Middlesex Power Distribution Corporation

January 9, 2009

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

Re: EB-2008-0350, EB-2008-0322 EB-2008-0194 MAAD Application Middlesex Power Distribution and Newbury Power and Dutton

Dear Ms. Walli:

Please find enclosed Middlesex Power Distribution Corp. responses to the Board staff's Interrogatories on MAAD application between Middlesex Power, Newbury and Dutton.

Should there be any questions, please do not hesitate to call me at the number below.

Yours truly,

Cheryl Decaire
Co-ordinator of Regulatory and Rates
(519) 352-6300 ext 405
Email: cheryldecaire@ckenergy.com

CC: Dave Kenney, President of Middlesex Power Distribution
Jim Hogan, Chief Financial and Regulatory Officer

Question #1 Valuation of Dutton Hydro Shares

Ref. Section 2.3.1

In its application, Middlesex Power states that the rate assumption for Dutton Hydro included a rate change to reflect an 8.57% ROE effective in 2009. Please confirm whether the valuation of Dutton Hydro shares included an ROE of 8.57%

Answer:

The valuation of Dutton Hydro shares in section 2.3.1 included the ROE of 9%. The 9% was used because the valuation of the share was completed in February 2007 which was prior to the OEB updating the ROE.

Middlesex Power is aware that the ROE used in the valuation of the shares is higher than the current OEB approved ROE, Middlesex Power will work to manage the difference.

Question #2 Application for Rate Rebasing

Ref. Section 2.1.4

In its application, Middlesex Power states it will not implement a rate harmonization plan until rate rebasing occurs, which will be deferred up to five years as allowed in the Report of the Board on Rate-making Associated with Distributor Consolidation (EB-2007-028).

a) Please confirm that it is Middlesex Power's intention not to rebase its rates for a period of five years from closing the transactions.
b) If not confirmed, please clarify Middlesex Power's proposal for rebasing the consolidated entity.

Answer:

a) Middlesex Power's intention is to defer the rate rebasing for up to 5 years that is allowed in the Report of the Board on Rate-making Associated with Distributor Consolidation (EB-2007-028).

The following chart summarizes the rate plan for the three service areas after a successful decision on this MAAD;

Service Area	2009	2010 - 2013
MPDC	2nd Gen IRM	2nd Gen IRM
NPI	2nd Gen IRM	2nd Gen IRM
DHL	Rate rebasing (RRB)	2nd Gen IRM

In 2014, or earlier depending upon economic conditions and the ability to change the rates in the Dutton service area, MPDC would come forward with a forecast Cost of Service (COS) application on a merged basis. At that time MPDC will provide a harmonized rates plan.

b) See above.

Question #3 Rate Rebasing for Dutton Hydro

Ref. Section 2.1.4

In its application, Middlesex Power states that some of the reasons for not harmonizing rates for a period of time are that Dutton Hydro's rates must be increased on a stand-alone basis to recover its reasonable costs.

a) Please clarify Middlesex Power's proposal for adjusting Dutton Hydro's rates in 2009. Does Middlesex Power's proposal involve a cost of service application?
b) If so, please confirm whether Middlesex Power is proposing a historical test year cost of service application or a historical test year cost of service application with certain forecasting elements?

Please note section 2.2.2 of the Board Report which indicates the Board's expectation that following the closing of a consolidation, distributors should stay on the applicable IRM plan for the duration of the deferral period. In addition, pursuant to the recent Power Stream/Barrie Hydro Decision (EB-2008-0335), the Board was not inclined to preclude evidence of the impacts of consolidation in a stand-alone future test year cost of service application for one of the entities involved in the consolidation.

c) If Middlesex Power's proposal is for some kind of historical test year application, please identify the historical test year that will be used.
d) Middlesex Power and Newbury Power received a rate adjustment based on a 2004 historical test year cost of service application in 2006. For 2007 and 2008, both distributors received a rate adjustment based on 2^{nd} generation IRM. Currently, both distributors have filed applications for 2009 rates based on 2^{nd} generation IRM. If Dutton Hydro were to file for a rate adjustment for 2009 rates that would follow an identical process (i.e. an adjustment based on a 2004 historical test year cost of service application using the 2006 EDR model followed by three 2^{nd} generation IRM adjustments commensurate with the models used for 2007, 2008 and 2009 rates) would this provide Middlesex Power with sufficient revenue to recover Dutton Hydro's reasonable costs until such time as the rebasing of the consolidated entity?
e) Please provide approximate bill impacts, both on deliver and total bill, for a typical residential and GS>50kW customer if the plan articulated in d. above is implemented.
f) Please provide a brief discussion on what kind of rate mitigation plan would be needed if the rate plan discussed in d. above were to be implemented for Dutton Hydro.
g) If the Board is not persuaded that Dutton Hydro's rates should be adjusted for 2009 on any basis, and the transaction is completed, please explain the impact on Middlesex Power's approach in terms of operating the Dutton Hydro service area.

Question 3 continues

Answer:

a) b) c)

Middlesex Power has proposed to file a "light" cost of service application based upon a forecast test year. Middlesex Power is referring to the application as a "light" cost of service because the current level of information known on Dutton's service territory is limited and therefore the level of information would not meet the current standards of a true cost of service application.

Middlesex Power was of the belief that the Board would only review forecast rate applications which is not the preferred method for the Dutton service area and this MAAD application.

Middlesex Power does understand the decision in the PowewrStream/Barrie MAAD that a rate application on a forecast test year would not treat the costs of the service area on a stand alone basis and will not exclude the information from the MAAD in the rate proceeding, however Middlesex Power believes that this MAAD is brought together for very different reasons.

The Board has recognized that there are different motivations as to why Local Distribution Companies (LDCs) come together, the Board's report on Rate-making Associated with Distributor Consolidation highlights this in section 2.2;

> "There are different circumstances among distributors and different motivations for consolidation transactions. Each transaction may be based on a different rationale and each offers the potential for different kinds of benefits that vary in nature, timing, and certainty."

The merger being proposed by MPDC is based upon providing a safe and reliable system that would benefit the customers and the public. Some of the issues that are facing the DHL service area are;

- They do not meet the Electrical Safety Authority standards
- They have not been pro active in removing transformer with PCBs
- There is very little, if any, information on service quality standards (SQI)
- The line losses are 6.6% which is well above the maximum level that the Board has set
- More details of the issues are provided in the answer to Q7.

Question 3 continues

d) Middlesex Power's intention is to have the rates for Dutton's service area to be at a level that will recovery the costs and earn a fair and reasonable return. Middlesex Power believes that a rate application for Dutton's service area using the 2006 EDR model and then implementing the IRM adjustments for 2007, 2008 and 2009 would provide the necessary financial tools to ensure that a safe and reliable distribution system is provided to the customers and the community. This level of rates would bring the customers in the Dutton service area to a similar position as the customers in Newbury and those in the current Middlesex service area.

Using the 2006 EDR filing it would be based on 2004 historical year with the following Tier 1 adjustments;

Tier 1 O&M	
ESA fees	$3,500
Tier 1 Capital	
PCB	$8,500
Pole replacement	$40,000

The O&M costs that are currently spent by Dutton is much lower than the provincial average of $87 per customer;

	2002	2003	2004	2005	2006	2007
O&M	$26,098	$25,007	$25,485	$33,475	$16,419	$25,678
Customers	598	598	598	598	598	598
Cost per customer	$44	$42	$43	$56	$27	$43

The only O&M costs that Middlesex Power would be looking for additional recovery of is the ESA fees which were not in the 2004 base and are required to provide a safe and reliable system for the customers, residents and the staff. Middlesex Power should be able to continue to manage the system at the lower level of O&M.

The capital additions are to meet the Ministry of Environment commitments for PCB removal and the pole replacement is to ensure that the system is a safe and reliable for the customers, residents and the staff.

See answer to Question 7 for additional information regarding the costs and additional issues that Middlesex Power will address to ensure that the customers and the residents will receive a safe and reliable service.

Question 3 continues

e) The bill impact based on the proposal in (d)

	Delivery		Total Bill		% Percentage	
Rate Class	**2002**	**2009**	**2002**	**2009**	**Delivery**	**Total Bill**
Residential	27.86	41.31	108.57	122.83	48.28%	13.13%
General Service >50	45.54	66.68	210.38	232.78	46.42%	10.65%

The increase includes $1 for smart meters and the low voltage charges for on going services from Hydro One but does not include any recovery of variance accounts for transmission, connection and low voltage charges.

f) If the above proposal was adopted and approved by the OEB then Middlesex Power would mitigate the rate by limiting the rate increase in year 1 to 10% and then pass on the remaining increase during the 2010 IRM process.

g) If Dutton's service area does not have a reasonable increase in their rates Middlesex Power will then be required to file a merged cost of service application because they will not be earning a return on this investment. A full cost of service application costs $100,000 to $150,000 which would be a significant increase in revenue requirement from these customers. A less costly solution being the one discussed in e) above will provide similar results.

Question 4 Deferral Account for Transaction Costs

Ref. Section 2.5.1

In its application, Middlesex Power states that it will be recording the transaction costs on the balance sheet as a deferral account.

a) Please confirm whether Middlesex Power is applying for the establishment of a deferral account in this application.
b) If so, given that Middlesex Power states that it does not plan to apply for rate rebasing for up to five years from the transaction closing date, please provide justification for the creation of a deferral account. Please discuss the response within the context of the statements at section 2.2.2 of the Board Report which states:

> It is not appropriate for a distributor to also be permitted to recover an acquisition premium or net consolidation losses in whole or in part through rates while retaining the realized benefits of the transaction over the deferral period. Either the distribution retains the benefits of consolidation over the deferral period to offset the costs, or the distributor can apply to recover the costs net of the benefits in rates.

c) Please clarify what Middlesex Power means by a "sharing mechanism" for the recovery of transaction costs.
d) If Middlesex Power decides to rebase the consolidated entity earlier than five years, please discuss the impact that this would have on Middlesex Power's ability to offset transaction costs through efficiency savings.

Answer:

a) Middlesex Power is requesting that a deferral account be established to cover the transaction costs.

b) The concern that Middlesex Power has is that the transaction costs can be significant in any MAAD. In this case they can be even more significant because Dutton and Newbury are so small. Many of the transaction costs are fixed with little room to reduce them. In Middlesex Power's case a significant amount of work is being performed internally (limited consultants costs) and using local lawyers to assist in keeping the transaction costs as low as possible.

The issue is, usually there would be savings on a go forward basis to recover the transaction costs and in this case there would not be any savings or synergies. As summarized in Q 3 a,b,c this transaction is not based upon any synergies from the current operating base. This transaction is to provide the customers and the

Question 4 continues

community with a safe and reliable system while meeting all the current and future regulatory requirements (OEB, ESA, Ministry of Energy etc.)

Therefore the customers of Dutton and Newbury benefit significantly from this transaction and therefore should share in some of the transaction costs if Middlesex Power does not attain additional benefits to cover the transaction costs.

c) Middlesex Power would only seek recovery of those transaction costs that are over and above any benefits that are attained through this transaction. If the benefits do not cover the transaction costs Middlesex Power will propose to recover a portion or all the net transaction costs from those customers. Middlesex Power believes they will be required to demonstrate that the customers of Dutton and Newbury benefited from the transaction and should share in the transaction costs.

d) The only reason why Middlesex Power would apply for rate rebasing earlier than 5 years is because the merged LDC is not earning a fair and reasonable return due to external circumstances being the impacts of the difficult economic conditions and the inability to attain reasonable rates for the Dutton service area to ensure that the customers and the community receive a safe and reliable distribution system. These conditions would mean that there are no additional benefits to offset the transaction costs which the customers should contribute to since they will receive benefits from the transaction in the form a safer and more reliable distribution system.

Question 5 The Transaction

Staff notes that the merger agreement filed with the subject application does not include rate assumptions for Dutton Hydro or a provision for a deferral account.

a) If the Board is not persuaded that Dutton Hydro's rates should be adjusted for 2009 on any basis, nor that a deferral account for transaction costs should be established, please confirm whether or not the transactions would still be completed on the same terms and conditions as are in the merger agreement.
b) Please explain whether the inflated valuation of Dutton Hydro's shares would in any way harm the financial viability of Middlesex Power.

Answer:

a) The Transaction between Dutton Hydro and Middlesex Power will still be completed on the same terms and conditions in the merger agreement whether the rate are to adjusted for 2009 and deferral account approved.

If the rates for Dutton Hydro are not adjusted Middlesex Power will most likely be required to apply sooner to the Board for a full cost of service application which would cost $100,000 to $150,000 which would have to be passed onto the customers.

b) Middlesex Power has a strong balance sheet before and after the purchase of Dutton and Newbury, therefore this transaction will not negatively harm the financial viability of Middlesex Power.

Question 6 Premium Paid for Shares of Dutton Hydro and Newbury Power

Please confirm Middlesex Power's understanding, as per the August 31, 2005 combined MAADs Decision (EB-2005-0234, EB-2005-0254 and EB-2005-0257) and the Board's Report, that any acquisition premium is not normally recoverable in rates.

Answers

Middlesex Power understands that the premium paid is not recoverable in rates.

Question 7 Completion of the Record

Please file any additional information in support of your application that Middlesex Power feels would provide the Board with as complete a record as possible for this application.

Answer

Middlesex Power would like to reinforce with the Board that this transaction is not about obtaining significant amount of synergies but is focused more on providing a safe and reliable service to the customers in Dutton and Newbury. The transaction will ensure that the LDCs will meet all current and future regulatory requirements from the OEB, ESA and Ministry of Energy to name a few. This transaction will provide additional benefits to those communities to reduce costs on a go forward basis, especially in smart meter technology.

Specifically in the Dutton service area there are several issues and concerns with the Middlesex Power has to assist in bring them up to standards and to provide their customers with adequate service. The following is the areas that require improvements:

Electrical Safety Authority (ESA)

During the due diligence process it was discovered that DHL are not in compliance with ESA. These issues can be resolved by MPDC but will require investments in audits, construction and material standards certification and inspections.

Plant Assessment (focussed on PCB's and Pole Condition)

Part of Due diligence included a 3rd party assessment of the transformer locations to determine PCB levels and the condition of the transformer poles. Only one serious PCB concern was discovered (115 PPM) but it will require the replacement of a 3 phase transformer bank and the structure at a cost of approximately $8,500. In the assessment 6 poles were found that require immediate replacement. As this was approximately 10% of the total pole locations tested (50) we believe that it would appropriate to prorate this over the entire pole population of approximately 200 and assume that there are over 20 poles requiring replacement at a cost of approximately $40,000.

Staffing requirement

MPDC's current service territory includes 3 communities over an 800 sq kilometre area. With the addition of DHL and NPI, 2 more communities are added and the service territory increases to 1,850 sq km. With only 3 Power Line Maintainers an additional employee will be required, this will allow there to be two-two person crews which will allow for appropriate coverage over the

Question 7 continues

entire service territory. The staffing requirements will ensure that the merged MPDC will meet the Board's SQI standards.

SQI's

As no service quality data is available the reliability performance of the Dutton and Newbury distribution systems are currently unknown. There will be a cost to include Dutton and Newbury into the MPDC service quality tracking system as information will need to be gathered on transformer and switch location data etc. Also depending upon the results of the SQI's investments will in either O&M or capital will be required.

Capital investment

As indicated a significant investment will be required in pole replacement and due to the ESA issues there will be some investment required to ensure systems are constructed to appropriate standards. The community of Dutton has residential growth potential with some lands designated for development and we believe an investment in ensuring the system will sustain existing customers and supply growth will also be required.

Line Losses

DHL has a high level of losses and one of the most efficient ways of reducing losses is making investments in replacing substations or removing them all together. Unfortunately DHL does not own any substations therefore the any investments that would be required to reduce losses are much higher.