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Ontario

BY EMAIL ONLY

June 17, 2008

Mr. B. Randall
President & CEO
Norfolk Power Distribution Inc.
PO Box 588, 70 Victoria St.
Simcoe ON N3Y 4N6

Dear Mr. Randall:

Re: Norfolk Power Distribution Inc. – 2008 Rates
Board Staff Submission, Norfolk Power Distribution Inc. draft Rate Order
Board File No. EB-2007-0753

A copy of Board staff's submission on the draft Rate Order filed by Norfolk Power Distribution Inc. is enclosed herewith.

Yours truly,

Original signed by

Kirsten Walli
Board Secretary

VT INCEPIT FIDELIS SIC PERMANET

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION ON DRAFT RATE ORDER

2008 ELECTRICITY DISTRIBUTION RATES

NORFOLK POWER DISTRIBUTION INC.

EB-2007-0735

June 17, 2008

OVERVIEW

The Board issued its Decision on May 26, 2008. Norfolk Power Distribution Inc. ("Norfolk Power") filed its Draft Rate Order on June 9, 2008.

The Decision required Norfolk Power "to file detailed supporting material, including all relevant calculations showing the impact of this Decision on the Company's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates." It is Board staff's submission that Norfolk Power's submitted material (the "Draft Rate Order") does not provide the required resultant revenue requirement and the necessary justifications and explanations to adequately confirm that the resulting rates comply with the Board's Decision in a number of areas.

Board staff has specific submissions on the following areas:

- Operating, Maintenance & Administrative Expenses
- Rate Base – Capital Expenditures
- Rate Base – Cash Working Capital
- Cost of Capital
- Deferral and Variance Account Disposition
- PILs Calculations

Board Staff also makes a submission on the Revenue to Cost Ratio's.

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

At page 14 the Board's Decision stated that:

> Accordingly, the Board will approve an increase in other costs of an amount equivalent to 12% over the 2006 actuals, excluding costs associated with smart meters. The Board will not stipulate how the overall OM&A budget ought to be spent beyond the direction provided for regulatory and bad debt costs, but rather will approve an envelope increase of 12% to be managed by Norfolk Power as it see's fit.

The 2006 actual as shown on page 5 of the Decision is $3,797,656. A 12% increase means that the allowed amount is $4,253,375. On page 2 of 30 of the Draft Rate Order, Norfolk Power uses a figure of $4,400,000, which is $146,625.28 higher than the approved level arising from the Board's Decision. This appears to be because Norfolk Power is interpreting the Board's Decision as allowing increases in Regulatory Costs of $76,618 and Bad Debt Expenses of $70,000 as outside the envelope, which does not appear consistent with the Board's Decision.

Additionally, on page 11 of 30, Norfolk Power shows an adjusted OM&A expense amount of $4,485,762 as going into the revenue requirement calculation. This amount is different from that shown on page 3 by $85,762 and the difference is unexplained.

RATE BASE

Rate Base

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

Capital Expenditures

The Board's Decision included two reductions from the 2008 capital expenditures proposed by Norfolk Power:

- Elimination of $120,000 for a new transformer station that will not be in service until 2009; and
- Elimination of smart meter capital expenditures of $4.061 million.

On page 7 of its Draft Rate Order, Norfolk Power shows the recalculation of its 2008 capital expenditures with these exclusions, and derives a 2008 capital expenditure of $6,008,600. Norfolk Power states that it is unable to reconcile this with the $5,938,600 quoted in the Board's Decision.

Staff notes that the $5,938,600 is from Norfolk Power's own evidence, provided in the response to Board staff interrogatory #2 as Norfolk Power's proposed 2008 capital expenditure excluding smart meters. The $120,000 for the transformer station should also be removed from this amount.

If Norfolk Power believes that another amount is more accurate, it should provide a detailed derivation and explanation in its reply submission.

Cash Working Capital

At page 25 of its Decision the Board noted that Norfolk Power proposed to reduce the Low Voltage costs in its reply submission. Staff notes that the Low Voltage costs have been reduced from $371,652 to $252,864 at page 8 in the Draft Rate Order, and Norfolk Power cites the current Hydro One Networks distribution application. However, as Norfolk Power did not provide the details of how this amount was derived staff are unable to confirm this number.

Smart Meters

In its Decision, the Board concluded that the forecasted smart meter costs (capital expenditure and operating expenditure) should be removed from rate base and revenue requirement. The Board also approved an increased smart meter adder to $1.00 per month per metered customer to facilitate implementation of Norfolk Power's smart meter implementation upon it receiving authorization from the Government.

On page 7 of the Draft Rate Order, Norfolk Power states and shows a table where the $4.061 million in smart meter capital expenditure is removed to comply with the Board Decision. Norfolk Power also states that the $1.00 smart meter rate adder is included in the proposed rates for metered customer classes.

However, Norfolk Power has not provided a determination of the new revenue requirement and how that revenue requirement is translated into the proposed rates and without this information Board staff is unable to confirm Norfolk's stated treatment.

Cost of Capital and Capital Structure

On pages 17-18 of the Board's Decision, the Board approved Norfolk Power's cost of capital as amended in its application, with an overall cost of capital of 7.19% based on the 2008 updated cost of capital parameters announced by the Board on March 7, 2008.

On page 8 of the Draft Rate Order Norfolk Power provides the summary table of the cost of capital as approved in the Board's Decision. Norfolk Power states that it has used these to calculate the proposed rates.

However, Norfolk Power has not provided a determination of the new revenue requirement and how that revenue requirement is translated into the proposed rates, and without this information Board staff cannot confirm Norfolk's stated treatment.

Board staff also observes that Norfolk Power's revenue requirement, shown on pages 10-11 of the Draft Rate Order, are derived as adjustments from its original proposed revenue requirement. The new return on capital is shown as $3,462,375, derived as an adjustment of ($349,294) on the original return on rate base of $3,811,769. Board Staff is unable to confirm compliance with the Board's Decision without the derivation of the revenue requirement per the Board's Decision with direct and detailed calculations.

DEFERRAL AND VARIANCE ACCOUNT DISPOSITION

The Board's Decision did not directly address the disposition of account 1550. Page 10 of Norfolk Power's Draft Rate Order stated for "*Account 1550* As this account was not addressed in the Board Decision, Norfolk Power would like to seek clarification from the Board on how to address the disposition of this account." Norfolk Power has not proposed a calculated rate rider for this account in its Draft Rate Order.

Norfolk Power should provide a schedule of the calculated rate riders for the Board to consider in order to clear this account.

PAYMENTS IN LIEU OF TAXES ("PILs") Calculations

Regulatory net income and rate base. Reference Exhibits: Pages 3-6

Rate base is shown as $48,173,794 on page 6. There is no schedule that reconciles the original rate base to this revised number to show that the Board's Decision has been properly reflected.

There is no indication that rate base has been calculated as an average of the opening and closing net fixed assets plus the working capital allowance. That is, the half-year rule for inclusion of capital expenditures in test year.

Regulatory net income is calculated as rate base multiplied by the equity percentage multiplied by the ROE percentage. From section 5 on page 8, the equity component is 46.7% of rate base and the ROE is 8.57%.

Regulatory net income should be: $48,173,794 x 46.7% x 8.57% = $1,928,007. On page 4 the income number is shown as $1,926,631. While staff notes that this is not a material difference, there should be no difference.

Ontario Capital Tax. Reference Exhibit: Page 6

On December 13, 2007 the Ontario government issued an Economic Outlook and Fiscal Review. The document included corporate tax measures to reduce income tax on small businesses and to modify aspects of the capital tax calculations. The legislation, Bill 44, received Royal Assent on May 14, 2008. The effective date for the decrease in the capital tax rate from 0.285% to 0.225% was changed retroactively to January 1, 2007.

On page 6, Norfolk has shown $33,173,794 as taxable capital. By applying the rate of 0.225% to taxable capital, a capital tax of $74,641 can be calculated. Norfolk has requested $94,545. The difference is $19,904 for 2008 rates.

On page 36 of the Board's Decision, the Board determined that the effective date will be the date of the final Rate Order. Since this will be after May 14th, it appears that the new Ontario capital tax rate would apply.

Page 17 of the Board's Decision states that, "The Board finds that Norfolk Power should incorporate all known income and capital tax changes into its PILs calculations for 2008."

Amortization of smart meters. Reference Exhibit: Page 11

Amortization is recovered as a cost and it is used in the calculation of PILs.
Capital expenditures for smart meters of $4,061,000 were removed for 2008 as shown in table 4 on page 7. Using the half-year rule, and 15 years for the amortization period, staff estimated that the reduction in amortization should be about $135,400. On page 11, Norfolk has shown a reduction in amortization for smart meters of $80,320.

Capital Cost Allowance (CCA)

On page 3 of the Draft Rate Order, the capital additions for 2008 are shown to total $6,007,600. However, on page 7, the revised capital expenditures are $6,008,600. While not material to the calculations there should be no difference.

Norfolk Power has indicated in a table 4 footnote on page 7 that it was unable to reconcile a difference of $70,000 with the Board's decision on capital expenditures. The final reconciled capital expenditure numbers should be used in the CCA calculations.

Submission

Capital expenditures and the calculation of rate base should be revisited and all of the necessary tables to show the derivation of the numbers should be submitted in Norfolk Power's reply submission. Once the final numbers have been determined, these same numbers should be used in the PILs income and capital tax calculations.

Amortization expense should be verified due to the removal of smart meters from rate base and the variance with the Board's Decision.

The capital tax rate to be used in the Rate Order evidence should be 0.225%.

REVENUE TO COST RATIOS

The proposed rates for Street Lights and Sentinel Lights yield appropriate revenue to cost ratios, as per the Decision. This conclusion is based on the assumption that the proportions of cost allocated to each class stays constant from the Informational Filing, which is the only feasible assumption in the absence of an updated cost allocation study. This conclusion is based on an analysis of the proportion of revenue from each class, comparing calculated revenues with existing rates and those proposed in the Draft Rate Order, and is not based on class revenue requirements expressed in absolute amounts.

It appears that the volumetric rate of $3.9408/kW for the General Service 50 – 4999 kW class as shown on page 13 of the Draft Rate Order may be a typographical error. This is the only rate that increases when compared to the proposed rates filed with the original Application at Exhibit 1/Tab1/Schedule 6/page 1.

If the volumetric rate of $3.9408/kW noted above is intended, the following comment is pertinent: The proportion of revenue coming from the GS 50 – 4999 kW class with the existing rates is 17.0%, which yields a revenue to cost ratio of 102.5%, and in the Application, the proportion was decreased to 16.5% and a ratio of 98.8%. (Reference: Exh 8 / Tab 1 / Schedule 2 / p. 3). With the rates in the Draft Rate Order, the proportion would increase to 17.6% of total distribution revenue, and it is reasonable to conclude that the revenue to cost ratio would be higher than the status quo which is 102.5%.

Submission

Board staff submits that the proposed rates should be lowered such that the GS 50 – 4999 kW class should produce distribution revenue not above 17% of the total, and that Residential rates should be higher than in the Draft rate order to yield the revenue shortfall created by the adjustment to the GS 50 – 4999 kW rates. Board staff notes that the Residential class is the beneficiary of the increased revenue to cost ratios in Street Lights and Sentinel Lights, even with the adjustment just described, which is consistent with the Board’s Decision at p. 27.

SUMMARY

Board staff submits that Norfolk Power has not provided the required total revenue requirement reflecting the Board Decision and adequate supporting material by which the Board, Board staff or other parties can evaluate whether and how Norfolk Power’s proposed rates comply with the Board’s Decision and that Norfolk Power be required to provide the material prior to the issuance of the final Rate Order. Board staff further submits that the date of for the filing of cost claims by Intervenors included as part of the Decision may need to be revised.

~ ALL OF WHICH IS RESPECTFULLY SUBMITTED ~