



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES
RIDEAU ST. LAWRENCE DISTRIBUTION INC.
EB-2007-0762

February 26, 2008

INTRODUCTION

Rideau St. Lawrence Distribution Inc. ("RSL" or the "Applicant") is the licensed electricity distributor serving a customer base of approximately 7,532 in the town of Prescott and within the Villages of Cardinal, Iroquois, Morrisburg, Westport and Williamsburg.

RSL submitted an application for 2008 electricity distribution rates on November 22, 2007. The application was based on a future test year cost of service methodology. On February 13, 2008, RSL submitted its response to interrogatories from Board staff and the two intervenors, the School Energy Coalition ("SEC") and the 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, and are intended to assist the Ontario Energy Board (the "Board") in evaluating RSL's application and setting reasonable and just rates.

THE APPLICATION

RSL has requested a revenue requirement of \$2,220,565 to be recovered in new rates effective May 1, 2008.

OM&A

Background

RSL's Summary of Operating Costs ("Summary") is found at Exhibit 4, Tab 1, Schedule 2, page 4 of the application. The as-filed test year Total Controllable OM&A Expenses forecast is \$1,586,626. This results in a 17% (or \$225,374) increase compared to the 2006 actual level.

Discussion and Submission

Overall OM&A

Board staff would note that RSL's evidence suggests that 74% of its OM&A costs are incurred through shared services and, as such, it is very substantially, a virtual utility. Shared service costs are discussed in a subsequent section of this submission.

Using the Summary as its base, Board staff created three different tables and asked interrogatories concerning each table. RSL confirmed the accuracy of each of the tables through its response to Board staff interrogatory 3.

Table 1 summarizes the key components of RSL's operating costs for 2006 Board approved and actuals, 2007 Bridge and 2008 Test years.

Table 2 highlights the significant sources of variance for controllable expenses.

Staff notes that the increase noted in Total Controllable OM& Expenses results mainly from a 3.3% increase in operations spending, and a 15.0% increase in maintenance spending.

Table 1

OM&A Expenses	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
Operations	245,294	145,283	185,080	189,708
Maintenance	91,951	197,528	291,216	401,986
Billing & Collecting	357,668	374,843	354,708	363,576
Community Relations	270	242	248	254
Administrative and General Expenses	463,851	643,356	595,662	631,102
Total OM & A Costs	1,159,034	1,361,252	1,426,914	1,586,626
LV Charges	166,396	-	-	-
Taxes Other Than Income	21,246	21,345	21,879	22,426
Dist. Expenses before Amort. /Taxes	1,346,676	1,382,597	1,448,793	1,609,052
Amortization Expense	156,359	192,403	217,414	253,818
Total Distribution Expenses	1,503,035	1,575,000	1,666,207	1,862,870
LCT, OCT & Income Taxes	39,438	25,909	-	32,968
TOTAL OPERATING COSTS	1,542,473	1,600,909	1,666,207	1,895,838

Table 2

OM&A Expenses	2006 Board Approved	Variance 2006/2006	2006 Actual	Variance 2007/2006	2007 Bridge	Variance 2008/2007	2008 Test	Variance 2008/2006 Act
Operations	245,294	-100,011 -8.6%	145,283	39,797 2.9%	185,080	4,628 0.3%	189,708	44,425 3.3%
Maintenance	91,951	105,577 9.1%	197,528	93,688 6.9%	291,216	110,770 7.8%	401,986	204,458 15.0%
Billing & Collecting	357,668	17,175 1.5%	374,843 -	20,135 -1.5%	354,708	8,868 0.6%	363,576 -	11,267 -0.8%
Community Relations	270	- 28 0.0%	242	6 0.0%	248	6 0.0%	254	12 0.0%
Administrative and General Expenses	463,851	179,505 15.5%	643,356 -	47,694 -3.5%	595,662	35,440 2.5%	631,102 -	12,254 -0.9%
Total OM & A Costs	1,159,034	202,218 17.4%	1,361,252	65,662 4.8%	1,426,914	159,712 11.2%	1,586,626	225,374 16.6%

Cost Drivers

In response to Board staff interrogatory 3b, RSL provided the following cost driver review table to assist in understanding the increases in Total Controllable OM&A expenses identified above. The review starts with the 2006 Board Approved cost of \$1,159,034 and progresses forward to the 2008 Test year amount of \$1,426,914.

	2006 EDR to 2006 Actual	2006 Actual to 2007 Forecast	2007 Forecast to 2008 Test
Prior year OM & A	1,159,034	1,361,252	1,426,914
OM & A Cost drivers:			
CUPE contract wage increase @ 3% - current year	18,691	20,764	21,870
CUPE Increase for 2nd year from 2006 EDR - 3%	19,308		
Staff Level changes:			
Meter Reader hired August 2006(Electric Allocation only)	9,000	18,000	
Meter Reading Savings -reduced Lineman time		-8,735	
MEARIE Benefits increase	10,732	10,629	9,691
Billing Clerk - Hired June 6 to replace LTD employee		18,320	
Wage Grid increases for employees		5,088	
Lineman added to staff June 2007		40,000	
Lineman cost for the balance of the 2008 year			35,000
Bad Debt Expense - 2006 portion of \$120K loss	28,468	-28,468	
Wholesale meter credit from Hydro One	-18,152	18,143	
Wholesale meter credit from Hydro One Eliminated			62,400
LDC portion of OMERS disallowed in 2006 EDR	37,442		
Book to Physical Inventory Adjustment	-10,050		
Outside Services- IT Services	15,291		
Outside Services -Hydro One Load Shape	10,200		
Outside Services - Misc.	1,693		
Increase in Property Insurance	9,714		
Extraordinary Item	54,940	-54,940	
Maintenance of PCB Transformers - Outside Services		40,000	
Contract Tree Trimming	9660		
Regulatory Expenses - 1/3 of Rate Application Cost			23,333
Corporate Charge		-11,015	
	1,355,971	1,429,038	1,579,208
Unexplained Difference	5,281	-2,124	7,418
Total OM & A Costs	1,361,252	1,426,914	1,586,626

The increase in operations and maintenance spending are mainly attributed to the following cost drivers: wages and staff changes, elimination of wholesale meter credit from Hydro One, Maintenance of PCB Transformers, and regulatory expenses.

Wages and Staff Changes

Board staff notes that an examination of the above table shows that 76%, or \$170,627, of RSL's total controllable expenses is as a result of a 3% increase to wages as part of the CUPE collective agreement and a series of staff changes. Further discussion of employee compensation can be found later in the submission.

Elimination of Wholesale Meter Credit

In response to Board staff interrogatory 3b, RSL stated that the reason for this increase was that effective November 1, 2007, Hydro One will be invoicing RSL for each of its 11 wholesale meter points. The charge is \$6,200 per year per meter. It should be noted that the wholesale transmission rate was reduced by the unbundling of the wholesale meter costs from the wholesale transmission rates. Hydro One has applied to the Board to have the retail transmission rates charged to RSL reduced but the amount has yet to be approved. The total impact on OM&A is shown as \$62,400, but it is unclear to staff how this amount was calculated. The Applicant may wish to comment on this observation in its reply submission.

Maintenance of PCB Transformers

In 2007, RSL incurred \$40,000 for the testing and replacement of PCB contaminated transformers. However, the amount was not removed for the 2008 test year. It is unclear to Board staff if the amount was a one-time cost or recurring expense. The Applicant may wish to comment on this observation in its reply submission.

Regulatory Expenses

RSL's claim for regulatory expenses amounts to \$23,333. As noted in its response to interrogatory 3b, the amount is for 2008 expenses for the 2008 rate application. Furthermore, the amount indicated is one third of the total expense and will be recovered over three years. Board staff has no concerns with the recovery approach; however, no further details regarding the breakdown of these costs were provided.

Tree Trimming

In 2006, RSL incurred costs of \$9,660 for tree trimming. Board staff notes that the Applicant has not incurred any tree trimming costs in 2007 nor is it clear from its response that it foresees any spending for the 2008 test year and beyond on this item. Board staff invites the Applicant to

clarify whether costs for tree trimming are included in its 2008 test year and to confirm the amount.

Employee Compensation and Benefits

The following Table, prepared by Board staff, summarizes the information on labour costs provided by RSL in Exhibit 4 Tab 2 Schedule 7:

Table 1
Total Compensation and Benefits

	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
Compensation	\$ 627,504	\$ 623,024	\$ 692,126	\$ 728,992
Pension and Benefits	\$ 143,521	\$ 156,896	\$ 179,869	\$ 188,862
Incentive Pay	\$ -	\$ -	\$ -	\$ -
Total Compensation	<u>\$ 771,025</u>	<u>\$ 779,920</u>	<u>\$ 871,995</u>	<u>\$ 917,854</u>
OM&A	\$ 671,045	\$ 736,990	\$ 829,417	\$ 874,211
Capitalized	\$ 99,980	\$ 42,930	\$ 42,578	\$ 43,643
Total Compensation	<u>\$771,025</u>	<u>\$ 779,920</u>	<u>\$ 871,995</u>	<u>\$ 917,854</u>
OM&A	87%	94%	95%	95%
Capitalized	13%	6%	5%	5%

In response to Board staff interrogatory 1, RSL confirmed that it has not made any changes to its capitalization policies or estimates. This is further evidenced in the consistency of the above percentage splits.

In comparing the distributor's labour costs to Total Controllable OM&A, Board staff notes that Labour is approximately 56% of operation costs as indicated in the following Table 2.

Table 2
Total Compensation as a percentage of Total OM&A

	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
OM&A Labour	\$ 671,045	\$ 736,990	\$ 829,417	\$ 874,211
Total Controllable OM&A Expenses	\$ 1,159,034	\$ 1,361,252	\$ 1,426,914	\$ 1,586,626
Labour as a percent of OM&A	57.9%	54.1%	58.1%	55.1%

Board staff prepared the following Table 3 to identify the final value of labour cost drivers to be used in the following cost driver analysis table.

Table 3				
Year over Year Change in Total Compensation				
	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
OM&A	\$ 671,045	\$ 736,990	\$ 829,417	\$ 874,211
Annual Labour Changes		\$ 65,945	\$ 92,427	\$ 44,794
% Change		8.9%	11.1%	5.1%

From Table 3, the significant variance is the 11% increase in the 2007 bridge year. One of the key components of this increase is total salary and wages, which increased by 11% from 2006 to 2008. In response to Board staff interrogatory 9, which asked the utility to explain this increase, RSL stated that the bulk of the increase was due to changes in staffing levels. The utility notes that 4 out of 5 of its linesmen are eligible to retire within the next few years. To ensure an adequate transfer of knowledge, RSL hired an apprentice linesman in preparation for these retirements. RSL also hired a meter reader to replace line staff which were previously doing this work. The utility notes that the cost of hiring a meter reader has been offset by the lower hourly pay grade. Furthermore, an additional employee was hired to replace a billing clerk who was on long term disability for 7 months during 2006. Lastly, RSL claims that a wage grid increase was given to 2 employees, as per the utility's collective agreement.

The second major component of this increase is the two-year increase in average employee benefits of 11%. In response to Board staff interrogatory 10, which asked the utility to justify this increase, RSL stated that the increase was due to increases in health care premiums as well as an increase in number of employees covered, i.e. apprentice linesman and meter reader.

SHARED SERVICES

Background

RSL Holdings Inc. ("RSL Holdings") owns 100% of RSL and Rideau St Lawrence Utilities ("Utilities"). Utilities' principal businesses are providing services to RSL; water and sewer billing to the Town of Prescott and the Villages of Westport, Morrisburg, Iroquois and Cardinal, as well as hot water tank rentals and service. RSL Holdings also owns Rideau St Lawrence Services, the principal business of which is to provide dark fibre and high speed communication, chiefly in Cardinal and Prescott.

When RSL and Utilities were formed in 2000, employees, tools, administrative buildings, office equipment, water heaters and rolling stock (vehicles) were transferred into Utilities so Utilities could provide services to RSL and its municipal shareholders. Prior to their merger in 2000, these services were provided by its four predecessor municipal electric utilities. Subsequently, some services have been transferred back to RSL.

Discussion and Submission

RSL's shared service costs for the 2008 test year of \$1,176,723 are 74% of its total OM&A costs of \$1,586,626. There is also an increase of 17.9% in these costs in the 2008 test year relative to the 2006 actual level.

The Board, in its 2006 Decision, expressed concerns about RSL's shared services stating in part that "In its next rate case, the Applicant must provide detailed financial information on its operations and details of costs incurred by its affiliates in providing services to the Applicant."

Board staff interrogatory 7 asked RSL to provide total annual expenses incurred by shared services. The information provided by RSL is summarized and totalled in the table below prepared by Board staff:

Service	2006 Actual	2007 Bridge	2008 Test	% Increase 2008/2006
Meter Reading	\$58,500	\$50,466	\$51,693	-11.6
Billing	\$148,216	\$173,212	\$178,669	20.5
Collecting	\$30,825	\$31,598	\$32,388	5.1
Administration	\$363,370	\$396,289	\$406,196	11.8
Ops, Maint, & Cap	\$396,919	\$471,471	\$507,777	27.9
Total	\$997,830	\$1,122,976	\$1,176,723	17.9

Staff notes that these costs represent a significant proportion of RSL's total OM&A costs for each of the actual, bridge and test year, and specifically 74% of the OM&A costs in the 2008 test year. Staff also notes that there are significant increases in these costs in the 2008 test year relative to the 2006 actual level, with an overall 17.9% increase and increases of over 20% for both the 'billing' and 'operations, maintenance and capital' services. These services are all purchased from Utilities.

The evidence provided by RSL may not be sufficient to support that its shared services model is cost effective for the regulated utility, and that the proposed 2008 cost recovery would result in just and reasonable rates. While RSL has explained what it does in order to assign RSL its portion of shared services costs, the response to Board staff interrogatory 7 does not clearly state why these approaches would necessarily result in reasonable cost allocations.

For instance, the allocation of billing costs results in an increase of 20% from 2006 to the 2008 test year. RSL states that a key factor used to allocate these costs is what it describes as a “complexity rating,” which assigns hydro bills a factor of 3 and water bills a factor of 1. It appears that this allocation factor multiplied by the number of bills produced allocates 80% of the billing system costs to RSL. Staff is unclear how this allocation procedure takes into account the fixed costs of the billing system, which are equally applicable to both electricity and water bills. The evidence also indicates that “hydro only costs” are added to the allocation,. It is not clear why those costs are not reflected in the complexity rating which assigns hydro bills a factor of 3.

Staff has similar observations where administration costs are concerned. RSL describes the administration costs allocation process in its response to Board staff interrogatory 7 as:

“Total administration costs are determined. From that amount an allowance for the administration of Utilities is calculated based on the contract value of activities in Utilities. A 10% adder for executives is the estimation of the effort required by the executive in the performance as a contract administrator for Utilities contracts. Utilities contracts requiring an executive role will be increased by 10% to cover those costs.”

Staff is unclear how the methodology outlined above adequately accounts for the fixed component of administration costs. It appears that if the contract value in Utilities went down, Utilities would receive a reduced allocation of these costs, while RSL would receive an increased allocation, whether or not fixed cost components could be reduced. Staff is also unclear why only 10% of executive costs would be assigned to Utilities.

With regard to operations, maintenance and capital (OM&C), staff notes that this is the largest service purchased from Utilities, with costs forecast to be \$507,777 in 2008,, an increase of 28% since 2006 . The cost allocation process for OM&C was described in RSL’s response to interrogatory 7 as follows: “Costs are allocated based on work function performed. Costs are allocated based on time sheet tracking.”

Staff notes it is not clear from the evidence the extent to which costs are allocated to other affiliates and how such allocations would impact on RSL. For instance, it is stated in Exhibit 4 Tab 2 Schedule 4 Page 20 that Utilities provides “services to RSL, as well as to its municipal shareholders” but it is not clear how costs are allocated to those shareholders. Also, RSL has another affiliated company, RSL Services, and it is not clear how costs are allocated to this affiliate and how such allocations would impact RSL.

RSL may wish to comment on these observations in its reply submissions.

COST OF CAPITAL

Summary

With respect to the Cost of Capital, RSL's application, as clarified and corrected on the record, complies with the Board's guidelines for Cost of Capital for the purposes of electricity distribution rate-setting, with the exception of and subject to Board staff's comments on the capital structure and long-term debt.

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

RSL has provided its proposed Cost of Capital in Exhibit 6, which is summarized in the table below.

Summary of Capital Structure

Cost of Capital Parameter	RSL's Proposal
Capital Structure	50.0% debt (composed of 46.0% long-term debt and 4.0% short-term debt) and 50.0% equity. This proposal to not transition towards the 60:40 capital structure is discussed below.
Short-Term Debt	4.77%, to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	4.99%, as the forecasted interest rate on a long-term debt (both affiliated to the shareholding municipalities and to new long-term debt). This is further discussed below.
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	6.83% 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.

RSL's approach to cost of capital appears generally to be consistent with the Board Report. However, certain information was sought through discovery to complete, clarify and correct the record. With the explanations and clarifications provided, Board staff submits that RSL's proposal, with the exception of capital structure, is consistent with the Cost of Capital methodology in the Board Report.

Discussion and Submission

Capital Structure

RSL is proposing to retain the 50:50 capital structure and not to transition towards the deemed capital structure of 60:40 in accordance with the guidelines in the Board Report. However, it is incorporating a deemed short-term debt component of 4.0% into the capital structure.

RSL argues that its actual capital structure is 71% equity and 29% debt, and that transitioning towards the 60:40 capital structure would create a wider variance between the actual and deemed capital structure. RSL proposes to retain the 50:50 capital structure and to revisit it at the time of its next rebasing.

In response to Board staff interrogatory #20, RSL states:

The Board Report is a guideline that sets out a generic approach to the cost of capital. Notwithstanding this generic approach, the Board is still legally obligated to consider the specific circumstances of the applicant in setting rates for RSL. In addition, the Board is legally obligated to ensure that RSL's rates allow RSL to recover a reasonable return on its invested capital. In setting just and reasonable rates, the Board is legally obligated to ensure that those rates allow for recovery of a reasonable return on invested capital and recovery of reasonably incurred costs to provide distribution service.

RSL's actual capital structure is about 29% debt and 71% equity as a result of the transfer bylaw that was passed at the time that RSL was incorporated pursuant to the Electricity Act. RSL's rates have been based on a 50:50 deemed capital structure, which means that RSL has not been recovering a return on about 21% of its invested capital. Increasing the amount of deemed debt at this stage will make this issue worse.

The question to be answered then is whether RSL's circumstances justify varying from the guidelines.

It is not clear why RSL has its current capital structure. RSL incorporated in late 2000 under transfer by-law. RSL's Audited Financial Statements, filed pursuant to the Board's Reporting and Record-keeping Requirements and part of the record in its 2006 EDR application (RP-2005-0020 / EB-2005-0414) indicate that RSL has been increasing its equity component. It has been paying down its third-party debt but has been replacing it with retained earnings. RSL has

provided no rationale for this approach to capital financing. Staff notes that this approach results in the use of higher-cost equity financing in place of cheaper debt financing. Higher equity components are often needed to offset higher risk. RSL has not provided evidence to support a higher risk profile.

Board staff notes that there are other electricity distributors that have actual capital structures similar to those of RSL. Some of these distributors, namely Wellington North Power Inc.(EB-2007-0693), and Sioux Lookout Hydro Inc.(EB-2007-0785) have 2008 Cost of Service applications currently before the Board, and these distributors are proposing to comply with the Board's guideline to transition to the 60:40 capital structure. Similar to RSL, these distributors anticipate acquiring a capital structure closer to 60:40 in the near term through the use of debt financing for major projects, such as Smart Meter implementation.

RSL has provided no justification (i.e., with respect to specific business risk that it faces that justifies its currently high equity ratio) for its current structure, and why the 50:50 capital structure should be retained.

Board staff observes that the statement "RSL has not been recovering a return on about 21% of its invested capital" is unsubstantiated. For rate-setting purposes, the 21% of additional actual equity has been treated as debt. The allowed debt rate is lower than the approved ROE, but there has been some return on this equity built into approved rates. Further, as discussed above, RSL has been increasing the retained earnings and hence equity over time. If RSL's shareholders were concerned over the achieved return on equity, it is unclear why they have not taken the earnings as dividends (and re-invest elsewhere), and RSL could, presumably, take on additional debt financing.

RSL has not demonstrated why the Board should deviate from the guidelines and allow RSL to retain a deemed 50:50 capital structure until the next time that RSL rebases. RSL's capitalization is a matter that is under management's control to some extent, and RSL has been increasing its equity portion since incorporation. It has not demonstrated why this approach of using more expensive equity in place of debt is advantageous and prudent. It has shown no reason, such as specific business risk faced by RSL that would justify treatment different from that of other distributors that are similarly structured but which are adhering to the guidelines in the Board Report.

CAPITAL EXPENDITURES

Background

RSL is projecting 2008 capital expenditures of \$347,400. This represents a decrease of approximately 16.6% as compared to 2007 projected capital expenditures of \$416,538 and an increase of 37.4% from the 2006 actual level of \$252,818. The capital expenditure amounts for 2006 to 2008 do not include expenditures for smart meters.

Discussion and Submission

Board staff notes that the information on the rate base in the filing is essentially complete. Supplementary information on wholesale meter service costs, trends and history were properly supplied with confirmation of the rate base definition.

Increase in 2008 Capital Expenditures

Table 1 below was provided as part of RSL's response to Board Staff Interrogatory 15:

Table 1

in 000's

Year	2002	2003	2004	2005	2006	2007	2008
Net Income	\$ 123	\$ 256	\$ 329	\$ 130	\$ 122	\$ 57	\$ 259
Actual ROE%	4.69%	9.05%	10.60%	4.14%	3.86%	1.81%	8.68%
Allowed ROE%	3.29%	3.29%	3.29%	9.00%	9.00%	9.00%	8.68%
Retained Earnings	\$ 123	\$ 323	\$ 595	\$ 622	\$ 640	\$ 594	\$ 745
Dividends to Shareholder	\$ -	\$ 57	\$ 57	\$ 103	\$ 103	\$ 103	\$ 103
Total Capital expenditures	\$ 168	\$ 150	\$ 364	\$ 217	\$ 249	\$ 417	\$ 347

Capital expenditures have increased significantly in 2007. However, they are projected to decrease in 2008. RSL stated that the drivers for the relatively large percentage increase in capital expenditures in 2007 are due to truck replacement and, in 2008, are due to wholesale metering point and software upgrades.

Exhibit 2 Tab 3 Schedule 3 Page 35 states that one of the major expenditures in 2008 is for wholesale metering point upgrades. RSL's response to VECC interrogatory 8 advises that market rule changes made June 4, 2003 provided meter market participants with various options with respect to their wholesale meter points upon meter seal expiry. RSL decided to upgrade all wholesale meter points to the standard provided by IESO. In 2007, RSL budgeted

\$13,000 to upgrade the wholesale metering point at Prescott East; however in 2008, the budget for two metering points (Cardinal and Iroquois) is \$62,400. The pre-filed evidence does not provide an explanation for the increase.

In response to Board staff interrogatory 19, RSL identified two projects, truck replacement and the interval meter program, which were carried over from 2007 to 2008. Staff notes that both projects are included in the 2007 Rate Base. Staff invites comment from RSL and parties as to whether or not there is a need to make an adjustment in revenue requirement related to the timing of the postponement of these two capital projects. For example, such adjustment might be subjected to the half-year rule.

Assessment of Asset Condition and Asset Management Plan

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

LOAD FORECASTING

Background

In Exhibit 3 of the Application, the development of the Applicant's customer count and load forecasts are discussed. Utilizing the 2002 to 2006 historical data, the 2007 actual customer count was projected to establish the 2008 test year customer count 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.

The Applicant provided additional information in response to Board staff and VECC forecasting interrogatories.

Discussion and Submission

Methodology and Model

The Applicant has provided a comprehensive explanation of the trend in customer connections experienced during the 2002-2006 period and the extrapolation of that trend to 2008 for each of its customer classes. With regard to the General Service > 50 kW class, the Applicant noted the loss of one large customer in 2006; while this has a negligible effect on customer count it has, as discussed later, a significant impact on the resulting kWh load. One of the complications

in projecting the Applicant's number of customers in the Residential class was the 2005 conversion of various residences from bulk metering to individual meters.

Turning to its kWh volume forecasts, the Applicant explained that for its weather sensitive load, it 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 Hydro One. The Applicant explained in Exhibit 3 - and confirmed in response to Board Staff interrogatory 26 - that the 2004-based retail NAC was assumed to be applicable in the future and was used without change as the basis for the load forecasts; the single exception to this was the GS>50 kW class where the loss of a large customer in 2006 was taken into account. The forecasted kWh loads were determined by multiplying the 2004-based retail NAC by the forecasted number of customers in the forecast year.

Board staff observes that the methodology chosen utilizes only a single year of weather-normalized historical load to determine the future load. Board staff note that assuming that the retail NAC value remains constant over a number of years may not be a robust assumption. This is the equivalent of stating that no CDM improvement has occurred during the past few years and none is expected in the immediate future. The effect of the constant assumption could be an error in the estimate of the weather sensitive load by a few percent and correspondingly underestimate the required rates.

The Applicant presented its kW forecast for those customer classes that use this charge determinant. No rationale is presented for the determination of these values.

Weather Normalization

The Applicant noted that Hydro One carried out the weather normalization that was performed, albeit only for the year 2004. It is not clear whether Hydro One used the weather normalization method approved by the Board in the Distribution Cost Allocation Review (EB-2005-0317) and Hydro One's own 2006 Distribution Rate case (RP-2005-0020/EB-2005-0378). The Applicant may wish to clarify this in its reply submission.

Results

The Applicant's forecast shows a 0.2% annual average growth in customer numbers from 2006 to the 2008 Test Year which is lower than the historical 2002-2006 historical growth of 0.5% p.a. Board staff observes that the forecasted growth in customer numbers is fairly consistent with what one might expect based on the input data.

The Applicant's forecast shows a negative 0.3% annual average kWh load change from 2006 to the 2008 Test Year. [Exhibit 3, Tab 2, Schedule 1, Page 8] This compares with an average annual kWh load change of negative 1.2% during the 2002 to 2006 period. [Response to Board Staff interrogatory number 28]

As noted earlier, Board staff has noted that using the 2004-based retail NAC values without change for 2008 is likely to result in a less accurate load forecast. In response to Board staff interrogatory 28, the Applicant developed an alternative forecast that took weather normalization fully into account for each of the years 2002 to 2006. Board staff's analysis of the results of the interrogatory concluded that the Applicant's filed forecast is likely to be a few percent higher than the data would suggest.

LINE LOSSES

Background

In response to Board staff interrogatory 35, RSL affirmed that the proposed total loss factor ("TLF") for the test year 2008 is 1.0774, which is marginally higher than the approved TLF of 1.0772 for 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 1.0725 and is based on a 4-yr average of actual DLF's for the period 2003 to 2006. Since RSL is embedded within the Hydro One distribution system, this DLF (as indicated in Ex.4, Tab2, Sch.9, p.27) includes losses (3.4%) that occur in the Hydro One distribution system. Losses that occur specifically in the RSL system have been on a downward trend in the 3-yr period from 2004 to 2006 and the projection for 2008 is the difference between 7.25% and 3.40%, i.e. 3.85%.

Board staff observes that RSL's proposed TLF for the test year 2008 is based on a DLF that is lower than actual DLF's in 3 years of the 4-yr period (2003 to 2006). Board staff notes the downward trend in losses incurred in the RSL system.

COST ALLOCATION AND RATE DESIGN

LOW VOLTAGE COSTS

Background

The application includes \$168,161 for the forecast LV charges by its host distributor Hydro One. The approved amount for 2006 was \$166,396. In its response to Board staff interrogatory 32, the Applicant states that actual costs from LV charges were \$148,199 in 2006, and \$224,303 in 2007.

Discussion and Submission

Staff notes that the forecast cost is a small escalation from the previous approved amount. However, it is significantly higher than the 2006 actual costs and considerably lower than the 2007 costs. RSL sums up the response to the interrogatory by expressing concern that its forecast may be too low.

Staff notes that Hydro One has an application currently with the Board that includes lower rates for its LV service, which would reduce the effects of a low forecast. The final reconciliation of a forecast that is too low is captured in a variance account.

CUSTOMER RECLASSIFICATION

Background

The Applicant proposes to discontinue the Westport Sewage Treatment Plant class, and to include the single customer in the General Service > 50 kW class. Billing load information is provided for four years showing the customer's demand at approximately 200 kW per month (reference: Exhibit 9 / Tab 1 / Schedule 7 / p. 10). A cost allocation model (Run 3) is available using the proposed class definitions.

Runs of the cost allocation model with the existing classification structure (Runs 1 and 2) show a revenue to cost ratio for the Westport Sewage Treatment Plant of 16.43% (reference: Exhibit 8 / Tab 1 / Schedule 3 / p. 5). The calculated under-contribution is \$5073 per year.

Board staff interrogatory 33 asked for an impact calculation for the affected customer. The response included three calculations at different volumes, which yielded estimated total bill impacts ranging from a decrease of 4.8% up to an increase of 146%. Based on an analysis of

the billing load, the third impact calculation appears to resemble the actual customer's volume and load factor, and the calculated total bill impact is a 30% increase.

Discussion and Submission

The Westport Sewage Treatment Plant class originated as a time-of-use class, described in the application as being designed to track generation cost differentials when electricity rates were integrated to include generation and transmission costs along with distribution. The customer had an unusual pattern of usage and would have been affected badly by standard rates at that time. The existing approved rate, based on kWh, is unusual for a customer of this size. The typical approach has been for this type of customer to be on a KW rate determinant.

The billing information shows that the customer is in the typical size range for its proposed new class. However, analysis of the billing data provided shows that the customer has a rather low load factor, compared what would generally be expected of a larger General Class customer. In general, this would suggest that being changed from a kWh volumetric rate to a kW rate would have an unfavourable impact on the customer. Furthermore, the proposed monthly fixed charge is more than a five-fold increase from its existing charge.

Of the three impact calculations provided, the third one appears to be at approximately the scale and load factor of the customer. Unfortunately, the calculation without explanation contains a different commodity cost of power in the "before and after" scenarios. Correcting this anomaly, staff has calculated that the total bill impact on this customer would be approximately \$12,000 annually, which is an increase of 43%. RSL may wish to verify or correct staff's estimate.

Some considerable impact on this customer is to be expected even if there is no re-classification, because of the cost allocation results (Runs 1 and 2) and a general increase in the distribution rates. However, it appears to staff that the proposed effective increase would 1) match the general increase, and 2) correct the under-contribution in one step. However, the increase appears to be greater than what is necessary to compensate for the first two factors.

Board staff submits that this impact is greater than 10% and no rate mitigation mechanism has been proposed.

REVENUE TO COST RATIOS

Background

RSL included the ratios from its Informational Filing (EB-2007-0003). The ratios included in the following table are from Run 3, which assumes that the Westport Sewage Treatment Plant is included in the GS > 50 kW class. It is more straightforward to compare the ratios that result from the proposed rates with Run 3, because the proposal assumes that the separate class has been discontinued.

The application also includes the ratios where this customer is a separate class (reference: Exhibit 8 / Tab 1 / Schedule 2 / p. 5). In Runs 1 and 2, the revenue to cost ratio for this single-customer class is 16.43%, and for the GS > 50 kW class, without this customer, that ratio is 150.38% in place of 148.27% shown in the table.

The application included proposed ratios. However, the Applicant made some adjustments to its calculations to ensure consistency between the cost allocation model and the calculation of ratios in the application. The initial proposed ratios are shown in the second column of data, and the revised calculation is shown in the third data column.

For ease of comparison, the Board's policy range is shown in the final column.

RSL Revenue to Cost Ratios

%	Information al Filing Run 3	Application: Exhibit 9 / Tab 1 / Schedule 1 / p. 2	Revised Proposal: Response to Staff Interrogatory # 21(g)	Board Policy Range
Customer Class				
Residential	105.24	103.00	104.07	85 – 115
GS < 50 kW	65.09	91.36	64.76	80 – 120
GS > 50 kW	148.27	118.89	153.48	80 – 180
Street Lights	41.61	49.84	42.24	70 – 120
Sentinel Lights	49.08	79.47	48.68	70 – 120
USL	152.26	106.93	130.45	80 -- 120

Discussion and Submission

Board staff points out that the ratio moved further from the 100% point for every class with the recalculation, that is between the second and third data columns. Three of the ratios have moved from within the Board's policy range to outside the range. This is an unexpected outcome from the interrogatory. The logic behind the recalculation of the ratios is not apparent and no explanation was provided by RSL.

Board staff notes that four classes have proposed ratios outside the Board's policy range, three on the low side, and one on the high side. The one on the high side is comparatively small; therefore, rebalancing the class revenues will imply a decrease in rates to the classes that are within range but have ratios above 100%.

RATE DESIGN

Background

The monthly service charges approved for 2006 are compared with the ceiling and floor calculations from the cost allocation filing, at Exhibit 9 / Tab 1 / Schedule 3 / p. 3, first three columns of data. The proposed charge is in the column beside that.

The proposed changes to the monthly service charges can be compared with the changes in the volumetric charges, in percentage terms, at Exhibit 9 / Tab 1 / Schedule 7 / starting at p. 13.

Discussion and Submission

The 2006 charge was outside the ceiling / floor range for only one class, GS > 50 kW. The proposed charge is lower than the existing approved charge for that class. For each class, the proposed increase in the monthly service charge is lower in percentage terms than the corresponding volumetric charge.

RETAIL TRANSMISSION SERVICE RATES

Background

RSL is an embedded distributor. It has stated that it will file an addendum to its application with revised Retail Transmission Service Rates when more information is available concerning its costs with its host distributor Hydro One. (Exhibit 1 / Tab 1 / Schedule 7 / p. 36)

Hydro One, the host distributor, has applied for changes in its Retail Transmission Service Charges (EB-2007-0681, Exhibit G1 / Tab 6 / Schedule 1 / Table 2 / ST Class).

RSL has negative balances in its variance accounts that are related to Transmission. (Exhibit 5 / Tab 1 / Schedule 2 / p. 9, accounts 1584 and 1586).

Discussion and Submission

Board staff submits that there are a number of issues to be decided with respect to Hydro One's application that could affect the ultimate transmission costs paid by RSL. Nevertheless, staff is unsure why RSL did not assume that the rates proposed by Hydro One will prevail, and that it would estimate its forecast transmission costs accordingly and propose Retail Transmission Service Rates to recover the forecast costs.

The fact that RSL has negative balances in the variance accounts may suggest that its own current approved Retail Transmission Service Rates would continue to under-collect.

Board staff recognizes that these adjustments work in opposite directions. It is unclear if the effects would cancel out for both Network and Connection service. RSL is asked to comment on the impacts of making an adjustment to these rates.

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 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 income tax rate for 2008 is 11%. The effective Ontario rate is 5.5%, after deduction of the small business credit.

Discussion and Submission

Board staff observes that RSL has not included the change in federal income tax in the calculation of its PILs allowance.

DEFERRAL AND VARIANCE ACCOUNTS

Background

RSL is proposing to:

- clear the balances of certain deferral and variance accounts; and
- establish a new deferral account for future capital projects.

Request for Disposition

RSL is requesting that the following accounts and balances as per Exhibit 5, Tab 1, Schedule 3, Page 11 and the response to Board Staff Interrogatory 41 be cleared for disposition as of December 31, 2006 balances plus interest to April 30, 2008.

1508	Other Regulatory Assets, \$21,184
1518	RCVA – Retail, \$8,318
1548	RCVA – STR, \$17,716
1550	LV Variance, \$49,547
1562	Deferred Payments in Lieu of Taxes, \$37,790
1580	RSVA – Wholesale Market Service Charge, (\$36,076)
1582	RSVA – One Time Wholesale Market Service, \$7,214
1584	RSVA – Retail Transmission Network Charges, (\$61,910)
1586	RSVA – Retail Transmission Connection Charges, (\$44,124)
1588	RSVA – Power, \$119,152

Total: \$118,813

The applicant's proposal is to collect these amounts from rate payers over 3 years beginning May 1, 2008 via rate riders as per Exhibit 5, Tab1, Schedule 3, Page 11.

Discussion and Submission

Continuation of Deferral and Variance Accounts

The Board has already approved and defined, through the APH and associated letters, the period and functionality of deferral and variance accounts in the electricity distribution sector. Therefore, staff question the necessity for the applicant to request permission to continue using open deferral and variance accounts as per the APH.

Request for New Deferral Account

Future Capital Projects Deferral Account

In response to Board staff Interrogatory 36, RSL is requesting this deferral account “to collect the costs of capital expenditures incurred during non-rebasing years for consideration for disposal by the Board at the time of the next rebasing.” The annual cost of service items to be included will be depreciation and return but not PILs. The net book value of those assets will also be included in the deferral account. It is unclear why the company is proposing to include the annual cost of service and the net book value of the assets in the deferral account. This account should only capture the incremental cost of service for the period between re-basing years. Assets should be left in rate base at their net fixed asset value until the next rebasing.

Board Staff question how this account will be used.

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. RSL did not provide the total expected costs or calculations in its response to Board Staff Interrogatory 36, so materiality cannot be determined.

Board staff notes that the request to establish this deferral account is analogous to including a capital investment factor in an IRM year. The mechanistic calculation for Third Generation IRM has not been finalized, as it is currently before the Board, and may include a capital component.

Board staff seeks comments as to whether RSL has sufficiently justified the need for a new account. It would be helpful for parties to comment on the new account proposed and provide reasons.

Treatment of 1562

RSL is also requesting for disposition of Account 1562. Board staff discovered an error made by RSL in accounting for 1562 during the interrogatory phase, which the Applicant had corrected in its application. The Applicant had erroneously continued to use account 1562 after April 30, 2006, even though the account should have been closed at that date. These findings indicate that RSL was not correctly accounting the deferral accounts related to PILs in its books as per instructions provided in the Accounting Procedures Handbook and associated Frequently Asked Questions before the initiation of the rate case.

This account was created as part of the original Performance Based Regulation plan in 2001. The tax years covered by this account are still subject to review and reassessments by the Canada Revenue Agency, which can have material impact on the balances of this account. The Board has not yet established a policy or methodology for clearing this account. A more in depth examination of this account may be required to determine the accuracy of the balance proposed for disposition.

Treatment of RCVAs and RSVAs

The applicant is applying for disposition of RCVA and RSVA accounts. The Board has recently announced that it intends to develop a streamlined process for account 1588 RSVA Power and possibly include the remainder of the RCVA and RSVA accounts as part of this process. The Board may wish to consider the impact of ordering disposition of these accounts upon that process.

Treatment of Account 1508

In the response to Board Staff Interrogatory 37, RSL stated that “the balance in account 1508 is the variance between the OEB annual costs assessment fees previously captured in 2001 rates and the amounts charged in 2004 and subsequent years. This balance has been improved at a rate of interest at 5.75% per annum.” Board staff has three observations regarding this account:

1. As per the Accounting Procedures Handbook, balances can be accrued up to April 30, 2006 in account 1508 for these types of costs. It is not clear whether RSL ceased this accrual as of April 30, 2006.
2. It is not clear whether the company is comparing its 2004/05 and 2005/06 invoices to the 1999/2000 OEB cost assessment.
3. The Board stated in its letter to LDCs on November 28, 2006 that the Board prescribed interest rate for deferral and variance accounts should be used effective May 1, 2006, for account 1508, sub account OEB Cost Assessments, as listed on Appendix B of the letter.

It is unclear whether the Board-prescribed rate was used from May 1, 2006 for this account.

RSL may wish to comment on these observations in its reply submission.

~ All of which is respectfully submitted ~