



# **ONTARIO ENERGY BOARD**

## **BOARD STAFF SUBMISSION**

### **2008 ELECTRICITY DISTRIBUTION RATES**

Chapleau Public Utilities Corporation

EB-2007-0755

**April 21, 2008**

## **INTRODUCTION**

Chapleau Public Utilities Corporation ("Chapleau" or the "Applicant") is the licensed electricity distributor for the Township of Chapleau and serves about 1,300 customers.

Chapleau submitted an application for 2008 electricity distribution rates on November 22, 2007. The application was based on a future test year cost of service methodology. Chapleau submitted its response to interrogatories from Board staff and one intervenor, the Vulnerable Energy Consumers Coalition ("VECC"), on March 28, 2008.

These submissions reflect observations and concerns arising from Board staff's review of the pre-filed evidence and interrogatory responses from the Utility, and are intended to assist the Ontario Energy Board (the "Board") in evaluating the Chapleau application and in setting just and reasonable distribution rates.

## **THE APPLICATION**

Chapleau has requested a revenue requirement of \$723,891 to be recovered in new rates effective May 1, 2008. The electricity bill for a residential customer consuming 1,000 kWh per month is expected to decrease by 4.5% if the application is approved as filed. The reasons for the bill decrease include reductions in the Regulatory Asset Rate Rider, Retail Transmission Rates and the Wholesale Market Service Charge, which offset increases in distribution rates. (The distribution-only cost increase for a Residential Customer using 1000 kWh per month is 13.4%).

Chapleau has experienced a reduction in overall kWh sales of 17% from 2002 to 2006 while the Township has suffered a reduction in population of 12% over the same time period.

## **OPERATIONS, MAINTANANCE & ADMINISTRATION**

### **Background**

Chapleau's Summary of Operating Costs is found in Exhibit 4, page 159 of 184 of the Application. In response to Board staff interrogatory #2 Chapleau amended its Controllable OM&A expenses request to \$567,822 in the 2008 test year or a 14% increase compared to the 2006 actual level.

### **Discussion and Submission**

#### **Overall OM&A**

Board staff notes that Chapleau's evidence suggests that over 75% of its OM&A costs will be incurred through shared services in the 2008 test year. Shared service costs are discussed in a subsequent section of this submission.

Using Operating Costs as its base, Board staff created three different tables and asked interrogatories concerning each table. Chapleau amended the tables through its response to Board staff interrogatory #2.

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

**Table 1**  
**Operating Costs, 2006 to 2008**

***Amended Table 1***

	<u>Approved</u>	<u>Historical Yr.</u>	<u>Bridge Year</u>	<u>Test Year</u>
Operations and Maintenance	263,311	274,181	296,913	302,585
Billing & Collecting	65,879	60,018	66,539	64,112
Community Relations	2,607	1,707	1,063	1,200
Executive Salaries and Expense	59,881	59,331	62,672	64,552
Office Supplies and Expense	22,176	19,432	21,661	22,248
Outside Services Employed	38,352	47,795	104,528	72,425
Property Insurance	13,601	12,119	13,000	13,500
Regulatory Expenses	5,734	4,584	5,769	6,000
Misc. General Expenses	6,546	10,612	15,000	12,000
Bank Charges	8,247	8,941	9,883	9,200
Controllable OM&A Expenses	<u>486,334</u>	<u>498,720</u>	<u>597,028</u>	<u>567,822</u>
Low Voltage Charges (8 Months Only)	0	0	0	24,631
Depreciation	37,890	37,370	36,273	36,563
<b>TOTAL OPERATING COSTS</b>	<u>524,224</u>	<u>536,090</u>	<u>633,301</u>	<u>629,016</u>

**Table 2**  
**Controllable Expense Variances**  
**2006 to 2008**

	Approved	Variance Historical/ Approved	Historical Yr.	Variance Bridge/Historica l	Bridge Year	Variance Test/Bridge	Test Year	Variance Test/Historical
Operations and Maintenance	263,311	10,870 2.2%	274,181	22,732 4.6%	296,913	5,672 1.0%	302,585	28,404 5.7%
Billing & Collecting	65,879	-5,861 -1.2%	60,018	6,521 1.3%	66,539	-2,427 -0.4%	64,112	4,094 0.8%
Community Relations	2,607	-900 -0.2%	1,707	-644 -0.1%	1,063	137 0.0%	1,200	-507 -0.1%
Executive Salaries and Expense	59,881	-550 -0.1%	59,331	3,341 0.7%	62,672	1,880 0.3%	64,552	5,221 1.0%
Office Supplies and Expense	22,176	-2,744 -0.6%	19,432	2,229 0.4%	21,661	587 0.1%	22,248	2,816 0.6%
Outside Services Employed	38,352	9,443 1.9%	47,795	56,733 11.4%	104,528	-32,103 -5.4%	72,425	24,630 4.9%
Property Insurance	13,601	-1,482 -0.3%	12,119	881 0.2%	13,000	500 0.1%	13,500	1,381 0.3%
Regulatory Expenses	5,734	-1,150 -0.2%	4,584	1,185 0.2%	5,769	231 0.0%	6,000	1,416 0.3%
Misc. General Expenses	6,546	4,066 0.8%	10,612	4,388 0.9%	15,000	-3,000 -0.5%	12,000	1,388 0.3%
Bank Charges	8,247	694 0.1%	8,941	942 0.2%	9,883	-683 -0.1%	9,200	259 0.1%
Controllable OM&A Expenses	486,334	12,386 2.5%	498,720	98,308 19.7%	597,028	-29,206 -4.9%	567,822	69,102 13.9%

### Cost Drivers

In response to Board staff interrogatory #2, Chapleau provided the following cost driver table (Table 3) to explain the increases in Total Controllable OM&A expenses identified above. The review starts with the Historical (2006 Actual) amount of \$498,720 and progresses forward to the 2008 Test year amount of \$567,822.

**Table 3**  
**Cost Driver Review**

	<u>2008</u>	
Opening Balance (2006 Historic Year)	498,720	
<b>Operations &amp; Maintenance:</b>		
Salary Increases of 3% for each year (2007 & 2008)	8,150	
Pension Increase	5,050	
Additional Repairs and Maintenance Expense		
as per Interrogatory # 5	<u>13,700</u>	26,900
<b>Billing and Collecting:</b>		
Salary Increases of 3% for each year (2007 & 2008)	2,800	
Increase write offs	<u>1,300</u>	4,100
<b>Executive salaries and expense:</b>		
Salary Increases of 3% for each year (2007 & 2008)	2,750	
Additional Travel Expense	<u>1,500</u>	4,250
<b>Office Supplies and Expense</b>		
Timing of purchasing supplies	<u>2,816</u>	2,816
<b>Outside Services Employed:</b>		
Additional cost for Regulatory Filings		15,000
 Recovery of one time costs (Interrogatory #3)		11,605
Unexplained Difference		4,431
 Closing Balance Test Year (2008)		567,822

The increase in Controllable OM&A spending is mainly attributable to the following cost drivers: salaries and pensions, additional repairs and maintenance, regulatory expenses and recovery of one-time costs.

### **Salaries and Pensions**

Board staff's comments on this topic are contained in the Compensation and Staffing submission which follows.

### **Additional Repairs and Maintenance**

Chapleau identifies in Table 3 above that repairs and maintenance costs are increasing by \$13,700. The table references Board staff interrogatory #5, but the reason for this increase remains unclear to Board staff after reviewing the interrogatory response. Board staff would invite Chapleau to provide additional clarification of this matter in its reply submission, by referring to the relevant information in its Application.

### **Regulatory Expenses and Recovery of One-Time Costs**

Chapleau has identified additional costs for regulatory filing as a cost driver in the amount of \$15,000. Staff found no direct reference to this amount in the original application or interrogatories filed. However, in response to Board staff interrogatory #4, the applicant identified a similar amount as a projected cost from its outside services provider "Regulatory Compliance Services" referenced against "2<sup>nd</sup> Generation". It is unclear to staff whether this amount is meant to be a one-time expense for 2008 or an annual on-going charge. The Applicant also included in this cost item, an additional amount of \$3,000 as "IRM application 2007 and 2009 Rates". It remains unclear to Board staff as to the intended use for these amounts. Staff invites the Applicant to provide further clarification of this matter in its reply argument, citing the evidence as filed.

Chapleau has also identified, in its response to Board staff interrogatory #3 (which requested a breakdown of regulatory costs), one-time costs in the amount of \$11,605, as a cost driver recovery item. The origin of this value is identified as the average of three years of consultant expenses in the amount of \$29,605 from 2006 through 2008 less an amount of \$18,000, which is described as consultant costs for regulatory matters. In the original application, in Exhibit 4 Operating Costs, the applicant identified a similar amount of \$18,000 in the table identified as "Outside Services Employed" charged by "Regulatory Compliance Services". This amount is broken down in response to Board staff interrogatory #4.

It appears to Board staff that the Applicant has misinterpreted the purpose of Board staff interrogatory #3b, which requested that the Applicant set out how the utility proposes to recover one-time costs related to its 2008 rate application and not the consultant costs for the 2006 to 2008 period. Staff invites the Applicant to clarify its evidence regarding this matter in reply argument.

### **Increase in Compensation and Staffing**

Chapleau states that employee costs are charged indirectly through its affiliate company, Chapleau Energy Services Corporation.

Table 4 was prepared by Board staff to summarize the information on labour costs provided in Exhibit 4/Tab 2/Sch 5.

**Table 4**  
**Labour Costs**

	2006 Board				
	Approved	2006 Actual	2007 Bridge	2008 Test	
Compensation	\$ 201,675	\$ 197,120	\$ 213,331	\$ 219,676	
Pension and Benefits	\$ 70,198	\$ 74,432	\$ 84,672	\$ 84,994	
Incentive Pay	\$ -	\$ -	\$ -	\$ -	
Total Compensation	<u>\$ 271,873</u>	<u>\$ 271,552</u>	<u>\$ 298,003</u>	<u>\$ 304,670</u>	
Capitalized	\$ 87,485	\$ 86,564	\$ 93,984	\$ 96,803	
OM&A	\$ 184,388	\$ 184,988	\$ 204,019	\$ 207,867	
Total Compensation	<u>\$ 271,873</u>	<u>\$ 271,552</u>	<u>\$ 298,003</u>	<u>\$ 304,670</u>	
Capitalized	32%	32%	32%	32%	
OM&A	68%	68%	68%	68%	

In response to Board staff interrogatory #1, Chapleau confirmed that it has not made any changes to its capitalization policies or estimates. This is confirmed in the consistency of the above percentage splits from the 2006 Board approved year to the 2008 test year.

In comparing the distributor's labour costs to Total Controllable OM&A, Board staff notes that labour is approximately 37% of operating costs as indicated in the following Table 5.

**Table 5**  
**Labour Costs as a Percentage of O&MA**

		2006 Board				
		Approved	2006 Actual	2007 Bridge	2008 Test	
OM&A Labour	A	\$ 184,388	\$ 184,988	\$ 204,019	\$ 207,867	
Total Controllable OM&A Expenses	B	\$ 486,334	\$ 498,720	\$ 601,738	\$ 556,217	
Labour as a percent of OM&A	C = A / B	37.9%	37.1%	33.9%	37.4%	

## Shared Services

### Background

The Township of Chapleau owns 100% of Chapleau Public Utilities Corporation (CPUC) and Chapleau Energy Services Corporation (CESC). CPUC is the local distribution

company and CESC is the services company. Chapleau PUC does not have any employees, nor does it own any fixed assets other than distribution assets and inventory. Chapleau PUC contracts with CESC to supply all labour and equipment required for new construction and repairs and maintenance to CPUC's distribution system, management support, billing and collection, rent, phone, post office supplies and office equipment.

### **Discussion and Submission**

In response to Board staff interrogatory #5, Chapleau provided information on its shared services arrangements. Chapleau stated that all services are charged to the distribution company at the actual cost of the service plus applicable overhead (benefits) with no mark-up. Chapleau also noted that CESC also does work for other clients including the Township of Chapleau and Hydro One Networks Inc.

In its response to Board staff interrogatory #5, Chapleau also provided the total dollar value of services supplied by CESC to Chapleau for the years 2006 to 2008. These amounts are \$383,417, \$416,577 and \$425,852, respectively and represent an increase of 11.1% for the 2008 versus 2006 period. Staff notes that these expenses also represent a significant component of Controllable OM&A expenses, 77%, 69% and 77%, respectively.

Chapleau then discussed the allocation of these costs and stated that "All of the items above are allocated based on the allocators as calculated below, except for the on-call costs allocated at 100% to item 3 and the overhead distribution line supplies in item 7 purchased for CPUC and allocated at 100%." Staff notes that it is not clear from this response what the items 3 and 7 are referring to and would invite Chapleau to provide clarification of this evidence in its reply submission.

Chapleau then stated that "The basis to determine the cost allocators is the percentage (%) of actual direct hours worked for Chapleau Public Utilities Corporation divided into the total hours worked by all employees" and that "due to a calculation error the wrong allocators were identified in the original submission." The interrogatory response only referred to one allocator which is the ratio of actual hours worked for CPUC to total hours worked by all 5 employees. By contrast, Exhibit 4, page 26 lists a number of charge determinants. In addition, page 27 refers to a total of six employees, rather than the five referenced in the interrogatory response.

Board staff invites Chapleau to clarify, in its reply submission, which allocators are being used for which services and the number of employees that are involved in providing these services.



## **CAPITAL EXPENDITURES**

### **Background**

Chapleau is projecting 2008 capital expenditures of \$63,861. This represents an increase of approximately 579.2% compared to 2007 projected capital expenditures of \$9,402, and 162.9% compared to 2006 actual capital expenditures of \$24,292.

The capital expenditure amounts for 2008 includes total of \$29,361 in expenditures for smart meters. Smart meter capital expenditures are discussed elsewhere in this document.

### **Discussion and Submission**

#### **Compliance with the Filing Requirements**

According to the Board's *Filing Requirements for Electricity Transmission and Distribution Applications*, dated November 14, 2006, an applicant should file its rate base, determined as an average of the opening and closing fiscal year balances. This is also consistent with Chapleau's past practice in their 2006 rate application, as submitted in compliance with the *2006 Electricity Distribution Rate Handbook*.

However, Chapleau is using the year-end value of Net Fixed Assets for the 2008 test year to determine its rate base for 2008. In response to VECC interrogatory # 4 (I), Chapleau stated that the reason for this approach is to achieve a higher rate base going forward to 2010. Board staff is unclear of the evidence in the application where the principles and justification for a rate base calculation differ from that of other distributors (determined as the average of the opening and closing net fixed assets) for the 2008 test year.

#### **Increase in 2008 Capital Expenditures**

As noted above, Chapleau's capital expenditures indicate significant variations in recent years and for 2008. Based on the Applicant's response to Board staff interrogatory #14 b, the table below lists the percentage change of the capital expenditures from 2006 actual to the 2008 test year, including and excluding smart meter capital expenditures.

**Table 1**

\$	2006 Actual	2007 Bridge	2008 Test
Capital Expenditure	\$24,292	\$9,402	\$63,861
% change as compared to the prior year	-	-61.3%	579.2%
Capital Expenditure (excl. Smart Meters)	\$24,292	\$9,402	\$34,500
% change as compared to the prior year	-	-61.3%	266.9%

Capital expenditures have increased significantly in 2008 compared to 2006 and 2007. In response to Board staff interrogatory #6 b), the Applicant explained that the increase was mainly due to installation of regulators to balance voltage levels with the Applicant's distribution system, for a total value of \$23,500, and expenditures related to deployment of smart meters. Chapleau has stated that its capital assets are only those for its distribution network and inventory (Board staff interrogatory #5) and that it does not own any buildings or computer hardware and software (VECC interrogatory #4).

#### Assessment of Asset Condition and Asset Management Plan

Even though the Applicant has provided a report in its application related to system loss reduction and performance optimization, it is not clear whether the Applicant has undertaken any initiatives related to development of an asset management plan.

In the absence of an asset management plan, it is not clear how Chapleau prioritizes its work plans and expenditures on a short and long term basis in order to maintain its assets. Board staff invites parties to comment on the merits of an independent assessment of asset condition and the development of a formal asset management plan.

### **Smart Meters**

#### **Background**

Chapleau is not one of the 13 Ontario distributors authorized to undertake smart meter activities, nor was the utility named in the combined smart meter proceeding, EB-2007-0063. The Board, in its decision on Chapleau's 2007 IRM application (EB-2007-0515), approved a Smart Meter rate adder of \$0.26 per month per metered customer. In setting this rate, the Board confirmed its understanding that Chapleau would not be undertaking any smart metering activity in 2007.

In its application, Chapleau states that it is not applying for Smart Meters. However, in its response to Board staff interrogatory #14, Chapleau has included an amount of \$29,361 in 2008 for Smart Meter capital expenditures and \$77,304 for Smart Meter operating expenses.

In response to VECC interrogatory #4 (f), Chapleau states that it does not have government approval to proceed with Smart Meter installations, but anticipates receiving approval within the current year.

Chapleau indicates that it is a member of the Northeast Ontario utilities working group (referred to as District 9) who are working together to meet the government's smart meter mandate. In response to Board staff interrogatory # 43 (a), the utility states that the Ministry of Energy is aware of the working group's status and that the Ministry will be recommending to Cabinet an amendment to O. Reg. 427/06 in order to accommodate the group. A copy of the Assistant Deputy Minister's letter, dated

December 21, 2007, was filed with Chapleau's interrogatory responses. The letter notes that:

"...the Ministry cannot bind Cabinet's decision making. As such, nothing in this letter shall be construed as obligating the Cabinet or the legislature of the Province of Ontario to approve or promulgate the proposed amending regulation."

Chapleau has requested, in its response to Board staff interrogatory #43 (b), that the Board consider its proposal to increase its Smart Meter rate adder, or approve a comparable rate to cover its capital and operating expenses. The utility's proposal includes an increase of \$1.24 to its current Smart Meter adder, in order to recover the return and depreciation expenses related to capital expenditures of \$24,113, in addition to a rate rider of \$4.76 per month for recovery of \$74,793 in operating expenditures.

### **Discussion and Submission**

Board staff notes that these amounts reflect an average of operating expenses and recovery of capital investments for smart meters being installed from 2008 to 2010 (and not just in the 2008 test year), as is shown in this interrogatory response. However, in response to Board staff interrogatory #43 (a), Chapleau states that it is tentatively scheduled to begin smart meter installations in the spring of 2009.

When questioned why all of its Smart Meter costs are being included in Rate Base, as per response to VECC interrogatory #4 (i), Chapleau states that no approved template has been provided.

Board staff questions the appropriateness of Chapleau's proposed treatment of smart meter costs given that the majority of these investments are planned to occur in 2009 and 2010, beyond the 2008 test year for which rates are being set. Board staff note that Chapleau's proposal is inconsistent with regulatory rate-making principle and practice, as it is proposing to include in rate base and recover the return, depreciation expense and associated operating expense as if these smart meters were in service and "used and useful". Board staff invites parties to comment on Chapleau's smart meter proposal, in light of the above issues and also considering that Chapleau is not one of the utilities approved to proceed with Smart Meter installations.

## **COST OF CAPITAL**

### **Background**

The Applicant has provided its proposed Cost of Capital in Exhibit 6, which is summarized in the following table:

<b>Cost of Capital Parameter</b>	<b>Applicant's Proposal</b>
Capital Structure	53.3% debt and 46.7% equity. In its initial application, Chapleau included only long-term debt and equity components. In response to Board staff interrogatories, Chapleau amended its proposal to include a 4.00% deemed short-term debt component, hence complying with the transitional capital structure for 2008 as documented in the Board Report.
Short-Term Debt	Initially, Chapleau did not include a short-term debt component. Through responses to IRs, Chapleau amended its proposal to include a deemed short-term debt component and to use the updated deemed short-term debt rate of 4.47% announced by the Board on March 7, 2008.
Long-Term Debt	Initially, 7.25%, as the interest rate on long-term debt owed to the municipal shareholders. However, it was noted in the 2006 Audited Financial Statements that Chapleau was not covering interest payments. In response to interrogatories, Chapleau filed copies of Township resolutions for restructuring the utility's capital structure and altering the terms of the affiliated debt. This restructuring is not yet completed. In response to Board staff interrogatory #20, Chapleau amended its application to use the updated deemed long-term debt rate of 6.10% announced by the Board on March 7, 2008.
Return on Equity	Initially set as 9.00%, as documented in its application. In response to a Board staff interrogatory, Chapleau clarified its proposal and amended its application, stating that it would use the updated ROE of 8.57% announced by the Board on March 7, 2008.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	Initially set as 10.08%, as documented in its initial application. Exhibit 6 documented a WACC of 8.07%, different from above. In response to Board staff interrogatory #23, Chapleau amended its application to seek a WACC of 7.19% based on the weighted average of the ROE and long-term and short-term debt rates, as amended in responses to interrogatories. Board staff considers the amended proposal to be consistent with the policies in the Board's Decision.

The Applicant's approach to cost of capital, as amended through responses to interrogatories, is consistent with the policies in the Board Report.

### **Discussion and Submission**

While Chapleau's cost of capital, as amended in its responses to interrogatories, complies with the policies documented in the Board Report, Board staff notes that the updated Revenue Requirement calculation provided in response to Board staff interrogatory #23 b) iii uses a weighted average cost of capital of 7.25%, in contrast to the 7.19% in the amended application. The Applicant and other parties are invited to address this issue, with reference to the record in the proceeding, in their submissions.

## **REVENUE SUFFICIENCY/SURPLUS**

In Exhibit 7, Chapleau indicates that its applied-for rates for the test year will produce a revenue excess of \$26,359 and an actual return of 10.08%. Board staff question the rate making principles or justification in the evidence that supports a request to earn a return higher than that allowed by Board policy. Board staff invites parties to comment on this request.

## **CUSTOMER AND LOAD FORECASTS**

### **Background**

This application is unique among the 2008 Cost of Service applications received in that there is very little information provided in support of the load forecast. The information provided by the Applicant was presented in the form of a locked Excel spreadsheet which, in Board staff's submission, was difficult to interpret and does not appear to even identify the kWh forecast it is requesting the Board to approve.

In the Applicant's evidence, Load Forecasting is discussed in:

- The Overview of the Application, where the development of the Applicant's customer count is briefly discussed.
- Exhibit 3, where the load forecast is referenced and data is presented in the form of an Excel spreadsheet. In this exhibit, by utilizing the 2005, 2006 and some 2007 historical data, the 2007 Bridge Year and 2008 Test Year customer count by class and the kWh forecast (together with the kW forecast for appropriate classes) are developed by customer class.

Some additional information was provided in response to Board staff and VECC interrogatories.

### **Discussion and Submission**

#### **Methodology and Model**

The Applicant explained briefly the sharp downward trend in customer connections experienced during the 2002-2005 period and noted that this trend appears to have now stabilized. The historical values were extrapolated to 2007 and 2008 by using the past two years' data by customer class. In response to Board staff interrogatory #25 (c) the Applicant appears to suggest an error was made in the number of Residential customers for 2008 but no correction appears to have been made to the previously filed information. That apparent error aside, the tabulated customer connections data and the explanation are consistent.

Turning to its kWh volume forecast, the Applicant's only description of the forecast's development reads: "Load Forecast was developed using actual consumption data". A

locked Excel spreadsheet is then referenced in which the various formulae that were utilized cannot be read. In response to Board staff interrogatory #24 and VECC interrogatory #5, the Applicant explained that the forecasted kWh values are the simple average of the two preceding years' data.

The Applicant did not include weather normalization in the forecast. In response to Board staff interrogatory #24, the Applicant stated: "The Cost of Service Informational Filing showed that weather normalization impact on the 2004 actual data was minor...and therefore does not warrant conversion of the 2008 forecast data."

Board staff are unable to draw any conclusions associated with the forecast methodology/model due to the lack of information available.

### Results

The Applicant's forecast was determined using the Excel spreadsheet submitted. It does not appear in the body of the forecasting exhibit. In response to Board staff interrogatory #25 (d), i to iv, the Applicant confirmed that it is proposing a negative 0.3% per annum change in customer connections and positive 0.4% per annum change in kWh load. The Applicant also confirmed that the historical customer connections change was approximately zero per annum and the historical kWh change was negative 4.2% per annum.

In Board staff interrogatory # 25 (d),v, the applicant was asked to rationalize how a historical zero customer connections growth drove a negative kWh load change whereas a forecasted negative customer connections change is expected to drive a positive load growth. The Applicant responded that this "is due to the use of average consumptions in 2006 and 2007". Board staff does not understand this reply. The Applicant goes on to say that this is a very minor growth and that it "should not warrant further consideration." In Board staff interrogatory #25 (d) vi, the applicant was asked to identify the anticipated events that are expected to drive the reversal in customer connection numbers and kWh growth. The Applicant responded "No comment" and pointed to its earlier reply. Board staff is concerned with the lack of information provided by the Applicant in its main filing and in response to interrogatories.

Board staff invites the Applicant and intervenors to comment on the Load Forecast and supporting documentation, in light of the above observations and submissions.

## **LOW VOLTAGE CHARGES, COST ALLOCATION and RATE DESIGN**

### **Costs of Low Voltage Charges**

#### **Background**

Chapleau is an embedded distributor, served by host distributor Hydro One. Chapleau has provided an estimate of its LV costs at \$36,903. Chapleau provided monthly

statements for the 12 months October 2006 – September 2007, for its Shared Line and Shared High Voltage Distribution Station charges from the host distributor. The total for the 12 months was \$36,947 (Response to Board staff interrogatory #27(b))

Hydro One has applied for a change in its LV Rates that would be paid by embedded distributors such as Chapleau (Hydro One 2008 Distribution Rate Application EB-2007-0681 ExhG2/Tab94/Sch1/pg 2). The application is for approval of a monthly rate for “Common ST Line” at \$0.58 per kW, compared to the existing rate for “Shared LV Lines” at \$0.633, a rate for HVDS of \$1.42 per kW compared to \$1.678, and a new fixed monthly service charge of \$188.

Chapleau submitted that LV cost is allocated to the customer classes in proportion to kWh consumption. (Response to Board staff interrogatory #27(c))

### **Discussion and Submission**

Board staff submits that the proposed rates for Common ST Line and for a shared distribution station, to be applied to all Sub-transmission customers, including embedded distributors such as Chapleau, are substantially lower than the existing Shared LV Line rate.

Board staff notes that Chapleau did not use the data in the Hydro One application to calculate its own estimate of its cost under the proposed Hydro One rates.

With respect to the allocation of LV cost, Board staff submits that the existing allocation method is based on billed amounts from the Retail Transmission Service Rate for connection for each class, which was done within the model provided in 2006. Chapleau proposes to change this allocation to one that is based on energy consumption (row 74, Exhibit 5(b))

Board staffs submits that the Applicant should comment, in its reply submissions, on whether its original estimate is materially different assuming the new rates will be implemented throughout the year.

### **Cost Allocation**

#### **-Revenue to Cost Ratios**

##### **Background**

Chapleau submitted its Cost Allocation Informational Filing Run 2 (EB-2007-0001) in this application. The Revenue to Cost Ratios in the following table are from the Informational Filing found in Exhibit 8 (page 35). The Board’s guideline ranges from the Report of the Board, Application of Cost Allocation for Electricity Distributors EB-2007-0667 November 28, 2007 are also presented.

**Table 6**  
**Revenue to Cost Ratios (%)**

<b>%</b>	<b>Informational Filing Run 2</b>	<b>Range (Nov 28, 2007)</b>
<b>Customer Class</b>		
Residential	113.5	85 – 115
GS < 50 kW	91.4	80 – 120
GS > 50 kW	78.8	80 – 180
Street Lights	17.4	70 – 120
Sentinel Lights	45.4	70 – 120
Unmetered Scattered Load	78.7	80 - 120

### **Discussion and Submission**

Board staff submits that the Revenue to Cost ratios in the Informational Filing are representative of the current rate design. The revised ratios presented in response to Board staff interrogatory #28 are difficult to compare with the Informational Filing, in part because they are expressed as inverses (ie Cost to Revenue) but also because the revenues are inclusive of a number of other charges such as transmission and wholesale market rates.

Board staff notes that the ratios for two classes are within the Board's guideline range and two classes are very close to being within range.

Staff note that the Board in other recent decisions has sought to require distributors to move the revenue to cost ratios for those classes outside the range, in a stepwise fashion. Parties are invited to comment if a similar treatment is appropriate for the street lighting and sentinel lighting customer classes.

### **-Rate Design**

#### **--Fixed Charges**

#### **Background**

The following table is taken from the Manager's Summary of Chapleau's Informational Filing. The final row has been added for convenience to show the Monthly Service Charges proposed by Chapleau for 2008 (Exhibit 9(b) 'CA Rate Design', less Smart Meter Charge \$0.26 for metered customers).



**Table 7**  
**Sheet - O2 Fixed Charge /Floor/Ceiling**

Description/Class						
Customer Unit Cost per month	Residential	GS<50k	GS>50kW	Street Lights	Sentinel Lights	U. S. L.
	\$	\$	\$	\$	\$	\$
Avoided Cost	3.68	8.75	26.01	0.01	0.22	11.13
Directly Related	6.34	15.26	48.18	0.01	0.42	20.41
Minimum System with PLCC Adjustment	12.99	20.32	45.13	8.05	8.35	23.27
Fixed Charge per approved 2006 EDR	19.74	30.89	151.53	0.79	2.63	15.32
Fixed Charge per 2008 rate application (less Smart Meter Charge)	22.01	40.31	226.77	1.50	4.42	20.17

Chapleau has proposed to maintain the existing fixed/variable split in each class, by increasing the Monthly Service Charge and the volumetric charge by the nearly identical percentages in each class.

### Discussion and Submission

Board staff notes that the Board's policy recommendation for 2008 rebasing is stated as follows, for situations in which the existing approved charge is above the ceiling, (ie the amount in the row "Minimum System with PLCC Adjustment"):

"...the Board does not expect distributors to make changes to the MSC [monthly service charge] that result in a charge that is greater than the ceiling as defined in the Methodology for the MSC. Distributors that are currently above this value are not required to make changes to their current MSC to bring it to or below this level at this time".

Board staff submits that this policy applied to Chapleau would indicate that the Monthly Service Charge would remain at its current level for the Residential class and both of the General Service classes, because the 2006 rates were above the ceiling and the proposed ones are higher than 2006. (This would require a corresponding increase in the proposed volumetric charges.)

Staff invites Chapleau and other parties to comment on proposal to adjust Monthly Service Charges in light of the submissions noted above.

### **- Low Voltage Rate Adder**

Chapleau included the LV charge from the host distributor as a component of its Operating Costs for the first time in 2008 (Exhibit 4, item 12 under Administrative and General Expenses). It appears that the calculation of distribution rates is designed to recover this cost. Chapleau has also calculated a “Low Voltage Rate” with a footnote to the effect that the calculated amount is no longer intended for use as a rate adder. (Exhibit 5(b))

### **Discussion and Submission**

Board staff submits that the established practice has been to calculate the distribution rates to recover costs net of the cost of LV, and the cost of LV has been recovered by means of a rate adder that is a component within the volumetric rate. In other words, the established practice has been to treat LV cost separately in cost allocation and rate design, except insofar as the cost is also a component of working capital and that component is not treated separately.

Staff notes that Chapleau has prepared a calculation of what the rate adders would be according to the established practice (Exhibit 5(b)), except for the fact that the allocation to classes is in proportion to energy rather than Transmission – Connection revenue.

Board staff invites the Applicant and intervenors to comment on this departure from the established pattern for recovery of LV costs.

### **- Retail Transmission Service Rates**

#### **Background**

The Chapleau forecast for wholesale transmission costs for network service is \$151,833 and for connection service, \$56,204. The host distributor (Hydro One) has applied for a change in its Retail Transmission Service Rates that would be paid by embedded distributors such as Chapleau (Hydro One 2008 Distribution Rate Application EB-2007-0681 ExhG2/Tab94/Sch1/pg 2). The existing rates and those in the application are found in the following table, along with percentage changes calculated by Board staff.

**Table 8**  
**Hydro One Retail Transmission Service Rates**

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

Chapleau proposes to decrease its Retail Transmission Service Rate – Network by an amount of approximately 11% for each rate class, and its RTSR – Connection by over 60%, compared to the currently approved rates. It presents forecast revenues of \$149,657 for Network and \$142,273 for Connection. (Exhibit 5(b)).

### **Discussion and Submission**

Board staff submits that Chapleau's cost forecast appear to have been made on the basis of Hydro One's existing Retail Transmission Service Rates that apply to embedded distributors and not the newly proposed rates. (This forecast would also have an effect on the working capital estimate).

Board staff invites the Applicant and intervenors to comment on the RTS proposal.

### **- Wholesale Market Service Rates**

Chapleau has proposed a change in its Wholesale Market Service Rates from \$0.0052 per kWh to \$0.0041. It provided the rationale for this change in response to Board staff interrogatory #32, including cost and revenue data from 2006 – 2008. The Applicant also provided additional data from 2003 – 2005 in Exhibit 5(b).

Board staff notes that the pattern of over-recovery did not appear prior to 2006. There was significant over-collection in 2006, due to a decrease in the cost of Wholesale Market Service of approximately 25%. The pattern of over-collection is evident in 2007, but the cost and revenue data from June – December are estimates. The forecast for 2008 is based on 2006 and 2007, and may be affected by the large component of estimated cost and revenue in the latter year.

Board staff submits that the Wholesale Market Service Rate be adjusted, but only on the basis that the underlying data is accurate. Considering the above, Board staff invites the Applicant and intervenors to comment on the WMSR proposal.

## **LINE LOSSES**

### **Background**

In the original Application, Chapleau included a Distribution Loss Factor of 1.0565 based on the average of the five year period from 2003 to 2007.

However, in response to Board Staff interrogatory #26, Chapleau revised their Distribution Loss Factor from 1.0565 to 1.0606 using the average of the 3-yr period from 2004 to 2006 because of errors in the recording of 2003 kWh figures. Based on a Supply Facilities Loss Factor (SFLF) of 1.0045, the revised proposed Total Loss Factor (TLF) would be 1.0654. Chapleau indicated that this proposed TLF is higher than the approved TLF of 1.0497 for each of 2006 and 2007 as these TLFs were set too low due to errors in earlier years (2002 and 2003).

## Discussion and Submission

Since Chapleau is embedded within Hydro One's distribution system, the proposed DLF includes losses that occur in the Hydro One system. In the response to Board Staff interrogatory #26, Chapleau also indicated that it was taking steps to improve the actual loss factor through investment and training.

## DEFERRAL AND VARIANCE ACCOUNTS

### Background

Chapleau is proposing to clear the balances of certain deferral and variance accounts as shown in Exhibit 5 of the Application and addressed in interrogatory responses.

As indicated in response to Board staff interrogatory # 34 Chapleau is requesting that the following accounts and balances be cleared for disposition as of December 31, 2006 and balances plus interest to April 30, 2008.

1508	Other Regulatory Assets,	\$ 22,965
1550	LV Variance,	\$ 14,121
1580	RSVA – Wholesale Market Service Charge,	(\$ 27,372)
1584	RSVA – Retail Transmission Network Charges,	(\$ 27,480)
1586	RSVA – Retail Transmission Connection Charges,	(\$207,193)
1588	RSVA – Power,	(\$ 36,389)
1590	Recovery of Regulatory Asset Balances,	\$ 17,928

**Total:** **(\$243,420)**

Chapleau proposes to dispose of these amounts over three years beginning May 1, 2008 through rate riders as indicated in the response to Board staff interrogatory # 39.

## Discussion and Submission

### Forecasting Balances

In the original Application, Chapleau's forecasting deferral and variance account principal and interest balances were forecast to April 30, 2008. In response to Board staff interrogatory #40, the Applicant gave the impression that it was no longer forecasting principal transactions, but was using audited December 31, 2006 balances as the basis for the application. However, Chapleau is requesting disposition of account 1590, which implicitly means that Chapleau is forecasting transactions for this account. Also, numerous adjustments were made to deferral and variance accounts balances, but it is unclear when these adjustments were made, the period that the adjustment affects, and whether the adjustment has been audited. Further information on this issue is found in the section on adjustments below.

Board staff notes that in the natural gas sector, utilities do forecast principal and interest on deferral and variance accounts for disposition to the end of the current test year.

However, these forecasts generally do not exceed two or three months once the applicant provides an update before the decision is released. The forecast balances are then trued up to the actual and any differences are placed in a deferral account for disposition in the next rate case. This approach has not been used for electricity distributors.

In the electricity distribution sector, it has not been Board practice to order disposition of forecast balances of principal transactions on deferral and variance accounts. Usual practice for disposing of variance and deferral accounts in the electricity sector is to use the most up-to-date audited balances, as supported by audited financial statements, plus forecast carrying charges on those balances up to the start of the new rate year. The most recent Chapleau balances that have been independently audited are the December 31, 2006 balances. It would be inconsistent with the Board's past practice in this sector to dispose of forecast principal balances. In addition, Board staff is unclear which accounts Chapleau has forecast principal transactions beyond December 31, 2006 in this application.

#### Treatment of account 1590

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

In the Phase 2 decision for the Review and Recovery of Regulatory Assets for the five large distributors (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)

Chapleau has proposed to dispose of account 1590 before the final balance has been determined. The Board may wish to consider if this reflects a proper true-up. The Phase 2 decision quoted above suggests that the current regulatory asset rate rider be removed as of May 1, 2008. Once the residual balance in account 1590 is finalized, this balance is to be disposed of at a future hearing. The final balance in account 1590 cannot be confirmed until after the current recovery period has expired, i.e. April 30, 2008. The residual balance will not be finalized until after April 30, 2008, and electricity

sector standard practice would be to defer disposition of account 1590 until the balance has been finalized and verified.

#### Transfers to account 1590 – 2006 EDR

From the regulatory asset continuity schedule in the response to Board staff interrogatory #34, it is unclear whether the transfer to account 1590 for the regulatory assets approved for disposition in 2006 EDR, occurred. Regulatory assets of \$23,813 were approved for disposition in 2006 EDR and this transfer is not shown in the continuity schedule, impacting account 1590. Instead a different number is shown, including a negative interest amount, instead of the expected positive interest amount. The impact of this transfer on the other regulatory assets is not clear.

#### Adjustments to 2006 Audited Financial Statements

Chapleau provided data in response to Board staff interrogatory #34, shown in Table 9 below. The data shows that there are uncertainties regarding the adjustments to the financial statements. In some cases, the balances reported in the written area of the response to Board staff interrogatory #34 are different from the numbers reported in the Regulatory Asset Worksheet.

**Table 9**  
**Adjustments to 2006 Audited Financial Statements**

<b>Account</b>	<b>Adjustment made per written area of response (Bstaff Int. #34)</b>	<b>Adjustment made per Regulatory Asset Worksheet in response</b>
1590 Recovery of Regulatory Asset Balances	\$3,294	\$2,807
1590 Recovery of Regulatory Asset Balances	\$48,538	\$44,538
1565 CDM Expenditures and Recoveries	(\$48,538)	(\$25,819)
1590 Recovery of Regulatory Asset Balances	\$4,976	\$4,874
1565 CDM Expenditures and Recoveries	(\$4,976)	(\$4,326)
1508 Other Regulatory Assets	(\$1,660)	(\$1,660)
1508 Other Regulatory Assets	(\$77)	(\$77)
1508 Other Regulatory Assets	(\$12,937)	(\$12,937)
1508 Other Regulatory Assets	(\$13,727)	(\$13,727)
1508 Other Regulatory Assets	(\$241)	(\$241)

The Applicant has not clarified the total amounts for the listed adjustments, the audited financial statement periods impacted, and in some cases, the other side of the journal entries. It is also unclear whether or not these adjustments impact the total deferral and variance account balance proposed for disposition as at April 30, 2008, and why these adjustments were made.

In addition, in response to Board staff interrogatory #33, Chapleau listed an adjustment of (\$45,642) to energy sales. The explanation provided, "energy sales includes regulatory asset variances" is not clear nor is the impact of this adjustment on the variance accounts proposed for disposition.

#### Treatment of RSVAs

The Applicant 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 the Bill 23 process. The Board may wish to consider the impact of ordering disposition of these accounts on the Bill 23 process.

#### Treatment of RSVA account 1586

In its response to Board Staff interrogatory #38, Chapleau stated that it accrued costs in account 2405 from Hydro One invoices for Hydro One's regulatory asset recovery as approved by the Board. However, total Hydro One charges for Phase I and II of Hydro One's regulatory assets should be accrued in accounts 1586 as per the APH and the December 2005 Frequently Asked Questions #8 and #9, issued by Board staff.

Chapleau is applying for disposition of account 1586. It is not clear if Chapleau used account 1586 to record historic Hydro One charges for Hydro One's regulatory assets. These amounts are a proxy for the amounts included in the distributor's regulatory asset rate riders in relation to Hydro One's Low Voltage charges approved for the periods ended December 31, 2003 and April 30, 2006. From the response to Board staff interrogatory #38, it is unclear whether the balances are appropriately accounted for in 1586. Finally, there are questions on how the Applicant transferred approved 2006 EDR balances from account 1586 to account 1590.

Board staff has not been able to ascertain whether the Applicant is complying with the APH and the December 2005 Frequently Asked Questions #8 and #9 in accounting for accounts 1586 and 2405.

Board staff encourages the Applicant, based on the evidence filed, to clarify the deferral and variance account issues raised above.

#### Payments in Lieu of Taxes

The Applicant has filed information on Taxes at Exhibit 4/Tab3. Board staff notes that Chapleau indicates that it will not be subject to PILs in the near future due to past corporate losses. Board staff also notes that Chapleau is not subject to capital tax due to its size.

~ All of which is respectfully submitted ~