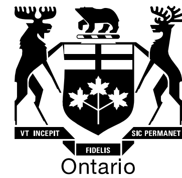
Ontario Energy Board | **Commission de l’énergie de l’Ontario**



EB-2007-0704

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Hydro 2000 Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2008.

BEFORE: Paul Vlahos
Presiding Member

Bill Rupert
Member

DECISION

Hydro 2000 Inc. (“Hydro 2000” or “the Company”) is a licensed distributor of electricity providing service to consumers within the limits of the former villages of Alfred and Plantagenet. Hydro 2000 filed an application with the Ontario Energy Board, received on September 13, 2007, under section 78 of the *Ontario Energy Board Act*, *1998*, seeking approval for changes to the rates that it charges for electricity distribution, to be effective May 1, 2008.

Hydro 2000 is one of over 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010. On May 4, 2007, as part of the plan, the Board indicated that Hydro 2000 would be one of the electricity distributors to have its rates rebased in 2008. Accordingly, Hydro 2000 filed a cost of service application based on 2008 as the forward test year.

The Board issued a Notice of Application and Hearing dated September 28, 2007. The Vulnerable Energy Consumers Coalition ("VECC") and the School Energy Coalition ("SEC") intervened in the proceeding. The evidence in the application was tested through written interrogatories from Board staff and intervenors. Board staff and intervenors filed written submissions and Hydro 2000 filed written reply submissions. The submissions phase was completed on January 4, 2008.

The full record is available at the Board's offices. The Board has chosen to summarize the record to the extent necessary to provide context to its findings.

In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year, by electricity distributors. The Board found that Hydro 2000's application, while generally complying with the filing requirements, was unclear in several areas and difficult to follow. The lack of quality and clarity of responses to interrogatories and the Company's reply submission has caused the Board to spend a disproportionate amount of effort to understand the application and the Company's positions on certain issues, as they kept changing. The Board expects the Company to do a better job in its next cost of service application and to familiarize itself with the Board's regulatory processes for setting rates.

RATE BASE

For a distributor, rate base consists of net fixed assets (gross fixed assets minus accumulated depreciation and any contributed capital) plus an allowance for cash working capital. Net fixed assets are determined as the average of the beginning and the end year values, and reflect capital additions for the test year. The Board's guidelines stipulate a level of cash working capital equal to 15% of the sum of OM&A expenses and the cost of power. The cost of power consists of the commodity cost of power and transmission charges. Hydro 2000, being an embedded distributor, has transmission charges levied by Hydro 2000's host distributor, Hydro One Networks Inc. ("Hydro One Distribution"). These are comprised of charges by Hydro One Transmission and by Hydro One Distribution's own transmission charges, the latter known as Low Voltage ("LV") charges.

In its filing, the Company had proposed a rate base of $735,075, consisting of $386,443 in net fixed assets and $348,632 in cash working capital.

VECC questioned Hydro 2000's assumption that the transmission connection charges from Hydro One Distribution would increase by seven per cent. VECC submitted that this charge would be expected to increase with Hydro 2000's load growth unless Hydro One Distribution adjusts its transmission service charges. In that regard, VECC noted that as a result of the Board's EB-2007-0759 decision regarding uniform transmission rates, transmission costs to Hydro One Distribution should decrease effective November 1, 2007. VECC requested that Hydro 2000 clarify its assumptions on the transmission connection charge.

In its reply, Hydro 2000 noted that the rates charged by Hydro One Distribution to embedded distributors like Hydro 2000 have yet to change.

Board Findings

The Board accepts Hydro 2000's proposed capital expenditures for purposes of setting 2008 rates.

Elsewhere in this Decision, the Board directs Hydro 2000 to adjust its retail transmission charges by certain percentages. The Board directs Hydro 2000 to adjust its calculation of cash working capital to reflect the adjusted retail transmission service charges.

OPERATING COSTS

Operating costs include OM&A expenses, depreciation and amortization expenses, taxes, and any transformer allowance payments to customers. Taxes are of two types: capital and property taxes, and Payments in Lieu (PILs) of Taxes payable to the Ontario Government, a proxy for taxes that would have to be paid if the distributor were not owned by a municipality or Government.

Operating costs also include interest charges on the Company's debt. Interest costs are dealt with elsewhere in this Decision.

The provision for PILs taxes for ratemaking purposes is determined after the Board makes its findings on other relevant parts of the Company's filings. This determination

will be made by the Company as part of its Draft Rate Order. In that regard, the Board notes that the Company has used the most recent changed rates for income tax and capital cost allowances.

The issues dealt with below are: OM&A – Incremental Billing System Costs; OM&A – Regulatory Costs; and, Low Voltage Costs.

OM&A – Incremental Billing System Costs

In late 2006, Hydro 2000's billing system provider (Advanced Infinity Company) was purchased by the Harris Co., which advised Hydro 2000 that it would not support the Advanced system going forward. Consequently, through its host provider (Ottawa River Power), Hydro 2000 replaced the Advanced system with Harris Co.'s NorthStar CIS version 6.2. Harris Co. charged only the data conversion costs totaling $57,200, which Hydro 2000 has included in its 2008 rate base. Hydro 2000 also forecast additional OM&A costs of $15,073 annually for licence and Electronic Business Transaction costs.

Board staff submitted that it is unclear whether the $15,073 of OM&A costs are incremental and invited Hydro 2000 to affirm that these costs are not in fact replacing other similar on-going costs related to the Advanced billing system that are currently embedded in Hydro 2000's revenue requirement. VECC agreed with staff's concern.

In reply, the Company advised that the incremental costs are only $6,907. However, Hydro 2000 noted that a new salary grid was approved in December 2007 which will result in an additional $8,136 in cost for 2008 which was not included in its evidence up to this point.

Board Findings

The Board accepts Hydro 2000's revised total of $6,907 relating to the incremental billing system costs, not the $15,073 amount included in its original filing. Upon filing its Draft Rate Order, Hydro 2000 should revise its revenue requirement to remove the non-incremental portion identified in Hydro 2000's reply submission as $8,166.

However, the Board will not accept the $8,136 of new costs introduced by Hydro 2000 in its reply submission. An integral part of the hearing process is the examination and testing of evidence by the intervenors and Board staff. To ensure that the intervenors

and Board staff have that opportunity prior to the filing of written argument, an applicant is required to disclose and file the evidence on which it intends to rely by the time interrogatories are completed. The evidentiary portion of the subject proceeding had closed by the time parties filed their arguments. To allow these costs at this juncture would be unfair for the remaining parties who have not had an opportunity to test and comment on the new proposed costs.

OM&A – Regulatory Costs

In its original submission, Hydro 2000 proposed $197,631 for Administrative and General Expenses for the 2008 test year, representing an increase of $61,290, or 45%, over the 2007 bridge year. That increase was primarily due to a $60,000 amount related to the preparation and completion of the Company's 2008 cost of service application and was comprised of: $30,000 for services from Elenchus Research Associates, $19,000 for services from Deloitte, and $11,000 for anticipated intervenor cost awards and for consulting costs to be incurred prior to the completion of the rates proceeding.

In response to a Board staff interrogatory, Hydro 2000 revised its request. It stated that its revised application excluded the $60,000 amount from test year expenses and that it would record regulatory expenses in deferral account 1508, to be recovered by way of a rate rider over the three-year period ending April 30, 2010. Board staff noted that although Hydro 2000 stated that it removed $60,000 of regulatory costs from OM&A, it appears that only approximately $40,000 had been included in account 1508. Board staff invited Hydro 2000 to clarify why it has not requested all of its originally stated costs in its revised filing.

Board staff also expressed concerns with the recovery of these amounts by way of deferral account disposition as the final amount of this deferred amount is unknown. Board staff noted that, currently, the balance of this sub-account is $39,573 plus associated interest. Regulatory expenses are normally associated with account 5655, Regulatory Expenses. If Hydro 2000 receives approval to dispose of the balances by way of a variance account, the proper account to record such costs is account 1525, Miscellaneous Deferred Debits, and not account 1508, Other Regulatory Assets – Sub-account OEB Cost Assessment.

VECC stated that it assumes that the $40,000 represents the amount spent to date and requested an explanation from Hydro 2000. VECC submitted that the costs associated

with this cost of service application should be amortized over three years, given that regulatory costs in 2009 and 2010 should be significantly lower than in 2008. VECC submitted that the appropriate recovery should be through a rate rider.

In reply, Hydro 2000 stated that it included $40,000 in account 1508, this amount being the actual costs up to November 15, 2007, and that the other expenses will be recorded as they are incurred in the "proper variance account".

In its reply, Hydro 2000 also appeared to change its position by proposing two methods of disposing of the regulatory expenses associated with the 2008 rates proceeding. The first method would be to record in account 5655 all budgeted costs (i.e. $60,000) and then dispose off them over three years. The second method would be to retain the variance account approach but record the costs in account 1525 as per Board staff's suggestion.

Board Findings

The Board is satisfied that Hydro 2000's forecast of $60,000 is reasonable based on the evidence regarding the amount of actual expenditures as of November 15, 2007. The Board approves an amount of $60,000 for regulatory costs. However, the Board agrees with VECC that these costs should be recovered over three years given the fact that regulatory costs will be less in the years leading up to Hydro 2000's next re-basing. The Board also finds that variance account treatment is not appropriate in this case given the Board's practice of generally not allowing recovery of forecast variance account balances post December 31, 2006 (as described later in this Decision under Deferral and Variance Accounts). The Board will, therefore, allow one third in the 2008 OM&A test year forecast. On the expectation that the 2008 approved revenue requirement will remain in place for three years, Hydro 2000 will have recovered the full amount by the time it re-bases in 2011. To allow for the time value of money, the Board will allow an amount of $21,000 to be reflected in 2008 rates.

The Board will also allow Hydro 2000 to increase its 2008 forecast OM&A by $3,000 in respect of an amount that was incorrectly included in deferral account 1508, as noted later in this decision under "Deferral and Variance Accounts."

Low Voltage (LV) Costs

Hydro 2000 is an embedded distributor, served by its host distributor Hydro One Distribution. The LV costs approved for inclusion in 2006 base rates totalled $106,241. In its November 19, 2007 filing, Hydro 2000 revised its low voltage calculation for the 2008 test year from $121,000 to $143,000. The Company indicated that it had better information on the actual costs for 2007 by the time it responded to interrogatories and believed it was prudent to update the LV forecast.

Board Findings

The Board notes that Hydro 2000 provided a detailed calculation of the updated LV value and accepts $143,000 for the purposes of setting 2008 rates.

OPERATING REVENUES

For purposes of setting base distribution rates for the electricity sector, the Board determines the operating revenues from sales and subtracts revenues associated with certain charges by the distributor other than base rates. The Board deals below with the issue of Load Forecast.

Load Forecast

To forecast load for 2008, Hydro 2000 first calculated a weather normalized use per customer for each customer class (in either kWh or kW) by using 2004 weather normalized load data. That 2004 data was developed by Hydro One Networks Inc. for Hydro 2000 as part of the Board's cost allocation initiative[1]. Hydro 2000 then multiplied forecast 2008 customer count for each class by the weather normalized per customer use.

VECC submitted that Hydro 2000 needs to clarify whether the normalized average consumption includes or excludes losses. VECC noted that part of the evidence would suggest that normalized average consumption refers to wholesale values (measured at point of delivery to Hydro 2000 and therefore inclusive of losses), but in other parts such consumption refers to retail values.

[1] This initiative began in 2002 and culminated in the Board Report "Application of Cost Allocation for Electricity Distributors", November 28, 2007.

In reply, Hydro 2000 stated that, in its opinion, the Hydro One Networks Inc. methodology overestimates load. Hydro 2000 stated: “Based on 2007 actual figures the load forecast calculated by Hydro 2000 is more accurate than the load forecast of HONI which is off by approximately 7%. Hydro 2000 Load Forecast prediction is about 0.5% off”. Notwithstanding that statement, it appears that the proposed rates, as revised in the November 19, 2007 filing, reflect the Hydro One methodology.

Hydro 2000 did not address VECC’s concerns regarding losses.

Board Findings

The Board will accept the use of the 2004 weather normalized data prepared by Hydro One Networks Inc. for setting Hydro 2000’s 2008 rates. Notwithstanding Hydro 2000’s contention that its own forecast may be more accurate, it appears that Hydro 2000 has not requested to change its application in this regard. As it stands following the close of the evidentiary record, Hydro 2000’s proposal is to maintain the use of Hydro One Networks Inc.’s methodology for the purpose of setting 2008 rates.

With respect to VECC’s concern regarding the treatment of losses, the Board agrees that Hydro 2000’s evidence and other submissions on its load forecast are not clear. Based on Exhibit 3, Tab 2, Schedule 1, page 4 from Hydro 2000’s November 19, 2007 filing, it appears that Hydro 2000’s load forecast for 2008 is measured at point of delivery to the customer and, therefore, appropriately excludes losses. Should the Board’s understanding about Hydro 2000’s treatment of losses be incorrect, the Board expects Hydro 2000 to adjust its forecast to exclude losses when preparing the Draft Rate Order.

CAPITALIZATION/COST OF CAPITAL

Hydro 2000 reports one long-term debt instrument, a note with the Township of Alfred and Plantagenet. VECC noted that Hydro 2000 has quoted a rate of 5.8% in its application and in response to an interrogatory with respect to the note, but in its 2006 financial statements the cost of the note is 5.5%. VECC submitted that, unless Hydro 2000 can provide a satisfactory explanation, the 5.5% rate should apply.

In reply, Hydro 2000 confirmed that the interest rate is 5.5%.

With respect to other aspects of capitalization and the cost of capital, through the record of the proceeding Hydro 2000 affirmed that it would comply with the requirements of 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. By this, Hydro 2000 proposed to use a deemed capital structure of 53.3% debt, composed of 49.3% long-term debt and 4.0% short-term debt, and 46.7% equity.

Board Findings

The Board notes Hydro 2000's correction of its long-term debt rate and expects the Company to use the 5.5% rate for purposes of calculating the revenue requirement upon filing its Draft Rate Order.

The Board approves Hydro 2000's capitalization for rate-setting purposes as it is consistent with the Board's Cost of Capital guidelines applicable to electricity distributors.

In preparing the Draft Rate Order, Hydro 2000 shall update its revenue requirement to reflect the updated ROE and deemed short-term debt rate as set by the Board under "Implementation Matters" at the end of this Decision.

COST ALLOCATION AND RATE DESIGN

Allocation of LV Costs

The LV costs approved for 2006 were allocated to rate classes in proportion to the revenue from the Retail Transmission Rate – Connection.

Board staff noted that no information was provided in response to interrogatories on how the forecast 2008 LV costs would be allocated to rate classes. Board staff noted that it appears that the LV costs have been erroneously allocated on the same basis as other distribution-related costs and that Hydro 2000 should address this in its reply submission. VECC agreed with Board staff's submissions.

In reply, Hydro 2000 re-submitted allocations of LV costs on the basis of the Board's 2006 method.

Board Findings

The Board accepts Hydro 2000's revised allocations in its reply submission and notes that they are consistent with the Board's methodology of allocating LV costs to the classes.

Smart Meter Adder

Hydro 2000's proposed rates include a Smart Meter adder of $0.26 to the monthly fixed charge. This charge was previously approved by the Board to fund activities toward the installation of smart meters.

VECC submitted that Hydro 2000 has erroneously treated the revenue from the adder as a distribution cost for purposes of determining and adjusting its 2008 revenue to cost ratios.

Board Findings

The Board notes that, in its reply submission, Hydro 2000 provided revised revenue to cost ratios excluding the fixed monthly rate adder, which is appropriate. The Board finds that the continuation of the Smart Meter rate adder, as proposed by Hydro 2000 in its November 19, 2007 filing is reasonable.

Revenue to Costs Ratios

Table 1 below shows various revenue to cost ratios (in percentages) filed by Hydro 2000 in this proceeding, and the Board's target range of ratios.

- Column A – Informational Filing based on data in its 2006 rates case (the revenue requirement allocated in the Informational Filing did not include LV costs).
- Column B – Interrogatory response showing ratios derived from the proposed 2008 rates.
- Column C – Board target ranges as set out in the Board Report, *Application of Cost Allocation for Electricity Distributors*, issued November 28, 2007.

Table 1: Revenue to Cost Ratios

Customer Class	2006 Informational Filing Run 2 [A]	Proposed Rates per Original Application [B]	Board Target Ranges [C]
Residential	115.0	108.8	85 - 115
GS < 50 kW	81.4	88.2	80 - 120
GS > 50 kW	94.5	108.4	80 - 180
Unmetered Scattered Load (USL)	10.4	11.3	80 - 120
Street lighting	50.3	71.8	70 - 120

To allocate the 2008 revenue requirement to the rate classes, Hydro 2000 used the percentage allocation of revenue requirement from its 2006 Cost Allocation filing, which was based on 2004 data.

Board staff noted that, with the exception of the Unmetered Scattered Load ("USL") class, the ratios are within the Board's target ranges. Board staff also noted that the values in column B are not based on a forward year cost allocation study. Hydro 2000's intention, as stated in response to a Board staff interrogatory, was to move approximately 30% to 40% of the distance from the existing ratios toward 100%. Board staff stated that it has been unable to replicate the ratios in column B from the data available and submitted that Hydro 2000 should address why it has moved the revenue to cost ratio for the GS > 50kW class from 94.5% past the neutral point to 108.4%, and that the Board should consider whether Hydro 2000 should adjust its USL rate to conform to the new Board policy.

In VECC's view, the percentage allocation of the 2008 revenue requirement from the Hydro 2000's 2006 Informational Filing approach only works if the billing quantities forecast for each customer class for 2008 are all directly proportional to the billing quantities used to generate the revenues in the 2006 Cost Allocation filing, which in VECC's view is not the case. In VECC's view, the correct approach is to calculate the revenues for each class based on 2008 volumes and the 2006 rates (exclusive of the Smart Meter adder and LV recovery built into the basic rates) consistent with the Informational Filing's revenues.

VECC submitted that given the results of Hydro 2000's 2006 Informational Filing and the Board's guidelines, Hydro 2000's first priority should be to move the rates for GS<50kW, Street Lighting and USL up to the lower end of the ranges set by the Board

in each class and the resulting increase in revenues should be reallocated to the Residential class, the only class with a ratio over 100%. Any movement in the GS>50kW class' revenue to cost ratio is not a priority at this time given that the ratio is at 94.5%, well within the range of reasonableness.

In reply, Hydro 2000 stated that "when Hydro 2000 was answering all the interrogatories it did realize the problem but did not have the time to correct this problem, redo all calculation and re-submit all exhibits. In the approval of rates Hydro 2000 Inc. is ready to rectify this problem".

Hydro 2000 noted that if it were to meet the Board's target of 70% revenue to cost ratio for the USL class, the fixed charge for the class would have to be increased over current levels by over 400% and the volumetric charge by almost 1700%. Hydro 2000 noted that there are only three customers with a total of six connections in the class.

Board Findings

The Board notes that, in its reply submission, Hydro 2000 revised its proposed revenue to cost ratios as shown in Table 2 below.

Table 2: Revenue to Cost Ratios

Customer Class	Proposed Ratios per Reply Submission
Residential	104.2
GS < 50 kW	100.0
GS > 50 kW	100.0
Unmetered Scattered Load (USL)	27.9
Street lighting	71.8

Regarding the GS>50kW class, the Board notes that in its reply submission, Hydro 2000 reduced the ratio to 100 from 108.4. The Board accepts the ratios for the GS<50kW, GS>50kW and Street Lighting classes as submitted by Hydro 2000 in its reply submission.

For the USL class, it appears that the proposed rates for 2008 as set out in Hydro 2000's reply submission reflect costs that are appreciably more than the regular metered class (i.e. GS <50kW). The proposed fixed charge for both classes is the same, set at $24.52 per month. The proposed volumetric rate for USL is $0.0152/kWh

while for GS<50kW the rate proposed is lower, at $0.0125/kWh. These rates reflect costs that are as much as four times more to serve the USL class than the GS<50kW class. The Board therefore questions whether the allocation model has been applied correctly. Consequently, the Board will set the USL fixed charge at 50% of the GS<50kW class and the USL volumetric rate at a level equal to the GS<50kW rate, which has been the Board's general practice in setting 2006 rates. In order to reflect the new rates, any residual costs that need to be removed from the USL class should be allocated to the Residential class.

When filing its Draft Rate Order, Hydro 2000 should show all detailed calculations supporting the filed rates and the revenue to cost ratios on which the new rates are based.

Fixed Charges

Hydro 2000 originally proposed to increase the monthly service charge for the Residential class from $8.20 to $10.71.

Board staff noted that, while the proposed fixed charges are not higher than the calculated ceiling for any class, the calculated ceiling in a forward test year model would be higher, especially since Run 2 did not include LV costs. Nevertheless, the proposed monthly fixed service charges are in several instances more than double the existing approved rate. Board staff stated that it appears that Hydro 2000 has made an explicit decision to increase its monthly fixed service charges relative to its volumetric charges to achieve stability in its revenues. Board staff noted that the impact on smaller customers in each class is higher than on larger customers and that Hydro 2000 acknowledges that it is unable to identify a Board policy that would support Hydro 2000's approach.

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

VECC noted that the proposed $10.71 is the upper end of the range for monthly service charges as calculated by Hydro 2000's Cost Allocation Informational Filing. VECC submitted that the proportion of residential revenues collected from the 2008 fixed

versus volumetric charges should remain unchanged from that generated by existing rates.

In reply, Hydro 2000 noted that on the basis of its cost allocation and revenue to cost ratio proposals, as amended, the residential fixed charge will only increase to $8.50 from $8.20.

Board Findings

The Board considers Hydro 2000's revised proposal of $8.50 as the monthly fixed charge for the Residential class to be reasonable and accepts it.

Retail Transmission Service (RTS) Rates

On October 17, 2007, the Board issued its EB-2007-0759 Rate Order, setting new Uniform Transmission Rates for Ontario transmitters, effective November 1, 2007. The Board approved a decrease of 18% to the wholesale transmission network rate, a decrease of 28% to the wholesale transmission line connection rate, and an increase of 7% to the wholesale transformation connection rate. The combined change in the wholesale transmission line connection and transformation connection rates amounts to a reduction of 5%.

On October 29, 2007, the Board issued a letter to all electricity distributors directing them to propose an adjustment to their retail transmission service (RTS) rates to reflect the new Uniform Transmission Rates for Ontario transmitters effective November 1, 2007. The objective of resetting the rates was to minimize the prospective balance in variance accounts 1584 and 1586 and also to mitigate inter-generational inequities.

Hydro 2000 filed a proposal to adjust its RTS rates by accounting for the difference between the current RTS rates that it is charged by Hydro One Distribution and the new wholesale transmission rates. Hydro 2000 also took into account the balances in deferral accounts 1584 and 1586; this adjustment is considered later in this decision under "Deferral and Variance Accounts".

Board Findings

The Board notes that there is a variance account mechanism for all distributors to capture differences between their transmission costs and the charges they levy on their customers. The issue is not whether the distributors or the customers would be financially harmed. Good ratemaking suggests that to the extent possible and practical rates and charges at a point in time should reflect the most current information so that any differences captured in variance accounts would be minimized. This would lead to smoother rate making and reduced concerns about inter-generational inequities.

In making its proposal, Hydro 2000 correctly notes that Hydro One Distribution has not yet received approval to lower the charges for Hydro 2000. The new Uniform Transmission rates that transmitters like Hydro One Transmission can charge took effect November 2007. There is an application by Hydro One Distribution currently before the Board for new distribution and other rates effective May 1, 2008 (Board file EB-2007-0681). Although the Board has not yet approved Hydro One Distribution's new rates, the latest available information about what Hydro 2000 and other embedded distributors may be charged in the 2008 test year are the retail transmission rates contained in Hydro One Distribution's application.

The Board agrees that Hydro 2000 should revise its RTS rates but does not accept the approach proposed by the Company. It is not appropriate to derive new RTS rates by comparing, as Hydro 2000 has done, the current RTS rates charged by Hydro One Distribution to Hydro 2000 and the new wholesale transmission rates charged by Hydro One Transmission to Hydro 2000's host distributor, Hydro One Distribution. The Board directs Hydro 2000 to reduce its current RTS – Network Service Rate by 18% and its current RTS – Line and Transformation connection Service Rate by 5%. Those percentages are based on the reductions in wholesale transmission rates that were effective November 1, 2007 and are similar to the reductions proposed by Hydro One Distribution in its current rates case.

DEFERRAL AND VARIANCE ACCOUNTS

Hydro 2000 requested disposition of forecast April 30, 2008 balances of the five accounts shown in Table 3 (all amounts in the table represent charges to customers). In addition, Hydro 2000 requested clearance of $103,700 of account 1590, which is used to track the deferral and variance account recoveries that were approved in 2006.

Table 3: Deferral and Variance Accounts – Disposition Requested by Hydro 2000

	1508 Other Regulatory Assets	**1550** Low Voltage Variance Account	**1580** RSVA – Wholesale Market Charges	**1588** RSVA – Power	**1592** Post-April 2006 PILs Account
December 31, 2006	$4,706	$21,012	$8,359	$60,427	$10,211
Interest	901	2,094	366	3,465	1,306
New charges	40,773	42,000	-	-	39,300
April 30, 2008	**$46,380**	**$65,106**	**$8,725**	**$63,892**	**$50,817**

Hydro 2000's proposal is to recover these amounts from ratepayers through rate riders, combined into one net rate rider per rate class for all charges and credits, over three years beginning May 1, 2008.

Hydro 2000 has five other deferral and variance accounts for which it is not requesting disposition at this time. The forecast balances of these other accounts as of April 30, 2008 are shown in Table 4. Except for account 1565, all balances are credits to customers.

Table 4: Deferral and Variance Accounts – No Request for Disposition

	1555 Smart Meter Adder	**1562** Pre-May 2006 PILs Account	**1565** CDM	**1584** RSVA – Transmission Network	**1586** RSVA – Transmission Connection
December 31, 2006	$(2,402)	$(97,705)	$2,710	$(25,949)	$(18,245)
Interest	(145)	(5,413)	172	(1,494)	(1,381)
New charges	-	-	161	-	-
April 30, 2008	**$(2,547)**	**$(103,118)**	**$3,043**	**$(27,443)**	**$(19,626)**

The Board's findings are set out below under the various issues that were raised. In each case where the Board approves disposition of an account, it approves recovery beginning May 1, 2008 over a three-year period, as requested by Hydro 2000.

Account 1508 – "Other Regulatory Assets"

Most of the forecast balance in account 1508 at April 30, 2008 relates to expenditures incurred in connection with Hydro 2000's 2008 rate application. As explained earlier in this Decision under "OM&A – Regulatory Costs," the Board finds that those costs should not be charged to account 1508. Hydro 2000 should remove the amount of those expenditures (approximately $40,000) from this account together with related forecast interest.

As for the other costs booked in the account, Board staff submitted that they exceeded amounts that can properly be recorded in account 1508. Board staff noted that Hydro 2000 calculated and booked the difference between the OEB assessment costs in 1999 and current assessments levied on Hydro 2000 projected to April 30, 2008. The Board's Accounting Procedures Handbook specifies that account 1508 is to be used to record variances in OEB cost assessments only up to April 30, 2006. Since Hydro 2000 received approval for new rates effective May 1, 2006, only balances associated with OEB assessments levied before April 30, 2006 should be included in account 1508. In reply, Hydro 2000 confirmed that it incorrectly continued to record the Board's cost assessment costs after April 30, 2006 in account 1508 and that the proper balance is $2,925.58 plus interest of $182.83. Hydro 2000 also noted that the remaining amount in account 1508 of approximately $3,000 should be recovered by way of normal OM&A in account 5655, Regulatory Expenses.

<u>Board Findings</u>

The Board finds that only $2,925.58 plus associated interest should be cleared from account 1508 commencing May 1, 2008. Hydro 2000 should remove from account 1508 all expenditures related to its 2008 rate application. In addition, Hydro 2000 should also remove from the account all amounts related to post-April 30, 2006 Board cost assessments. The Board finds that those costs, which are approximately $3,000, should be part of Hydro 2000's forecast of 2008 OM&A expenses; they do not belong in account 1508.

Account 1550 – "Low Voltage Variance Account"

This account captures variances between the LV charges (a) billed to Hydro 2000 by Hydro One Distribution, and (b) the amounts billed by Hydro 2000 to its customers. Hydro 2000 has requested disposition of the balance at December 31, 2006 and an additional amount of $42,000 for actual or forecast variances up to April 30, 2008.

Board staff noted that in the electricity distribution sector the Board generally has not ordered disposition of forecasted balances; the usual practice is to use the most up-to-date audited balances, plus forecasted carrying charges on those balances up to the start of the new rate year. The most recent Hydro 2000 balances that have been independently audited are the December 31, 2006 balances.

In reply, Hydro 2000 stated that it used the forecast balances to show the impact if forecast balances are not cleared at this time and that by disposing of the forecast balances “rates will be more accurate with less fluctuation.”

Board Findings

The debit balance in account 1550 at December 31, 2006 indicates that the rates Hydro 2000 charged its customers were less than the amounts charged by Hydro One Distribution. It is not surprising that that situation would continue in 2007 and the first four months of 2008. Hydro 2000’s current LV charges to its customers were set in 2006 based on an annual charge from Hydro One Distribution of $106,241. As noted in the “Operating Costs and Revenues” section of this Decision, the Board found that Hydro 2000’s forecast LV costs for test year 2008 should be $143,000, a significant increase over the cost that was used to compute the Company’s 2006 rates.

To the extent possible and practical, the balances of variance and deferral accounts that are approved for clearance should be measured at the same date for all distributors. The Board acknowledges that it has accepted settlement agreements in a few other electricity cases that included clearance of deferral and variance accounts based on measurement dates other than the date of the most recent audited financial statements. But in all other cases not involving settlement agreements, the Board has not departed from the policy of approving only the disposition of actual audited balances.

The Board finds that an exception to this general Board policy should be made in the case of account 1550. The forecast balance in this account is very large in relation to Hydro 2000’s revenue requirement. It would be unreasonable to require the Company to carry the balance for an extended period. The Board approves clearance of the balance of $65,106 from account 1550. As noted above, that balance includes amounts that have not yet been subject to audit. Therefore, if any adjustments to the balance are required as a result of the audit of Hydro 2000’s 2007 financial statements, those adjustments should be recorded in account 1550.

Retail Settlement Variance Accounts (RSVAs)

Hydro 2000 has applied to clear two RSVAs (1580 – Wholesale Market Service Charges, and 1588 – Power) but has not applied for disposition of the RSVAs related to retail transmission rates (1584 – Network, and 1586 – Connection).

With respect to account 1588, RSVA – Power, Board staff noted that this account is reviewed quarterly for disposition by the Board as part of the process required by Bill 23 (which is set out in section 78 (6.1) of the *Ontario Energy Board Act, 1998*). Hydro 2000 replied that it is asking for disposition of this account to show the Board that there is a large amount sitting in the account. Hydro 2000 said, however, it will follow any Board directions resulting from a quarterly review under the Bill 23 process.

In reply, Hydro 2000 clarified that it is not asking for disposition of accounts 1584 and 1586 because it is proposing to take those balances into account when setting new retail transmission service charges. That is, under Hydro 2000's proposal, new retail transmission service charges would be lower than they otherwise would be, which would result in debit entries into accounts 1584 and 1586 in 2008 and subsequent periods to absorb the current credit balances.

Board Findings

On February 19, 2008, which is after the completion of the argument phase, the Board announced an initiative for the review and disposition of commodity account 1588 (RSVA-Power). The Board noted that, as part of this initiative, it will consider whether to extend this initiative to other accounts that are similar in nature, and named certain RSVA accounts.

Notwithstanding this initiative, the Board finds that disposition of account 1588 for Hydro 2000 is appropriate at this time. The debit balance in this account of $63,892, including interest to April 30, 2008, is almost 20% of Hydro 2000's 2008 revenue requirement (exclusive of LV amounts). Requiring Hydro 2000 to continue to carry this balance for possibly an extended period would not be reasonable.

Similarly, given the relatively large credit balances in accounts in 1584 and 1586, the Board also directs disposition of the forecast April 30, 2008 balances (as shown in Table 4). In that regard, the Board directs Hydro 2000 to re-calculate its new retail transmission rates without the effect of the two transmission variance account balances. Retail transmission rates should stand on their own and should not be affected by the balances or disposition period of variance accounts.

The Board will not approve the disposition of the balance in account 1580, RSVA – Wholesale Market Service Charges at this time.

When submitting its Draft Rate Order, Hydro 2000 should revise its variance account rate riders to reflect the Board's findings above.

Account 1592 – "PILS and Tax Variance for 2006 and Subsequent Years"

Board staff raised numerous concerns about the Company's accounting entries to this account.

Board Findings

The Company's evidence in this area is not clear. For example, the Board is uncertain at this time whether the $10,211 applied for belongs in account 1592 or account 1562. In addition, the Board does not have confidence that the remaining balance in account 1592 has been reasonably calculated. Therefore, the Board will not dispose of this account in this proceeding. Account 1592 should be reviewed for disposition subsequent to the Board's planned combined proceeding announced March 3, 2008 to review the methodology for account 1562.

Account 1590 – "Recovery of Regulatory Asset Balances"

When the Board approved new rates for distributors for 2006, it also approved recovery of regulatory asset balances on a final basis. For Hydro 2000, the Board-approved balance of $450,775 reflected principal amounts to December 31, 2004 and interest to April 30, 2006. The Board approved rate riders to facilitate the recovery of the approved balances over the two remaining years of the four-year recovery period mandated by the Minister of Energy. The regulatory assets rate riders identified on Hydro 2000's current approved Tariff of Rates and Charges cease to be effective on May 1, 2008.

According to Hydro 2000, the balance in account 1590 at December 31, 2006 was $395,384. The Company has forecast that the balance at April 30, 2008, when the current rate riders expire, is $103,700. The Company requested that the forecast balance be cleared starting May 1, 2008.

Board staff referred to the Board's Phase 2 decision for the Review and Recovery of Regulatory Assets for the five large distributors (RP-2004-0117, RP-2004-0118, RP-2004-0100, RP-2004-0069, RP-2004-0064), and submitted that Hydro 2000's proposal to dispose of account 1590 before the final balance has been determined does not

reflect a proper true-up. The Phase 2 decision specifies that the rate rider associated with account 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. after April 30, 2008.

In reply, Hydro 2000 stated that it is proposing "a blending recovery of its regulatory assets".

Board Findings

The Board agrees with Board staff that account 1590 should only be disposed once the final residual balance is verified. Given the substantial amount of the forecast residual balance at April 30, 2008, the Board would have considered starting disposition earlier if it had confidence in the Company's estimate of that balance. But based on Hydro 2000's application, and its replies to interrogatories, the Board cannot determine why the residual balance is expected to be so large. It is not clear whether the current rate riders are too low or whether there have been entries into the account over and above the approved amount of $450,775.

The Board will not approve clearance of the expected residual balance at this time. Once the actual residual balance at April 30, 2008 in account 1590 is determined, Hydro 2000 has the ability to apply for Board review and disposition of the balances in this account.

Request for New Deferral Account

Hydro 2000 is requesting a new deferral account to capture capital expenditures in 2009 and 2010 for planned disposition in 2011. The purpose of the deferral account is to capture the revenue that would be derived from immediately including in rate base planned capital expenditures in 2009 and 2010.

Board staff stated that, while Hydro 2000 did not fully explain what this revenue would be composed of, normally revenue associated with capital in rate models includes depreciation, PILs, and return on rate base. Board staff noted Hydro 2000's proposal that if it does not achieve planned capital expenditures reflected in the approved revenue requirement for 2008, the deferral account would be adjusted to reflect this with

a reduction to the amounts posted to this account, and submitted that the Board may wish to consider that the request to establish this deferral account is analogous to including a capital investment factor in an IRM year.
Board staff submitted there are three reasons that support not approving this account.

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

Second, in its December 2006 Report, the Board concluded that there is no need for a capital investment factor in the 2nd Generation IRM plan and those distributors with an inordinate capital spending program can be accommodated through rebasing. The mechanistic calculation for 3rd Generation IRM has not been finalized, as it is currently before the Board, and may include a capital component.

Third, Hydro 2000 has not demonstrated that financial hardship will be achieved if the deferral account is not allowed.

VECC submitted that Hydro 2000's request is premature. Hydro 2000 was unable to respond to interrogatories regarding the actual operation of the account. VECC stated that the Board should decline to make a determination on this matter until after the 3rd Generation IRM has been established.

The full text of the Company's reply is set out below:

> "All members of the CHEC [Cornerstone Hydro Electric Coalition] Group are asking for a New Deferral account.
>
> By asking a deferral account this will eliminate rebasing cost and all the process of new application in front of the Board. Another option would be to submit an application being more complex with different set of rates for each year."

Board Findings

The Board does not approve a deferral account for capital expenditures in non-rebasing years. Hydro 2000 did not provide even the very basics of how the proposed account would be operationalized. The Board is currently considering the structure of its 3rd Generation Incentive Rate framework, including whether capital expenditures should be incorporated in some fashion in rates during the incentive period. Hydro 2000 has not made a case that its needs may not be met by that process. For Hydro 2000, the issue is best dealt with in that process.

OTHER MATTERS

Line Losses

Section 3.2 of the Retail Settlement Code requires a distributor to adjust consumption measured at a consumer's meter for total losses when determining retail settlement amounts. Total losses for a distribution system equal the difference between wholesale energy delivered to a distributor (including supply from embedded retail generators and load transfers) and the total energy measured at all retail and wholesale meters connected to the distribution system. For an embedded distributor, total line losses include all losses that occur at distribution voltages, including those experienced by the host distributor. Hydro 2000 is an embedded distributor, served by Hydro One Distribution.

In its Decision dealing with Hydro 2000's 2006 rates (RP-2005-0020/EB-2005-0380), the Board directed Hydro 2000 to file a plan to reduce distribution losses. Hydro 2000 subsequently filed with the Board a study, titled the Utility Load Flow and Evaluation Study ("the Study").

The Study outlined two recommendations for the near term. First, Hydro 2000 should update the system single lines to add further system information, including the ratings of all switches, the size of all conductors and other details – at an estimated cost of $6,000. Hydro 2000's response was that this would be accomplished in future years as the Study assumed a load growth of 3% over the next 10 years whereas Hydro 2000's load growth from 1999 to 2007 was only 0.89%.

Second, there ought to be a re-balancing and re-phasing of the Alfred and Plantagenet feeders – at an estimated cost of $2,000. Hydro 2000's response was that it will re-balance the feeders in early 2008. Hydro 2000 noted that Hydro One Distribution provided notice to Hydro 2000 that its Plantagenet feeder is out of balance by 25%. In rebalancing the feeders, Hydro 2000 stated that will also try to find the cause of the unbalance. Hydro 2000 also noted that Hydro One Distribution will re-assess the feeder in 2008 for its own analysis and will provide to Hydro 2000 the result of the rebalancing for both the village of Alfred and the village of Plantagenet.

Board staff noted that in the 2006 rates proceeding the Total Loss Factor ("TLF") for Hydro 2000 was 1.061, including Hydro One Distribution's losses of 3.4%. The application in the current proceeding originally requested a Total Loss Factor ("TLF") of 1.070, which is the product of a Distribution Loss Factor ("DLF") of 1.066 and a Supply Facilities Loss Factor ("SFLF") of 1.0045. However, Hydro 2000's proposed Tariff showed a TLF of 1.066, while as noted above, the currently approved TLF is 1.061. Board Staff noted that while Hydro 2000 confirmed its requested DLF of 1.066 in an interrogatory response, it did not confirm its TLF. Board staff invited Hydro 2000 to confirm its requested TLF and, if different from 1.07, to explain this difference.

Board staff also noted that the evidence shows a steady increase in the DLF, with a slight downturn in 2006. The requested amount of 1.066 is a five-year average, which is lower than the record achieved during the most recent three years. According to Board staff, this trend may be a matter of concern over the longer term. Board staff submitted that the Board may wish to consider if further direction should be provided to Hydro 2000 regarding the management of the DLF.

VECC stated that it supports Board staff's submissions on this topic. VECC suggested that approval of loss factors "slightly less" than those calculated based on past experience may be appropriate in anticipation of the analysis and feeder rebalancing Hydro 2000 will be undertaking.

In reply, Hydro 2000 confirmed that the proposed TLF is indeed 1.066 (which would revise the proposed DLF to 1.061). Hydro 2000 explained that the proposed TLF of 1.066 "was between 1.061 to 1.07".

Board Findings

The Board approves a TLF of 1.066, which is slightly less than the originally requested TLF of 1.070. The Board is concerned that the TLF requested has increased from the currently approved 1.061. However, the Board is encouraged that Hydro 2000 has decided to proceed with the re-balancing and notes that this will assist in reducing losses. The Board also notes that about one-half of Hydro 2000's losses occurs outside Hydro 2000's service territory and are not within its control.
It is unclear whether Hydro 2000 intends to include the $2,000 estimated cost to accomplish the re-balancing in its 2008 revenue requirement. Nevertheless, it is clear from Hydro 2000's reply submission that Hydro 2000 intends to proceed with the re-balancing, a position supported by VECC. The Board will therefore allow Hydro 2000 to include the $2,000 in its revenue requirement for 2008 when it files its Draft Rate Order. Hydro 2000 should file any material that supports the inclusion of this amount including all calculations showing the derivation of the final rates.

IMPLEMENTATION MATTERS

Cost of Capital Update

In mid-2006, the Board initiated a consultative process to examine the cost of capital applicable to the Ontario electricity distribution sector. This process was conducted in conjunction with the development of the 2nd Generation Incentive Regulation plan. The product of these consultations was the Board Report, issued December 20, 2006 noted earlier in this Decision under "Capitalization/Cost of Capital". The Board Report considered the extensive consultation record and established, in part, guidelines for setting and updating the cost of capital parameters for distribution rate-setting from 2007 onwards, including the return on common equity ("ROE"), the deemed short-term debt rate, and, as appropriate, the deemed long-term debt rate.

The Board Report established that the approved ROE to be used for rate-setting purposes should be calculated by application of the formula in Appendix B of the Board Report. In setting the ROE for the establishment of 2008 rates, the Board has used the *Consensus Forecasts* and published Bank of Canada data for January 2008, in accordance with the Board's guidelines. In fixing new rates and charges for Hydro 2000 the Board has applied the policies described in the Board Report. Based on the final

2007 data published by *Consensus Forecasts* and the Bank of Canada, the Board has established the ROE to be 8.57%.

The Board Report also established that the short-term debt rate should be updated using the methodology in section 2.2.2 of the Board Report. The Board has set the short-term debt rate at 4.47% using data from *Consensus Forecasts* and the Bank of Canada for January 2008.

Draft Rate Order

The Board has made numerous findings throughout this Decision. These are to be appropriately reflected in a Draft Rate Order incorporating an effective date of May 1, 2008 for the new rates and charges.

In filing its Draft Rate Order, it is the Board's expectation that the Company will not use a calculation of a revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects the Company to file detailed supporting material, including all relevant calculations showing the impact of this Decision on the Company's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. The Draft Rate Order shall also include customer rate impacts.

A Rate Order will be issued after the processes set out below are completed.

1. The Company shall file with the Board, and shall also forward to intervenors, a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision.

2. Intervenors may file with the Board and forward to the Company responses to the Company's Draft Rate Order within 20 days of the date of this Decision.

3. The Company shall file with the Board and forward to intervenors responses to any comments on its Draft Rate Order within 26 days of the date of this Decision.

A cost awards decision will be issued after the steps set out below are completed.

4. Intervenors eligible for cost awards shall file with the Board and forward to the Company their respective cost claims within 26 days from the date of this Decision.

5. The Company may file with the Board and forward to intervenors eligible for cost awards any objections to the claimed costs within 42 days from the date of this Decision.
6. Intervenors, whose cost claims have been objected to, may file with the Board and forward to the Company any responses to any objections for cost claims within 49 days of the date of this Decision.

The Company shall pay the Board's costs of, and incidental to, this proceeding upon receipt of the Board's invoice.

DATED at Toronto, March 14, 2008.

Original signed by

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Paul Vlahos

Original signed by

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Bill Rupert