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BY EMAIL

April 4, 2008

Kirsten Walli
Board Secretary, Ontario Energy Board
P.O. Box 2319, 27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Espanola Regional Hydro Distribution Corporation
Board File No. EB-2007-0901

Dear Ms. Walli:

Please find attached the Board Staff Submission for the above proceeding. Please immediately forward the attached document to Espanola and all intervenors in this proceeding.

Yours truly,

Original Signed By

Colin J. Schuch
Case Manager

/ attach.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

ESPANOLA REGIONAL HYDRO DISTRIBUTION CORPORATION

EB-2007-0901

April 4, 2007

INTRODUCTION

Espanola Regional Hydro Distribution Corporation ("Espanola", the "utility", or the "Applicant") is an electric distribution utility that operates in Northern Ontario near the north shore of Lake Huron. It serves three urban communities – the Town of Espanola, Massey and Webbwood, the latter two being communities located within the municipality of the Township of Sables-Spanish Rivers. The utility has 3,268 metered customers.

Espanola submitted an application for 2008 electricity distribution rates on November 6, 2007. The application was based on a future test year cost of service methodology. On March 7, 2008, Espanola filed 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 Espanola's application and setting reasonable and just rates.

THE APPLICATION

Espanola has requested a revenue requirement of $1,340,404 to be recovered in new rates effective May 1, 2008. The revenue deficiency for 2008 has been calculated at $240,637.

OPERATIONS, MAINTENANCE & ADMINSTRATION COSTS (OM&A)

The Applicant's Summary of Operating Costs is found at Exh 4 / Pg 3 of its application ("Summary"). The 2008 Total Controllable OM&A Expenses forecast is $964,229. The result is a 3% (or $28,295) decrease compared to the 2006 actual level.

Using the Summary as its base, Board staff created three different tables and asked interrogatories concerning each table to clarify the drivers of this increase. The Applicant confirmed the accuracy of each of the tables through its response to Board staff interrogatory # 6.

Table 1 summarizes the key components of the Applicant's operating costs for the 2006 Board approved and actual, 2007 Bridge and 2008 Test years and Table 2 highlights the significant sources of variance for controllable expenses:

Table 1

	2006 Board Approved $	2006 Actual $	2007 Bridge $	2008 Test $
Operation	188,791	233,568	216,616	237,426
Maintenance	88,939	163,899	184,343	187,328
Billing and Collections	223,645	267,466	251,828	254,687
Community Relations	0	1,000	2,000	2,000
Administrative and General Expenses	237,792	326,591	286,325	282,788
Controllable OM&A	739,167	992,524	941,112	964,229
LV Charges	135,448			
Amortization Expenses	216,028	188,561	178,061	179,455
Taxes other than income	5,003	12,602	25,964	0
Other Operating Costs	0	245,971	133,025	132,375
Total Operating Costs	1,095,645	1,439,658	1,278,162	1,276,059

Table 2

	2006 Board Approved $	Variance 2006/2006	2006 Actual $	Variance 2007/2006	2007 Bridge $	Variance 2008/2007	2008 Test $	Variance 2008/2006
Operation	188,791	44,777	233,568	-16,952	216,616	20,810	237,426	3,858
		6.1%		-1.7%		2.2%		0.4%
Maintenance	88,939	74,960	163,899	20,444	184,343	2,985	187,328	23,429
		10.1%		2.1%		0.3%		2.4%
Billing and Collections	223,645	43,821	267,466	-15,638	251,828	2,859	254,687	-12,779
		5.9%		-1.6%		0.3%		-1.3%
Community Relations	0	1,000	1,000	1,000	2,000	0	2,000	1,000
		0.1%		0.1%		0.0%		0.1%
Administrative and General Expenses	237,792	88,799	326,591	-40,266	286,325	-3,537	282,788	-43,803
		12.0%		-4.1%		-0.4%		-4.4%
Controllable OM&A	739,167	253,357	992,524	-51,412	941,112	23,117	964,229	-28,295
		34.3%		-5.2%		2.5%		-2.9%

To assist in understanding the increases in Total Controllable OM&A expenses identified above, Board staff prepared the following cost driver table which was confirmed by the Applicant in response to Board staff interrogatory # 6. The review starts with the 2006 Board Approved costs of $739,167 and progresses forward to the 2008 Test year amount of $964,229.

Cost Driver Review	2006	2007	2008
Opening Balance	$ 739,167	$ 992,524	$ 941,112
Dissolved Service Company			
Reallocation of management salaries	$ 110,404		
Harris support costs	$ 26,887		
Bad Debts sent to collector	$ 11,731		
Consulting fees - Audit, Legal PUC	$ 100,154	-$ 35,669	
Mgmt Salaries reallocated to Contract		-$ 13,980	
Labour - Overhead lines			$ 23,166
Unexplained Variance	$ 4,181	-$ 1,763	-$ 49
Closing Balance	$ 992,524	$ 941,112	$ 964,229

Other Operating Costs

Board staff notes that Exh 4 / Pg 6 of the Application includes a component of Total Operating Costs entitled “Other Operating Costs” in the amount of $132,375 in the 2008 Test Year. Exh 4/ Pg 5 breaks down this amount as consisting of “Interest on Debt to Associated Companies” in the amount of $84,625 and “Other Interest Expense” in the amount of $47,750. It remains unclear if the Applicant has included “Interest on Debt to Associated Companies” in the amount of $84,625 and an additional separate amount in the rate base calculation. Board staff invites Espanola to clarify this matter in its reply submission and confirm that there is no double recovery of interest expense.

Increase in Compensation and Staffing

Table 3, prepared by Board staff, summarizes the information on labour costs provided in Exh 4 / pg 31.

Table 3

	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
Compensation	$ -	$ 344,317	$ 354,646	$ 365,285
Pension and Benefits	$ -	$ 134,155	$ 138,178	$ 142,323
Incentive Pay	$ -	$ -	$ -	$ -
Total Compensation	$ -	$ 478,472	$ 492,824	$ 507,608
Capitalized	$ -	$ 81,005	$ 83,433	$ 85,936
OM&A	$ -	$ 397,467	$ 409,391	$ 421,672
Total Compensation	$ -	$ 478,472	$ 492,824	$ 507,608
Capitalized	-	17%	17%	17%
OM&A	-	83%	83%	83%

Based on the Applicant's response to Board staff interrogatory #2, there were no employees in the utility for the 2006 Board approved year as such employees were in the affiliated service company. Accordingly, Board staff has intentionally left these columns blank in the tables in this section.

In response to Board staff interrogatory #4, the Applicant stated that it has made some minor changes to its capitalization policies. Based on the consistency of the above percentage splits from the 2006 Actual to the 2008 test year, it appears that any changes made have had an insignificant impact on the allocation of employee compensation costs.

In comparing the distributor's labour costs to Total Controllable OM&A, Board staff notes that Labour averages approximately 42% of operating costs as indicated in the following Table 4.

Table 4

	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
OM&A Labour	$ -	$ 397,467	$ 409,391	$ 421,672
Total Controllable OM&A Expenses	$ 739,167	$ 992,524	$ 941,112	$ 964,229
Labour as a percent of OM&A	-	40.0%	43.5%	43.7%

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

Table 5

	2006 Board Approved	2006 Actual	2007 Bridge	2008 Test
OM&A	$ -	$ 397,467	$ 409,391	$ 421,672
Annual Labour Changes		$ -	$ 11,924	$12,281
% Change		-	2.9%	2.9%

From the above table, it appears that there are no significant variances in the Applicant's employee compensation forecasts.

Shared and Purchased Services

Exh 1 / pg 46 of the pre-filed evidence provides the utility organizational chart. The Applicant is the local distribution company which provides regulated electrical power distribution in its service territory. It is owned by Espanola Regional Hydro Holdings Corporation ("ERHHC"), which is in turn owned by the Town of Espanola (81%) and the Township of Sable-Spanish Rivers (19%). The Applicant also owns Espanola Regional Hydro Services Corporation ("Services Corporation"), which has been inactive since December 31, 2005.

Exh 1 / pg 45 of the Applicant's evidence states that it has a management services agreement with PUC Services Inc. which commenced in 2006 and succeeded earlier arrangements with Services Corporation to provide such services. The agreement is stated as including participation in Board meetings, supervision of all staff, oversight/awareness/monitoring of daily operations, regulatory and legislative requirements, contract administration, purchasing, customer service, billing and collecting, financial requirement, revenue requirements including rate setting, human resources, preparation of annual budgets and forecasts. In addition, a billing/customer service agreement with PUC Services has been in place since December 1, 2001.

Discussion and Submission

In assessing the reasonableness of the cost of services that Espanola is purchasing from PUC Services, Board staff notes that there is a significant increase in the stated costs after provision of most of these services changed over from the Services Corporation to PUC Services effective January 2006. The 2006 level of Controllable OM&A arising out of the Board's 2006 Decision was $739,167 which, compared to the 2006 Actual level of $992,524, represents a 34% increase. It appears that much of the cost increase is due to the new service purchase arrangements. Espanola explained the differential as follows:

> The $739,167 board approved figure reflects controllable costs for only part of the operations of Espanola as in 2004 the Services Corporation was still active and bore the balance of the costs. The Services Corporation wound down at December 31st 2005 which resulted in 100% of the controllable costs being reflected in LDC in 2006. Refer to Draft Issues list in Exhibit 1 page 35 on Historical Board Approved 2004 year.

It is unclear from the above explanation whether the Services Corporation was not adequately recovering its costs through its charges to the Applicant, or whether other factors were involved and, if so, what they were and how this situation had arisen.

In this context, it is Board staff's understanding that the Services Corporation provided similar services to those now provided by PUC Services, except that the relevant staff, which had worked for Services Corporation prior to 2006 are now back in the regulated distribution company. This is based on the Applicant's statement that:

> Prior to 2006, Espanola operated as part of an affiliated group of companies providing electric services. All employees were in the employ of Espanola Regional Hydro Services Corporation (Services Company). Espanola was charged by the Services Company for the management, operations, maintenance and administrative services necessary to operate the distribution utility. During the review of a 2005 rate application initiated by Espanola (file number EB-2005-0243) the Board expressed concerns regarding the financial information provided by Espanola and transactions with the affiliated Services Company. Subsequent to 2005, the Services Company is no longer active; all employees are now members of Espanola. Forming part of this rate application is information for the Historical Board Approved Year of 2004. As noted above there are concerns with the financial data, in particular, the allocations between affiliated companies. The Historical Actual Year of 2006 is the first year of operating after the reorganization and provides a more accurate picture for comparative purposes of total utility costs.

Board staff questions whether the new services company arrangements are producing reasonable costs for the Applicant as there is a significant increase in costs with the present supplier, PUC Services, compared to the costs incurred when the Services Corporation was the supplier. Board staff notes that the higher cost levels are generally sustained throughout the 2007 Bridge and 2008 Test years.

The Applicant is invited to direct staff in its reply submission to any references in the case record that would provide further justification and/or clarification for this increase. Board staff also invites other parties to provide their views on this matter in their submissions.

RATE BASE

The Applicant has requested a rate base for 2008 of $2,763,963, which includes average net fixed assets of $1,894,833 and an allowance for working capital of $869,130. This represents a decrease of approximately 0.4% as compared to forecasted 2007 rate base of $2,775,638. Allowance for working capital is approximately 31% of the rate base and the distribution plant makes up the bulk of the remaining 69%.

In response to SEC interrogatory #1, Espanola provided the calculation to explain a discrepancy in the 2006 gross asset average balance. Although Board staff remains unclear on the calculation methodology used, staff confirmed that the amount of $3,410,575 (2006 gross asset average balance) had been used in the rate base calculation consistently. Therefore, the proposed 2008 rate base represents a decrease of 1.5% from the 2006 actual level of $2,805,987.

The Applicant projects a 2008 capital expenditure level of $204,399. Table 6 provides the comparisons for the rate base and the capital expenditures for 2006, 2007 and 2008 exclusive of any smart meter investment.

Table 6

Rate Base ($)

	2006 Actual	**2007 Forecast**	**2008 Projected**
Capital Budget	$69,781	$146,808	$204,399
% change as compared to the prior year	-	+110.4%	+39.2%
Rate Base	$2,805,987	$2,775,638	$2,763,963
% change as compared to the prior year	-	-1.1%	-0.4%

Discussion and Submission

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

Reconciliation of Numbers

Board staff noted a number of discrepancies in the evidence related to total capital expenditures and rate base. As indicated in the following tables, there are discrepancies between information provided in the application and the interrogatory responses concerning actual capital expenditures in 2006 and rate base for 2006 and 2007. Board staff invites the Applicant to clarify the discrepancy in its reply submission limiting its explanation to materials already filed with the Board in its application.

Total Capital Expenditure			
Reference	2006 - Actual	2007 Bridge	2008 Test
Exhibit 2/ Page 24-26	$ 69,781	$ 146,808	$ 204,399
Response to Staff IR # 11.b	$ 98,444	$ 146,808	$ 204,399

Rate Base			
Reference	2006 - Actual	2007 Bridge	2008 Test
Exhibit 2/ Page 3	$ 2,777,357	$ 2,775,638	$ 2,763,963
Response to Staff IR # 11.b	$ 3,081,501	$ 3,008,347	$ 2,763,963

Increase in 2008 Capital Expenditures

The main drivers of the increase in 2008 capital expenditures are the replacement of deteriorated poles and the replacement of underground primary cable.

In response to Board staff interrogatory #14, the Applicant stated that the amount of $41,644 will be budgeted for replacing underground residential distribution cables and $98,196 will be budgeted for pole replacement. In addition, the response also stated that condition assessment for underground system and poles will be initiated in 2008. Given that the work for condition assessment of infrastructure has not yet been completed, Board staff remains unclear as to how these levels of expenditures were determined and if they would be adequate for replacement of deteriorated poles and underground primary cables. Board staff invites other parties to comment on this matter.

Variance between 2006 Board Approved and 2006 Actual:

Exh 2 / Pg 13-14 in the application states, under the Gross Assets table, the variance between 2006 Board Approved ($4,839,724) and 2006 Actual ($3,445,465) is $1,394,259. In response to Board staff interrogatory #13, the Applicant explained that the Board approved gross assets balances were based on 2004 Actual balances so that the variance is for a two-year period. In addition, the Applicant stated that, prior to 2006 the fully depreciated assets were not removed from the gross assets or accumulated depreciation. The removal was done in 2006 and caused reductions to the gross asset and accumulated depreciation balances.

Service Reliability Indices

In response to Board staff interrogatory #17, the Applicant stated that the service reliability indicators had not been factored into determination of the 2008 capital expenditure program. The Applicant advised that the capital projects were undertaken because equipment was at end-of-life, and based on past experience to account for the unforeseen construction. Overall, Board staff notes that insufficient evidence was provided to permit an accurate evaluation as to whether or not there has been an appropriate methodology used for development, evaluation, and prioritization of 2008 capital projects. The Applicant and other parties to the proceeding are invited to comment on this matter in their reply submissions.

Asset Management Plan

In response to Board staff interrogatory #14, Espanola advised that the condition assessment of the underground system and wood poles will be initiated in 2008. No further information on assessments of other assets was provided. Parties are invited to comment on whether the Applicant should develop a formal asset management plan.

COST OF CAPITAL

The Applicant has provided its proposed Cost of Capital in Exhibit 6. The following table summarizes its proposed Cost of Capital:

Cost of Capital Parameter	**Applicant's Proposal**
Capital Structure	53.3% debt (composed of 49.3% long-term debt and 4.0% short-term debt) and 46.7% equity. There is some confusion as Espanola has variously rounded the percentages, but Board staff understands that Espanola is proposing to use the transitional capital structure for 2008 as documented in the Board Report.
Short-Term Debt	4.77%, to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	5.82%, as the forecasted interest rate on long-term debt owed to the municipal shareholder and which is being renegotiated. This is further discussed below.
Return on Equity	8.69%, but to be updated in accordance with the methodology in Appendix B of the Board Report.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	7.12% 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.

The Applicant's approach to cost of capital appears to be consistent with the Board Report.

Capital Structure

The Applicant is proposing to comply with the guidelines in the Board Report and to transition to the general deemed capital structure of 60% debt and 40% equity for rate-making purposes. This means that the Applicant's 2008 deemed capital structure for rate-making purposes will be 53.3% debt, composed of 49.3% long-term debt and 4.0% short-term debt, and 46.7% equity.

Board staff notes that the Applicant's actual capital structure is different from the deemed structure, and that which is in place for most electricity distributors. As documented on page 3 of Exhibit 6, the Applicant has a 2006 actual capital structure of 109% debt and (6.0%) equity. This is supported by its 2006 Audited Financial Statements filed in Exhibit 1, showing a Shareholders' Equity (Deficit) of ($569,149) comprised of $1,000 of share capital and retained earnings (deficit) of ($570,149) for 2006.

In response to the Board staff interrogatories #19, #22b and #22c, and VECC interrogatory #15b and #15c, Espanola responded that it is renegotiating its capital financing with its municipal shareholder, which is also the debt holder, presumably to address its long-term financial outlook. Espanola also stated that the capital restructuring is expected to be completed by the spring of 2008.

Long-term Debt Rate

Espanola proposed in Exhibit 6 a long-term debt rate of 5.82%. This is increased from a 5.00% long-term debt rate shown for 2006 and 2007. The Applicant's debt consists of Promissory Notes due to the municipal shareholders. Copies of the Promissory Notes were filed in response to Board staff interrogatory #22. The documentation filed, however, does not make it clear what interest rate is payable. However, Note 5 of the Applicant's 2006 Audited Financial Statements state that, for these debt instruments, "interest at 5% per annum is paid on the notes payable." Board staff invites Espanola to clarify this matter.

The Applicant has not stated how or why the rate has increased from 5.0% to 5.82% other than to state, on page 4 of Exhibit 6 that: "[t]he reduction of the long-term debt is being negotiated with the municipal shareholder at a rate of 5.82%."

Board staff submits that to be consistent with Board guidelines the allowed debt rate should be the lower of the 5.82% and the updated deemed debt rate, which the Board has determined to be 6.10%, communicated on March 7, 2008.

OTHER DISTRIBUTION REVENUE

Board Staff notes that in Exhibit 7 / Pg 2, Espanola used the 2007 bridge year Other Distribution Revenue to calculate the 2008 revenue deficiency. Espanola explained that it took this approach because "The purpose of the calculation of revenue deficiency is to compare the estimated 2007 revenue to the estimated 2008 level of expenses. The other distribution revenue of $156,075 is the 2007 Bridge year amount".

Board Staff notes that the normal approach in calculating the 2008 revenue requirement would be to do so using an estimate of the 2008 level of other distribution revenue, rather than a 2007 number. Board staff invites Espanola to confirm the reasoning for using the 2007 number.

Board Staff is also unclear as to whether Espanola has included the SSS Administration revenue in the other distribution revenue figures. Board staff invites Espanola to confirm that it has in fact included the SSS Administration revenue in the other distribution revenue figures and if not, provide the reason.

LOAD FORECASTING

Exhibit 3 of the Application outlines the development of Espanola's customer count and load forecasts. The 2007 Bridge Year and 2008 Test Year customer count by class were determined utilizing 2002 to 2006 historical data. The kWh forecast – and the kW forecast for appropriate classes – is presented by customer class. Variance analyses are presented in support of the forecasts.

Methodology and Model

Espanola explained the trend in customer connections experienced during the 2002 to 2006 period, and the extrapolation of that trend to 2007 and 2008. The Applicant stated that it had used a simple trend growth given the slow growth and consistent trend in customer numbers in the service territory and the minor variations experienced over time. Espanola noted that 2002-03 were anomalous for growth for some classes and these data were excluded from the trend line.

Board staff has not identified any concerns with respect to the method used to develop the customer count.

In terms of the kWh volume forecasts, Espanola 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 # 25 - that the 2004-based retail NAC was assumed to be applicable in the future and was used as the basis for the load forecasts. 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 is concerned that the methodology chosen utilizes only a single year of weather-normalized historical load to determine the future load. The assumption that the retail NAC value remains constant over a number of years may yield inaccurate results. 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 to over-estimate 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 and a complete explanation for it was presented in response to Board staff interrogatory # 27.

Weather Normalization

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

Forecast Results

The Applicant's forecast shows a negative 0.1% annual average change in customer numbers from 2006 to the 2008 Test Year which is virtually identical to the historical zero growth reflected in the 2002-2006 period. Board Staff submits that the forecasted growth in customer numbers is consistent with expectations based on the input data.

The Applicant's forecast shows a zero annual average kWh load change from 2006 to the 2008 Test Year. [Exhibit 3, Page 9] This compares with an average annual kWh load change of negative 0.8% during the 2002 to 2006 period (Response to Board Staff interrogatory # 28). As noted earlier, in Board Staff's opinion using the unmodified 2004-based retail NAC values for 2008 is likely to result in a slightly higher load forecast. In response to Board Staff interrogatory # 28, the Applicant effectively developed an alternative forecast that took weather normalization fully into account for each of the years 2002 to 2006. The difference between the two forecasts was much smaller than Board Staff expected. Board staff analysis of the results concluded that the smaller-than-expected difference appears to be because of the essentially flat customer numbers and kWh load.

COST ALLOCATION

LOW VOLTAGE COSTS

Espanola is a totally embedded distributor, receiving all of its electricity through the host distributor Hydro One. The Application includes $139,296 for the forecast LV charges by the host distributor Hydro One. The cost in 2007 was $133,538.

The cost of LV service is included as a rate adder. The adder for each class is based on an allocation to the classes proportional to Retail Transmission Connection Service revenues. (Ref: Exh 9 / Pg 12)

Discussion and Submission

Board staff notes that the host distributor, Hydro One, has an application currently with the Board that includes lower rates for several services that are used by embedded distributors. (Ref: EB-2007-0681 / Exhibit G1 / Tab 4 / Schedule 4 / Pg 2) Staff submits that the Applicant should make a comprehensive estimate of its 2008 LV cost, based on the assumption that the Hydro One application will be approved in respect to the proposed Subtransmission rates, and using all rate changes that are relevant to Espanola's LV cost. Based on this updated estimate of LV cost, staff submits that the Applicant should re-calculate the LV adjustments to the volumetric distribution rate for each class. (Ref: Exh 9 / Pg 12)

In response to Board staff interrogatory # 29(b), Espanola provided an itemized monthly accounting of its 2007 LV costs but the table is not labelled sufficiently in order to estimate the effect. It is possible to infer that two of the five line items are for Shared Line (Common Subtransmission Line in the Hydro One application), and to infer that the other three line items (which are much larger in total) must be for services such as distribution stations or specific lines. The Applicant might assist the Board by providing details of its updated LV cost forecast.

In the event that the Hydro One application is not approved, the final reconciliation would be captured in the variance account.

Board staff submits that Espanola's allocation of LV cost to the customer classes is an appropriate continuation of the current approved method.

REVENUE TO COST RATIOS

The Application proposes to change the proportion of distribution revenue from the respective classes, generally increasing the proportion from classes where the Informational Filing indicated a revenue to cost ratio less than 100% and decreasing the proportion from classes with a ratio above 100%. The result of this re-balancing can be seen in the following table, by comparing columns 1 and 2. (Ref: Exh 8 / Pg 8) For ease of comparison, the Board's policy range is shown in column 3.

Espanola Revenue to Cost Ratios (%)

	Informational Filing / Run 2 **Col 1**	**Application: Exhibit 8 / p. 8** **Col 2**	**Board Policy Range** **Col 3**
Customer Class			
Residential	109	102	85 – 115
GS < 50 kW	113	109	80 – 120
GS > 50 kW	57	100	80 – 180
Street Lights	16	29	70 – 120
Sentinel Lights	32	47	70 – 120
USL	92	92	80 -- 120

Discussion and Submission

Board staff notes that two classes have proposed ratios that remain outside the Board's policy range, both on the low side. Rebalancing the class revenues further, such that all classes would be within the policy range, would imply a decrease in rates to one or both of the classes that are within range but have ratios above 100%.

Staff notes that the proposal is to take the ratio for the larger General Class customers from a low ratio all the way to 100%. The impact on the total bill of some of the representative customers is calculated at nearly 10% as a result (Ref: response to Board staff interrogatories / Pg 182). However, revisions to components of the bill discussed elsewhere in this submission would decrease the impact to some extent.

Board staff notes also that the proposed re-balancing leaves the ratio for Unmetered Scattered Load unchanged.

The proposed ratio for Streetlighting is 29%. (Ref: Exh 8 / Pg 8) Board staff notes that in recent decisions (for example, Barrie Hydro) with similar situations the Board has directed the applicant to move the ratio to within accepted Board policy ranges over a two year period.

Staff notes that the ratio for Sentinel Lighting is proposed to increase from 32% to 47%. Staff notes that a ratio of 51% would be the midpoint from the ratio in the Informational Filing and the lower boundary of the board's policy range. This again is the same situation as noted with streetlighting.

RATE DESIGN

Monthly Service Charge

For most of the classes, the Monthly Service Charge in 2006 was within the range between the floor and ceiling amounts calculated in the Informational Filing cost allocation study. (Ref: response to Board staff interrogatories / Appendix C / Pg 51) The exception is the GS > 50 kW class, whose Monthly Service Charge is more than double the ceiling amount that is calculated in the Informational Filing (Ref: Exh 8 / Pg 9). In the proposed rate schedule, this charge would be held constant at its current approved amount.

The proposed rate schedule also includes the Residential Monthly Service Charge at its current approved amount.

For the remaining classes, the proposal is to increase the Monthly Service Charge by a larger percentage than the corresponding volumetric charge. In three cases, the volumetric rate would decrease. The percentage changes in the following table are taken from the itemized bill impact calculations provided in response to Board staff interrogatories, pages 178 – 184.

Monthly Service Charge (% change 2007 – 2008)

Customer Class	Monthly Service Charge	Volumetric Charge
GS < 50kW	39.7	-15.8
Street Lights	100.0	91.2
Sentinel Lights	100.0	-7.5
USL	31.8	-0.7

Discussion and Submission

Board staff submits that the proposal to maintain the Monthly Service Charges to the Residential class and the GS > 50 kW class at the existing approved amounts is within the bounds as identified in the November 28, 2007 Board Report on Cost Allocation (page 12).

Transformer Ownership Allowance

The proposal is to retain the Transformer Ownership Allowance at $0.60 per kW. Board staff raises no objection to this proposal. Staff notes that the currently approved allowance is close to the cost-based result yielded by the Informational Filing cost allocation model. (Ref: Exh 8 / Pg 10)

RETAIL TRANSMISSION SERVICE RATES (RTSR)

Espanola is entirely embedded and as a result its entire wholesale cost of transmission service is determined by Hydro One's Retail Transmission Service Rates. Espanola's proposed Retail Transmission Service rates are unchanged from the currently approved rates. (Ref: Exh 9 / Pg 15-16, and Proposed Rate Schedule: response to Board staff interrogatory # 49 / Pg 185-186)
Discussion and Submission

Board staff submits that it may be reasonable for Espanola to calculate revised Retail Transmission Service Rates, based on the assumption that the rates it will pay to Hydro One for wholesale service will be approved per Hydro One's application (EB-2007-0681 / Exhibit G2 / Tab 94 / Schedule 1 / Pg 3)

It might assist the Board if Espanola were to identify the revised rates in its reply submission. It would also be helpful if Espanola provided revised calculations of the total bill impacts to Streetlighting and Sentinel Lighting, in place of the estimates already provided (Ref: response to Board interrogatory # 49 / page 183-4).

LINE LOSSES

In response to Board staff interrogatory #37, Espanola reaffirmed that the proposed Total Loss Factor (TLF) for 2008 of 1.0543 is based on a distribution loss factor (DLF) of 1.0495 derived from the averaging of actual DLFs for the 3-yr period 2004 to 2006 and a Supply Facilities Loss Factor (SFLF) of 1.0045.

Espanola's actual DLF has declined during the 3-yr period from 2004 to 2006 as shown in the table below.

	2004	**2005**	**2006**	**Average (2004 – 2006)**
Actual DLF	1.0614	1.0476	1.0394	1.0495

Discussion and Submission

Espanola is an embedded distributor within the service territory of Hydro One. Board staff is of the opinion that the DLF provided by Espanola would be reasonably "in line" with the DLF of an embedded distributor provided it includes losses incurred in the host distributor's system. However in its interrogatory response, Espanola stated that the DLF and SLF provided do not include losses that occur in Hydro One's distribution system (typically 3.4%).

Board staff is concerned that the DLF associated with a distributor with a compact service territory as is the case with Espanola should be as high as the value proposed (1.0495).

Espanola's overall TLF deduced after including upstream Hydro One losses in their proposed TLF of 1.0543 could be comparable to Hydro One's proposed TLF for its core retail customers located in a lower density service territory compared to Espanola's customers.

Parties may wish to comment on whether Espanola should be required to provide details of the locations of the defined meter point on the primary or high voltage side of the transformer and the metering installation on the secondary or low voltage side of the transformer in order to confirm the inclusion/exclusion of Hydro One losses in the DLF provided.

DEFERRAL AND VARIANCE ACCOUNTS

Espanola is proposing to:

- Clear the balances of certain deferral and variance accounts including Account 1590; and
- Establish two new accounts for future use.

Request for Disposition

Espanola is requesting that the following accounts and balances as per responses to Board Staff Interrogatories #46 be cleared for disposition as of April 30, 2008. The balances provided below include the December 31, 2006 balances and interest forecast to April 30, 2008:

1508 Other Regulatory Assets, $56,165
1525 Miscellaneous Deferred Debits, $1,762
1550 LV Variance, $62,680
1580 RSVA – Wholesale Market Service Charge, ($8,286)
1584 RSVA – Retail Transmission Network Charges, ($63,443)
1586 RSVA – Retail Transmission Connection Charges, ($19,749)
1588 RSVA – Power, $248,164

Subtotal, $277,293

1590 Residual Balance ($31,772)

Total $245,521

Espanola's proposal is to collect these amounts from rate payers over two years beginning May 1, 2008 via rate riders (Ref: Board Staff Interrogatory #46, Appendix A).

Continuation of Deferral and Variance Accounts

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

Request for New Deferral Accounts

Espanola is requesting two new deferral accounts:

a.Late Payment Class Action Suit
b.Meter Data Management Repository Account (MDMR)

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

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

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

a.In the electricity distribution sector, the Board has usually used the APH, the Uniform System of Accounts, 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 may set a precedent for other distributors.

b.The establishment of new deferral and variance accounts outside of the APH will impact the level of business risk that the applicant is exposed to, which will directly tie to the equity component of the return on capital.

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

Late Payment Class Action Suit Deferral Account

Espanola stated that a class action claiming $500 million in restitutionary payment plus interest was served on Toronto Hydro on November 18, 1998. The action was commenced against Toronto Hydro as the representative of the defendant class consisting of all electricity distributors in Ontario which have charged late payment charges on overdue bills at any time after April 1, 1981. If the action against Toronto Hydro is successful at trial or settlement, Espanola would be liable for any claim that relates to late payment charges paid by Espanola customers.

Espanola is requesting a new deferral account to record any claim and costs that Espanola would incur assuming the claim against Toronto Hydro succeeds.

Meter Data Management Repository Deferral Account (MDMR)

Espanola is requesting a new deferral account to record MDMR costs.

Espanola has not provided evidence of the materiality and causality of this request in its response to Board Staff Interrogatory #39.

The costs that Espanola would incur are unknown. Provincial regulation O. Reg. 426/06, states that a distributor may not recover costs for functionality exceeding minimum functionality unless the costs are approved by the Board. MDMR may be considered excess functionality, therefore the principle of prudence is not proven by Espanola.

If the MDMR is considered to be cost recoverable, the Board already has defined through the APH, the variance and deferral accounts that could be used. One is account 1556, which is defined by the APH to "be used by the distributor to record incremental operating, maintenance, amortization and administrative expenses directly related to smart meters." However, 1556 may not be the most appropriate mechanism as MDMR costs will be levied by the IESO. The IESO has not brought forward an application to the Board concerning recovery of these costs so that there has been no approval granted by the Board for the IESO to do so nor has any recovery mechanism been decided by the Board. One mechanism could be a fee to distributors, for which account 1556 may be the most appropriate account. Another recovery mechanism could be levied via a wholesale market charge, thereby impacting the RSVAs instead of 1556. Since the Board has not yet approved if and how the MDMR costs will be levied by the IESO on distributors, distributors have not been instructed whether and how to recover these costs. Parties may benefit from Espanola clarifying why they require a deferral account specifically for MDMR when the Board has not yet approved if and how MDM/R costs will be recovered, and already has two potential mechanisms for recovery if MDMR is considered to be a recoverable cost.

Treatment of 1508

Espanola is requesting disposition of $9,221 in Account 1508, Sub-Account OEB Costs Assessments as at April 30th, 2008. In its response to Board Staff Interrogatory #41, Espanola described Account 1508, Sub Account Costs Assessment (CA) as costs assessed by the OEB including carrying charges. Board guidance stated that utilities should not be adding principal into this account after April 30, 2006. Board Staff is unclear from the application and responses to interrogatories that Espanola ceased including principal amounts in this account after this time period. Espanola should clarify its response to this matter in its reply.

Treatment of 1550 and 1586

Espanola is requesting disposition of Account 1550 in the amount of $62,680. Espanola is also requesting disposition of Account 1586 for a total customer credit of ($19,749). Both balances are calculated current to April 30, 2008.

Espanola stated in its response to Board Staff Interrogatory #42 that from May 1 to October 2006, the low voltage (LV) costs were reflected in account 4720 but rolled into USA (APH) account 4716 for variance purposes. Beginning November 2006, the LV costs were reflected in account 4750. The amount in 4720 was moved to account 4750. It is not clear whether the amount rolled into account 4716 for variance purposes was restated and moved to account 4750. Since 4716 impacts account 1586 and 4750 impacts account 1550, it is unclear whether these variance accounts are stated in accordance with Board guidance with respect to LV charges, as follows:

- Account 1550 shall be used to record the variance between LV charges from a host transmitter including Hydro One (recorded in account 4750 – Charges LV) and LV charges approved in the distribution rates of a distributor (recorded in account 4075 – Billed LV) effective May 1, 2006.

- Account 1586, RSVACN shall be used to record LV charges approved for historic amounts. These amounts are included in historic regulatory asset rate riders. These amounts are in relation to Hydro One's LV charges allocated to a distributor and approved for the periods ended December 31, 2003 and April 30, 2006.

Submission

Board staff is uncertain if the underlying balances in accounts 1550 and 1586 have been calculated correctly. If the balances have just been misclassified, Board staff is unclear as to the impact on the regulatory assets rate riders, if any, and the impact on the projected RTS rates, if any. If there has been no misclassification, Board staff is unclear whether the balances are calculated in accordance with the Board's guidance provided in the APH and the December 2005 Frequently Asked Questions #8 and #9. If Board guidance was not followed for these accounts, Board staff cannot comment on what the impact on regulatory assets, rate riders, and RTS rates would be. Parties may wish to comment on whether the Board should disallow clearance until the balances can be adequately verified.

Treatment of RSVAs

Espanola is applying for disposition of 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 RSVA accounts as part of this Bill 23 process.

Treatment of 1590

Board Staff is unclear on whether principal balances for the residual balance in 1590 are being forecasted beyond December 31, 2006. The response to Board Staff Interrogatory #46 b indicates that no principal balances are being forecasted beyond December 31, 2006. However, in the response to VECC Interrogatory #14, Espanola stated that balances are being forecasted beyond December 31, 2006

In the 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), the Board stated that:

- "Also as of April 30, 2005, all four Applicants shall debit the Regulatory Asset Recovery Account (1590, Recovery of Regulatory Asset Balance) by the approved total recovery amounts. Starting May 1, 2005, revenue from the monthly rate riders shall be credited to the Regulatory Asset Recovery Account (1590). Interest shall continue to apply to this account." (Section 9.018)

- "At the end of the three year period, at April 30, 2008, as there will be a residual (positive or negative) balance in the Regulatory Asset Recovery Account (1590), this balance shall be disposed of to rate classes in proportion to the recovery share as established when rate riders were implemented." (Section 9.019)

Espanola has proposed to dispose of account 1590 before the final balance has been determined. The Phase 2 decision quoted above suggests that the rate rider associated with 1590 be removed as of May 1, 2008. Once the residual balance in account 1590 is finalized, the residual balance is to be disposed at a future proceeding. The final balance in account 1590 cannot be confirmed until after the current recovery period has expired, i.e. April 30, 2008. As the residual balance will not be finalized until after April 30, 2008, electricity sector standard practice would be to defer disposition of account 1590 until the balance has been finalized and verified.

SMART METERS

Espanola is not one of the 13 distributors authorized to undertake smart meter activities and is not named in the combined smart meter proceeding, EB-2007-0063. The Board, in its decision on Espanola's 2007 IRM application (EB-2007-0525), confirmed its understanding that Espanola would not be undertaking any smart metering activity in 2007.

In "Exhibit 1 /Page 35 /Draft Issues List – Smart Metering", Espanola stated that it has not included any costs related to Smart Metering in its application.

In response to Board Staff IR# 51-iii, Espanola confirmed that it is requesting the continuation of the current smart meter rate adder of $0.26 per month per metered customer.

However Espanola is proposing to commence deploying smart meters in 2009 as a participant in the Northeast Ontario utilities working group's smart meter implementation plan. ref: Board Staff # 51 (i) and VECC # 2 (a).

> The district group through its consultant is participating as an observer in the London Hydro Smart Meter RFP process. The Ministry of Energy has been informed of the status and approach by the Northeast utilities with respect to smart meters. The Assistant Deputy Minister, Consumer and Regulatory Affairs, has provided correspondence dated December 21, 2007, that the Ministry of Energy will recommend to the Cabinet an amendment to O. Reg. 427/06 to accommodate London Hydro and consortium members as well as any other LDCs outside the consortium (Espanola as part of the District 9 group) that have chosen to participate in the process.

The utility stated that it has not been authorized to undertake smart meter installations. Parties are invited to comment on this matter.

~ All of which is respectfully submitted ~