided Appendix 2IR_G that showed the OM&A expenses up to September 30, 2010, totalled \$535k which, on a proportional basis, equates to a full-year expenditure of \$713k. Hearst Power emphasised that it had "held off on most of its 2010 spending until the proposed revenue requirements is approved". The extrapolated 2010 year-to-date expenditure of \$713k is an 11.2% reduction from the 2009 actual.

In Appendix 2-H, Hearst Power showed additional OM&A cost drivers from 2008 to the 2009 bridge year were the use of outside services in support of its rebasing application (\$108k in 2009) and employee pension and benefits resulting from resolution from an earlier strike (\$83k); from 2009 to 2010, a main cost driver was associated with the reading of smart meters (\$52k).

In response to VECC interrogatory #15, Hearst Power provided detailed calculations of its revised rebasing cost estimate of \$207,649 and its IRM estimate of \$62,436; together these totalled \$270,085. The response continues that \$67,521 (i.e. $\$270,085 / 4$) has been added to the Outside Services account bringing the Total OM&A from its previous value of \$867,878 to \$935,399. However, it would seem that in Hearst Power's response, \$76,516 (not \$67,521) has been added to the 2010 OM&A expenses to achieve the \$935,399 total; this would suggest the total regulatory amount is \$306,064. Hearst Power is invited to confirm the total regulatory amount being claimed.

In response to VECC interrogatory #14 which asked: "What inflation rate has Hearst assumed for non-labour expenses in 2009 and 2010?" Hearst Power responded "Zero". In response to Board staff supplemental interrogatory #23 which enquired about the inflation rate used for the 2010 OM&A forecast, Hearst Power stated that it did not apply a specific inflation factor but rather "used a more judgemental approach" and that "Each account is looked at individually".

Total compensation was examined and determined as having increased by 3.0% per annum over the 2006-2010 period. In response to VECC interrogatory # 17, Hearst Power filed evidence that showed the portion of the utility's wages that is used to provide support activities for the Town of Hearst is fully paid for by the Town.

In response to Board staff supplemental interrogatories #26 and #30, Hearst Power confirmed that it had not included any late payment penalty litigation costs or Low Income Energy Assistance Program (LEAP) costs in its 2010 test year application.

In conclusion regarding Hearst Power's OM&A expenses, Board staff suspects that the very large percentage OM&A increases that Hearst Power has experienced – and expected to experience – are attributable to expenditures which would probably be somewhat the same dollar magnitude for any utility, but appear to be excessive in percentage terms for Hearst because of its small size. For example, Hearst Power reports (Exhibit 4, Tab 1, Schedule 1, page 1) that in anticipation of an expected

retirement, it had to hire an apprentice line maintainer at a cost of \$91k in 2010 – this is 9.9% of its 2010 OM&A cost. (In response to VECC interrogatory #12, Hearst Power stated that its apprentices are trained outside of Hearst and that the \$91k includes travel and accommodation costs.) Similarly, the cost to obtain external assistance for its current rebasing was \$270k (or \$306k?) which is not dissimilar to that for much larger utilities but, again, represents a much larger percentage increase for Hearst Power. Board staff makes no submission regarding Hearst's proposed OM&A expenses, but requests that Hearst Power confirms the regulatory amount being claimed.

Board staff examined Hearst Power's affiliate relationships and concluded it has no issue.

Board staff followed up in its supplemental interrogatory #28 on details of the tendering process for a number of Hearst Power's larger expenditures and concluded it has no issue.

Income and Capital Taxes

Certain data relating to PILs calculations appeared to be missing and/or variously stated in the application. The amount of PILs included in the 2010 revenue requirement was \$14,479.

Discussion and Submission

In response to Board staff interrogatory #11, Hearst Power filed a revised PILs model. As a result, Board staff has no issue.

COST OF CAPITAL AND RATE OF RETURN

Overview

In Exhibit 5, Tabs 1-3 of the application, Hearst Power applied for a 7.31% cost of capital which it expected would produce a return of \$179,378 (per Exhibit 5, Tab1, Schedule 2, page 3). The components of the Cost of Capital requested are:

- Long-term Debt: 5.87%
- Short-term Debt: 2.07%
- Equity : 9.85%

Approval was requested for a capital structure of 60% debt and 40% equity.

Hearst Power noted it has a demand promissory note from the shareholder with a debt rate of 12% p.a. and with the principal variously stated as \$1.8 million and \$1.7 million.

Discussion and Submission

In response to Board staff interrogatory # 12 and Board staff supplemental interrogatory # 31, Hearst Power explained that the promissory note was for \$1.8 million with a remaining balance of \$1.7 million. In response to VECC interrogatory #21, Hearst Power confirmed that the promissory note is payable to the Town on demand.

In Board staff supplemental interrogatory #9 and VECC supplemental interrogatory #40, Hearst Power was asked to explain why, in the process of responding to the preliminary interrogatories, it had increased the long-term debt rate from 5.87% in the original filing to 12.5% in the latest filing. Hearst Power responded that the rate “should have been set at the Board’s prescribed ceiling of 5.87%” and that had been rectified in its updated filing.

On the understanding that the long term debt calculation is based on \$1.7 million and at the Board’s ceiling of 5.87% (since the actual debt rate is 12%), Board staff has no issue.

REVENUE DEFICIENCY OR SUFFICIENCY

Overview

Hearst Power noted in the application (Exhibit 6, Tab 1, Schedule 1) that it has determined its gross revenue deficiency for the 2010 test year is \$205,773 and that this is due to:

- the inclusion of a union contract;
- budget for a line maintainer apprentice;
- return on capital; and
- depreciation associated with smart meter program.

Discussion and Submission

In response to Board staff interrogatory #15, Hearst Power updated its Gross Revenue (before Transformer Allowances) to \$1,470,766 and after Transformer Allowances to \$1,417,236. In response to Board staff interrogatory #18, Hearst Power updated its Service Revenue Requirement to \$1,430,734 and its Base Revenue Requirement to \$1,361,827.

COST ALLOCATION AND RATE DESIGN

Overview

In Exhibit 7 of the application, Hearst Power provided its revenue to cost ratios based on 2006 data; the rerun was carried out with the transformer allowance removed. Hearst Power showed that the proposed 2010 revenue to cost ratio is within the Board's policy range.

Discussion and Submission

In response to the preliminary interrogatories (preamble to Board staff interrogatory #14 and VECC interrogatory #23), Hearst Power noted that certain updates had not been made in accordance with the Board's guidelines and therefore revisions to the Cost Allocation Study were required. Significant changes to the previously-filed cost allocation information – including revenue to cost ratios – were made in the newly-filed cost allocation report (i.e. Appendix Y).

Monthly Fixed and Volumetric Rates

The Applicant stated (Exhibit 8, Tab 1, Schedule 1) that the fixed rates were established utilizing the guidance provided in the cost allocation model for determining maximal values and minimal values. This was understood to mean that the proposed monthly fixed rates were developed with the primary purpose of maintaining the existing fixed/variable revenue splits by customer class while setting the absolute value of the fixed rate no higher than the Monthly Service Charge ceiling as calculated in the updated cost allocation model. The result of the calculations was that the fixed-rate

percentage for Residential and Street Lights decreased while the fixed-rate percentage for all other classes increased – sometimes substantially.

Discussion and Submission

The proposed fixed charge for all classes except Street Lights appears to be within the calculated minimum/maximum range.

An “adjustment of \$23,000” related to Miscellaneous Revenues appeared in earlier versions of the Cost Allocation model. In response to VECC supplemental interrogatory #42, Hearst suggested the inclusion of the adjustment was an error and has since been corrected.

Various iterations were made in refining the revenue to cost ratios as ultimately proposed. In response to VECC supplemental interrogatory #48, Hearst Power confirmed that the proposed ratio for the Intermediate class customers was adjusted from above 100% to below 100% - specifically, 0.99%. Board staff submits that while a change in ratio from one side of unity to the other is contrary to Board directions, the effect is not material and should, for setting rates in this case, be accepted by the Board.

Transformer Ownership Allowance

With respect to the Transformer Ownership Allowance (TOA), Hearst Power briefly explained that it proposed decreasing the TOA from \$0.60 per kW to \$0.35 per kW.

Discussion and Submission

In Board staff supplemental interrogatory #33, Hearst Power was asked to provide details of the TOA adjustment it planned to make, including the justification and supporting calculations for reducing the TOA from \$0.60 per kW to \$0.35 per kW. Hearst Power’s response pointed to its earlier response to Board staff supplemental interrogatory #5 which, in part read: “Hearst cannot provide calculations supporting the reduction of the TOA ...” and “Considering the age of the assets, Hearst considers an allowance of \$0.35 to be fair and reasonable.” Board staff submits that this is an inadequate basis on which to reduce the allowance to those customers that provide their own transformation and therefore the Board should reject the requested TOA change.

Retail Transmission Service Rates

Hearst Power provided data (Exhibit 8, Tab 1, Schedule 2) which showed that it was over-recovering on its Retail Transmission Service Rates (RTSR). The data showed the RTSR network charge over-recovery was 3.86% and the RTS line connection charge over-recovery was 18.08%. As a consequence, Hearst Power proposed a reduction in the RTS R.

Discussion and Submission

The current RTS Rates have been reduced by the over-recovery percentages quoted in the application in order to arrive at the proposed rates. In response to VECC interrogatories #7 and #27, Hearst Power provided updated RTS R calculations. In response to VECC supplemental interrogatory #49, Hearst Power further revised its proposed RTS R. Board staff does not have an issue with the ultimately-proposed RTS R

Low Voltage Charges

The Applicant stated (Exhibit 8, Tab 1, Schedule 3) that it has a 24% over-recovery on its Low Voltage (LV) charges. The application appears to say that the current rates were reduced by the quoted percentage to arrive at the proposed rate.

Discussion and Submission

In response to VECC interrogatory #7, Hearst Power clarified how its LV charges are incorporated in its application. In response to VECC interrogatory #25, Hearst Power provided an updated projection of its 2010 LV costs of \$77,713. Board staff has no issue.

Loss Factors

Detailed calculations were provided (Exhibit 8, Tab 1, Schedule 4) in support of the requested Loss Factors. Hearst Power originally proposed a 5-year average rate of 1.0419 based on the 2004-2008 Total loss factors.

Discussion and Submission

Board staff supplemental interrogatory #34 asked why Hearst Power's Total Loss Factor was trending upwards over time. While not addressing the reason(s) behind the upward trend, Hearst Power stated it had made an error in using the 2004-2008 average (which produced the 1.0419 value) and should instead have used the 2005-2009 average. Because the 2009 Total Loss Factor had suddenly increased to 1.0563 (which, Board staff notes, is in excess of the Board's 5% threshold), the new 5-year average increased

to 1.0460 and is the new value for which Hearst Power requests approval; this is also the value it has utilized both in the latest-filed rate schedule in Appendix 2IR_A and in its cost of power calculations. Board staff notes that had Hearst Power filed its application on time, the 2009 value would not have been known and the updated value would not have been an issue. Moreover, Board staff submits that it is unfair to Hearst Power's customers to have their rates adversely affected by a sudden unexplained increase in loss factor that is in excess of the Board's 5% threshold and for which the utility, contrary to section 2.9.4 of the Filing Requirements, provides no action plan to correct. Board staff submits that the appropriate loss factor value is 1.0419. Board staff further submits that Hearst Power, before its next cost of power rates application, undertake a study to examine its losses and to file a report with the Board detailing the actions it has recently completed and those it plans to undertake in the two years following the issuance of the report.

Rate Schedules and Bill Impacts

Hearst Power purports (Exhibit 8, Tab 1, Schedule 5) to provide a reconciliation for the proposed rates but no actual comparison of the expected revenue and revenue requirement was provided.

The Applicant provided a table of the bill impact for Residential customers using 800 kWh per month. While delivery charges are shown to increase by 20.82% (\$3.66 per month), the total bill averaged over winter and summer increases by 2.73% (\$2.33 per month). For some customer classes it is not clear if summer-only rate changes or whole-year rate changes are being shown.

Discussion and Submission

In response to Board staff supplemental interrogatory #18 and VECC supplemental interrogatory #37, Hearst Power provided a reconciliation of its proposed rates and forecast volumes. While the reconciliation showed the calculated and allocated values were very close, Board staff observes that the variable rates used for most of the customer classes in the calculations do not match those in Appendix 2IR_A which is the latest-filed rate schedule. Board staff submits that in order to give the Board a degree of confidence in the rates being proposed, in its Reply Submission Hearst Power should provide a reconciliation utilizing the latest-filed load forecast in Appendix 2IR_F and the updated proposed rate schedule.

In response to Board staff supplemental interrogatory #12, Hearst Power confirmed that no rates or charges are included in its Conditions of Service.

DEFERRAL AND VARIANCE ACCOUNTS

General Rate Rider

Hearst Power identified (Exhibit 9, Tab 1, Schedule 3) the deferral accounts it proposes to dispose of over a four year period and those accounts which it proposes to await Board direction. The rate riders resulting from combining the various amounts were provided without supporting rationale or calculation. There is a lack of clarity in the application regarding the nature of some of the account balances that the Applicant proposes to clear. Also, the calculation of the proposed four-year rate riders is not transparent.

Discussion and Submission

In response to Board staff supplemental interrogatory #37, Hearst Power provided a detailed explanation regarding how it proposed to clear its deferral and variance accounts. It also stated that it is not opposed to the establishment of a variance account to capture the reduction in OM&A and capital expenditures due to HST though it states its preference would be to use the method proposed used by Renfrew Hydro; i.e. the establishment of a variance account to track the Input Tax Credits ("ITCs") on revenue requirement items that were previously subject to PST.

In response to Board staff supplemental interrogatory #40 regarding the Global Adjustment, Hearst Power calculated the applicable rate rider and verified that it would only apply prospectively to non-RPP, non-MUSH (Municipalities, Universities, Schools and Hospitals) sector customers.

Board staff submits it has no issue with Hearst Power's proposed clearance of its deferral and variance accounts and the calculation method of its proposed rate riders.

Establish a Deferral Account for Unforeseen Considerations

In Exhibit 1, Tab 1, Schedule 4, Page 2, when presenting the List of Specific Approvals Requested, item #12 on that list seeks approval: "To establish a deferral account to be used for reasonable costs not allowed by the OEB because of considerations not foreseen by the applicant".

Discussion and Submission

In VECC interrogatory #2, Hearst Power was asked to provide further details of its item #12 and, in particular, to identify exactly what types of circumstances the account is meant to address and how these circumstances would differ from those applicable for a Z-factor adjustment. Board staff understands Hearst Power's response to be that it wishes to have a general deferral account to accommodate a range of contingencies and especially those related to regulatory compliance. Board staff submits that the Board has already prescribed adequate mechanisms to handle contingencies and that the Board should not approve the additional deferral account.

Smart Meter Riders

Hearst Power stated in its application (Exhibit 9, Tab 1, Schedule 4) that it began installing Smart Meters in March 2009. By 2009 year end, 86% of the meters were installed and by 2010 year end, 100% (2,751 meters) are forecasted to be installed. In its application, Hearst Power requested approval to discontinue the Smart Meter \$1.00 per month funding adder for all metered customers. Hearst Power has requested that its main Smart Meter capital account (\$437,190) be cleared as at December 31, 2009, and that 2010 Smart Meter capital acquisitions (\$114,896) be treated as regular capital expenditures and charged accordingly; it proposes its other Smart Meter accounts (stranded meter accounts and operations accounts) continue for reasons it explains.

Discussion and Submission

In response to VECC interrogatory #30, Hearst Power stated that it had 90.80% of its smart meters installed by January 31, 2010, and projected to have 100% installed by December 31, 2010; supporting calculations were provided in Appendix U. While Hearst Power is clearly aware (e.g. its response to VECC interrogatory #32) of the existence of Guideline G-2008-0002 – Smart Meter Funding and Cost Recovery (the "Guideline"), it appears to Board staff that the requirements of the Guideline have not been adhered to. For example; section 1.5 of the Guideline notes that "smart meter cost recovery must be based on costs already expensed (i.e. not forecast)..." whereas in Hearst Power's calculations in Appendix U the costs which are requested for disposition appear to be both those incurred up until December 31, 2009 and those *expected* to be incurred during 2010; the supporting audit only references smart meters installed by December 31, 2009. Also, while in Appendix U a disposition rate rider is calculated and shown to have a value of \$4.95 per month per metered customer, it is not evident how this is reflected in the Rate Schedule and for what duration.

While Hearst Power has requested that its main Smart Meter capital account of \$437,190 be cleared as at December 31, 2009, in response to VECC supplemental interrogatory #44 reference is made to the 2009 smart meter capital additions of \$443,384. Hearst Power is invited to differentiate between the two values and confirm that despite the new value quoted, it is the former amount of \$437,190 which it wishes to dispose of.

Board staff submits that Hearst Power should either:

- (a) with its Reply Submission, re-file a detailed Smart Meter Funding Model including only those 2009 costs that have been audited, together with a full explanation of any disposition rate rider it requests in order to account for the prior period residual revenue requirement, or
- (b) at a later date (e.g. when 100% of the smart meters have been installed and costs audited), re-file its request for cost recovery of 2009 and 2010 smart meter costs outside of this cost of service application.

~ All of which is respectfully submitted ~