



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

Sioux Lookout Hydro Inc.

EB-2007-0785

January 31, 2008

Introduction

Sioux Lookout Hydro Incorporated ("Sioux Lookout" or "applicant") is the electricity distributor licensed to serve the Municipality of Sioux Lookout. The Company currently delivers electricity through a network of over 205 kilometres of overhead wires, through transformer stations, to approximately 2750 customers in residential, general service classes. Sioux Lookout's distribution revenue in 2006 was \$1,504,264.75 million.

Sioux Lookout submitted an application for 2008 electricity distribution rates on October 30, 2007, using the cost of service methodology. No parties intervened in the proceeding.

These submissions reflect observations and concerns which arise from Board staff's review of the pre-filed evidence and interrogatory responses made by the utility.

Summary

The summary below provides an overview of the key aspects of the original application,

Revenue Requirement	\$1,921,709
Deficiency	\$215,122
Rate Base	\$6,667,607

Typical Residential Rate Impact

1,000 kWh; -\$6.28 (-5.3%)

Typical GS<50 Impact

2,000 kWh; -\$21.96 (-5.7%)

OM&A

Background

Sioux Lookout's Summary of Operating Costs is found at Exhibit 4/Tab 2/Schedule 1 page 1 ("Summary") of its application. The as-filed test year Total Controllable OM&A Expenses forecast is \$1,136,826. This results in a 9.4% (or \$98,128) increase compared to the 2006 actual level.

Discussion and Summary

Using the Summary as its base, Board staff created the following table and asked interrogatories of Sioux Lookout related to it. Table 1 below compared OM&A expenses for 2006, 2007, and 2008.

Board staff notes that where Sioux Lookout's Total Controllable OM&A Expenses are concerned, the applicant proposes to increase controllable operations expenses in the amount of \$98,128 or 9.4% over the two year period from 2006

to 2008, resulting from a 23.9% increase in operations spending and a 16.4% increase in billing and collections.

Table 1
Summary of OM&A Costs

SUMMARY OF OM&A COSTS	2006 Board Approved	Variance 2006/2006	2006 Actual	Variance 2007/2006	2007 Bridge	Variance 2008/2007	2008 Test	Variance 2008/2006
Operation (Working Capital)	337,710	2,843	340,553	61,886	402,439	19,388	421,827	81,274
		0.8%		18.2%		4.8%		23.9%
Maintenance (Working Capital)	89,819	-16,952	72,867	17,888	90,755	-3,474	87,281	14,414
		-18.9%		24.5%		-3.8%		19.8%
Billing and Collections	242,157	55,898	298,055	9,759	307,814	39,012	346,826	48,771
		23.1%		3.3%		12.7%		16.4%
Community Relations	0	2,218	2,218	-2,218	0	0	0	-2,218
Bad Debt	2,814	48,926	51,740	-11,740	40,000	-20,000	20,000	-31,740
		1738.7%		-22.7%		-50.0%		-61.3%
Property Insurance	25,446	282	25,728	448	26,176	524	26,700	972
		1.1%		1.7%		2.0%		3.8%
General Advertising Expenses	785	-239	546	254	800	200	1,000	454
		-30.4%		46.5%		25.0%		83.2%
Administrative and General Expenses	222,888	24,103	246,991	4,317	251,308	-18,116	233,192	-13,799
		10.8%		1.7%		-7.2%		-5.6%
Controllable OM&A	921,618	117,080	1,038,698	80,594	1,119,292	17,534	1,136,826	98,128
		12.7%		7.8%		1.6%		9.4%
4750-LV Charges	0	339,143	339,143	857	340,000	456	340,456	1,313
Taxes Other Than Income Taxes	7,466	1,209	8,675	25	8,700	0	8,700	25
Amortization Expenses	223,151	9,628	232,779	78,233	311,012	12,092	323,104	90,325
Total Operating Costs	1,152,235	467,060	1,619,295	159,709	1,779,004	30,082	1,809,086	189,791

To assist in better understanding Sioux Lookout's increases in Total Controllable OM&A Expenses, Board staff prepared the following Table 2 of key cost drivers from Exhibit 4/Tab2/Schedule 1. These include operation labour, miscellaneous distribution expense, customer billing, and collecting. The balances and variances between 2006 and 2008 are shown below:

Table 2
Controllable Expenses

	2006 Actual	2007 Bridge	2008 Test	Variance (2008 - 2006)	% Change from 2006
Operations (working capital)					
Operation labour	\$ 236,087.56	\$ 296,282.00	\$ 305,170.00	\$ 69,082.44	29.26%
Miscellaneous Distribution Expense	\$ 14,106.93	\$ 15,157.00	\$ 20,157.00	\$ 6,050.07	42.89%
Billing and Collections					
Customer Billing	\$ 152,078.00	\$ 159,403.00	\$ 179,865.00	\$ 27,787.00	18.27%
Collecting	\$ 69,623.00	\$ 69,641.00	\$ 86,006.00	\$ 16,383.00	23.53%

When assessing the reasonableness of the above increases, Board staff notes that in the case of Operation Labour, Sioux Lookout identifies on Exhibit 4/Tab

2/Schedule/3 page 1 that the driver of this increase is an adjustment to accrued sick leave in the amount of \$50,729. This is a one-time only entry that was identified in an audit that revealed the company was carrying a liability for accrued sick leave which was incorrect.

In regards to the other cost drivers, Board staff notes that there is insufficient information regarding the increases noted above to determine if they are supported by evidence.

Board staff is concerned with the lack of information provided by the applicant to justify the increases sought, and invites Sioux Lookout to address the potential impacts of the possibility of the Board denying a portion of its proposed capital expenditures for 2008 in its reply submission.

Employee Compensation & Benefits

To obtain a better understanding of the impact of employee compensation and benefits on Sioux Lookout's costs, Board staff turned to Exhibit 4/ Tab 2/Schedule 7 of the application, which provided a breakdown of labour costs. The following Table 3 prepared by Board staff summarizes the information on labour costs provided in this schedule.

In its response to Board staff interrogatory #1.7, Sioux Lookout confirmed that it had not made any changes in its capitalization policies or estimates. This is further evidenced below by the consistency in the resultant percentage splits:

Table 3
Summary of Labour Costs

	2006 Board			
	Approved	2006 Actual	2007 Bridge	2008 Test
Compensation	\$ 374,565	\$ 446,150	\$ 459,481	\$ 474,644
Pension and Benefits	\$ 33,840	\$ 32,228	\$ 34,803	\$ 35,847
Incentive Pay	\$ -	\$ -	\$ -	\$ -
Total Compensation	<u>\$ 408,405</u>	<u>\$ 478,378</u>	<u>\$ 494,284</u>	<u>\$ 510,491</u>
Capitalized	\$ -	\$ 64,959	\$ -	\$ -
OM&A	\$ 408,405	\$ 413,419	\$ 493,194	\$ 509,109
Total Compensation	<u>\$ 408,405</u>	<u>\$ 478,378</u>	<u>\$ 493,194</u>	<u>\$ 509,109</u>
Capitalized	0%	14%	0%	0%
OM&A	100%	86%	100%	100%

In comparing Sioux Lookout's labour costs in Table 4 to Total Controllable OM&A Expenses, Board staff notes that Labour averages approximately 45% of these costs.

Table 4
Labour Component of OM&A

		2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
OM&A Labour	A	\$ 408,405	\$ 413,419	\$ 493,194	\$ 509,109
Total Controllable OM&A Expenses	B	\$ 921,618	\$ 1,038,698	\$ 1,119,292	\$ 1,136,826
Labour as a percent of OM&A	C = A / B	44.3%	39.8%	44.1%	44.8%

Board staff prepared the Table 5 below to identify the final value of labour cost drivers to be used in the cost driver analysis:

Table 5
OM&A Labour Change

		2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
OM&A	\$	408,405	\$ 413,419	\$ 493,194	\$ 509,109
Annual Labour Changes			\$ 5,014	\$ 79,775	\$ 15,915
% Change			1.2%	16.2%	3.1%

From the above table, the significant variance is the 16.2% increase in the 2007 bridge year. The key component of this increase is total employee benefits, which increased by 11% from 2006 to 2008.

In response to Board staff interrogatory #1.4, which asked the utility to explain this increase, Sioux Lookout stated that its Employee Benefit Program is provided by the MEARIE Group and that the costs of providing these benefits has increased by 8.7%, 4.7% and 6.1% respectively, since 2006.

Capital Expenditures

Background

Sioux Lookout projects a 2008 capital expenditure level of \$651,890 and a corresponding rate base of \$6,667,607, as shown in Table 6 below. The 2008 projected capital expenditure level represents an increase of 450% over the 2006 actual level of capital expenditures.

Staff notes that the numbers in the table below are based on the incorporation of numerous changes which were made to the data provided in the application by Sioux Lookout following interrogatories by Board staff. As a result of Board staff interrogatory #2.8, Sioux Lookout made significant changes to its Accumulated Depreciation, Rate Base and Continuity statements. These changes are reflected in Table 6 below.

Table 6
Capital Expenditures Increases

\$	2006	2007	2008
Capital Expenditures	118,463	344,290	651,890
% of increase as compared to the prior year	-	+190%	+89%
Rate Base	5,838,721	6,210,576	6,667,607
% of increase as compared to the prior year	-	+6.4%	+7.3%

Discussion and Submission

Staff has a concern regarding the consistency of the evidence related to the level of Sioux Lookout's 2006 capital expenditure program. In Sioux Lookout's response to Interrogatory #2.2, the applicant provided capital expenditure amounts which sum to \$208,644 in 2006. However, in Table 6 above, which is derived from the continuity statement at page 20 of Sioux Lookout's interrogatory response #2.8, an amount of \$118,463 is shown. Board staff believes that this difference arises from capital contributions of \$90,181, which, per the Board 2006 EDR Handbook chapter 4.5, are not to be included in rate base, and therefore are not included in the Table 6 capital expenditures. On this basis, Board staff was able to reconcile these figures. Staff would invite the applicant to comment on whether or not it is in agreement with this reconciliation

Staff notes a further discrepancy in regard to the total of 2006 budgeted expenditures, as provided in response to interrogatory #2.10, on page 27, where the 2006 capital expenditures add up to \$229,600. Staff invites the applicant to further explain how the \$20,956 difference labelled "D" in Table 7 below arises:

Table 7
2006 Capital Expenditures

<i>Label</i>	<i>Source of data</i>	<i>2006 Capital Expenditures</i>
A	Exhibit 2/Tab2/Schedule1/Page 4	\$118,463
B	Capital contributions (IR #2.8 response p. 20)	\$ 90,181
A+B	IR response #2.2 b, p. 12, totalled	\$208,644
C	IR response #2.10, p. 27, totalled, budget	\$229,600
D=C-(A+B)	Difference to be explained	\$ 20,956

3. Increase in 2008 Capital Expenditures

The information provided in Table 8 below is based on Sioux Lookout's response to Board staff Interrogatory # 2.2 b:

Table 8
Internal Cash Analysis

in 000's

Year	2002	2003	2004	2005	2006	2007	2008
Net Income	\$ 295	\$ 308	\$ 77	\$ 59	\$ 129	\$ 109	\$ 262
Actual ROE%	7.36%	7.58%	1.92%	1.47%	3.20%	2.72%	8.68%
Allowed ROE%	9.88%	9.88%	9.88%	9.88%	9.00%	9.00%	8.68%
Retained Earnings	\$ 362	\$ 538	\$ 483	\$ 409	\$ 253	\$ 253	\$ 253
Dividends to Shareholder	\$ 88	\$ 133	\$ 133	\$ 133	\$ 285	\$ 109	\$ 262
Total Capital expenditures	\$ 423	\$ 451	\$ 384	\$ 312	\$ 209	\$ 344	\$ 652

This table demonstrates that capital expenditures in 2008 are expected to be significantly higher than the historical values.

Table 9 below provides a breakdown of these capital expenditures and indicates in which areas the forecasted increases are occurring. It is derived from information provided in response to IR #2b on page 12:

Table 9
Capital Expenditures

Capital Expenditures (\$)	2006	2007	2008
Sustainment	17,415	132,890	135,590
Development	66,899	75,000	295,000
Operations	115,782	115,000	131,300
Other	8,548	21,400	90,000
Total (matches table 8 above)	208,644	344,290	651,890

Staff notes that the overall magnitude of the capital program more than triples in the 2006 to 2008 period. The key components of this increase are an approximate eight-fold increase in sustainment capital expenditures and an approximate four-fold increase in development capital from 2006 to 2008. As Board staff will note later in this submission, Sioux Lookout has included \$50,000 in 2007 and \$270,000 in 2008 for Smart Meters.

Board staff is concerned that the detailed definitions of what is considered development, sustainment and other capital have not been provided.

Board staff is also of the view that while Sioux Lookout has indicated that it is expanding and reinforcing its distribution system in order to meet the demands of new and existing customers, the drivers behind such a significant increase in the size of the capital program are not clearly identified in the application.

In summary staff is concerned with the lack of information provided by the applicant to justify the increases sought, and invites Sioux Lookout to address in its reply submissions the impacts of the possibility that the Board might deny a portion of its proposed capital expenditures for 2008.

4. Service Reliability Indices

Service reliability figures are measures of performance of the system as seen by customers. SAIDI and SAIFI provide information as to the duration and frequency respectively of interruptions experienced by customers on the system averaged over the total number of customers. CAIDI represents the average duration of interruption averaged over the number of customers that are interrupted.

Sioux Lookout, in its response to Board staff interrogatory # 2.13 regarding statistics for service reliability figures, provided the following information in Table 10:

Table 10
Reliability Indices

	SAIDI	SAIFI	CAIDI
2002	.748505	1.314943	.569
2003	1.239169	.882968	1.403
2004	.768215	1.524585	.504
2005	15.58064	3.549832	4.389
2006	18.06	5.26	21.02

Board staff notes that Table 10 shows a deterioration in all three service reliability indices. That said, it appears that the CAIDI figures shown above for 2006 is an error. Board staff request that Sioux Lookout correct this table in its reply submission. Notwithstanding the clarification noted above, Board staff makes the following observations:

- Sioux Lookout provides some explanation for the apparent deterioration in response to interrogatory #2.13a, where it is stated that "... Sioux Lookout experiences a number of outages due to loss of supply from Hydro One ..." and also that "The majority of our outages are caused by extreme weather conditions"
- Staff notes that Sioux Lookout does not quantify these impacts so it is not clear the extent to which the external factors noted by Sioux Lookout account for the experienced deterioration in service quality, as compared to factors specific to Sioux Lookout and the state of its network.

Board staff invites Sioux Lookout to address this issue in its reply submission.

5. Assessment of Asset Condition and Asset Management Plan

Sioux Lookout provides a description of its asset inspection program and includes inspection sheets and schedules for equipment inspection.

In light of Sioux Lookout's deteriorating reliability statistics, Board staff invites the applicant to comment on whether it has considered implementing Asset Condition Assessment programs, if it has not already done so, or if it has considered and rejected such a program to state why this was the case. Furthermore, Board staff invites the applicant to comment on whether Sioux Lookout has considered developing an asset management plan to prioritize and establish work plans required to maintain and operate its assets.

COST OF CAPITAL

Summary

With respect to the Cost of Capital, Sioux Lookout Hydro's application, as clarified and corrected on the record and, subject to Board staff's comments on the applicable rate for the cost of long-term debt, complies with the Board's guidelines for Cost of Capital for the purposes of electricity distribution rate-setting.

Background

The Board has documented its guideline Cost of Capital methodology in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Board Report"), issued December 20, 2006. The Board Report is a guideline, and departures from the methodology in the Board Report are expected to be adequately supported.

Sioux Lookout has provided its proposed Cost of Capital in Exhibit 6. The following table summarizes Sioux Lookout's proposed Cost of Capital:

Table 11
Proposed Cost of Capital

Cost of Capital Parameter	Sioux Lookout Hydro's Proposal
Capital Structure	53.3% debt (composed of 49.3% long-term debt and 4.0% short-term debt) and 46.7% equity
Short-Term Debt	4.77%, Confirmed that this is to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	6.00%, as the current interest rate on a demand installment loan with a commercial bank. The rate is variable and equal to the prime business rate for the year.
Return on Equity	8.68%, but to be updated in accordance with the methodology in Appendix B of the Board Report.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	7.20% as proposed, but subject to change as the short-term debt rate and ROE are updated per the Board Report at the time of the Board's Decision.

With the exception of the Long-term Debt Rate discussed below, Sioux Lookout Hydro's approach to cost of capital appears to be consistent to the Board Report.

Discussion and Submission

Long-term Debt Rate

Sioux Lookout proposed in Exhibit 6/Tab 1/Schedule 1 that the embedded cost of long-term debt for setting its 2008 revenue requirement would be 6.00%, pertaining to the current rate applicable to a demand instalment loan with an (unaffiliated) commercial bank.

In response to Board staff interrogatory 3.4, Sioux Lookout provided further documentation on the demand instalment loan, including a copy of the documentation with the bank. The loan attracts interest at the average prime rate over the year. The prime rate at the time of application was 6.0%, and Board staff notes that this corresponds with the Chartered Bank Administered Interest Rate: Prime Business for most of 2007 as documented on the Bank of Canada's website.

However, the interest rate is variable and subject to change based on market conditions, as acknowledged by Sioux Lookout in its response to interrogatory #3.4 v):

"The rate for the demand instalment loan is based on a floating rate of prime rate per year, which has payments of fixed principal amounts, plus interest."

Board staff notes that section 2.2.1 of the Board Report states the following:

“For all variable-rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate.

When setting distribution rates at rebasing these debt rates will be adjusted regardless of whether the applicant makes a request for the change.” [Emphasis in original]

Based on this, Board staff would ask the applicant to comment on whether the deemed long-term debt rate, as updated in accordance with section 2.2.1 and Appendix A of the Board Report, should be the applicable cost of long-term debt for determining Sioux Lookout’s 2008 revenue requirement and distribution rates.

SMART METERS

Background

Sioux Lookout is not one of the 13 distributors allowed to undertake smart meter activities and named in the combined smart meter proceeding, EB-2007-0063.

Sioux Lookout’s EDR 2007 rate application Decision¹ approved an amount for smart meter costs of \$0.25 per month per metered customer. In so doing, the Decision and Order stated that “It is the Board’s understanding that Sioux Lookout will not be undertaking any smart metering activity (i.e. discretionary metering activity) in 2007.”

Sioux Lookout, in Exhibit 1/Tab 1/Schedule 7 page 2 of its current application, states that “Sioux Lookout has not included any costs related to Smart Metering”.

However, Sioux Lookout has included capital amounts of \$50,000 in 2007 and \$270,000 in 2008 for Smart Meters. Also, in response to Board staff Interrogatory #2.6, Sioux Lookout explains that it has included in the budget for 2008 an adjustment for the replacement of 1,113 conventional meters with smart meters, at an estimated residual value of \$60 per meter replaced with a smart meter, for a total of \$66,780.

In response to Board Staff IR # 5.1 a), Sioux Lookout confirmed that, as of the date of filing of the application no costs have been incurred with respect to Smart Metering and that there are no smart meter installations.

In response to the same Board Staff interrogatory, Sioux Lookout stated:

“Sioux Lookout Hydro is part of the consortium with London Hydro for the RFP for smart meters. Subsequent to filing, Sioux Lookout Hydro has entered into an agreement with Util-assist to act as a consultant on the RFP process as well as the implementation process. There are no meter installations.”

In response to Board Staff IR # 5.1 b), Sioux Lookout confirmed that, in Test Year 2008, it is going to maintain its current rate adder of \$0.25 per month per metered customer which was approved by the Board in the April 12, 2007 Decision and Order (EB-2007-0576).

¹ EB-2007-0576 Decision and Order, April 12, 2007

In response to Board staff's interrogatory #2.6, Sioux Lookout indicated that it is removing from rate base \$66,780 representing 1,113 conventional meters being replaced by smart meters. Staff notes that on page 16 of the Smart Meter Decision EB-2007-0063 the Board stated that it accepts the proposition that "the stranded costs associated with existing meters should stay in rate base."

Discussion and Submission

It is unclear to Board staff how the Board could approve expenditures for smart meter installations for this applicant without authorization from the provincial government. If the Board does not have that authority, the inclusion of the capital expenditure amounts in 2007 and 2008 for Smart Meters is inappropriate.

PILs

Background

On Exhibit/4/Tab 3/Schedule 2 Sioux Lookout identifies its Capital Cost Allowance ("CCA") calculation for the years 2006 – 2008. Sioux Lookout did not use the appropriate CCA class 47, but rather class 1. Class 47 has a rate of 8% twice that of the 4% Class 1 rate.

In response to Board staff IR #10.27 b) Sioux Lookout claimed that they were in error using Class 1 in 2006. However, the effect is cumulative over the years and a correction for this error would be consistent with current tax treatment.

Submission

The applicant is requested to comment on the impacts to rates and PILs of the following corrections:

1. The use of CCA Class 47, 8% CCA rate, for the applicable capital additions in 2005, 2006, 2007 and 2008.
2. The combined income tax rate applicable to the applicant has declined to 16.5% with effect from January 1, 2008.

Deferral and Variance Accounts

Disposition

Background

Sioux Lookout is requesting that the following accounts and balances be cleared for disposition as of April 30, 2008 per the revised Exhibit 5/ Tab 1/Schedule 3, in response to Board staff Interrogatory #10.14. The balances provided below are projected as at April 30, 2008.

Table 12
Deferral Accounts

1508 Other Regulatory Assets,	\$84,982
1518 RCVA – Retail,	\$9,248
1550 LV Variance,	\$384,051
1562 Deferred Payments in Lieu of Taxes,	(\$51,945)
1563 PILs Contra Account,	\$51,945
1565 CDM Expenditures and Recoveries,	\$30,630
1566 CDM Contra,	(\$30,630)
1572 Extraordinary Event Losses,	\$6,609
1580 RSVA – Wholesale Market Service Charge	\$11,779
1584 RSVA – Retail Transmission Network Charges,	(\$27,078)
1586 RSVA – Retail Transmission Connection Charges	(\$656,591)
1588 RSVA – Power	\$84,926
Total	<hr/> (\$104,076)

The Sioux Lookout proposal is to collect these amounts from rate payers over a three year period beginning May 1, 2008 via rate riders as per Exhibit 5/ Tab1/Schedule 3

Discussion and Submission

Continuation of Deferral and Variance Accounts

The Board has already defined, through the APH and associated letters, the period and functionality of deferral and variance accounts in the electricity distribution sector. Therefore, Board staff submits that it is unclear why the applicant finds it necessary to request permission to continue using open deferral and variance accounts as per the APH.

Treatment of RSVAs

Sioux Lookout is applying for disposition of 1588 RSVA Power. This account is reviewed quarterly for disposition by the Board as part of a separate process and the Board may wish to consider the impact of ordering disposition of this account in this process.

Transfers to Account 1590, Regulatory Assets Recoveries

Sioux Lookout is proposing to clear December 31, 2006 balances with interest forecasted to April 30, 2008 and adjusted for a June 2007 transaction. Sioux Lookout received approval for clearing its December 31, 2004 variance and

deferral account balances in May 2006 through a rate rider. However, the amounts approved for recovery were transferred to account 1590 in mid June 2007 instead of May 2006. If the Board were to dispose of the December 31, 2006 deferral and variance account balances to 1590 without adjustment for the June 2007 transaction, it would be staff's understanding that the balances up to the end of 2004 would be collected a second time. However, the applicant's proposal is to reflect the transaction of June 2007 in the December 2006 amount to be cleared to eliminate double collection. The applicant is asked to comment on whether staff's understanding is correct.

Treatment of Account 1550 and 1586

Sioux Lookout is applying for disposition of accounts 1550, LV Variance, and 1586, RSVA – Retail Transmission Connection Charges, with balances of \$384,051 and (\$656,591) respectively, as at April 30, 2008. As per the Accounting Procedures Handbook (APH), accounts 1550 and 1586 shall be used as follows:

“Embedded distributors shall use account 1550 to record LV charges for which an LV amount was included in distribution rates effective May 1, 2006. This account was approved in the Board's decision for the 2006 EDR generic issues proceeding (RP-2005-0020/EB-2005-0529). Account 1586, RSVA shall be used to record LV charges approved for historic amounts included in the regulatory assets rate riders (i.e., regulatory assets phase I and II proceedings).”

Board staff is unclear if Sioux Lookout used account 1586 to record historic LV charges. These amounts are a proxy for the amounts included in the distributor's regulatory asset rate riders in relation to Hydro One's LV charges approved for the periods ended December 31, 2003 and April 30, 2006. From the response to Board staff Interrogatory #10.6, it is unclear whether the balances are appropriately accounted for in account 1550 and account 1586.

Board staff is also unclear whether Sioux Lookout is complying with the APH and the December 2005 Frequently Asked Questions #8 and #9 in accounting for accounts 1550 and 1586. It is unclear what Sioux Lookout has tracked in these two accounts.

Board staff is also concerned with how Sioux Lookout has accounted for amounts that have not been paid to Hydro One but have been accrued. Finally, there are questions with how Sioux Lookout transferred the approved 2006 EDR balance from 1586 to 1590, and the involvement of account 1550 in this transfer.

Due to the 2007 EDR Decision, it is particularly important that these balances be recorded correctly:

“The Board directs Sioux Lookout to file a detailed plan in its next cost of service rate application to address the insufficiency in its revenue requirement to recover ongoing LV charges from Hydro One Networks Inc. and the over-collection in Sioux Lookout's Retail Transmission Service rates.”

This matter also has rate design implications mentioned below.

Board staff questions whether the underlying balances in accounts 1550 and 1586 are correct. Sioux Lookout is asked to comment on the need to have the values in these accounts restated, with supporting schedules, in accordance with the APH and the December 2005 Frequently Asked Questions #8 and #9. If the applicant is unable to do so in its reply submission, it is not clear how the account balances can be confirmed.

Treatment of Account 1562 and 1563

Sioux Lookout is erroneously seeking disposition of account 1563, PILs Contra Account. This account is a contra account, used to track the offsetting entries to account 1562 and does not represent an obligation to either the applicant or the ratepayer. Account 1563 has a projected balance of \$51,945 as at April 30, 2008.

Board staff discovered several errors made by Sioux Lookout in accounting for account 1562, Deferred Payments in Lieu of Taxes (PILs), and account 1563 during the interrogatory phase. Sioux Lookout corrected some of these errors in its general ledger and some errors were not corrected (e.g. lack of accrual of carrying charges, no PILs entry made for 2002, etc.). Sioux Lookout also changed methods for accounting for PILs in its general ledger during the life of the account. These findings indicate that Sioux Lookout was not correctly accounting for the deferral accounts related to PILs in its books as per instructions provided in the APH and associated Frequently Asked Questions before the initiation of the rate case. With the information provided, the applicant is asked to comment on how it could be possible to determine the accuracy of the balances proposed for disposition.

Treatment of 1565 and 1566

Sioux Lookout is seeking disposition of 1565 CDM Expenditures and Recoveries and 1566 CDM Contra, with balances of \$30,630 and (\$30,630) respectively, as at April 30, 2008. These accounts track the expenditures for CDM, and together will equal zero. These accounts were set up as a means to track the expenditures on conservation activities and not as a future liability for customers.

In an earlier proceeding (RP-2004-0203), distributors were granted approval to increase rates to recover the final one third of their market based rate of return ("MARR") as long as they committed to spend the equivalent amount of one year's worth of that one third of MARR on conservation programs. Accounts 1565 and 1566 were established to track spending. The approved amount for spending was \$43,447. Spending to date has been \$30,630. Staff is unclear whether the clearance of these accounts means the applicant has completed its spending commitment on conservation activities. Staff is also unclear why a clearance is needed for these accounts when in fact the funding for the conservation activities was implicitly provided in the RP-2004-0203 case for the 2005 rate year through to September 30, 2007 only, unless an extension has been granted.

Line Losses

Background

In response to Board staff interrogatory # 6.1, Sioux Lookout affirmed that the proposed Total Loss Factor (TLF) for the test year 2008 is 1.0642 and is derived from the 5-year average of the actual TLFs for 2002 to 2006. The proposed TLF is higher than the approved TLF of 1.0547 for each of 2006 and 2007.

Discussion and submission

Based on a Supply Facility Loss Factor of 1.0045, the underlying Distribution Loss Factor (DLF) for the test year 2008 is 1.0594. Since Sioux Lookout is embedded within the Hydro One Networks Inc. ("HONI") distribution system, this DLF includes losses that occur in the HONI distribution system. In light of the increasing DLF, the applicant should comment on whether it should provide:

- A breakdown of losses that occur in the Sioux Lookout and HONI distribution systems, and
- An action plan to decrease the DLF during the test year (2008) and/or during a longer planning period.

Revenue to Cost Ratios

Background

Sioux Lookout has submitted its Informational Filing, which yielded Revenue to Cost Ratios found in the first column of the following Table 13. In its application, Sioux Lookout provided a calculation of the revenue requirement of each class as part of the test year revenue requirement, assuming the same proportion as in the Informational Filing. It also provided a comparison of this calculated amount compared to the forecast revenue of each class.

The ratio of forecast revenue to the allocated cost is found in the final column in the table².

² Interrogatory # 8.4(b), page 70

Table 13
Revenue to Cost Ratios

%	Informational Filing Run 2	Proposed Rates
Customer Class		
Residential	97.16	95.87
GS < 50 kW	106.44	95.10
GS > 50 kW	150.58	173.01
Streetlighting	10.41	7.29
Unmetered Scattered Load	100.45	94.74

Discussion and Submission

Board staff note that the ratios based on the proposed rates are within the range of the Board's report *Application of Cost Allocation for Electricity Distributors, EB-2007-0667, November 28, 2007*. The exception is the Streetlighting Class, which has a very low ratio based on current approved rates, and is proposed to remain very much below the lower end of the range for this ratio found in the Board report. The proposed ratio is 7.3%, compared to 70%.

The application increases the monthly service charge and the volumetric rate to Streetlighting by 14%, the same as for all of the other classes. However, Board staff notes that, according to the application, the bill impact is a decrease of 18.0% when considered on the Streetlighting's total bill. The applicant is asked to comment on the justification for not following the Board policy on revenue to cost ratios for this rate class.

Monthly Service Charges

In Sioux Lookout's Informational Filing EB-2007-0003 the monthly service charges approved in 2006 are compared for each rate class to costs from the cost allocation model. The model identifies a floor and a ceiling within which the monthly service charge should fall. The floor and ceiling were established in the Report of the Board on cost allocation³. The monthly service charges approved for Sioux Lookout are consistent with Board policy except for the GS 50 to 4,999 kW class. For this class, the ceiling in the informational filings was \$63.43 per month for GS>50 kW, which is lower than the current monthly service charge of \$414.94, and the proposed 2008 rate of \$473.17.

Parties should comment on the appropriateness of moving the monthly service charge farther from the ceiling calculated in the cost allocation model.

³ Application of Cost Allocation for Electricity Distributors, EB-2007-0667, November 28, 2007

Low Voltage Rate Adder

Background

In the Board's Decision in EB-2007-0576, one of the Board's Directions is:

"In its next cost of service rate application, Sioux Lookout shall file a detailed plan proposing a remedy for its under-collection of ongoing Low Voltage charges levied on it by Hydro One Networks Inc."

The evidence is that Sioux Lookout incurs a cost for Low Voltage service from its host distributor averaging \$28,340 per month, or \$340,000 per year. The allocation to the rate classes is shown at Exhibit 9/Tab 1/Schedule 1 page 6. The basis for the allocation is provided in response to Interrogatory 8.9 c). The amounts of the rate adders are shown, also at Schedule 1 page 6.

The projected amount in Account 1550 'LV Variance Account' as of April 2008 is \$384,051⁴. This balance is dealt with through the Regulatory Asset Rate Rider, and does not affect the proposed LV rate adder⁵.

Discussion and Submission

Board staff notes that Sioux Lookout filed evidence consistent with a plan to remedy the undercollection of low voltage charges. The proposed allocation of Low Voltage cost to the rate classes is close to what would have resulted from a strict application of Board policy (Response to Interrogatory #8.9 c).

Transformer Ownership Allowance

Background

Sioux Lookout has applied for approval of a monthly Transformer Ownership Allowance of \$0.305 per kW. The currently approved allowance is \$0.60 per kW, which is a long-standing allowance used by most distributors.

The Informational Cost Allocation model provide a calculated value of the fully allocated cost of line transformers, allocated to the portion of the GS>50 kW class that receives transformer service from the distributor. One purpose of this calculation is to yield an estimate of the cost saved by the distributor attributable to those customers that provide their own transformer. The value in Sioux Lookout's Informational filing was \$0.3741.

Discussion and Submission

Sioux Lookout has applied for approval of a transformer ownership credit based on their own calculation and have not used the cost allocation method determined by the Board. The derivation of the proposed credit was described in response to

⁴ Exhibit 5 / Tab 1 / Schedule 3

⁵ Interrogatory #10.14, page 100 of 112

Interrogatory #8.6. Sioux Lookout's method results in a credit of \$0.305, which is lower than the credit derived from the cost allocation model of \$0.3741.

Board staff questions the proposed method for developing the \$0.305 credit. The proposed method does not use Sioux Lookout's own costs, but rather develops costs using the existing approved \$0.60 credit. Further, to determine the unit charge Sioux Lookout uses a kW demand that is different from the kW demand for the customers who own transformers. Staff is unclear about the rationale around the causality of the costs when \$0.60 is not a cost to the utility. Staff is also unclear on the rationale for determining the unit charge using a demand different from the billing demand.

Retail Transmission Service Rates

Adjustment for previous over-collection of wholesale costs

Background

In the Decision in EB-2007-0576 the Board noted that Sioux Lookout had been over-collecting Retail Transmission Services amounts, as evidenced by the credit balance of \$922,613 in the variance account 1586. The Board directed Sioux Lookout as follows:

In its next cost of service rate application, Sioux Lookout shall file a remedy for its over-collection of Retail Transmission Service charges⁶.

The projected balances in the variance accounts at April 2008 are credits of \$27,078 and \$927,797 for Network and Connection respectively. These balances are dealt with by means of the Regulatory Asset Rate Rider⁷.

The current approved Retail Transmission Service Rates and the proposed rates are shown in the following Table 14⁸. The Network rates are decreased a uniform 4% for all classes, and the Connection rates a uniform 68%, except for Streetlighting.

⁶ Exhibit 1/Tab 1/Schedule 11 page 3, item # 5

⁷ Exhibit 5 / Tab 1 / Schedule 3

⁸ Exhibit 9/ Tab 1/Schedules 4 and 6 respectively

Table 14
Allocated RTS Rates

Class and RTS Rate		Existing	Proposed
Residential			
Network	¢/kWh	0.0057	0.0055
Connection	¢/kWh	0.0050	0.0016
GS < 50 kW			
Network	¢/kWh	0.0052	0.0050
Connection	¢/kWh	0.0045	0.0015
GS > 50 kW			
Network	\$/kW	2.1218	2.0390
Connection	\$/kW	1.7882	0.5883
GS > 50 kW Interval Metered			
Network	\$/kW	2.2535	2.1656
Connection	\$/kW	1.9603	0.6449
GS Interval Metered > 1000 kW			
Network	\$/kW	2.2508	2.1630
Connection	\$/kW	1.9763	0.6502
Unmetered Scattered Load			
Network	¢/kWh	0.0052	0.0050
Connection	¢/kWh	0.0045	0.0015
Street Lighting			
Network	\$/kW	1.6002	1.4722
Connection	\$/kW	1.3824	0.4355

Discussion and Submission

Board staff notes that the existing approved rates are the standard Retail Transmission Service Rates that all distributors were directed by the Board to implement in October 2001. The cover letter at that time said “Since the Retail Transmission Service Rate is a cost-recovery rate in nature, distributors should only consider requesting rates other than the Standard Rates if significant cash flow deficiencies can be demonstrated.”⁹

The record does not have the detailed breakdown of the wholesale billing load and the retail sub-class loads that would be required to verify that revenue under the proposed retail rates will balance the forecast wholesale cost.

⁹ Memo to All Licensed Electricity Distributors, “Ontario Uniform Transmission Rate Order, EB-2007-0759”, p. 2

The proposed decrease in the Network rate for Streetlighting is a larger percentage than for the other classes, at 8% compared to 4%. This anomaly is in addition to the revenue to cost ratio discussed above, which concerns distribution rates only. While there is not a large proportion of the wholesale cost at stake, nevertheless it is not clear to staff whether the record supports a treatment for the Streetlighting class more favourable than the other classes.

Adjustment for 2007 changes in wholesale transmission rates

Background

Sioux Lookout has forecasted an amount of \$597,037 for Account 4714 'Charges – NW' for the test year, compared to \$569,058 in the bridge year. Similarly, the forecast amount for Account 4716 'Charges – CN' for wholesale connection cost is \$511,895 compared to \$488,473.

Discussion and Submission

The increase in wholesale cost is almost 5%, both Network and Connection. It appears that the cost forecast has been made using constant wholesale prices, without adjusting for any decrease in the wholesale Network rate or any changes in the Connection rates. Sioux Lookout's host distributor HONI is currently applying for a decrease of approximately 20% in the Network Service Rate to its embedded distributors, more than 30% decrease in the Line Connection Service Rate, and less than 3% increase in the Transformation Connection Service Rate¹⁰.

The applicant is asked to comment on whether a proactive adjustment should be made to the Network Retail Transmission Service Rates as a result of the HONI application.

Board staff notes that the proposed Line and Transformation Connection Retail rates are lower than the current approved rates by percentages ranging from 66.5% to 68.6%¹¹. This proposed adjustment is quite substantial. Further, the changes in HONI's application with respect to new Line and Transformation Connection Retail rates are offsetting to some extent.

¹⁰ EB-2007-0681 Exhibit G2/Tab 94 page 3; EB-2007-0542, Appendix C page 2

¹¹ Exhibit 1/Tab 1/Schedule 6