PUC Distribution Inc.

Reply Submission to
Board Staff Submission
And
Vulnerable Energy Consumer Coalition Submission

Concerning PUC Distribution Inc.'s
2008 Electricity Distribution Rate Application

EB-2007-0931

April 7, 2008

1. Introduction

PUC Distribution Inc. ("PUC" or the "Applicant") is a licensed electricity distributor serving the city of Sault Ste. Marie, Townships of Prince and Dennis, and Rankin Reserve. PUC Distribution has a customer base of approximately 33,000 customers (41,544 including connections).

PUC self-nominated for 2008 rate rebasing. PUC calculated a Revenue Requirement of $17,191,211 and our present rates will produce a deficiency of $4,107,414 in distribution revenue for the 2008 Test year. PUC therefore seeks the Ontario Energy Board's approval to revise its rates applicable to its distribution of electricity.

Through this application, PUC seeks:

To recover:
- Deficiency arising from changes in OM&A, Amortization, and the Rate of Return.
- Deferral and Variance Account Balances.

To change:
- Distribution Loss Factor

To reflect:
- Just and Reasonable Distribution Rates that have been modeled in accordance with the Ontario Energy Board Filing requirements for Distribution Rate Applications.

PUC acknowledges the receipt of Ontario Energy Board Staff's (Board staff) and the Vulnerable Energy Consumers Coalition's (VECC) submissions concerning PUC's 2008 EDR application and welcomes the opportunity to reply.

The following submission addresses the various components of PUC Distribution Inc.'s application and responds to submissions from the Board Staff and VEEC.

2. Operations Maintenance & Administration (OM&A)

PUC notes Board staff's comment regarding the increase to OM&A over the two year period 2006 to 2008 and also noted the Board's comments in its 2006 rate order regarding demonstrating the reasonableness of costs. With the Board's comments in mind, PUC submits that it has undertaken a prudent review of the programs that are required to improve system reliability and maintain service to customers. In addition to the internal report prepared by PUC's VP of Operations and Engineering, a third party (BDR/Metsco) was engaged to review PUC's OM&A and capital needs moving forward. The Metsco report concurred with PUC's conclusion that OM&A and capital programs are not adequate at the current levels. Both of these reports have been included in PUC's original application.

PUC's rate proposal includes increased staffing levels in order to implement and maintain the necessary OM&A and capital programs. Board staff have noted (page 17) in their submission that staffing of the increased program "may be a major challenge". Qualified labour resources are limited in northern Ontario. PUC recognizes this limitation and is therefore proposing a phased-in approach over the next six years to build local capacity and reach the required employee levels by hiring staff at the apprentice level. In doing so, productivity in the early years is lower than hiring experienced tradesmen; however, the likelihood of retaining local residents as long term employees is greatly enhanced and in the long term is more efficient.

PUC is requesting an increase in operations expenses of $1.8 million. In response to Board staff interrogatory 4 b), PUC provided a table indicating the reasons for the requested increase. In the following paragraphs are comments in reference to specific items identified by Board staff and VECC in their submissions. However, in summary, the major reasons for the percent increase in OM&A costs are i) the additional smart meter costs, ii) the one time reduction in 2006 costs as a result of a an adjustment for prior period pension expense and iii) increased staff levels as detailed in the Long-Term Capital and O&M Needs Report and the Review of Capex and O&M Plan included in Exhibit 2 (p. 41 and p. 126) of the original application. These three items account for approximately $1.5 million of the requested increase over 2006 actual. The remainder of the increase is the result of smaller items such as the PCB removal program and wage rate increases over the two year period that are listed in the response to Board staff interrogatory 4 b).

The following sections include comments in reference to specific items identified by Board staff and VECC in their submissions. As noted on page 2 of Exhibit 4 of the original application, PUC undertook a full budget process to establish 2008 test year projections, 2007 bridge year data was not simply adjusted by a fixed percentage. In doing so, in addition to the additional programs requested in the original application and detailed in the reports attached to the original application, items such as the deployment of existing labour resources may vary between financial statement line items from year to year. In completing Exhibit 4, pages 10 to 16, PUC did not attempt to reconcile the total differences from 2007 to 2008. Items were identified to explain the majority of the change in a specific line item. Changes to labour, vehicle expense, etc. allocations between accounts from year to year were not noted in the explanations - for example, labour in the amount of $5,000 may have been reduced in overhead distribution and increased by $5,000 in underground distribution between years. The type and area of expense can fluctuate from year to year based on various factors.

2.1 PCB Removal Program

Issue
Board staff notes that the amount of $130,000 indicated in PUC's response to Board staff interrogatory #4b and in Table 3 differs from the amount filed in the Applicant's original application [Exh 4/ Pg 11/ Ref. 5] The amount filed was $176,335, resulting in a difference of $141,227 from the 2007 actual, rather than the $130,000 differential shown in the interrogatory response.

PUC Comment
Account 5035 – Overhead Distribution Transformers – Operation is projected to increase by $141,227 from 2007 to 2008. The major increase is the PCB removal program at $130,000 as noted in the response to Board staff interrogatory #4b and Exh 4/ Pg 11/ Ref. 5 of the original application. The remainder of the difference is the result of the allocation of a portion of shared costs as per the Full Absorption Cost Allocation Report (summary on page 20 of Exhibit 4 of the original application – included in the Overhead Lines line item).

2.2 Railway Crossing Fees

Issue
Board staff notes that the amount of $108,000 indicated in PUC's response to Board staff interrogatory #4b differs from Ontario Energy Board Staff Submission 2008 Electricity Distribution Rates PUC Distribution Inc. Page 7 of 33 the amount filed in the Applicant's original application (Exh 4/ Pg 11/ Ref. 7) of $117,868

PUC Comment
Account 5090 – Underground Distribution Lines and Feeders – Rental Paid is projected to increase by $117,868 from 2007 to 2008. The major increase is the railway crossing fees at $108,000 as noted in the response to Board staff interrogatory #4b and Exh 4/ Pg 11/ Ref. 7 of the original application. The remainder of the difference is the result of the allocation of a portion shared costs

as per the Full Absorption Cost Allocation Report (summary on page 20 of Exhibit 4 of the original application – included in the Underground Lines line item).

2.3 New Maintenance Programs

Issue

Board staff notes that the amount of $130,000 for the introduction of programs for the maintenance of transformer gauges, refurbishment of breakers, and relays differs from the amount filed in Applicant's original application (Exh 4/ Pg 12/ Ref. 9), which showed a 2008/2007 differential of $116,381.

PUC Comment

Account 5114 – Maintenance of Distribution Station Equipment – is projected to increase by $116,381 from 2007 to 2008. The major reason for the increase is the programs noted but due the budget process undertaken to establish the 2008 test year balances, the account also includes decreases for internal labour, vehicles, etc. and an increase due to the allocation of a portion of shared costs as per the Full Absorption Cost Allocation Report (summary on page 20 of Exhibit 4 of the original application – included in the Stations line item). The net increase as a result of the additional programs and allocation of shared costs is offset by reductions in other budgeted costs for this account.

2.4 Line Clearing

Issue

Board staff notes that the amount of $145,000 to implement an effective vegetation management program differs from the amount filed in PUC's original application (Exh 4/ Pg 12/ Ref. 11), which showed a 2008/2007 differential of $251,475.

PUC Comment

The $251,475 increase noted in Exh 4/ Pg 12/ Ref. 11 includes the $145,000 increased contractor costs and also a portion of the additional labour costs noted in Table 3 (Cost Driver Table).

2.5 Pension Adjustment

Issue

Board staff observes that the pension adjustment of $350,000 is shown as a reduction from 2006 Board Approved to 2006 Actual and an increase from 2006 Actual to 2007 Bridge. The Applicant attributes this amount to an adjustment in 2006 following a regulatory accounting review. Board staff is unclear what this means.

PUC Comment

PUC engaged the services of an outside party to review its regulatory accounting procedures to ensure compliance with the APH. It was discovered during the review that PUC had overstated OMERs costs for the specified 16 month period ending May 1, 2006. The correction was processed in 2006 resulting in 2006 expenses appearing to be lower than normal had it not been for the correction. Subsequent to the third party review and the corrections noted above, Ontario Energy Board staff completed a review of regulatory asset and liability accounts in the 1500 to 2400 series of account numbers in the Uniform System of Accounts and did not note an issue with PUC's treatment of the OMERS correction.

The correction results in a one-time reduction in 2006 expenses which pertain to a prior period and understates the true costs in 2006. PUC respectfully submits that the 2006 expense level used to compare to the 2008 test year should be exclusive of the credit that reduces 2006 costs.

VECC also comments on the Pension Adjustment in Section 4.4 of its submission. To further clarify with respect to VECC's comments, the Pension Adjustment is not an ongoing cost for 2008, however because it was a credit in 2006, 2006 expenses were understated for comparison purposes. Had the adjustment not been recorded in 2006, it would not have shown as a reconciling item in 2006 and 2007 on the Chart in response to Board interrogatory 4 b).

2.6 Other Operating Costs

Issue

Exhibit 4 / Pg 6 of PUC's application includes a component on total Operating Costs entitled "Other Operating Costs" in the amount of $1,984,620 in the 2008 Test Year. A breakdown at Exh4/Pg8 attributes this amount to "Interest on Debt to Associated Companies" and "Other Interest Expense". Board Staff interrogatory #3c sought a detailed explanation as to why this amount was included by the Applicant. In its response, the Applicant stated that it had included this amount for comparative purposes and that the other interest expense is not included in the rate base. The Applicant may wish to clarify this matter in its reply submission and confirm that there is no double recovery of interest expense in its application.

PUC Comment

PUC Distribution confirms that there is no double recovery of interest expense in its application. To clarify, a detailed calculation of the total rate base is included below. The rate base of $49,406,580 agrees to PUC's Application Exhibit2/Page3 "Rate Base Summary Table". The eligible distribution expenses listed below agree to Exhibit4/Page6 exclusive of other operating costs in the amount of $1,984,620 which is "interest on debt to associated companies" and "other interest expense".

Eligible Distribution Expenses	
3500 – Distribution Expenses - Operation	3,018,799
3550 – Distribution Expense - Maintenance	2,277,648
3650 – Billing and Collecting	1,338,873
3700 – Community Relations	473,852
3800 – Administrative and General Expenses	1,397,297
3950 – Taxes Other Than Income Taxes	170,151
Total Eligible distribution Expenses	8,676,620
3350 – Power Supply Expense	49,044,109
Total Expenses for Working Capital	57,720,729
Working Capital Allowance 15%	8,658,109
Test Year Balances, Fixed Assets in Service	
Opening Balance	36,323,768
Closing Balance	45,173,173
Average Balance	40,748,470
Add: Working Capital Allowance	8,658,109
Total Rate Base	**49,406,580**

2.7 Employee Compensation and Benefits

PUC recognizes the challenges in performing labour comparisons due to the labour component included in shared costs and has made changes in its accounting system to simplify the comparison process for future rate applications.

Issue
On page 9 of its Submission, Board staff notes the following:

"In response to Board staff interrogatory #1, the Applicant confirmed that it has not made any changes to its capitalization policies or estimates."

PUC Comment
Following is PUC's response to interrogatory #1. PUC does confirm in response to interrogatory #1 that it has changed its capitalization policy:

"PUC Distribution has made changes to the allocation of costs between operations and capital expenses based on the consultant's (RDI) report included in the application."

<u>Issue</u>
Fluctuation in percentage splits between Capitalized and OM&A for Total Compensation and Benefits.

<u>PUC Comment</u>
The fluctuation in the percentage splits between capital and OM&A noted on page 9 of Board staff's submission is the result of the combination of the changes flowing from the consultant's cost allocation report and the primary functions of the additional 2008 staff. As Board staff has stated, the splits have been reasonably consistent.

<u>Issue</u>
Table 2, page 9 of the Board staff submission – Board staff states that labour averages approximately 29% of operating cost.

<u>PUC Comment</u>
The OM&A labour figure in Table 2, page 9 of the Board staff submission contains only labour that can be directly allocated to PUC. It does not include labour that is included in Total Controllable OM&A expenses as part of shared services costs.

<u>Issue</u>
24% increase in compensation in the 2008 test year.

<u>PUC Comments</u>
Board staff has indicated that since 2006, 9 employees have been hired. To clarify, one additional employee was hired in 2007 and 9 additional employees are proposed for 2008 (not as of yet hired). Of the 9 additional employees listed, one (the billing supervisor) is a shared employee. PUC felt it was not prudent to hire the additional employees until the final outcome of this rate application – if the rate application is not approved, not all of the proposed employees will be hired and not all proposed programs will be implemented.

<u>Issue</u>
20% increase in employee benefits.

<u>PUC Comments</u>
The increase in employee benefits is a result of the increased staff level. However, the benefits as a percentage of wages has decreased likely due to reasons associated with the new employees (less vacation entitlement than

existing employees, lower short term disability benefits than long term employees, etc.).

Issue
Table 4 (Cost Driver Summary) indicates employee costs are increasing by $923,703 from 2006 to 2008 while Table 3 (Year over Year Change in Total Compensation) shows that costs are increasing by $653,342.

PUC Comments
Table 4 lists the reasons for the increase in OM&A costs from 2006 to 2008 and identifies increased labour costs that are included in shared costs which are not included in Table 3 (Year over Year Change in Total Compensation).

3.0 Shared Services

In order to address the Board's concern regarding shared services as stated in its 2006 rate decision for PUC, a third party (RDI) was engaged prior to the completion of PUC's rate application in 2007 to undertake a Full Absorption Cost Allocation Report. The Board expressed concerns over the level of detail included in a previous cost allocation report completed by KPMG. The focus of the KPMG report was to allocate shared costs as identified by PUC. The 2007 report was more in depth and reviewed which costs should be allocated in addition to fair allocation factors.

Issue
Increase in shared services costs of 20%.

PUC Comments
Three main factors as noted by Board staff account for the increase in shared services costs:

1. The Cost of Capital Charge has been introduced as recommended in the Full Absorption Cost Allocation Report. This charge applies to all PUC affiliates and is designed to recover, on an annual basis, PUC Services financing costs for assets used to service the affiliates. The majority of the increase in shared services costs results from this pass through of costs.

2. The use of asset charge is the pass through at cost of the depreciation related to assets used by the LDC and owned by PUC Services. This is not a new charge but has increased in 2008 due to the additional vehicles and equipment required by the proposed additional staffing levels and the upgrade to software driven by the need for PUC to better maintain records as a result of Reg. 22. These costs and the proposed increase would be the same or perhaps higher due to the loss of sharing of efficiencies if they were owned by the LDC.

3. The joint service allocation has been adjusted as a result of a combination of factors:

a) the administrative percentage allocated to PUC was reduced based on the annual review of allocation percentages and the cost allocation study,

b) general wage increases and

c) the addition of a shared billing supervisor and a shared IT Manager.

The IT Manager was added at the end of 2007. It was determined that due to the planned software upgrade, the upcoming smart meter implementation, ongoing network security issues, the increasing reliance on computer technology, etc. that in-house expertise is now required in this area. The billing supervisor is proposed for 2008 to address issues associated with the introduction of smart meters and alleviate the workload and unpaid time of current billing manager. This is a position that has not been filled for several years. There is no evidence before the Board suggesting these positions are inappropriate or unreasonable.

VECC's submission (Section 4.8) notes the difference between the $192,000 reduction in joint costs shown in response to Board staff interrogatory # 4 b) and VECC # 18 a) which indicates a reduction of $562,616. It is PUC's understanding that the chart in response to Board # 4 b) was to explain the total difference in expense level between 2007 and 2008. This would include changes due to the allocation method but would also be affected by the level of expenses to be allocated. The response to VECC # 18 a) is a comparison of the 2008 joint service costs allocated under the 2007 allocation method and the 2008 allocation method.

4.0 Rate Base

On page 12 and 15 of the Board staff submission, it is stated that PUC's capital expenditure projection for 2008 would be $5,422,771 without smart meters. It should be clarified that PUC's projection for smart meters in 2008 includes an allocation of a portion of the $960,431 capital overhead allocation referred to on page 15 of the Board staff submission. The 2008 capital projection without smart meters is therefore $5,960,383.

Table 1 on page 12 of the Board staff submission lists the increase in capital expenditures in 2007 as 114.2%. PUC assumes this is typographical error which should read as an increase of 14.2%.

4.1 Profitability Index

Issue

Board staff notes that the rate base aspects of the application, supplemented by interrogatory responses, were essentially complete. However, Board staff notes that the Applicant did not provide the calculations for the Profitability Index (PI) in order to determine the revenue-producing capital expansions and to quantify the required capital contributions.

In VECC's submission, Section 2.2 it states that VECC is concerned that PUC is not currently carrying out the required economic evaluations for such projects in order to establish whether or not capital contributions are required. PUC has indicated that it intends to review its handling of capital contributions. However, to the extent there is no allowance included in the rate base for such contributions, rates for 2008 will be overstated if any contributions are subsequently established during this year. In order to address this issue VECC submits that the OEB should approve spending levels for Customer Demand Projects (for the purpose of rate base determination) that are nominally (e.g. 10%) less than requested.

PUC Comment
It is PUC understanding that the OEB's Distribution System Code does not outline the method to calculate a Profitability Index. PUC believes that a Profitability Index is a calculation conducted by a natural gas distributor to complete an economic evaluation of a system expansion on the natural gas distribution system but it is not applicable to an electric distributor in Ontario. For an electric distributor Appendix B of the Distribution System Code outlines the method to conduct an economic evaluation and determine if a capital contribution is required for those facilities that are classified as expansion facilities.

In the case of PUC, the rate application indicates for 2006 and 2007 capital investments to meet customer demand are $776,639 and $748,705 respectively. Both of these amounts include upgrades to existing services and connecting new services which lie along the existing distribution system. There are no system expansions associated with these items and therefore do not require an economic evaluation to determine if a capital contribution is required.

For the remaining amount of customer demand capital (Install underground servicing in new subdivisions) PUC has not conducted an economic evaluation to determine if any capital contribution is required. Capital contributions for new subdivisions and customer demand work are based on the current policy which recognizes that the developer is responsible for the increased costs of underground distribution beyond the costs of equivalent overhead distribution. The capital additions for subdivisions and customer demand work are shown net of contributed capital as stated in the original application Exhibit 2, pages 31 and 33.

PUC Distribution is currently reviewing the methods used to handle contributed capital and recognize this as a possible area of improvement before the next rebasing/cost of service application. However, for the purposes of supporting the capital investment included in this application PUC has concentrated on having a comprehensive “Long Term Capital and O&M Need Report” completed in order to address a fundamental issue of ensuring the PUC distribution system is reliable for the foreseeable future.

For the 2008 capital budget, PUC has included an amount of $760,698 to install services to meet customer demand. As in 2006 and 2007 these amounts include upgrades to existing services and connecting new services which lie along the existing distribution system and are not considered expansions. Underground servicing for subdivisions is budgeted at $260,811 for 2008. As noted on page 33 of Exhibit 2 of the original application, these amounts are net of contributed capital. The budgeted amount of contributed capital netted from the Install services to meet customer demand item is $150,000 and $360,000 for the underground servicing for subdivisions item. This budgeted contributed capital is in excess of the 10% reduction proposed by VECC in section 2.2 on page 2 of their submission and therefore a reduction is not required.

4.2 Drivers for Increases in 2008 Capital Expenditures

Issue
Increase in capital expenditures over historical values.

PUC Comment
As noted in Section 4.0 of this submission, it is stated by Board staff that PUC’s capital expenditure projection for 2008 would be $5.42 million without smart meters. It should be clarified that PUC’s projection for smart meters in 2008 includes an allocation of a portion of the $960,431 capital overhead allocation referred to on page 15 of the Board staff submission. The 2008 capital projection without smart meters is therefore $5.96 million.

PUC included with the original application a Long-Term Capital and O&M Needs report (Exhibit 2, page 41) and a third party report (Review of Capex and O&M Plan prepared by BDR North America Inc. - Metsco, Exhibit 2, page 126). The BDR report states (Exhibit 2, page 130): “Replacing or refurbishing aging assets in a timely fashion so they do not have significant adverse impact on reliability, safety and operating efficiency will require a significant increase in capital and operating budgets from previous years.” PUC respectfully submits that it has prudently approached the formulation of its capital plan. A phased in approach to reach the required level of expenditures is included in the 2008 budget and will continue over a number of years.

In Section 2.3, page 2 of its submission, VECC states it has no submissions regarding the need for the proposed work. VECC does express concerns (Section 2.4) with PUC’s ability to obtain and deploy the resources needed to complete the proposed 2008 capital program. Board staff have also noted (page 17) in their submission that staffing of the increased program “may be a major challenge". PUC's rate proposal includes increased staffing levels in order to implement and maintain the necessary OM&A and capital programs. PUC is proposing to continue the phased-in approach to reach the required employee levels by hiring staff at the apprentice level. In doing so, productivity in the early years is lower than hiring experienced tradesmen; however, the likelihood of retaining local residents as long term employees is greatly enhanced and in the long term is more efficient.

Through its budgeting process PUC has assigned labour costs to the O&M programs and capital projects based on the employee level requested in this rate application. These employee levels can be attained through the apprenticeship route due to the quality of graduates from the electric related programs at Sault College in Sault Ste. Marie and the lineman program at Cambrian College in Sudbury.

The 2008 proposed capital budget includes $347,748 for transformer station equipment (Exhibit 2, page 33, item 17 of the original application) and $717,851 for distribution station equipment (Exhibit 2, page 33, item 18 of the original application) for a total of $1,065,599 compared to the 2007 amount of $583,194 (Exhibit 2, page 31, items 15 and 16) for an increase of approximately $480,000. These costs are comprised mostly of equipment costs with a small labour component.

The other significant increase to the capital budget is the increase to the overhead allocated to capital as recommended in the Full Absorption Cost Allocation Report prepared by RDI (Exhibit 4, page 21 of the original application). This increase amounts to approximately $750,000.

PUC recognizes the significant increase over prior years but submits it has been prudent and realistic in setting its targets in the short and longer term.

4.3 Allocation of Overhead Costs to Capital Projects

<u>Issue</u>
Increase in overhead allocation to capital.

<u>PUC Comment</u>
PUC confirms, as stated in Board interrogatory #1, it has made changes to the allocation of costs between operations and capital expense based on the Full Absorption Cost Allocation Report (Exhibit 4, page 21 of the original application).

A comparison of shared services costs for 2007 and 2008 is included in the response to Board interrogatory # 8 ii. The overall increase to shared services allocated to PUC is $560,391. The reasons for the overall increase are detailed in Section 3.0 of this submission. The increase in the percentage allocated to capital is as a result of the overall increase in shared services costs and the recommendations in the Full Absorption Cost Allocation Study to allocate a portion of administrative expenses and the cost of capital charge to capital expense.

VECC requested in interrogatory # 18 a), the shared services costs allocated to PUC in the 2008 test year compared to the amount that would have been allocated in 2008 using the 2007 (pre-cost allocation report) allocations. The proposed test year allocation results in an increase to capital of $738,344 and a decrease to OM&A of $562,616.

4.4 Service Reliability Indices

Issue
Clarification of Tables

PUC Comment
PUC offers the following comments in response to comments noted on page 16 of the Board Staff Submission regarding inconsistencies in performance indicators.

Figure 19, found on page 70 of PUC Exhibit 2, is a chart that was developed some time ago in order to demonstrate the general, and rather dramatic, trend in system reliability. It was originally developed for internal use and was not intended to portray precise numbers. Since this chart was originally created, various revisions (corrections) to the raw data have occurred. Corrections included revision to customer counts at year-end and corrections to outage raw data after more closer analysis. These corrections were not reflected in Figure 19. Furthermore, Figure 19 includes inconsistent reporting of Loss of Supply. Some years reported included Loss of Supply while others excluded Loss of Supply.

The data presented in PUC's response to Board staff interrogatory #24b, is based on the revised data and is the "correct" information that should be referenced.

In the interest of clarity, the table below provides a comparison of the actual numbers plotted in Figure 19 for the years 2002 through 2006. Note that the data for 2003 excluded Loss of Supply while the other years included that data. In addition, note the 2003 figure for SAIFI in Board staff's summary from Exhibit 2, page 70 figure 19 should be 1.26 rather than 1.9.

		Exhibit 2, Page 70 figure 19 (all data includes Loss of Supply except for 2003)			Response to Board #24b (all data excludes Loss of Supply)	
Year		**SAIDI**	**SAIFI**		**SAIDI**	**SAIFI**
2002		1.80	1.76		2.06	1.78
2003		2.41	1.26		2.77	1.80
2004		3.64	3.30		3.61	2.65
2005		4.45	4.46		4.04	3.97
2006		2.36	3.25		2.38	3.29

Excludes Loss of Supply

The table below summarizes the factors that have contributed to the discrepancies between the two sets of data.

Year	Experienced Loss of Supply during the year?	Corrections to Raw Data?	Revisions to Customer Counts?	Comments (regarding discrepancies in reported indices)
2002	No	Yes	No	Discrepancies are due to revisions to raw data not reflected in Figure 19.
2003	Yes	Yes	Yes	Indices reported in Figure 19 excluded Loss of Supply for 2003 only. Discrepancies are due to the combined effect of corrections to raw data and customer count not reflected in Figure 19.
2004	Yes	Yes	Yes	Discrepancies are due to the combined effect of corrections to raw data and customer count not reflected in Figure 19.
2005	Yes	Yes	Yes	Discrepancies are due to the combined effect of corrections to raw data and customer count not reflected in Figure 19.
2006	Yes	Yes	Yes	Discrepancies are due to the combined effect of corrections to raw data and customer count not reflected in Figure 19.

<u>Issue</u>
2008 Reliability Target

<u>PUC Comment</u>
PUC set an improvement factor of target of 25% in the 2008 budget and a longer term goal of attaining and maintaining the provincial averages.

4.5 Asset Management Plan

<u>Issues</u>
Staffing challenge and structured process for updating the budget and needs identification on a regular basis.

<u>PUC Comment</u>
The BDR/METSCO report confirms our understanding of the urgent need to increase infrastructure renewal. The Consultant's review has determined that we need to go far beyond what we are currently proposing and PUC agrees with their recommendations. However, PUC notes that to attain the levels of renewal recommended would be unreasonably impactive on rates, in the short term.

PUC has also noted that availability of qualified labour is severely limited in northern Ontario, as it probably is across the Province. As noted in our internal report (refer to page 56 of Exhibit 2 of the original application) PUC will not be able to achieve the recommended levels in the short term. PUC recognizes this limitation and is therefore proposing a phased-in approach over the next 6 years to build local capacity and reach the required staffing levels.

PUC's rate proposal includes increased staffing levels in order to implement and maintain the necessary OM&A and capital programs. PUC is proposing to continue the phased-in approach to reach the required employee levels by hiring staff at the apprentice level. The goal is to make steady improvement in reliability and then maintain the reliability at an acceptable level through the asset management plan as documented by PUC in the Long-Term Capital and O&M Needs Report and the Review of Capex and O&M Plan (Exhibit 2 of the original application).

PUC's capital plan is reviewed on an annual basis each fall to prioritize the projects for the following year and assemble the capital and O&M budgets. The long term plans are re-evaluated and updated in conjunction with the annual budgets. Input is provided by engineering, lines, metering and stations staff. In addition, subsequent to restoring power after major outages, a review of the cause is undertaken by a committee of the staff noted above in order to initiate corrective or preventative action. The results of these reviews are also incorporated in the budgeting process.

4.6 Treatment of Construction Work in Progress

Issue
PUC is not currently recording an allowance for funds used during construction.

PUC Comment
This is an issue identified by PUC in 2007. It will be reviewed and PUC will prospectively commence recording.

4.7 Transmission Network Charges

Issue
Transmission Network Charges used in determining working capital allowance (VECC Submission – Section 2.8).

PUC Comment
PUC submits that the values for the cost of energy used for the working capital calculation are reasonable in comparison to 2007 actual results. The WMS expense is less than 2007 and should be adjusted upwards if it is determined that transmission charges should be further reduced.

5.0 Cost of Capital

Issue
Clarification of Board interrogatory # 28 e) – Return on Equity Rate, LTD rate, short term debt, weighted average cost of capital.

PUC Comment
It is PUC's intent to restructure its capital structure to the Board's deemed debt to equity. Exhibit 6 of the original application included the debt to equity structure for the 2007 bridge year and the 2008 test year at the projected levels. The anticipated restructuring has not yet been finalized, therefore the revised table for the 2007 actual debt to equity structure was included in Board interrogatory response 28 e), page 9 of 18. The revised 2008 table was also included in interrogatory response 28 e) at the deemed debt to equity structure of 60/40 at the current approved debt rate due to the anticipated reduction in shareholder loan. PUC's return calculation and resulting distribution rates in the original application were based on a return of 8.69% on equity at 40% and deemed debt rates of 5.82% (long term) and 4.77% (short term) on the debt portion of 60%. PUC's intent in its application was to base its return on:

- the deemed equity rate at the deemed equity level (now set at 8.57%),

- the lower of its actual long term debt rate with the shareholder (6.35%) and the deemed debt rate (now set at 6.10%) at the deemed long term debt level, and
- the deemed short term debt rate (now set at 4.77%) at the short term debt level.

PUC awaits the Board's direction in this matter.

6.0 Load Forecasting

Issue – Weather Normalization

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

Parties may wish to comment on Board staff's observation that the Applicant's filed forecast is about 1%-2% higher than the data would suggest.

VECC's submission 3.4 stated that VECC disagrees with the Board Staff's view that this alternative approach will yield a more accurate load forecast.

PUC Comment

It is PUC's understanding that Hydro One used the weather normalization method approved by the Board in the Distribution Cost Allocation Review (EB-2005-0317). PUC does not know if this weather normalization method was used by Hydro One in it's own 2006 Distribution Rate case (RP-2005-0020/EB-2005-0378). However, it is PUC understanding that Hydro One has used the same weather normalization method for a number of years. As result, PUC expects Hydro One used the same weather normalization method in both cases.

PUC is also concerned that the weather normalized volume forecast used to design the proposed rates is too high based on recent historical usage. However, as outlined in the Board's *Filing Requirements for Transmission and Distribution Applications*, issued November 14, 2006 a weather normalized forecast was required for the design of distribution rates. In order to complete the weather normalized forecast, the Hydro One weather normalized data used in the cost allocation appeared, at the time of preparing the application, to be the only source of weather normalized data. The Hydro One weather normalized data was based on 31 years of average weather and PUC has concerns with this average as it reflected weather that occurred 31 years ago when Sault Ste Marie had much colder winters than it does now.

In this regard, PUC respectively submits that it might be more appropriate to use the average usage per customer from the past 5 years as the retail NAC values for 2008. PUC understands that this is not a “pure” weather normalized value but it does reflect recent weather conditions.

7.0 Smart Meters

Issue
Authorization to undertake smart meter activities.

PUC Comment
PUC has not installed any smart meters and does not intend to install smart meters until authorized by the Board. However, in order to meet installation deadlines, for itself and other members of the Northeast Utilities group, PUC has formulated a plan that projects the installation of approximately 32,000 smart meters in 2008. The costs to date amounting to $53,625 which were referenced in the response to Board interrogatory # 43 a) ii have been recorded in the smart meter capital variance account.

PUC is proposing with this submission to address the recovery of smart meters by using a smart meter rate adder as suggested by VECC in its submission. PUC does not however, agree with an arbitrary “discount factor”. Along with this proposal, PUC would request that existing accounts 1555 and 1556 would be used to record the revenue from the smart meter rate adder and the costs associated with the smart meters.

PUC proposes to use the OEB smart meter rate adder model to determine the smart meter rate adder amount when final rates are determined. Board staff would have the opportunity to ensure the calculation is correct before final rates are approved.

The inputs into the OEB smart meter rate adder model would include $6,200,000 of capital in 2008 and $365,000 in OM&A expenses in 2008. The capital amount would be removed from rate base and the OM&A expense would be removed from expenses for the calculation of working capital and revenue requirement. As per the smart meter adder model the resulting adder would be applied to all metered customers.

8.0 Revenue to Cost Ratios

Issue
Revenue to cost ratios for street light and sentinel light classes.

PUC Comment

PUC is concerned about further increases to these customers bills should the ratios be further adjusted but awaits the Board's direction on this matter.

9.0 Rate Design

Issue
Monthly service charges for the GS < 50 kW and GS > 50 kW.

PUC Comment
PUC awaits the Board's direction on this matter.

10.0 Retail Transmission Service Rates

Issue
Retail transmission rate reduction less than wholesale rate reduction.

PUC Comment
PUC reduced retail transmission rates by 16% as part of its 2006 EDR (Sheet 8-6) for rates effective May 1, 2006 as a result of the surplus in the variance account that Board staff noted in their submission on page 23. PUC reviewed transmission revenue and expenses for the period subsequent to the rate change – May 1, 2006 to September 30, 2007 and determined in order to pass through costs to ratepayers, the reduction to retail transmission rates should be 10.5% (before rounding). This is based on the May 2006 to September 2007 period revenue of $4.577 million and projected expense of $4.096 million for the same period at the revised wholesale rate.

Issue
Retail transmission rate for Interval Metered customers not reduced.

PUC Comment
PUC confirms that this is an oversight and will be corrected on the Draft Rate Order.

11.0 PILS

Issue
In response to Board staff interrogatory #2 d) [Pg 192], PUC submitted a PILs calculation that excluded the interest addition and deduction, and uses the effective tax rate of 33.5%. The excess interest penalty should not be required since the government's legislation should limit the interest deduction used in the actual tax returns.

In VECC's submission 4.9 and 4.10 it states that in its submission Board Staff invites parties to comment on PUC's proposal to not deduct its excess interest expense for purposes if calculating PILS. It is VECC's understanding that the Board has already addressed this issue in its EB-2007-0723 Decision regarding PUC's 2007 rates. VECC notes that in response to VECC #21, PUC has updated its CCA schedule calculations for 2008 to reflect the impact of the March 2007 Federal budget. VECC submits that these revised values should be used in PUC's 2008 PILs calculations.

PUC Comment
PUC Distribution has no further comment on this issue.

12.0 Deferral and Variance Accounts

12.1 Request for new deferral account – Capital works during the non-rebasing years

Issue
PUC is requesting to establish a deferral/variance account for capital works during the non-rebasing years to collect the revenue requirement costs associated with the cost of construction.

PUC Comment
PUC requested the approval of the new deferral account for capital works during the non-rebasing years as suggested in the Board's *Filing Requirements for Transmission and Distribution Applications*, issued November 14, 2006, Chapter 2, Section 2.0 Preamble, Page 7, the last paragraph in the section states:

> *"For the distributors, recognizing that rebasing may occur every three years, a distributor may consider applying for deferral accounts for capital works during the non-rebasing years to collect the cost of construction"*

It was PUC understanding that in order to address the lost revenue requirement that occurs on capital investments placed in service in non-rebasing years the OEB was suggesting in the filing requirements that a distributor may apply for a deferral account for capital works during the non-rebasing years.

PUC understands this deferral account in analogous to including a capital investment factor in an IRM year. PUC also understands that a capital investment "Z factor" approach has been suggested in the Staff Discussion Paper on 3rd Generation Incentive Regulation for Ontario Electricity Distributors dated February 28, 2008. However, as stated in the staff submission:

> "*The mechanistic calculation for 3rd Generation IRM has not been finalized, as it is currently before the Board, and may include a capital component."*

It is PUC position that as of the date of this submission, the Board has not approved the capital component in the 3rd Generation IRM and it is only prudent for PUC to request the establishment of new deferral account for capital works during the non-rebasing years.

12.2 Request for new deferral account – MDMR Account

Issue
PUC is requesting a new deferral account to record MDMR costs.

PUC Comment
Based on the OEB staff Submission it appears there is method already in place to address the MDMR costs that are considered to be cost recoverable by using account 1556. PUC was not aware of this account could be used for this purpose and appreciates Board staff bringing this forward. As a result, PUC no longer see the need to establish a new deferral account for MDMR costs.

12.3 – Request for new deferral account – Full year return and depreciation on smart meter assets for 2009 and 2010.

Issue
PUC is requesting a deferral account for the variance between the return and capital and depreciation expense associated with smart meters capital for 2009 and 2010 and that which is included in revenue requirement for 2008 and subject to half-year rule.

PUC Comment

PUC is proposing with this submission to address the recovery of smart meters by using a smart meter rate adder. Along with this proposal, PUC would request that existing accounts 1555 and 1556 would be used to record the revenue from the smart meter rate adder and the costs associated with the smart meters. This would also mean PUC is no longer requesting the establishment of a new deferral account to address the full-year return and depreciation on smart meter assets for 2009 and 2010.

12.4 – Treatment of account 1590

Issue
The response to Board staff interrogatory #53 indicates a residual balance of $540,928 as at April 30, 2008 and that no principal balances are being forecasted beyond December 31, 2006. However, in response to VECC

interrogatory #22, PUC stated that balances are being forecasted beyond December 31, 2006 and a different balance in the account is proposed of $534,945 as at April 30, 2008.

PUC Comment

In response to VECC interrogatory #22 PUC was explaining how the residual balance in account #1590 was determined by taking the December 31, 2006 closing balance in account #1590 and deducting revenue generated from the rate riders and adding projected interest. There are no principal balances forecast beyond December 31, 2006. Please refer to page 48 of PUC Distribution responses to VECC for a detailed calculation of the 1590 residual balance. The balance of $534,945 is the amount PUC applied for in the 2008 rate application. In Board Staff interrogatory #53 board staff requested the balances for variance accounts to be revised with interest forecast to April 30, 2008 which changed the residual balance in account 1590 to $540,928.

12.5 – Transfer to account 1590

Issue

An amount of $4,651,697 of regulatory assets was approved for disposition in the 2006 EDR. However, it is not clear whether the transfer to account 1590 occurred properly.

VECC in submission #6.6 submits that this approach is inconsistent with the Board's Phase 2 Decision regarding the Recovery of Regulatory Assets. In that decision, the OEB stated that any residual balance in Account #1590 would be cleared after April 30, 2008.

PUC Comment

The regulatory asset continuity schedule provided to the Board staff in interrogatory #50 did not include Other Deferred Credits (OPGI Rebate) Account # 2220. The balance in account #2220 was transferred to account #1590 in the amount of $(660,197) as per the approved 2006 EDR but was not shown on the regulatory asset continuity sheet. The principal balance of $4,383,777 (agrees to continuity schedule) and the interest balance $935,718 (agreed to continuity schedule but is on the line above in error) less the $660,197 is a total of $4,659,298. The difference of $7,601 (approved balance $4,651,697 - $4,659,298) is in an error in the transfer of account #1570 Qualifying Transition Costs. PUC Distribution will correct the error of $7,601 transferred to account #1590.

12.6 – Rate Riders

Issue
In VECC submission 6.7 it was noted that in response to VECC #22 d) PUC has corrected the allocation factors to be used for Account #1584 and #1548. These revisions should be reflected in PUC's final rates.

PUC Comment
The allocation factor used when calculating the rate riders were in fact correct. The error was only a transposition error on the summary printed in Exhibit 5/page5. The summary incorrectly stated in the "allocation basis" column that 1548 was KWh and 1584 was # of customers. It should have stated in the "allocation basis" column that 1548 was # of customers and 1584 was KWh. There are no revised calculations that are required but rather an error on the labeling in the "allocations basis" column on Exhibit 5/page5.

13.0 – Summary

Through its original application, interrogatory replies and this reply submission, PUC feels it has demonstrated the need for the requests made in its 2008 rate application. PUC has been responsive to the issues raised in the 2008 interrogatories and also assigned significant resources to address issues raised by the Board in PUC's 2006 rate decision.

This submission has focused on addressing issues in the Board Staff and VECC submissions, under the assumption that all other items in the original application and interrogatory responses are considered reasonable and acceptable by the parties involved.

- All of which is respectfully submitted -