Ontario

# ONTARIO ENERGY BOARD

## STAFF SUBMISSION

## 2008 ELECTRICITY DISTRIBUTION RATES

## Lakefront Utilities Inc.

## EB-2007-0761

**February 13, 2008**

# Introduction

Lakefront Utilities Inc. ("Lakefront" or "the Applicant") serves approximately 24,000 customers in the Town of Cobourg and the former Village of Colborne. Lakefront is embedded to Hydro One Networks Inc. ("HONI"), and hosts no utility.

Lakefront submitted an application for 2008 electricity distribution rates on October 31, 2007 using the cost of service methodology. Interventions were received from School Energy Coalition ("SEC") and Vulnerable Energy Consumers Coalition ("VECC").

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

Lakefront applied for:

| | |
|---|---|
| Service Revenue Requirement | $5,077,851 |
| Base Revenue Requirement | $4,742,287 |
| Rate Base | $15,557,507 |
| Return on Rate Base | 7.82% |
| Deficiency | $1,011,962 |

With the following proposed rate impacts:

Res @ 750 kWh: $4.25 or +4.8% Dist$^n$ charges only: $4.62 or +5.2%
GS<50 @2,000 kWh**:** $16.00 or +5.3% Dist$^n$ charges only: $12.10 or +3.8%

# Operating Costs

## Background

Lakefront's Summary of Operating Costs is found at Exhibit 4/Tab 1/Schedule 2, Page 1 of its application ("Summary"). The forecasted Total Operating Costs for 2008 is $3,838,482., a 28% or $846,079 increase compared to the 2006 actual level

## Discussion and Summary

### Overall OM&A

Using the Summary as its base, Board staff created two different tables and asked interrogatories concerning each table to clarify the drivers of this increase. Lakefront confirmed the accuracy of each of the tables[1].

Table 1 summarizes the key components of Lakefront's operating costs for the 2006 Board approved and actual, 2007 Bridge and 2008 Test years. The controllable expenses are identified separately in this table.

[1] Board staff interrogatory 3.12a

Table 2 shows the sources of variance for controllable expenses and gives the percentage contribution these sources make to the total percentage increase. By way of example; the $139,137, or 7.7% increase in Operations as shown in column 8, lines 1 and 2 is 7.7% in absolute terms of the 33.1% increase from 2004 to 2006 shown in column 8, line 12.

## Table 1

| | 2006 Board Approved | 2006 Actual | 2007 Bridge | 2008 Test |
|---|---|---|---|---|
| **OM&A Expenses** | | | | |
| Operations | 523,452 | 481,734 | 568,635 | 620,871 |
| Maintenance | 104,971 | 88,033 | 114,011 | 324,385 |
| Billing & Collecting | 223,962 | 420,421 | 441,986 | 453,844 |
| Community Relations (adjusted for CDM) | 8,918 | 17,130 | 19,767 | 19,767 |
| Administrative and General Expenses (adjusted for Low Voltage) | 698,073 | 801,751 | 786,480 | 988,498 |
| **Total Controllable Expenses** | **1,559,376** | **1,809,069** | **1,930,879** | **2,407,365** |
| Low Voltage (from Admin and General Above) | 230,681 | - | - | - |
| CDM - Energy Conservation (from Community Relations above) | - | - | 119,169 | 80,408 |
| Taxes other than income | 21,919 | 52,040 | 53,601 | 55,209 |
| Amortization Expense | 737,576 | 824,816 | 780,981 | 888,341 |
| **Total Distribution Expenses** | **2,549,552** | **2,685,925** | **2,884,630** | **3,431,323** |
| LCT, OCT & Income Taxes | 323,377 | 306,478 | 568,666 | 407,159 |
| **Total Operating Costs** | **2,872,929** | **2,992,403** | **3,453,296** | **3,838,482** |

## Table 2

| | | *Col. 1* | *Col. 2* | *Col. 3* | *Col. 4* | *Col. 5* | *Col. 6* | *Col. 7* | *Col. 8* |
|---|---|---|---|---|---|---|---|---|---|
| | OM&A Expenses | 2006 Board Approved | Variance 2006 / 2006 | 2006 Actual | Variance 2007 / 2006 | 2007 Bridge | Variance 2008 / 2007 | 2008 Test | Variance 2008 / 2006 |
| 1 | Operations | 523,452 | -41,718 | 481,734 | 86,901 | 568,635 | 52,236 | 620,871 | 139,137 |
| 2 | | | -2.7% | | 4.8% | | 2.7% | | 7.7% |
| 3 | Maintenance | 104,971 | -16,938 | 88,033 | 25,978 | 114,011 | 210,374 | 324,385 | 236,352 |
| 4 | | | -1.1% | | 1.4% | | 10.9% | | 13.1% |
| 5 | Biling & Collecting | 223,962 | 196,459 | 420,421 | 21,565 | 441,986 | 11,858 | 453,844 | 33,423 |
| 6 | | | 12.6% | | 1.2% | | 0.6% | | 1.8% |
| 7 | Community Relations *(adjusted for CDM) | 8,918 | 8,212 | 17,130 | 2,637 | 19,767 | 0 | 19,767 | 2,637 |
| 8 | | | 0.5% | | 0.1% | | 0.0% | | 0.1% |
| 9 | Administrative and General Expenses **(adjusted for LV) | 698,073 | 103,678 | 801,751 | -15,271 | 786,480 | 202,018 | 988,498 | 186,747 |
| 10 | | | 6.6% | | -0.8% | | 10.5% | | 10.3% |
| 11 | Controllable OM&A | 1,559,376 | 249,693 | 1,809,069 | 121,810 | 1,930,879 | 476,486 | 2,407,365 | 598,296 |
| 12 | | | 16.0% | | 6.7% | | 24.7% | | 33.1% |
| 13 | CDM - Energy Conservation *(from Community Relations) | 0 | | 0 | | 119169 | | 80408 | |
| 14 | Low Voltage **(from Admin & General) | 230,681 | | 0 | | 0 | | 0 | |
| 15 | Amortization Expense | 737,576 | | 824,816 | | 780,981 | | 888,341 | |
| 16 | Taxes Other Than Income | 21,919 | | 52,040 | | 53,601 | | 55,209 | |
| 17 | Total Distribution OM&A Expenses | 2,549,552 | | 2,685,925 | | 2,884,630 | | 3,431,323 | |
| 18 | LCT, OCT & Income Taxes | 323,377 | | 306,478 | | 568,666 | | 407,159 | |
| 19 | TOTAL OPERATING COSTS | 2,872,929 | | 2,992,403 | | 3,453,296 | | 3,838,482 | |

Board staff submits that the 33 % increase in Controllable OM&A Expenses that has been requested by Lakefront for the 2008 test year, relative to the 2006 actual level is a significant two year increase.

## Cost Drivers

Lakefront provided the following cost driver review table[2] to assist in understanding the increases in Total Controllable OM&A expenses identified above. The review starts with the 2006 Board Approved cost of $1,559,376 and progresses forward to the 2008 Test year amount of $2,407,365 million.

**Table 3**

| **Cost Drivers by Year (increase / decreases)** | | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| **Opening Balance** | **1,559,376** | **1,809,069** | **1,930,879** |
| Increase in wages/benefits (including new employees) | 17,613 | 122,348 | 114,398 |
| Increase in computer support | 81,062 | | |
| Increase in outside services | 116,103 | | 16,650 |
| Decrease in outside services | | (79,206) | |
| Increase in bad debt expense | 45,586 | | |
| Smart Meters | | | 207,850 |
| Regulatory Expense | | | 100,000 |
| Decrease in other expenses | (10,671) | | |
| Increase supplies, services & expenses | | 78,668 | 37,588 |
| **Total Increase** | **249,693** | **121,810** | **476,486** |
| **Closing Balance** | **1,809,069** | **1,930,879** | **2,407,365** |

From the above Table 3, the key drivers of the 33% increase in controllable expenses are summarized In Table 4 below:

**Table 4**

| **Cost Drivers** | **Sum of 2007 and 2008 Increases** | **Percentage of Net Total Increase** |
|---|---|---|
| Increase in wages and benefits | $236,746 | 39.6% |
| Smart Meters | $ 207,850 | 34.7% |
| Increase in supplies, services & expenses | $116,256 | 19.4% |
| Regulatory Expenses | $100,000 | 16.7% |
| Decrease in outside services | ($62,556) | -10.5% |
| **Net Total Increase** | **598,296** | **100%** |

[2] Board staff IR 3.12

## Wages and Benefits

Staff's submission on the wage and benefits cost driver is contained in the compensation section of this submission which follows.

## Smart Meters

Staff's submission on smart meter cost driver is contained in the smart meter section of this submission.

## Increases in Supplies, Services & Expenses

There is a total increase in this item in the 2006 to 2008 period of $116,256. Board staff notes that Lakefront has provided little explanation in either its original application or interrogatory responses as to why these items are increasing. Board staff invites Lakefront to comment on this matter in its reply submission.

## Regulatory Expenses

Lakefront is requesting an increased recovery of regulatory expenses in 2008 of $100,000 relative to the 2007 level. Lakefront disclosed[3] that the incremental amount is for the cost of preparing its 2008 cost of service application.

Board staff notes that Lakefront is proposing to recover $149,198 in regulatory costs in 2008, a $100,000 increase from the 2007 level. Lakefront states[4] that this is due to "Increases in costs associated with the preparation of the 2008 rate application." Lakefront further justified its proposal in response to the Board staff interrogatory:

> "…It is unlikely that LUI will spend $100,000 during the non-rebasing years, however LUI will have regulatory expenses during those years that could be significant, depending on the adjustments permitted by the IRM mechanism and LUI's specific circumstances. LUI is not confident that it can wait until the year 2011 to rebase. Therefore, the full $100,000 should not be treated as a one-time expense. Rather, it would be more appropriate to include $75,000 in LUI's revenue requirement to recognize a partial amortization of this application's costs as well as future regulatory expenses.[5]"

Board staff invites Lakefront and other parties to provide comments whether or not it is reasonable for Lakefront to recover the amount that it is proposing of $149,198 for regulatory expenses in 2008 given Lakefront has attributed $100,000 of these expenses to the preparation of the 2008 rate application.

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[3] Board staff interrogatory 3.12 c)
[4] Exhibit 4/Tab 2/Schedule 3 Page 3
[5] I Board staff interrogatory 3.12 c)

### Decrease in Outside Services

There is a decrease in outside services required by Lakefront in the 2006 to 2008 period of $62,556. Lakefront states[6] that this was due to a decrease in outside services required in 2007 related to the cost allocation study and legal expenses for regulatory assets, offset by an increase in outside services in 2008 of $16,650 related to the cost allocation study. Board staff would invite Lakefront to provide additional clarification of these items in its reply submission.

## Employee Compensation and Benefits

The following Table 5 prepared by Board staff summarizes the information on labour costs provided in Exhibit 4/Tab 2/Schedule 7. Staff notes that Lakefront did not provide a breakdown of the allocation of OM&A expenses for the 2006 Board Approved year between OM&A and capital, which is why this breakdown is not presented in the following tables. Staff would invite Lakefront to provide any comments on this omission in its reply submission.

**Table 5**

| | 2006 Board Approved | 2006 Actual | 2007 Bridge | 2008 Test |
|---|---|---|---|---|
| Compensation | $ 768,423 | $ 905,236 | $ 998,900 | $ 1,063,400 |
| Pension and Benefits | $ 195,894 | $ 216,655 | $ 239,596 | $ 266,168 |
| Incentive Pay | $ - | $ - | $ - | $ - |
| Total Compensation | $ 964,317 | $ 1,121,891 | $ 1,238,496 | $ 1,329,568 |
| | | | | |
| OM&A | $ - | $ 826,449 | $ 911,996 | $ 975,084 |
| Capital Additions & Other | $ - | $ 295,442 | $ 326,500 | $ 354,484 |
| Total Compensation | $ - | $ 1,121,891 | $ 1,238,496 | $ 1,329,568 |
| | | | | |
| OM&A | | 74% | 74% | 73% |
| Capitalized | | 26% | 26% | 27% |

Lakefront confirmed[7] that it has not made any changes to its capitalization policies or estimates. This is further evidenced by the consistency of the above percentage splits.

In comparing the distributor's labour costs to Total Controllable OM&A, Board staff notes that labour averages approximately 45% of operation costs as indicated in the following Table 6.

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[6] Board staff interrogatory 3.12b
[7] Board staff IR 3.11

## Table 6

| | | 2006 Board Approved | 2006 Actual | 2007 Bridge | 2008 Test |
|---|---|---|---|---|---|
| OM&A Labour | A | $ - | $ 826,449 | $ 911,996 | $ 975,084 |
| Total Controllable OM&A Expenses | B | $ 1,559,376 | $ 1,809,069 | $ 1,930,879 | $ 2,407,365 |
| Labour as a percent of OM&A | C = A / B | - | 45.7% | 47.2% | 40.5% |

Board staff prepared the following Table 7 to identify the final value of labour cost drivers to be used in the following cost driver analysis table.

## Table 7

| | 2006 Board Approved | 2006 Actual | 2007 Bridge | 2008 Test |
|---|---|---|---|---|
| OM&A | $ - | $ 826,449 | $ 911,996 | $ 975,084 |
| Annual Labour Changes | | $ - | $ 85,547 | $ 63,088 |
| % Change | | 0.0% | 9.4% | 6.5% |

From the Table 7, the significant variance is the 9.4% increase in the 2007 bridge year. One of the key components of this increase is total salary and wages, of which management and unionized costs increased by 18% and 21%, respectively from 2006 to 2008. In response to Board staff interrogatory 3.5, which asked the utility to explain these increases, Lakefront stated that the increase in management salary and wages was due to the projected hiring of a Financial Clerk in 2008, in order to meet the increasing workload requirements demanded by the new regulatory environment. Where unionized costs are concerned, Lakefront stated that the increase in these costs was due to the addition of a lineman in 2007 and a general wage increase of 3%. The utility noted that the lineman position was approved by the Board in its 2006 EDR application. Board staff also notes that the addition of 4 summer student positions has increased labour costs by $22,374 in 2006, $23,145 in 2007 and $24,335 in 2008.

Board staff further notes that Lakefront incurs manpower costs, at least in part, through its affiliated company Lakefront Utility Services Inc. (LUSI). Lakefront states[8] that “LUSI is a non-profit services company that provides the manpower required by Lakefront Utilities Inc.” Accordingly, Lakefront’s shared services arrangements also impact upon its labour costs.

[8] Exhibit 4/Tab 1/Schedule 1 Page 2

## Shared Services

Shared services costs are a significant proportion of Lakefront's operating expenses. Based on the information provided[9], total costs allocated to Lakefront for shared services are $1.3 million, out of total operating costs of $3.0 million in 2006.

Lakefront states in its application that it is a subsidiary of the Town of Cobourg and its associated affiliates are LUSI and Cobourg Networks Inc. ("CNI"). Lakefront's Corporate Entities Relationship Charts[10] also indicates another associated affiliate, Lakefront Generation Inc., but Lakefront describes this entity as a venture company investigating generation initiative opportunities that at this point does not have any operational projects. Board staff are unclear whether costs are allocated to this entity, or will be allocated in 2008, but staff invites Lakefront to confirm this in its reply submission.

Where LUS is concerned, Lakefront states that it is a non profit entity that provides the manpower required by Lakefront, as well as services to CNI and water services to the Town of Cobourg. There are also various other services that are provided between the affiliated companies[11].

Lakefront was asked in Board staff interrogatory 3.2 to provide information on the type of service, the total annual expense by service and the rationale and cost allocators used for shared costs for each type of service.

In its response, Lakefront lists two services shared with LUSI, which are Billing & Collecting and General Administration comprising the source of the $1.3 million of costs referenced above. Lakefront also states that the Water Department pays rent to Lakefront for shared space in an amount of $48,000. It is not specified to which year this cost is attributable and staff would invite comment by Lakefront on this matter in its reply submission.

Board staff is concerned that the information provided by Lakefront related to its shared services is insufficient to provide an adequate record on which the Board can base a decision. Staff notes that Lakefront has not provided 2006 Board approved, 2007 or 2008 forecast numbers for shared services as specified in the filing requirements. Given the large increase being requested by Lakefront in OM&A costs in this application, Board staff would ask the applicant to comment on the impact of its operations of the Board denying these costs..

Board staff also notes that Lakefront's response to Board staff interrogatory 3.2 does not appear to be consistent with its filed evidence in terms of all the entities with which Lakefront shares services. Exhibit 1/Tab 1/ Schedule 14 Page 1 states that "CNI provides Internet services to LUI (Lakefront) in order for LUI to operate its Billing system through the Application Service Provider (ASP) model via Erie Thames Services ("ETS")." This would appear to be a shared service, but it is not discussed in the response to Board staff interrogatory 3.2. Board staff invites

[9] Board staff IR 3.2
[10] Exhibit 1/Tab 1/Schedule 14 Page 1
[11] Exhibit 4/Tab 1/Schedule 1 Page 2

Lakefront to address this matter in its reply submission and also to provide confirmation that its evidence is internally consistent and, if necessary, any relevant explanations and/or updates.

Board staff is also concerned that Lakefront has not met the Board's filing requirements where the rationale and cost allocators for the shared services are concerned. Lakefront states that "All costs and revenues are allocated based on proportioned usage by each company."[12] Staff would note that this description is incomplete, as it does not provide the cost allocators used to determine proportioned usage, nor the rationale for the use of these allocators. Staff invites Lakefront to address this matter in its reply submission.

# Rate Base

## Background

This utility serves approximately 24,000 customers in the Cobourg, Colborne and Grafton area. Customer growth rate appears steady at less than 2% or about 400 connections per annum.

The average rate base for 2008 with the smart meters excluded is $14,553,852[13]. This represents an increase of approximately 3.8% as compared to 2007 rate base (excluding smart meters) of $14,024,339 and an increase of 10% from the 2006 actual level of $13,228,047. Allowance for working capital consists of approximately 25% of the rate base; whereas the distribution plant makes up the bulk of the remaining 75%.

Lakefront projects a 2008 capital expenditure level (smart meters excluded) of $903,746. Table 8 provides the comparisons for the rate base and the capital expenditure for 2006, 2007, and 2008.

**Table 8[14]**

| | 2006 -Actual | 2007 | 2008 - Forecast |
|---|---|---|---|
| Capital Budget (excl Smart meters) | $1,637,086 | $1,463,932 | $903,746 |
| % change as compared to the prior year | - | -10.6% | -38.3%% |

| | | | |
|---|---|---|---|
| Rate Base (excl Smart meters) | $13,228,047 | $14,024,399 | $14,553,852 |
| % change from prior year | - | +6.0% | +3.8% |

[12] Board staff IR 3.2
[13] Board staff IR 2.5 d)
[14] From Board staff IR 2.1 b) and 2.5 d)

## Discussion and Submission

Board Staff notes that the information on the rate base is essentially complete. Supplementary information on reliability statistics, trends and history were properly supplied with confirmation of the rate base definition and inclusion of overhead and interest during construction in capital project costs.

### Increase in 2008 Capital Expenditures

**Table 9[15]**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|---|
| Net Income | $262,096 | $1,126,612 | $ 949,332 | $ 951,412 | $ 324,980 | $ 152,741 | $ 710,218 |
| Actual Return on Equity (%) | 5.03% | 17.78% | 15.20% | 14.41% | 5.14% | 2.40% | 10.14% |
| Allowed Return on Equity (%) | 9.80% | 9.80% | 9.80% | 9.80% | 9.00% | 9.00% | 8.68% |
| Retained Earnings | $526,848 | $1,653,460 | $1,564,880 | $1,916,292 | $1,641,272 | $1,685,999 | $2,322,175 |
| Dividends to Shareholders | | | $ 800,000 | $ 600,000 | $ 600,000 | $ 600,000 | $ 600,000 |
| Sustainment Capital Expenditures - NO SM | $488,683 | $ 346,427 | $ 530,106 | $ 499,490 | $ 503,583 | $1,328,932 | $ 468,746 |
| Development Capital Expenditures - NO SM | | $ 220,000 | $ 73,600 | $ 59,200 | $ 129,600 | | |
| Operations Capital Expenditures | $ 10,569 | $ 196,156 | $ 88,073 | $ 398,529 | $1,003,903 | $ 135,000 | $ 435,000 |
| Smart Meter Capital Expenditures | | | | | | $ 80,000 | $2,037,923 |
| Other Capital Expenditures (identify) | | | | | | | |
| Total Capital Expenditures (include SM) | $499,252 | $ 762,583 | $ 691,779 | $ 957,219 | $1,637,086 | $1,543,932 | $2,941,669 |
| Total Capital Expenditures (exclude SM) | $499,252 | $ 762,583 | $ 691,779 | $ 657,219 | $1,637,086 | $1,463,932 | $ 903,746 |
| Depreciation | $662,166 | $ 685,742 | $ 724,056 | $ 749,415 | $ 824,816 | $ 780,981 | $ 888,431 |

Table 9 demonstrates that capital expenditures in 2008, excluding smart meters, are expected to be significantly lower than the historical values. Projected capital expenditure in 2008 other than that planned for smart meters is about $0.9 million, considerably lower than the approximately $1.5 million spent in each of 2006 and 2007. However, this expenditure is still higher than the $0.5 million to $0.8 million range for the period 2002 through 2005. Staff's submission on smart meters expenditure is included in the smart meter section of this submission.

Table 9 also provides a breakdown of capital expenditures and indicates in which areas the 2006 and 2007 increases occurred and emphasizes the large 2008 smart meters component. In 2006, the large increase in capital expenditure was concentrated in the operations capital, whereas in 2007 the large increase was concentrated in the sustainment capital. Year 2006 projects concentrated on the utility's ability to respond to repair and construction needs (a new garage at $719,578 and a $190,134 expenditure on a digger truck with $267,523 for transformer and substation equipment). Year 2007 projects concentrated on the 28kV conversion with a total expenditure of $1,328,932.

The capital expenditure pattern conforms to Lakefront's assertions of a need for "catch-up" on infrastructure investment following low capital expenditures for

[15] Board Staff Interrogatory # 2.1 b)

years 2002 through 2005. Staff notes that the service reliability statistics improved considerably after 2004 (see Service Reliability Indices).

From the data in the Table 8, staff observes that much of the 2008 investment in utility's infrastructure (more than $2 million in capital expenditures and more than $1 million in rate base) is being diverted to smart meters. Staff is not clear if the level of 2008 capital expenditure, excluding smart meters, is consistent with the Lakefront's assertions of a need for "catch-up" on infrastructure investment following low capital expenditures for years 2002 through 2005 and the need for increased renewal, infrastructure investment, and maintenance activities. Staff invites Lakefront and other parties to comment on this observation and adequacy of utility's 2008 level of capital expenditure.

### Smart Meters

Lakefront has included an amount of $2,037,923 in their 2008 capital expenditure projection. As noted earlier, staff's submission on this expenditure is included in the smart meter section of this submission.

### Service Reliability Indices

Service reliability figures are measures of performance of the system as seen by customers. System Average Interruption Duration Index ("SAIDI") and System Average Interruption Frequency Index ("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. Customer Average Interruption Index ("CAIDI") represents the average duration of interruption averaged over the number of customers that are interrupted.

Lakefront provided the following Table 10 information[16]:

**Table 10**

| 2.3 | Service reliability Indices | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 (Desired Values are an avg of last 3 years recognizing uncontrollable items) |
| | | | | | | | | |
| SAIDI | | 1.709 | 11.099 | 6.34 | 1.59 | 3.69 | 2.36 | 2.55 |
| | | | | | | | | |
| SAIFI | | 0.963 | 1.884 | 0.599 | 1.6 | 1.85 | 2.03 | 1.83 |
| | | | | | | | | |
| CAIDI | | 1.77 | 5.89 | 10.58 | 0.99 | 1.99 | 1.16 | 1.38 |

Board staff notes that Table 10 shows relatively poor reliability performances in 2003 and 2004, followed by a major improvement in 2005 which has been effectively maintained. Possibly this quantitative reliability could be related to weather or to the utility's increased capital expenditures in 2005 and 2006. Board staff also notes that in 2007 the SAIFI exceeded the average of the

[16] Board staff interrogatory # 2.3(a)

previous three years (1.35), but the SAIDI was favourable as compared to the average of the previous three years (3.87). Lakefront set the 2008 reliability targets as the average of the last 3 years. Board staff observes that Lakefront has not filed any specific plan that indicates how it intends to achieve its desired reliability targets. Given the decrease in capital expenditure in 2007 and 2008, it is not clear to Board Staff if and how the utility can maintain the improved level of reliability performance. Furthermore, Board staff is concerned if the existing reliability performance would be negatively impacted in the future by decreased level of investment in the infrastructure. Board staff invites Lakefront to address this issue in its reply submission and comment on its plan to achieve its desired reliability targets.

### Assessment of Asset Condition and Asset Management Plan

Lakefront asserts[17] that it relies on a condition assessment, municipal requirements, developer requirements and voltage plans to establish their capital budget and always considers reliability as part of the budgeting process. Lakefront provided pole inspection forms, and voltage and load studies justifying conversion from a 4kV to a higher distribution voltage. However there is little evidence of a methodical asset management plan which might include:

1. An overview of the condition and age of all assets;
2. Documentation for the reliability of circuits
3. A procedure for converting the information in (a) and b) into a schedule for replacement/renewal, and
4. A plan to address reliability and asset condition problems identified on the short-term and long-term basis.

It is not clear to Board staff if Lakefront had undertaken any initiative in development of an asset management plan. Staff invites Lakefront and parties to comment on this issue.

# Cost of Capital

## Summary

With respect to the Cost of Capital, Lakefront Utilities' application, as clarified and corrected on the record and, subject to staff's comments on the applicable rate for the cost of long-term debt, is consistent 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.

[17] Board staff IR 2.10

The Board Report is a guideline, but departures from the methodology in the Board Report are expected to be adequately supported.

Lakefront Utilities has provided its proposed Cost of Capital in Exhibit 6. The following Table 11 summarizes Lakefront Utilities' proposed Cost of Capital:

**Table 11**

| **Cost of Capital Parameter** | **Lakefront Utilities' 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 | 7.25%, corrected to 7.161% per the response to Board staff interrogatory #1.2. See also discussion of Long-Term debt below. |
| Return on Equity | 8.68%, but confirmed that this is 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 | 7.82%, corrected to 7.77% 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. |

## Discussion and Submission

### Long Term Debt

Lakefront Utilities proposed[18] that the embedded cost of long-term debt for setting 2008 its revenue requirement would be 7.25%, pertaining to the current rate applicable to a promissory note held by the Town of Cobourg. Lakefront Utilities corrected this in response to an interrogatory[19], to incorporate into the average cost of long-term debt the rate of 6.25% for new third-party debt that Lakefront Utilities forecasts that it will incur in 2008.

In that interrogatory response, Lakefront Utilities stated that the long-term debt forecast of 6.25% was based on Table 2 on page 4 from the Board Report. Board staff submits that Lakefront Utilities' forecast of 6.25% is in error. Table 2 on page 4 of the Board Report states the capital structure and deemed long-term debt rate based on the size of a utility's rate base per the 2006 Electricity Distribution Rate Handbook, and which was used for determining the embedded cost of debt for setting electricity distribution rates in 2006. The Board adopted and issued the Board Report after an extensive consultative process to provide, in part, an updated methodology for dealing with cost of capital for electricity distribution rate-setting. The evolved methodology, for long-term debt, is documented in section 2.2.1 and Appendix A of the Board Report.

[18] Exhibit 6/Tab 1/Schedule 1
[19] Board staff interrogatory #1.3

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 guideline, Board staff submits that the deemed long-term debt rate for the new debt, as updated in accordance with section 2.2.1 and Appendix A of the Board Report, should be the applicable cost of this long-term debt for determining Lakefront Utilities' 2008 revenue requirement and distribution rates.

Board staff notes that the promissory note due to the Town of Cobourg is callable on demand[20]. This promissory note is affiliated debt. In compliance with the section of 2.2.1 of the Board Report quoted above, Board staff submits that the appropriate rate for this affiliated debt should also be the updated deemed long-term interest rate calculated in accordance with Appendix A of the Board Report.

### Return on Equity (ROE)

In its application[21], Lakefront Utilities proposed an ROE of 8.68%, while acknowledging that the ROE would be updated in accordance with the methodology in Appendix B of the Board Report for determining Lakefront Utilities' 2008 revenue requirement and distribution rates. Lakefront Utilities provided[22] the derivation of the ROE. Board staff is unable to replicate the number as the Bank of Canada data shown can not be readily identified. However, with the information on the record and given that the ROE is to be updated in accordance with the Board Report, Board staff note that Lakefront Utilities' approach is consistent with the Board Report.

### Weighted Average Cost of Capital (WACC)

In the table for the 2008 test year capital structure[23], Lakefront Utilities provided an estimated WACC of 7.82% based on the proposed ROE and short- and long-term debt rates. Lakefront Utilities updated[24] this to 7.77%, reflecting the correction to the average cost of Long-Term debt.

[20] Note 9 of Lakefront Utilities' 2006 Audited Financial Statements filed in Appendix G of the Application
[21] Exhibit 6/Tab 1/Schedule 1
[22] Board staff IR #1.2
[23] Exhibit 6/Tab 1 / Schedule 1
[24] Board staff IR #1.3

# Smart Meters

## Background

### Authorization for Undertaking Smart Meter Activity

Lakefront Utilities is not one of the 13 distributors authorized to undertake smart meter activities and is not named in the combined smart meter proceeding, EB-2007-0063.

Furthermore, Lakefront Utilities did not provide any evidence that it is authorized to undertake smart metering activities though requested to do so[25].

Lakefront Utilities is one of the "un-named" 11 distributors who filed a specific smart meter plan in the 2006 EDR proceeding. The Board, in its Decision and Order[26] found:

> "The Applicant did file a specific smart meter plan in the revenue requirement. In this situation, the Generic Decision provides that an amount determined as $3.50 per meter per month installed during the rate year be reflected in the Applicant's revenue requirement, instead of the smart meter-related costs proposed by the Applicant."

The Board, in its decision on Lakefront Utilities' 2007 IRM application[27], confirmed its understanding that Lakefront Utilities would not be undertaking any smart metering activity in 2007.

Lakefront Utilities confirmed[28] that it had not undertaken any smart meter activity in 2007 other than a study of inside and outside meters to be changed in preparation for the installation of smart meters. Lakefront Utilities participated with the other CHEC members in the technology selection process that would best suit the utility.

> "Lakefront Utilities Inc. participated with the Cornerstone Hydro Electric Concept (CHEC) group in submitting a comprehensive smart metering plan to the Ministry of Energy. Our intent is to install smart meters throughout our entire service territory in 2008"[29]

Lakefront also indicated[30] that the CHEC group requested a letter from the Ministry of Energy to authorize CHEC to move forward with the procurement stage of the Smart Meter Initiative while awaiting the update to the Discretionary Metering Regulations reflecting the right for the utilities to continue. Also, Lakefront Utilities remarked that Section 53.18 of the *Electricity Act, 1998* allows the Board to authorize discretionary metering by way of an order, which the Board could do as part of this proceeding.

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[25] Board staff IR# 4.1 a) and VECC IR# 6 a)
[26] RP-2005-0020 / EB-2005-0387
[27] EB-2007-0550/EB-2007-0106
[28] Board Staff IR# 4.1 c)
[29] Exhibit 1/Tab 2/Schedule 1
[30] Board Staff IR# 4.1 a) and VECC's IR# 6 a)

Furthermore, the utility provided a copy of a letter, dated December 21, 2007, to London Hydro, signed by the Ministry of Energy's Assistant Deputy Minister, Consumer and Regulatory Affairs which stated:

> "I am appreciative of the work done by London Hydro to develop a participation process that offers non-consortium LDCs with an opportunity to investigate a suitable technology for their own customers. I understand that the participation guidelines ensure that the integrity of the procurement process (which will be monitored by London Hydro's fairness commissioner) will be maintained in the event of expanded LDC participation."
>
> and
>
> "Following the successful completion of the RFP and Minister Phillips' approval, the Ministry will recommend to Cabinet an amendment to O. Reg. 427/06 to accommodate London Hydro and consortium members as well as any other LDCs outside the consortium that have chosen to participate in the process. **As you know, the Ministry cannot bind Cabinet's decision making. As such, nothing in this letter shall be construed as obligating the Cabinet or the legislature of the Province of Ontario to approve or promulgate the proposed amending regulation."** (emphasis added)

## Smart Meter CAPEX, OPEX & Method of Recovery of Costs

Lakefront Utilities stated[31] that it included the smart meter capital expenditure amounts in 2008 rate base, instead of tracking the revenue requirement impacts in smart meter deferral account and employing an appropriate rate adder, because the Government's mandate is to implement smart meters by 2010 and that approximately half of customers' meter seals are expired or are on the verge of expiration. The applicant believes that it would be imprudent and unfair to its customers to replace expired seal meters with regular kWh meters only to change them within a short period with smart meters. The cost of approximately $300,000 would be a stranded cost that Lakefront Utilities' rate payers would have to bear unnecessarily.

Lakefront Utilities stated[32] that its proposed smart meter capital expenditure amount for 2008 is $2,037,923, which is broken down into $1,956,245 for smart meters and $81,678 for repair of unsafe meter bases, consulting services, and legal expense for installation contract & old meter recycling. Lakefront Utilities confirmed[33] that computer related expense is not part of the planned smart meter investment in 2008.

Staff notes that the amount of $2,037,923 represents 69.3% of the total capital expenditure of $2,941,669 proposed by Lakefront Utilities for 2008[34]. Lakefront

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[31] Staff IR# 4.1 d) and VECC IR# 6 b)
[32] VECC IRs # 6 d) and 9 a)
[33] VECC IR# 22 a)
[34] Exhibit 2/Tab 3/Schedule 1 Page7

stated[35] that 8,923 smart meters, 7,873-residential & 1,050-GS < 50 kW, will be installed in 2008.

Lakefront Utilities provided a continuity schedule[36] for deferral accounts including "Account 1555 – Smart Meter Capital Variance – Recoveries" with an April 30, 2008 credit balance of $17,211. Lakefront Utilities stated that it is not requesting the disposition this credit balance in the smart meter deferral account at this time.

Staff notes that Lakefront Utilities' request not to dispose of the credit balance in the deferral account would be inconsistent with the Board's statement in the 2nd and 3rd paragraphs of the section:

> "The Rate Increase Methodology" on page 18 of its combined decision in EB-2007-0063 for authorized utilities: "Only three utilities, Toronto Hydro, Chatham-Kent and Middlesex are asking for recovery through rates at this time. The others propose to defer the matter until the next time. The Board will allow each utility to recover its costs as set out in Appendix "A" by including these costs in rate base for the 2006 and 2007 rate years and calculating a revenue requirement on that investment in the manner set out in Appendix "E". **Before calculating a rate increase from this revenue requirement, however, the utility must first deduct the amount of money previously collected in rate adders pursuant to the Orders of March 21, 2006.** (Emphasis added)".

Lakefront provided a breakdown for smart meter OM&A costs[37] of $220,278 in 2008. They stated:

> "Certain daily operations labour amount and interaction with the vendor along with testing makes up the maintenance expense as outlined in Exhibit 2, Tab 3, Schedule 1, pages 7 to 13. These should have been included as part of the capital cost instead of maintenance and Lakefront Utilities Inc. will adjust this item accordingly."[38]

Lakefront Utilities agreed with Board Staff's Table 3 – Cost Drivers by Year[39], which was based on the applicant's Exhibit 4 /Tab 2 /Schedule 1 for OM&A costs and where the 2008 increase in controllable expenses was analyzed by the main cost drivers. Staff notes that, according to this table, the 2008 increase of $207,850 with respect to smart meter OM&A expenses represents 34.7% of the 2008 increase of $598,296 in total controllable expenses from $1,930,879 in 2007 to $2,407,365 in 2008 according to the same Board Staff IR response.

## Discussion and Submission

### Authorization for Undertaking Smart Meter Activity:

Staff note there is no formal authorization from the provincial government for Lakefront Utilities to undertake smart meter activities. However, it is proposing to

[35] VECC IR# 12 a)
[36] Board Staff IR# 10.6
[37] VECC IR# 6 d)
[38] VECC IR#19 g)
[39] Board Staff IR# 3.12

participate in the CHEC group's smart meter implementation plan in 2008 by installing smart meters to all of its residential and general service < 50 kW customers. The applicant is asked to comment on the impact of its smart metering activities if the Board were to deny it's cost recovery at this time.

# CDM

# 2007 Incremental CDM Funding

## Background

As part of the 2007 EDR process Lakefront filed an application for an extension of its Conservation and Demand Management programs. Lakefront requested an additional budget of $550,000 for its Voltage Conversion project. This project was originally authorized as a component of the 2005 third tranche MARR CDM plan approved by the Board on February 8, 2005[40]. The Board's Decision and Order dated April 12, 2007[41] directed that a cost of service rate making approach be applied to the additional funding of the as applied for Voltage Conversion project. This meant that only the annual capital related expenses could be included in the 2007 rates. The Board approved the inclusion of an amount of $38,761 as a capital related expense, subject to final approval at a later date. On August 13, 2007 the Board issued their Decision[42] with respect to final approval of the CDM extension awarding a capital amount of $119,169, down from the original $550,000.

In the 2008 COS filing Lakefront included in OM&A the amounts of $119,169 and $80,408 for 2007 and 2008 respectively as CDM – Energy Conservation expense as shown in Table 1 above. Board staff interrogatory 3.15 questioned Lakefront in respect to this requested amount.

## Discussion and Submission

Board staff note that in the Board's decision of April 12, 2007 the intent was that post 3rd tranche incremental CDM funding provided for capital projects would be approved using a cost of service methodology. Using this method the value to be recovered from rates would be the equivalent to incremental revenue requirement and not the full amount of the cost of the project. The appropriate treatment for these costs is inclusion into rate base.

# PILs

## Background

For 2008, the previously published federal and Ontario combined maximum enacted income tax rate was 34.5%. Those businesses eligible for the small business

[40] EB-2004-0502
[41] EB-2007-0550 and EB-2007-0106
[42] EB-2007-0106

deduction had a combined income tax rate of 17%. The rate between these limits principally varied based on the company's taxable income.

The federal government released its Economic Forecast on October 30, 2007 which provided for reductions in GST and personal taxes, and further reductions in corporate taxes. The legislation, Bill C-28, received Royal Assent on December 14, 2007. The new reduced tax rates took effect on January 1, 2008.

Based on the applicant's evidence, the applicable federal rate for 2008 is 9.5%.

On December 13, 2007 the Ontario government issued an Economic Outlook and Fiscal Review. The document included corporate tax measures to reduce income tax on small businesses and to modify aspects of the capital tax calculations. First reading of the legislation, Bill 24, occurred on December 13, 2007. Royal Assent has not yet been granted. Generally, changes in Ontario tax legislation are not recognized until after Royal Assent.

### Discussion and Submission

Lakefront applied for income tax PILs of $405,513, and capital tax PILs of $1,646, for a total of $407,159. Lakefront used a combined income tax rate of 36.519% in the test year calculation of income tax PILs which is grossed up and recovered in rates. Based on evidence[43] the applicant did not calculate the correct combined tax rate, which resulted in incorrect higher PILs.

The income tax calculation includes computing the maximum tax and then deducting the amount of the small business credit. The Ontario deduction is phased out between a taxable income of $400,000 and $1,128,519 using a surtax rate of 4.667% applied to the amount of taxable income above the $400,000 threshold.

The applicant did not deduct the Ontario small business credit in its calculations. However, Lakefront added the surtax amount.

Board staff note that Lakefront's PILs calculation does not reflect the change in the Federal tax.

## Load Forecasting

### Background

In Exhibit 3 of the Application, the development of the Lakefront's customer count and load forecasts are discussed. Using a simple trend growth, the historical number of customers is projected based on 2003-2006 data to obtain both Bridge Year (2007) and Test Year (2008) customer counts by class. The kWh forecast, and the kW forecast for appropriate classes, is presented by customer class. Variance analyses are presented in support of the forecasts.

Lakefront provided additional information in response to Board Staff and VECC interrogatories.

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[43] Exhibit 4/Tab 3/Schedule 1 Page 1

## Discussion and Submission

### Methodology and Model

Lakefront explained that as a result of the limited amount of data available and the growth and trends in customer numbers in its service territory over the past five years, it had chosen to use a simple trend growth to determine the customer count forecast. The tabular data presented and the Applicant's response to an Interrogatory[44], which permitted the 2007 forecasted customer numbers to be compared with the subsequent actuals, substantiated the Applicant's description of its customer growth.

In regards to the kWh volume forecasts, the Applicant explained that for its weather sensitive load, Lakefront first developed the retail normalized average use per customer ("retail NAC") by customer class; the retail NAC value by class was based on the 2004 load values that had been weather-normalized for the Applicant by HONI. The kWh loads for 2007 and 2008 were determined by multiplying the retail NAC by the number of forecasted customers.[45]

Board Staff is concerned that the method chosen utilizes only a single year of weather-normalized historical load to determine the future load. Board staff ask parties to comment on whether a multi-year trend would provide a more comprehensive weather normalization method.

The Applicant presented its kW demand forecast for those customer classes that use this charge determinant. No rationale is presented for the determination of these values. Board staff invites Lakefront to comment on the development of the kW demand for 2008 in their submission.

Board staff also asks Lakefront to comment on the fact that the normalized kWh for 2004 was applied without adjusting for weather and other factors such as CDM.

The Applicant's forecast shows a 1.3% annual average growth in customer numbers from 2006 to the 2008 Test Year. This compares with an average annual customer growth of 1.5% during the 2003 to 2006 period. The forecasted growth in customer numbers is consistent with what one might expect based on the input data.

The Applicant's forecast shows a -1.8% (i.e. negative) annual average kWh load growth from 2006 to the 2008 Test Year. This compares with an average annual kWh load growth of 1.0% during the 2002 to 2006 period. This is inconsistent with the historical relationship between customer growth and kWh growth. That is, the historical 1.5% p.a. growth in customer numbers produced a 1.0% p.a. growth in kWh load whereas Lakefront forecasted 1.3% p.a. growth in customer numbers is expected to produce a negative 1.8% p.a. growth in kWh load.

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[44] VECC IR 15 b
[45] Board staff IR 6.1

# Line Losses

## Background

Lakefront has applied to set rates using a Distribution Loss Factor ("DLF") of 1.0541 which will be used for a three year period based on an average of their last three years[46].

Lakefront claims that as it "…expands its voltage conversion project, greater savings will be realized by our customers and they will be reflected in the calculated loss factor at the next rate setting.[47]"

## Discussion and submission

Board staff is concerned with the periodic increase in the actually observed DLF in the 2002 to 2006 period (1.0482 to 1.0549 to 1.0443 to 1.0499 to 1.0540) despite the fact that Lakefront's interrogatory response states that increased residential load at a low utilization voltage is a cause[48]. The applicant is asked to comment on whether it should be required to provide an assessment and action plan to manage its DLF.

# Low Voltage Charges, Cost Allocation and Rate Design

## Cost of Low Voltage Charges

### Background

Lakefront is an embedded distributor, served by the host distributor HONI. Lakefront has provided an estimate of its LV costs at $346,196, equivalent to $28,850 per month. Lakefront provided statements[49] for various months and various charges from the host distributor. The most recent of these statements were for August, September, and October 2007. The average cost over these three months was approximately $31,400.

Some of the earlier HONI statements of Lakefront's LV cost involve charges for services such as Specific Lines, which it is reasonable to assume are no longer applicable because they do not appear on the more recent statements.

HONI has applied for a change in its LV Rates that would be paid by embedded distributors such as Lakefront[50]. The application is for approval of a monthly rate for "Common ST Line" at $0.58 per kW, compared to the existing rate for "Shared LV Lines" at $0.633. The application also involves approval of charges which do not currently exist.

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[46] Board staff IR 9.1 c)
[47] Ibid
[48] Board staff IR 9.1 b)
[49] Board staff IR 7.2 a)
[50] EB-2007-0681 Exhibit G2/Tab 94/Schedule 1 page 2

### Discussion and submission

Board staff submits that the proposed rate for Common ST Line, to be applied to all Sub-transmission customers including embedded distributors such as Lakefront, is substantially lower than the existing Shared LV Line rate. The annual decrease in Lakefront's cost can be expected to be approximately $30,000. On the other hand, HONI is applying for new service charge and certain meter charges. Board staff is unclear which of these rates would apply to Lakefront in the event that the HONI application is approved. Lakefront is asked to comment on its preferred approach.

## Cost Allocation

### Revenue to Cost Ratios

***Background***

Lakefront submitted its Cost Allocation Informational Filing in which Run 2 yielded Revenue to Cost Ratios found in the first column of the following Table 13[51] as the basis for stetting rates. In the Managers Summary of the Informational Filing, Lakefront expressed concerns about the accuracy of the results, noting in particular that the results were influenced by allocating miscellaneous revenues across all classes using a composite allocator. Lakefront also expressed concerns about allocating costs to the Streetlighting class in proportion to connections.

Board staff suggested in an interrogatory that certain load data inputs to the Informational Filing appeared to be incorrect, and that the most serious effect was to under-state the revenue to cost ratio for the GS 3000-4999 kW class. Lakefront provided a re-calculation of its revenue to cost ratios, which are found in column 2 of the following Table 12. In addition to correcting the load data, Lakefront removed the miscellaneous revenue from the model, so the revenue to cost ratio for the whole group does not reconcile to 1.0, and the ratio for most classes is somewhat lower than in the first column.[52]

In their response to another interrogatory[53], Lakefront incorporated its concern about costs being allocated in proportion to connections, and substituted customer numbers in place of connections. There are two Streetlighting customers having 2693 connections in total. The result of this change is a significant decrease in the allocation of costs to the Streetlighting class from $482,541 down to $10,676, and a corresponding increase in the revenue to cost ratio. Other changes have also been made, to bring the total revenue up to the forward test year amount. Lakefront proposes that the ratios from this run of the model should be used for comparison with the Board's guidelines presented in the report Board Report *Application of Cost Allocation for Electricity Distributors*

[51] Exhibit 8/Tab 1/Schedule 2 page 3
[52] Board staff IR 7.3
[53] Board staff IR 8.2 b)

*EB-2007-0667 November 28, 2007* ("Board's guidelines"). The ratios are found in column 3 of the table.

For convenience, the range in the Board's guidelines for each class is found if column 4 of the table.

**Table 12**
**Revenue to Cost Ratios**

| | *Col. 1* | *Col. 2* | *Col. 3* | *Col. 4* |
|---|---|---|---|---|
| | **Informational Filing Run 2** | **Revised Inputs (Staff IR 7.3)** | **Proposed Ratios (Staff IR 8.2 b)** | **Range (Nov 28, 2007)** |
| **Customer Class** | | | | |
| Residential | 114.0 | 87.7 | 102.1 | 85 – 115 |
| GS < 50 kW | 141.4 | 114.9 | 122.6 | 80 – 120 |
| GS 50 - 2999 kW | 148.3 | 135.6 | 114.0 | 80 – 180 |
| GS 3000 - 4999 kW | 24.9 | 32.4 | 68.8 | 80 – 180 |
| Street Lights | 12.9 | 8.6 | 70.5 | 70 – 120 |
| Sentinel Lights | 29.3 | 36.4 | 14.6 | 70 – 120 |
| Unmetered Scattered Load | 96.5 | 96.0 | 59.1 | 80 - 120 |

## Discussion and submission

Board staff submits that the ratios found in column 2, rather than those produced in the Informational Filing, may provide a better basis for rate rebalancing in Lakefront's application as it reflects recent updates. The ratios are not directly useable, however, because the overall ratio (not shown in the table) is not reconciled at 100%; revenue over all classes in the response to Interrogatory 7.3 is only 92.4% of total cost.

To produce the third set of ratios in column 3 Lakefront appears to have substituted the number of customers for the number of connections in the model. The Board report Cost Allocation Review: *Board Directions on Cost Allocation Methodology for Electricity Distributors EB-2005-0317, September 29, 2006* ("Cost Allocation Methodology") states that "The weighted number of customers or connections will be used to allocate costs related to Services (Account

1855)[54]." Board staff submits that this wording does not permit a simple choice between the number of customers versus number of connections. If the number of connections do not allocate costs appropriately then the Cost Allocation Methodology permits using weighted customer counts.

Board staff note that the class revenue requirements provided by Lakefront in the response to Board staff Interrogatory 8.2 b is inconsistent with the Board's policy on cost allocation in terms of customers versus connections and revisions for base revenue requirements.

## Allocation of LV Cost

### Background

Lakefront's forecast of LV cost (Account 4750) is $346,196. Board staff Interrogatory 7.1(b) requested information on the allocation method and amounts that were being proposed for each class. Lakefront responded with the amounts allocated to each class, totalling $346,196, but did not provide information on how these amounts were derived. However, Lakefront has provided information on both the allocation method and the amounts for the LV Variance Account (1550).

The allocated LV amount divided by the volumetric charge determinant is provided in the response, and a similar set of calculations is provided in the response to Interrogatory 7.1(c). The resulting unit charges by class are different between the two interrogatories.

### Discussion and Submission

Board staff submits that the revenue collected from each class under the Retail Transmission Service Rate – Connection provides a reasonable allocation of the cost of LV service in Account 4750. This is the allocation method used in the 2006 EDR re-basing.

Staff notes that the proportions underlying the amounts in the interrogatory response are different from those used by Lakefront in the 2006 model. Staff is unclear whether the proportions in the response to Interrogatory 7.1 (b) are based on new RTSR revenues or alternatively are based on some other allocation method. Board Staff request Lakefront to clarify this question in its reply submission by providing the method and rationale.

Board staff further submit that it would be helpful in Lakefront's reply to clarify which cost per-unit calculation is used in the rate adder that recovers LV cost – the calculation in Interrogatory 7.1(b) or 7.1(c). This clarification applies only to Account 4750. The explanation[55] of Account 1550 'LV Variance Account' does not require any further clarification.

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[54] Board Report EB-2007-0317 section 9.3.4.2
[55] VECC IR 23 b)

## Rate Design

### Fixed Charges

#### *Background*

The comparison of approved Monthly Service Charges[56] with the range of per-customer customer-related costs in the Informational Filing shows that the charges for all of the major customer classes are above the ceiling reference point. The proposal is for increases to each of these rates, but the percentage increases are lower than the increases to the volumetric rates in the respective classes. The following Table 13 is derived from the class-by-class summaries[57].

**Table 13**

***Proposed Rate Increases***

| | *Col. 1* | *Col. 2* |
|---|---|---|
| **% increase 2007 - 2008** | **Monthly Service Charge** | **Volumetric Charge** |
| **Customer Class** | | |
| Residential | 20.2 | 31.9 |
| GS < 50 kW | 15.9 | 27.8 |
| GS 50 - 2999 kW | 18.8 | 48.4 |
| GS 3000 - 4999 kW | 272.6 | 461.2 |

#### *Discussion and Submission*

Board staff submits that the Board has not issued guidelines on whether Monthly Service Charges may be above the ceiling. Since Lakefront is starting from rates that are substantially above the ceiling, it is likely that the proposed Monthly Service Charges would also be above the ceiling calculated in a forward test year cost allocation study.

## Transformer Ownership Credit

Lakefront proposes to maintain the credit at its existing approved amount of $0.60 per kW per month. Board policy has indicated this credit should be determined on a case by case basis.

## Retail Transmission Service Rates

### Background

Lakefront proposes to not change the Retail Transmission Service Rates from their existing approved amounts[58].

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[56] Exhibit 9/Tab 1/Schedule 1 page 3
[57] Exhibit 9/Tab 1/Schedule 7
[58] • Exhibit 9/Tab 1/Schedule 7

The host distributor HONI has applied for a change in its Retail Transmission Service Rates that would be paid by embedded distributors such as Lakefront.[59] The existing rates and those in the application are found in the following Table 14, along with percentage changes calculated by Board staff.

**Table 14**
**HONI Retail Transmission Service Rates**

| Rate ($/kW) | Existing Approved Rate | Rate applied for EB-2007-0681 | % change |
|---|---|---|---|
| Network | 2.52 | 2.02 | - 19.8 |
| Transformation Connection | 1.35 | 1.39 | -31.1 |
| Line Connection | 0.74 | 0.51 | 3.0 |

### Discussion and Submission

Board staff asks Lakefront to comment on the impact on its rates and customers assuming the HONI application will be approved. Board staff further asks Lakefront to address whether there would be a significant variance accumulating in the deferral accounts if they did not proactively adjust for HONI's proposed rates.

# Deferral and Variance Accounts

## Background

Lakefront Utilities is proposing to:

- Continue recovery of transition costs through the regulatory asset rate rider until the amounts are fully recovered,
- Establish three new accounts for future use, and
- Clear the balances of certain deferral and variance account to the accounts of the customers including Account 1590 - Recovery of the Regulatory Asset Balances

### Request for New Deferral Accounts

The applicant is requesting three new deferral accounts:

1. Late Payment Class Action Suit
2. Meter Data Management Repository Account, and
3. Future capital projects

[59] EB-2007-0681 Exhibit G2/Tab 94/Schedule 1 page 3

### Clearing Account Balances

The applicant is requesting that the following accounts and balances[60] be cleared for disposition as of April 30, 2008. The balances provided below include the December 31, 2006 balances plus the interest on these balances from January 1, 2007 to April 30, 2008:

**Table 15**

| | |
|---|---|
| 1508 Other Regulatory Assets, | $129,296 |
| 1518 RCVA – Retail, | $20,731 |
| 1548 RCVA – STR, | $24,557 |
| 1550 LV Variance, | $91,718 |
| 1580 RSVA – Wholesale Market Service Charge, | ($359,475) |
| 1582 RSVA – One Time Wholesale Market Service, | $17,302 |
| 1584 RSVA – Retail Transmission Network Charges, | ($136,899) |
| 1586 RSVA – Retail Transmission Connection Charges, | ($164,589) |
| 1588 RSVA – Power, | $1,168,228 |
| 1590 Recovery of Regulatory Asset Balances, | $598,999 |
| Total | $1,389,869 |

The applicant's proposal is to collect these amounts from rate payers over 2 years beginning May 1, 2008 via rate riders.[61]

## Discussion and Submission

### Continuation of Deferral and Variance Accounts

The Board has already approved and defined, through the Accounting Procedures Handbook (APH) and associated letters, the period and functionality of deferral and variance accounts in the electricity distribution sector. Therefore, it is not necessary for Lakefront to request permission to continue using open deferral and variance accounts as per the APH.

### Request for New Deferral Accounts

In evaluating the request for these new accounts, consideration should be given to each of the four regulatory principles which guide the establishment of new accounts:

1. Materiality
2. Prudence
3. Causation
4. Management ability to control

There are also two other considerations that are universal to the three deferral accounts that all parties should consider:

[60] Exhibit 5/Tab 1/Schedule 3 page 1
[61] Exhibit 5/Tab 1/Schedule 3

1. 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 may set a precedent for other distributors.
2. The establishment of new deferral and variance accounts outside of the APH will impact the level of business risk that the applicant is exposed to, which will directly tie to the equity component of the return on capital.

The three new proposed accounts are discussed in more detail as follows:

***Late Payment Class Action Suit Deferral Account***

Lakefront is requesting a new deferral account to record any costs that will flow from an action against Toronto Hydro Hydro Electric Commission (“THEC”) concerning late payment charges.

Lakefront stated that on November 18, 1998, a class action claiming $500 million in a restitution payment plus interest was filed against THEC as the representative of the defendant class consisting of all electricity distributors in Ontario which have charged late payment charges on overdue bills at any time after April 1, 1981.

Assuming a claim on THEC is successful Lakefront stated that it is liable for any claim that relates to late payment charges paid by Lakefront customers.

Lakefront is requesting a new deferral account to record any claim and costs that would incur assuming the claim on THEC is allowed.

Lakefront has not provided evidence of the materiality and causality of this request in its response to Board Staff Interrogatory #10.2. The results of the class action and the costs that Lakefront would incur are unresolved and unknown at this time, showing no clarity to the principles of causality and materiality.

Board Staff is aware that there was a proceeding before the Board dealing with Enbridge Gas Distribution Inc. application (EB 2007-0731) regarding the recovery of class action suit deferral account (“CASDA”). There is a major difference between the CASDA deferral account and the one requested by Lakefront. The CASDA lawsuit covers a period when Enbridge had its rates and fees approved by the Board. The lawsuit period referenced by Lakefront covers a period when, the distributors were regulated by Ontario Hydro, which approved and set electricity distributor rates and fees and not the Ontario Energy Board.

The Board may consider deferring any decision until the results of the lawsuit are made available. This is consistent with past precedent where in the Enbridge Gas Distribution Inc. Decision, RP-2002-0133, on page 85, the Board had the following findings:

> “The issue before the Board is a question of a lawsuit associated with a single site in Toronto, the Cityscape action. As such the Board questions

> the appropriateness and necessity of a more generic deferral account at this time.
>
> Furthermore, the evidence presented in this proceeding is not adequate to convince the Board that a deferral account of either a generic or specific nature is required at this time. The Board is concerned that the mere existence of the deferral account may imply an expectation of future recovery by the Company. The Board therefore does not approve the creation of the MGPDA (Manufactured Gas Plant Deferral Account) at this time.
>
> The Applicant may reapply in the future for a MGPDA with greater details on the scope, potential costs, and grounds for any ratepayer responsibility for these costs."

### *Meter Data Management Repository (MDMR) Deferral Account*

Lakefront is requesting a new deferral account to record Meter Data Management Repository Account (MDMR) costs.

Lakefront has not provided evidence of the materiality and causality of this request in its response to Board Staff Interrogatory #10.3.

The costs that Lakefront would incur are "indeterminate costs"[62], showing no clarity to the principles of causality and materiality. If the MDMR is considered to be cost recoverable, the Board already has defined through the APH, the variance and deferral accounts that could be used. One is account 1556, which is defined by the APH to "be used by the distributor to record incremental operating, maintenance, amortization and administrative expenses directly related to smart meters." However, 1556 may not be the most appropriate mechanism as MDMR costs will be levied by the IESO.

The IESO has not brought forward an application to the Board concerning recovery of this cost, therefore, there has been no approval granted by the Board for the IESO to recover these amounts. Any such recovery mechanism has not been decided by the Board. Since the Board has not yet approved if MDMR costs will be recovered and how the MDMR costs will be levied by the IESO on distributors, the distributors have not been instructed if, and how, to recover these costs. Board Staff requests that Lakefront further clarify why they require a deferral account specifically for MDMR when the Board has not yet approved if and how the MDM/R costs will be recovered, and already has two potential mechanisms for recovery if MDMR is considered to be a recoverable cost.

### *Future Capital Projects Deferral Account*

Lakefront is requesting a new deferral account to record the annual cost of service such as depreciation and return but not PILs associated with the new assets,.

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[62] Board staff IR 10.3

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 characterized as both prudent and outside management's ability to control.

Rate base does impact revenue requirement, satisfying causality. Lakefront did not provide the total expected costs or calculations in its response to Board Staff Interrogatory #10.4, so materiality cannot be determined.

Parties may wish to consider that the request to establish this deferral account is analogous to including a capital investment factor in an IRM year. The mechanistic calculation for 3rd Generation IRM has not been finalized, as it is currently before the Board. Therefore, the request for a capital projects deferral account may be premature.

## Clearing the Deferral Accounts

### *Treatment of RSVAs*

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

### *Treatment of 1590*

The applicant is requesting that the projected April 30, 2008 balance in 1590, including forecasted principal transactions, be included in the current disposition of regulatory deferral and variance accounts.

In the Phase 2 decision for the Review and Recovery of Regulatory Assets for the five large distributors[63], 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."[64]
- "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."[65]

Lakefront has proposed to dispose of account 1590 before the final balance has been determined. The applicant is asked to comment on whether the Board should consider whether this reflects a proper true-up. The Phase 2 decision

[63] RP-2004-0117, RP-2004-0118, RP-2004-0100, RP-2004-0069, RP-2004-0064
[64] Section 9.018
[65] Section 9.019

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. Residual balance will not be finalized until after April 30, 2008, electricity sector standard practise would be to defer disposition of account 1590 until the balance has been finalized and verified.

## 2006 EDR Revenue Requirement Understatement

During the 2006 EDR, Lakefront stated that it made the error of including $296,000 of interest accrued on 1570 Transition Costs as a revenue requirement offset in the 2006 EDR. Lakefront is requesting that the Board allow the utility to recover the amount not included in 2006 EDR rates by extending the current rate riders beyond April 30, 2008 until the amount is recovered. A consideration of this matter would require a consideration of the retroactive impact of this charge on future customers.

## Horizon Plastic Metering Error

In May 2007, one of Lakefront’s customers, Horizon Plastics discovered that Lakefront over billed Horizon because of a metering error that resulted in over reading of Horizon’s consumption. The meter was installed in April 2004 and the error was detected and corrected in mid-2007. Lakefront stated that it has made the adjustments to correct the errors dating from 2004 to 2006, which are included in this application. Lakefront will apply for the portion of the adjustments made to regulatory assets to correct this error related to fiscal 2007 in a future application.

Lakefront made the refund to Horizon in 2007, and paid interest on that refund as per the Retail Settlement Code. This interest rate for billing errors as per the Retail Settlement Code is higher than the prescribed interest rates for deferral and variance accounts. The difference in these interest rates generated a debit balance of $16,970, which was included in the December 31, 2006 balance of Account 1588. The applicant is asked to comment on whether the Panel should consider whether the rate payers should bear the cost of the different interest rates for the error of a utility contractor.

This refund to Horizon impacted Lakefront line loss factor, RSVA balances and account 1550 LV for the period 2004 to 2006. Lakefront has adjusted the 2006 EDR approved balances of deferral and variance accounts to correct the error for the 2004 period. However, the balances of these accounts for the period between April 2004 (when the meter was installed) to December 31, 2004 were given final disposition as part of the 2006 EDR. The question that arises is should the panel consider changing the approved 2006 EDR amounts for final disposition?