Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

LAKEFRONT UTILITIES INC.

COMMENTS ON DRAFT RATE ORDER

EB-2007-0761

June 3, 2008

OVERVIEW

The Board issued its Decision on May 9, 2008. Lakefront Utilities Inc. ("LUI") filed its Draft Rate Order on May 27, 2008.

LUI'S DRAFT RATE ORDER

It is Board staff's submission that the Draft Rate Order should not be accepted as filed. As outlined in greater detail below, LUI's Draft Rate Order does not comply with the Board's Decision.

Board staff has specific submissions on the following areas of the Draft Rate Order:
- Operating, Maintenance & Administrative Expenses
- Rate Base – Capital Expenditures
- Rate Base – Cash Working Capital
- Smart Meters
- PILs and Amortization

OPERATING, MAINTENANCE & ADMINISTRATIVE EXPENSES ("OM&A")

<u>The Decision</u>

LUI was directed by the Board to make the following adjustments to its controllable OM&A:
- $66,667 reduction to reflect the amortization of the incremental regulatory expenses associated with the 2008 application over 3 years.
- $25,000 reduction related to bad debt expense
- $220,278 reduction for the forecasted smart meter costs

Regarding smart meters, the Board in its decision stated that:

> "The Government has established a phased approach to the implementation of smart meters across the province. The Board notes the letter from the Ministry of Energy which indicates that the Government is aware that LUI and others are seeking authorization and that it intends to consider those proposals in due course. The Board finds that unless there are exceptional circumstances, the Board will not order the deployment of smart meters for distributors that have not received government authorization through regulation.
>
> The Board concludes that LUI does not represent an exceptional circumstance. LUI's evidence is that "approximately half of our customer's meter seals are expired or on the verge of expiration." The Board notes, however, that an expired seal does not necessarily require replacement of the meter. Rather, the meters will be subject to further testing. In any event, at least half of LUI's meter seals have not yet expired, and therefore there is no requirement for these to be replaced. The Board concludes that the forecast smart meter costs should be removed from OM&A and rate base."

As a result of the above adjustments, 2008 controllable OM&A would be reduced from $2,407,365 to $2,095,420.

Furthermore, the Board directed LUI to reduce OM&A by $80,408 for incremental CDM funding and re-calculate its amortization expense to reflect the half year rule.

LUI's Draft Rate Order

In its Draft Rate Order, LUI made the above directed adjustments to OM&A but also included an adjustment for amortized costs for a "meter re-sealing program" in the amount of $83,396, which was not specified in the Board's Decision. In its Draft Rate Order, LUI justified this adjustment on the basis that:

> "After the Decision was issued, LUI investigated the possibility of resealing its expired meters as recommended by the Board. The OM&A cost of the resealing process is estimated to be $250,187. This estimate of $250,187 includes acquiring a limited number of used available meters from other LDCs that are changing out conventional meters for new smart meters. These used meters will facilitate the pulling of a number of existing meters to start the resealing process on a rotating basis. The resealing of all expired meters is expected to be completed in 2008. This program will not result in stranded capital assets as LUI intends to charge costs to O&M including labour of $205,795 in 2008.
>
> Because LUI would treat this program as OM&A, LUI has amortized the cost of the $250,187 meter re-sealing program over 3-years by including $83,396 in its 2008 OM&A budget. Given that the Board recognized re-sealing as an option for LUI and that $83,396 is a significant expense to LUI and that re-sealing its existing conventional meters is necessary to come into compliance with Measurement Canada's requirements, LUI believes that it is prudent to include this expense in its operating budget. If it is not included, LUI will not have the funds to comply with Measurement Canada's requirements."

Board Staff's Concerns

Board staff is of the view that the "meter re-sealing program" discussed above was neither applied for nor approved by the Board in its Decision. No evidence on these costs was presented through the hearing, and the figures presented by LUI are untested. The inclusion of these costs inflates the OM&A amount on which LUI's Draft Rate Order is based from $2,095,420, which Board staff believes is the level arising from the Board's Decision to $2,178,816.

Board staff also notes that in its Decision, the Board directed LUI to re-calculate its amortization expense to reflect the half year rule. LUI has decreased its amortization expense from $888,341 to $821,258; a difference of $67,083, but it is unclear to staff how this differential was calculated. The Draft Rate Order should provide a clear and complete explanation for changes of this kind including a detailed break down of the calculated change where necessary.

Board staff also notes that there are inconsistencies between amounts described in the Draft Rate Order as being from the October 31, 2007 application and what is contained in that application. As an example, on Page 23 of the Draft Rate Order LUI submits a balance of $249,905 for account 5175 – maintenance of meters as of October 31, 2007. The original application states a balance of $237,509. Staff has identified other inconsistencies of this kind. Board staff would invite the Applicant to confirm that the numbers contained in the Draft Rate Order are in fact from the October 31, 2007 application as described by LUI. and if so provide an explanation for the types of inconsistencies that have been identified by staff above.

RATE BASE

The Board dealt in its Decision with two aspects of Rate Base: Capital Expenditures and Cash Working Capital.

Capital Expenditures

The Board found in its Decision that the proposed capital expenditures ("CAPEX") for 2008, excluding smart meters, of approximately $900,000 was substantially lower than the level in 2006 or 2007. However, expenditures during the period 2002 through 2005 ranged from a low of $499,000 to a high of $763,000. On page 12, the Board accepted the proposed capital expenditures excluding the smart meter amounts.

Staff notes that LUI has included an additional, unauthorized amount of $325,262 in its Draft Rate Order for a potential 2009 voltage conversion program that was not approved by the Decision. LUI states that advancement of this 2009 proposal was documented in its application in the event that smart meter implementation was not granted, and the Board did not reject this proposal in its Decision. LUI also documents that the Board "was supportive of [LUI's] voltage conversion program" per comments on LUI's asset management program. As a result, LUI has assumed "that its proposal [i.e., to advance the 2009 voltage conversion] has been accepted by the Board and has included $325,262 in its capital budget for voltage conversion."

Staff submits that LUI's proposal is inconsistent with the Board Decision. The Board did not authorize smart meter implementation in the absence of government authorization through regulation as it felt that LUI's situation did not constitute an "exceptional circumstance". However, while the Board did not authorize smart meter implementation or the inclusion of the smart meter operational expenditures ("OPEX") and CAPEX, the Board did approve an increased smart meter rate adder in view of LUI's advanced plans for smart meter deployment if and when government authorization is granted.

Any assumption that the Board has approved advancement of the 2009 voltage conversion is, in Board staff's view, an incorrect interpretation of the Board's Decision, as the Board only approved and authorized capital expenditure for the 2008 rate year. On page 12 of the Decision, the Board accepted LUI's proposed 2008 capital expenditures, excluding smart meters, of $900,000. The Board did not turn its attention to the alternative proposal, and the 2009 voltage conversion program, and associated costs, was not tested during the proceeding, as it was outside of the 2008 test year.

Another variation found in the Draft Rate Order was for the WO#7594-Swayne capital project. The rate order lists an amount of $109,970 on pages 15 and 16, but in LUI's application the amount is shown as $104,963 (Exhibit 2 / Tab 3 / Schedule 1 / page 6).

Cash Working Capital

The Board ordered adjustments to reflect the Board's April 11, 2008 Price Report cost of power, the RPP price of $0.0545/KWh. In addition the Board ordered adjustments to be applied relating to transmission. These are described in the Decision at page 22, and include a decrease of 18% to the network rate and a decrease of 5% to the connection rate.

Staff confirms that the new RPP price was used to calculate the cost of power; however staff notes that LUI did not include the loss factor of 1.0541 in the cost of power calculation. LUI should recalculate the cost of power amount to reflect losses.

Staff is not able to confirm the Retail Transmission connection and network charges calculation, since the original amounts for connection and network charge costs listed on page 21 of the Draft Rate Order ($1,142,360.16 and $1,378,994, respectively) do not match with the amounts of $1,104,389 for connection and $1,104,389 for network) shown on page 23 under "As submitted October 31, 2007". Board staff notes that the connection charge cost of $1,085,242 and $1,130,775 for network, under "Revised as per Board Decision", are transposed.

	As submitted October 31, 2007	Revised as Per Board Decision	Percentage change
4714 - Charges - Connection	$1,322,705	$1,130,775	-14.5%
4716 - Charges - Network	$1,104,389	$1,085,242	-1.7%

Board staff notes that the revised amounts are different than the -5% for connection and -18% for network reductions corresponding to the transmission rate changes approved by the Board. LUI should fully document the calculations shown on pages 21 and 23 of its Draft Rate Order, and explain the above variations.

Board staff also notes that the update of the Working Capital Allowance is also affected by changes to operating expenses that LUI has shown in its Draft Rate Order. The changes to Opex are dealt with elsewhere in this submission.

Board staff notes that, in calculating its regulated rate of return, LUI has used the updated working capital allowance and average net fixed assets in the table at the bottom of page 24. Board staff's comments on the updated Working Capital Allowance are addressed elsewhere. Board staff also notes that the opening balance (i.e. January 1, 2008) for net fixed assets is $10,959,545, different from $10,944,829 in LUI's application and shown in the table under "Submitted October 31, 2007" on page 24 of the Draft Rate Order. Staff believes that the difference of about $15,000 is related to changing the amortization rate for metering, but does not understand why this change should affect the January 1, 2008 opening balance. As LUI currently does not have any smart meters deployed, it should have been using the 4.0% amortization/depreciation rate in its application for existing metering assets. LUI should clarify and adequately document this variation.

PAYMENTS IN LIEU OF TAXES ("PILs")

LUI has Calculated an Incorrect Income Tax Rate

The Decision

The Board directed LUI to refer to the maximum combined federal and Ontario income tax rate of 33.5% when preparing its Draft Rate Order. This tax rate appears at page 12 of the Board's Decision.

LUI's Draft Rate Order

LUI has used 35.547%, at page 12, as the combined federal and Ontario income tax rate in its Draft Rate Order. At page 12, LUI has requested to recover in rates $392,933 for grossed-up PILs.

Staff calculates the amount to be $316,662 based on a combined income tax rate of 30.77%. The difference is $76,271.

Based on the Applicant's evidence, the applicable federal income tax rate for 2008 is 19.5%. The Ontario income tax rate is incorrect in the Draft Rate Order evidence. The correct income tax rate is derived below.

Item	Description	Reference	Rates	$	PILs
1	Taxable Income	Page 12		712,464	
2	Ontario				
3	Income tax payable		14%	99,745	
4	Small business credit	400,000	8.5%	-34,000	
5	Surtax on (1-4)	312,464	4.667%	14,583	
6	Income tax			80,328	
7	Effective Ontario rate (6/1)				11.27%
8	Federal rate				19.50%
9	Combined tax rate				**30.77%**
10	Income tax PILs	(1) x (9)			$219,225
11	Grossed-up PILs	(10) / (1-30.77%)			$316,662

Missing or incorrect information needed to verify the PILs calculations

- The calculations of the reduced accounting, or book, depreciation and amortization have not been provided. The calculation of capital cost allowance has been submitted.
- Other additions and deductions have not been explained, or itemized with a table.
- Rate base on page 12 is not the same as it appears on page 24 of the Draft Rate Order
- Deemed portions of cost of capital, page 24 of the Draft Rate Order do not agree with the Board's Decision on page 18.

Discussion and Submission

The Ontario income tax PILs calculation includes computing the maximum tax and then deducting the amount of the small business credit. The Ontario small business deduction is phased out between a taxable income of $400,000 and $1,128,519 using a surtax rate of 4.667% applied to the amount of taxable income above the $400,000 threshold.

Board staff submits that LUI should recalculate its PILs using the correct method. The Applicant should provide all information to support the changes in its evidence as stated on page 30 of the Board's Decision.

~ ALL OF WHICH IS RESPECTFULLY SUBMITTED ~