Ontario

EB-2008-0237

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Niagara-on-the-Lake Hydro Inc. for an order approving or fixing just and reasonable rates and other charges for the distribution of electricity to be effective May 1, 2009.

BEFORE: **Cathy Spoel**
Presiding Member

Pamela Nowina
Member and Vice-Chair

DECISION AND ORDER

BACKGROUND

Niagara-on-the-Lake Hydro Inc. ("NOTL" or the "Applicant") filed an application with the Ontario Energy Board on August 6, 2008, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the rates that it charges for electricity distribution to be effective May 1, 2009. NOTL is the licensed electricity distributor serving the Town of Niagara-on-the-Lake.

NOTL is one of about 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year, by electricity distributors.

On January 30, 2008, as part of the plan, the Board indicated that NOTL would be one of the electricity distributors to have its rates rebased for the 2009 rate year. Accordingly, NOTL filed a cost of service application based on 2009 as the forward test year.

The Board assigned the application file number EB-2008-0237 and issued a Notice of Application and Hearing dated August 26. The Board approved four interventions: the Association of Major Power Consumers Ontario (AMPCO), Energy Probe, School Energy Coalition (SEC), and Vulnerable Energy Consumers Coalition (VECC). Board staff also posed interrogatories and made submissions. The Board determined that this application would be decided by way of a written hearing. The hearing closed with the filing by NOTL of its reply argument on January 23, 2009.

The full record is available at the Board's offices.

In its original application, NOTL requested a revenue requirement of $5,191,140 to be recovered in new rates effective May 1, 2009. The resulting requested rate increase was estimated as a 10.4% increase over 2008 on the delivery component of the bill for a residential customer consuming 1,000 kWh per month. In its final submission, NOTL agreed with a number of adjustments to its Application and revised its revenue requirement to $5,166,535.

The following aspects of NOTL's Application for rates were accepted by all parties.

- Asset management
- Service reliability
- Smart meters
- Adjustment to Transformer Ownership Allowance

The Board accepts the Applicant's evidence on these matters and the resultant rate consequences.

THE ISSUES

The issues listed below were raised in the submissions filed by Board staff and Energy Probe, SEC, and VECC and are addressed in the following sections of the Decision:

- Load Forecast
- Other Distribution Revenue
- Operating, Maintenance & Administrative Expenses
- Payments in Lieu of Taxes
- Capital Expenditures and Rate Base
- Long-term Debt Rate
- Cost Allocation and Rate Design
- Deferral and Variance Accounts

LOAD FORECAST

The following issues are addressed in this section:

- Methodology and model
- Customer forecast

Methodology and Model

In its Application, NOTL explained that it developed its weather normalized load forecast using a total system weather normalized purchased energy forecast based on a multifactor regression model that incorporated historical load, weather, and economic data.

The intervenors raised a number of concerns about the use of this model.

Energy Probe argued that that using a single multifactor regression model falsely assumed all rate classes were influenced by the same set of variables to the same degree. Energy Probe also argued that adding an additional independent variable based on the number of customers would establish a more accurate relationship to the total system purchased energy forecast. VECC agreed.

NOTL agreed that the number of customers should be included in the regression analysis, but noted that the monthly numbers of customers by class were not available in NOTL's records for the early years of the historical data.

NOTL proposed to apply a reduction to the weather normalized purchased energy forecast to reflect the impact of its CDM programs. VECC and Energy Probe submitted that the impact of the 2007 CDM savings had been captured in the regression model and therefore the CDM adjustment should be excluded.

NOTL noted that the CDM results had only been reflected in recent years, and that it had to address the CDM impact in the regression model which was based on the historical data from 1996 to 2007.

For the purpose of the load forecast calculation only, NOTL agreed to use the loss factor adjustment based on the average for the period 2003 to 2007, which is 1.0463 instead of 1.0501, as suggested by Energy Probe and VECC.

Energy Probe submitted that the load forecast methodology used by the Applicant also assumed the weather adjustment was proportional to each weather sensitive class, but that the three weather sensitive classes (residential, GS < 50kW, and GS > 50kW) would be expected to have different levels of sensitivity to the weather.

Energy Probe and VECC submitted that that the methodology demonstrated no relationship between customer count forecast and the total weather normalized billed energy forecast. For future forecasts, Energy Probe recommended the Board direct NOTL to develop the forecast for each rate class to include number of customers and the normalized average use according to an econometric estimation. VECC submitted that since this was the best information available, the Board should accept the results for NOTL load forecast methodology.

NOTL explained that its data has a number of limitations which led it to use the single multifactor regression model for all classes. The billing cycle meter reading schedules were not at month-end which was required in order for consumption data to match the heating degree days used in regression model, and the monthly billing data was not available for a large part of the regression period even though the billing data period matched the monthly consumption data. However, NOTL stated that it does have the monthly amount of kWh purchased from the IESO.

Board Findings

Given that NOTL does not have adequate information related to monthly numbers of customers and monthly billing data to forecast load by customer class, the Board finds that the Applicant's approach for the load forecast is reasonable. The Board therefore accepts the Applicant's load forecast for the purposes of setting 2009 rates. The Board notes that in its submissions NOTL stated that it expects to improve its load forecasting methodology in future, rebased, cost of service applications.

Customer Forecast

NOTL's customer forecast was developed using historical annual growth rate for the period from 2003 to 2007, as shown in Table 1. The forecast for the residential class was adjusted for expected lot developments and expected load transfers. Since NOTL proposed to eliminate the sentinel lights class, no growth would be expected for the sentinel lights class.

Table 1

Rate Class	2009 Number of customers/connections Forecast As Filed (Exhibit 3/ Tab 2/ Schedule 2/ Page 2/ Table 2)	2009 kWh Load Forecast As Filed (Exhibit 3/ Tab 2/ Schedule 2/ Page 2/ Table 2)
Residential	6,584	66,320,829
GS < 50kW	1,209	34,349,093
GS > 50kW	123	80,605,864
Street Lights	1,953	1,086,069
Unmetered Load	32	302,169

Energy Probe submitted that the Board should accept NOTL's customer forecast with the exception of the GS < 50 kW class. Energy Probe explained that in the response to Energy Probe interrogatory[1], NOTL stated the actual number of GS<50 kW at the end of October 2008 was 1,221, which was higher than the 2008 forecasted value of 1,212. Energy Probe further submitted that the 2009 customer forecast for GS < 50kW should be maintained at the October 2008 level.

SEC and VECC had no comment on the customer forecast.

NOTL explained that the trend over the past few years and the severe economic downturn would not support a forecast that maintains GS< 50kW at the October 2008 level. NOTL also pointed out that the 2008 year end forecast for residential class customers was higher than the actual. NOTL noted that if the Board accepts Energy Probe's suggestion to adjust the forecast for GS<50 kW, the decline in the customer forecast for residential class should be considered.

Board Findings

The Board recognizes that NOTL filed its customer forecast when it filed its application on August 6, 2008. The Board is of a view that an updated forecast is not necessary unless there is a material impact on revenue deficiency/sufficiency as a result of a change in the number of customers or load. The Board finds that the change relating to forecasting the GS<50 kW customer class that Energy Probe has proposed is not material. The Board therefore accepts the Applicant's customer forecast for the purposes of setting 2009 rates.

OTHER DISTRIBUTION REVENUE

Energy Probe submitted that the forecast for Late Payment charges, Miscellaneous Service Revenue, and Miscellaneous Non-Operating Income should use a pro-ration methodology based on the increases shown in October 2008 year-to-date actual over those of October 2007. These increases would be applied to the full year 2007 actual to produce a revised 2008 forecast. As a result, Energy Probe submitted that the 2009 revenue for these three revenue sources should be increased by $19,865.

VECC observed that the 2008 year-to-date Late Payment Charge and Specific Service Charge were higher than the 2007 results. VECC submitted that at a minimum the 2008 and 2009 forecasts for these two sources of revenue should be set at the same level as the 2007 actuals.

[1] Energy Probe Interrogatory # 14

In its reply submission, NOTL explained the total of the preliminary December 2008 actual Late Payment charges and Miscellaneous Service Revenue was close to the original estimates. Therefore, NOTL submitted that the forecast for these two sources was reasonable. In regards to Miscellaneous Non-Operating Income, NOTL noted that the preliminary December 2008 amount for the sale of scrap was higher than the original forecast due to sale of scrap from decommissioning the St. David's station. No decommissioning of stations or major facilities was expected in 2009.

Both Energy Probe and VECC submitted that the Interest and Dividend Income for 2009 forecast should exclude the amount associated with deferral and variance accounts because the interest costs were effectively double counted.

In its reply submission, NOTL submitted that over time the total cash collected from customers would be equal to the service revenue requirement. Therefore, interest costs would not be double counted.

Board Findings

The Board finds that the changes that intervenors have proposed to the forecast of Late Payment Charges, Miscellaneous Service Revenue and Miscellaneous Non-Operating Income are not material. The Board notes the explanation provided in NOTL's reply argument that no decommissioning of stations or major facilities is expected in 2009.

The Board therefore finds that NOTL's forecast for these three sources of other distribution revenue is reasonable and accepts NOTL's other distribution revenue forecast for the purposes of setting 2009 rates.

The Board finds that any interest associated with deferral and variance accounts does not form part of the calculation of the revenue requirement as it remains in and forms part of those accounts until cleared. Although the amounts are not large, as this is a matter of principle, the Board directs NOTL to remove these amounts from its distribution revenue.

OPERATING, MAINTENANCE and ADMINSTRATIVE EXPENSES ("OM&A")

Operating costs include OM&A expenses, depreciation and amortization expenses, payments in lieu of taxes ("PILs"), and any transformer allowance payments to customers. PILs are proxies for capital and income taxes that otherwise would have to be paid if the distributor was not owned by a municipality.

The final PILs allowance for ratemaking purposes is determined after the Board makes its findings on other relevant parts of a company's application.

Operating costs also include interest charges on the company's debt. These are dealt with in the cost of capital section of the Decision. The Board deals below with the following issues:

- OM&A expenses
- PILs

OM&A Expenses

Table 2 shows the components of the proposed OM&A expenses for 2009 and compares them with previous years.

Table 2 - OM&A Expenses ($)

	2006 Actual	2007 Actual	2008 Bridge	2009 Test
Operations	$260,994	$342,844	$377,390	$373,710
Maintenance	$388,961	$431,315	$474,671	$521,359
Billing & Collecting	$310,202	$355,606	$312,374	$318,798
Community Relations	$29,210	$8,783	$1,000	$1,020
Administrative & General (excl. LV)	$557,582	$580,205	$591,409	$652,587
TOTAL	**$1,546,949**	**$1,718,753**	**$1,756,844**	**$1,867,474**

The test year total OM&A expenses forecast is $1,867,474, an increase of 8.7% or $148,721, from 2007 actual spending.[2] OM&A expenses in 2008 were 2.2% higher

[2] Total OM&A excludes PILs and property taxes.

than the 2007 actual. The forecast increase from 2007 to 2009 is mainly attributed to inflation, wages and staff changes, 2009 rate rebasing costs, and distribution system maintenance. The Board will address issues pertaining to 2009 rate rebasing costs, management fees, and shared services.

2009 Rate Rebasing Costs

NOTL is requesting approval of regulatory costs at an amount of $100,000 for costs associated with the 2009 cost of service application and has amortized the costs over a 3-year period ($33,333/year). The costs include consulting, potential legal fees, and potential OEB and intervenor costs.

Board staff and the intervenors submitted that as per the Board's report on 3rd Generation IRM dated July 14, 2008 the incentive regulation mechanism (IRM) period was changed from a 3 year to a 4-year cycle and that regulatory costs should be amortized over 4 years.

Energy Probe submitted that the evidence provided by NOTL included costs related to an oral component of this proceeding and that since none was required, these costs should be reduced from the forecasted level of $100,000 to $80,000. VECC and SEC agreed.

NOTL agreed that the rebasing costs should be amortized over 4 years, but did not accept the proposal of reducing its rebasing costs to $80,000, as it feared a significant recovery shortfall. NOTL noted that three LDC's (Wellington North, Norfolk Power and Erie Thames)[3] that completed rebasing in 2008 without oral hearing components, experienced total rebasing costs at or about $100,000.

Board Findings

The Board finds it appropriate for the Applicant to recover the costs associated with the preparation of its 2009 rates case over the future period as these are one-time costs which will not be incurred again until the next rebasing. The Board accepts the proposed expense of $100,000 and finds, as was agreed by NOTL in its reply submission, that this expense should be amortized over 4 years. In making this finding the Board looks at the overall costs as individual components of these may vary from those anticipated by the Applicant. While there was no oral component to the hearing, there were additional procedural steps such as a second round of

[3] EB-2007-0693, EB-2007-0753, EB-2007-0928

interrogatories. The Board therefore allows an expense of $25,000 to be reflected in 2009 rates.

Management Fees

In response to a Board staff interrogatory[4], NOTL indicated that it pays its holding company, NOTL Energy Inc. (NEI) $20,000 primarily for NEI's Board of Directors' costs and annual audit fees.

VECC submitted that NEI is wholly-owned by the municipality and is the holding company for both NOTL and its affiliate Energy Services Niagara Inc. (ESNI). It also stated that NOTL's evidence indicated that the president of NOTL reports to the Board of Directors of NOTL. Therefore, VECC submitted that it is inappropriate for ratepayers to be assessed any costs for the holding company's Board of Directors.

Energy Probe agreed and added that the same rationale applies to the audit costs of the parent company which should not be approved. Energy Probe submitted that the $20,000 in management fees should be removed.

SEC noted that NOTL has three out of its five Board members on the NEI Board and argued that there was no basis for a management fee as the cost of those three Board members are already incorporated into rates.

NOTL replied that both NOTL and NEI pay for their own directorships and audit fees. It stated that the management fee of $20,000 charged to NOTL is in recognition of the "invaluable guidance" NEI provides to NOTL and that paying this fee for management services is appropriate.

Board Findings

The Board notes that the management fee of $20,000 is a result of management services provided by NEI to NOTL and includes annual audit fees. However, it is unclear to the Board what amount is being charged for each of management services and audit fees.

The Board approves the portion of the management costs related to the annual audit fees to be recovered through rates. However, the Board denies any portion of the $20,000 related to management services provided by NEI to NOTL. There is no

[4] Board Staff Interrogatory #1.2b and 1.2c

indication that this fee is for shared services. The Board is of the view that the costs of NEI's Board are costs to the account of its shareholders and are to be paid by NEI, notwithstanding NEI's choice to provide guidance to NOTL. To expense these costs out of the operating revenues of NOTL would be contrary to regulatory principles and is therefore inappropriate.

The Board directs NOTL to remove that portion of the applied for amount that is related to management services provided by NEI to NOTL in its draft rate order.

Shared Services

Energy Probe noted that the price paid by ESNI for the services received from NOTL are cost based and include markups on labour, trucks, material, contractor, and account payable. Energy Probe stated that it was uncertain if the costs allocated to the services provided to ESNI have been calculated on a fully allocated basis and whether shared assets are included in the cost based prices charged for shared services. Energy Probe submitted that, in its next rates rebasing application, NOTL should provide a detailed fully allocated costing to ensure that ratepayers are not paying for assets that are used to provide services to an affiliate.

Energy Probe also sought clarification as to whether NOTL included costs for shared services in the calculation of its working capital allowance.

NOTL submitted that the markups are put in place to ensure that the price paid by the affiliate for the services received reasonably reflects the full cost. This ensures that distribution ratepayers are not subsidizing the affiliate. NOTL submitted that it is appropriate to verify and update the markup percentages and indicated that it will do so before the next rebasing application. NOTL also confirmed that costs for shared services were not included in the working capital calculation.

Board Findings

The Board finds that NOTL's pricing approach regarding services provided by NOTL to ESNI is reasonable.

The Board does not find it necessary or cost effective for NOTL to engage in a fully allocated cost study at this time, but the Board does expect NOTL to verify and update the markup percentages for the next rebasing.

PAYMENTS IN LIEU OF TAXES (PILs)

NOTL's evidence[5] contained detailed tax calculations which showed a regulatory income tax amount of $411,031, as payable in the 2009 Test year. This was based on an assumed tax rate of 33%.

Board staff's submission noted that NOTL seemed to have calculated an income tax rate by adding the grossed-up PILs, already computed, to the regulatory net income. NOTL's methodology results in a higher tax rate, as adding the PILs tax amount to the regulatory net income produces a higher taxable income. Board staff stated that while NOTL's method diverges from the Board's established methodology, the impact of this divergence is not material. VECC submitted that it would be inappropriate to include such an amount in the revenue requirement absent compelling evidence that such divergence is in the public interest.

In its reply submission, NOTL stated that its methodology has been verified as correct by an independent auditor as well as a well known electricity industry consultant. NOTL also stated that, to the best of its knowledge, its method would appear to be correct using what it described as a typical top-down approach to calculate PILs.

Intervenors submitted that NOTL should calculate its income and capital taxes using the most recent information available, including tax rates that are applicable to 2009. In its reply submission, NOTL stated its willingness to make adjustments or updates as required.

Energy Probe also expressed concerns in its submission about the level of property tax recovery being sought by NOTL. Energy Probe stated that NOTL had forecast property taxes of $33,450 in 2009, but in an interrogatory response had increased this amount by $1,200 to $34,650, without providing any explanation or rationale for this increase. Energy Probe submitted that the Board should disallow this increase in this expense forecast.

NOTL explained that it had provided a justification in a footnote incorporated in the interrogatory response, but did not provide a detailed explanation due to the small amount involved.

[5] Exhibit 4 Tab 3 Schedule 1

Board Findings

The Board directs NOTL to adhere to the Board's established PILs methodology in its next cost of service rate adjustment filing. Due to the relative immateriality of the differential between the results of using NOTL's methodology and the results of using the Board's established methodology, the Board will not require NOTL to adjust its methodology for the purposes of rate-setting in this proceeding.

The Board accepts NOTL's submission that it did not provide a detailed explanation of the increase in its proposed property tax recovery because of the immateriality of the amount.

The Board finds that NOTL is required to correct all errors that have been identified in its PILs calculations, and incorporate in its draft rate order any adjustments to regulatory taxable income that arise from this Board Decision.

The Federal Budget enacted on February 3, 2009 included an increase in the small business income limit from $400,000 to $500,000 effective January 1, 2009, and a change in the capital cost allowance (CCA) applicable to certain computer equipment and related system software (CCA class 50) acquired between January 27, 2009 and February 2011. The Board has considered these fiscal changes and determined that the draft rate order should reflect the increase in the federal small business income limit for affected distributors and the change in the CCA.

NOTL is directed to incorporate any such changes into its draft rate order.

The Board directs NOTL to incorporate all other known income and capital tax changes into its PILs calculations for 2009 that have arisen since the application was filed.

RATE BASE

NOTL's application requested approval of $21.7 million for the 2009 rate base. This amount is a 1.4% increase ($307,231) from NOTL's 2007 actuals and a 2.6% increase ($557,536) from its 2006 actuals.[6]

The following issues are addressed in this section:

- Capital Expenditures

[6] Revised Exhibit 7/Tab 1/Schedule 1 – Page 5 of the Board Staff Interrogatory Responses

- Working capital allowance
- Disposition of meters
- Computer hardware and software depreciation

Capital Expenditures

From Table 3 below, NOTL's application proposes 2009 capital expenditures of $1,877,496. This represents an increase of approximately 45% compared to the 2008 projected level of $1,290,000, and an increase of approximately 78% compared to 2007 actual capital expenditures of $1,054,083.

Table 3 – Capital Expenditure for 2007 to 2009[7]

	2007 Actual Year	2008 Bridge Year	2009 Test Year
Capital Expenditures	$1,054,083	$1,290,000	$1,877,496
% change as compared to the prior year		22.4%	45.5%

NOTL's evidence outlines its five-year capital plan. This plan shows capital expenditures projected to be at approximately the $1.3 million level in 2008, rising to approximately $1.9 million in the 2009 test year and then returning to approximately the $1.3 million level in the 2010 to 2012 period. Spending for smart meters is not included in the 2008 and 2009 capital expenditures.

Board staff noted that the major reason for the 2009 increase is the Chautauqua underground project which is anticipated to cost $1.5 million over a three year period with $1,000,000 of these expenditures to be incurred in 2009. The remaining $500,000 would be split between 2008 and 2010 with $300,000 forecast to be incurred in 2008 and $200,000 in 2010. The Chautauqua project is described as a system enhancement project which includes voltage conversion and area improvement in the Old Town urban area.

Energy Probe expressed concern about the level of contributions and grants incorporated into NOTL's 2008 and 2009 forecast stating that the 2008 and 2009

[7] Based on Exhibit 2/Tab 3/Schedule 1

levels were substantially below the levels recorded in 2006 and 2007. Energy Probe submitted that the forecast level of contributions and grants of $150,000 in both years should be doubled to $300,000 in each year.

In its reply submission, NOTL stated that it was confident the projections for capital contributions submitted in its application are correct for the economic conditions in the NOTL area. NOTL noted that the majority of the capital contributions are derived from new subdivision construction and that new housing starts in Niagara-on-the-Lake have slowed dramatically.

Board Findings

The Board finds that NOTL's 2009 forecast capital expenditure level of $1,877,496 is reasonable. The Board is satisfied that NOTL has adequately justified the higher than normal level of capital expenditures, as it relates to the Chautauqua underground project and due to the need to synchronize the timing of this work with work being carried out by the Town of Niagara-on-the-Lake in the same area. The Board also notes that no parties objected to the Applicant's proposal.

The Board finds that NOTL's forecast of reduced levels of contributions and grants in 2008 and 2009 is reasonable. The Board accepts NOTL's explanation that the reduction in these amounts is related to the economic slowdown in the Applicant's service territory.

Working Capital Allowance

Energy Probe and VECC both made submissions on NOTL's proposed working capital allowance. Energy Probe stated that it accepted the approach taken by NOTL to calculate its working capital allowance with some proposed adjustments. However, Energy Probe continued to believe that the 15% methodology may be overstating the required allowance for working capital. Therefore, it recommended that the Board direct NOTL to prepare a lead lag study for its next rebasing application.

In its reply submission, NOTL stated that in the context of this application, the methodology it has used remains appropriate.

Energy Probe submitted that NOTL's calculation should be adjusted so that its cost of power component reflects the most recent cost of power forecast presented to the

Board. Energy Probe further submitted that the cost of power component should also reflect the forecast of network and connection transmission services provided by Hydro One Networks Inc. ("HONI"). VECC agreed.

Energy Probe submitted that since the rates for these services are currently being reviewed in a HONI rates proceeding, a variance account should be used to capture any differences between the rates used to calculate the working capital allowance in this proceeding and the rates ultimately approved by the Board - the methodology approved by the Board in its EB-2007-0693 Decision for Wellington North Hydro Inc.

VECC noted that some other distributors are not billed by the IESO for all components of the RPP price and are billed for different components for non-RPP customers. VECC submitted that the Board should work with distributors and the IESO to establish a common approach to determining what elements of the RPP Price Report should be included in the cost of power for purposes of determining working capital allowances.

NOTL agreed with VECC and Energy Probe regarding the use of the latest forecast of cost of power in the working capital calculation. In NOTL's view, the HOEP price is more appropriate than RPP since it better reflects the cost paid to the IESO for power. However, NOTL stated that it would be guided by the Board Decision as to which price to use.

Energy Probe also expressed concern with NOTL's inclusion of property taxes in its working capital calculation. In its view, Appendix A of the 2006 Handbook shows that property taxes are not included in the calculation of the working capital allowance.

NOTL agreed that Appendix A of the Handbook appears to exclude property taxes, but that the 2006 EDR model issued by the Board included property taxes in the working capital calculation. NOTL requested direction from the Board on this matter.

Board Findings

The Board notes that NOTL has followed the Board's Filing Requirements for Transmission and Distribution Applications dated November 14, 2006 which allows the utility to apply a 15% factor to derive the allowance for working capital. The Board will not require NOTL to prepare a lead lag study for its next rebasing application. In making this finding, the Board is mindful that for a small working capital requirement, the cost of an individual study is likely to exceed any adjustment that might result. The Board therefore finds NOTL's approach of using a 15% factor to derive its working capital allowance is reasonable.

The Board directs NOTL to update the cost of power used in calculating its working capital allowance to reflect the most recent cost of power forecast presented to the Board by Navigant on October 15, 2008.

The Board will not require NOTL to reflect the forecast of network and connection transmission services provided by HONI as these amounts have not yet been approved by the Board.

The Board notes VECC's request that the Board should work with distributors and the IESO to establish a common approach to determining what elements of the RPP Price Report should be included in the cost of power for purposes of determining working capital allowances. The Board views this matter as a generic policy issue outside the scope of this Decision. The Board finds that property taxes are properly included in the working capital calculation as they are distribution expenses.[8]

Disposition of Meters

Energy Probe submitted that NOTL had identified an impact on the 2009 revenue requirement related to the disposal of meters in both 2008 and 2009. NOTL noted that that this was an oversight and agreed to correct an additional error it found related to the disposal of substation equipment. NOTL submitted that the final 2008 and 2009 continuity schedules should include correction of these inadvertent errors with corresponding adjustment to the rate base and revenue deficiency calculations.

<u>Board Findings</u>

The Board notes the explanation provided by NOTL in its reply submissions for the revisions required that are related to the disposal of meters. The Board directs that all necessary corrections be incorporated into NOTL's draft rate order.

[8] While Appendix A-4 to the Handbook shows a working capital calculation that excludes property taxes, "Distribution Expenses" is defined to include them as part of Account 6105 "Taxes Other Than Income Taxes". Section 5.4 of the Handbook states that the working capital allowance calculation includes "2004 Distribution Expenses."

Computer Hardware and Software Depreciation

Energy Probe noted that NOTL's filed evidence showed an amortization period of three years for computer hardware contained in Account 1921, although the correct period is five years. NOTL agreed with Energy Probe, and pointed out that 5 years had been used, but that there was an error in the table included in the application.

Energy Probe also stated that NOTL appeared to be depreciating computer software over three years, whereas it submitted that this depreciation expense should be based on a five year period. SEC agreed.

NOTL confirmed that it was using a three year amortization period for computer software. NOTL stated that because software becomes out of date rapidly, a three year amortization period is reasonable. NOTL noted that it has used three years consistently since it was incorporated in 2000 and all depreciation rates used have been fully audited. Accordingly, NOTL submitted that an adjustment to reflect a five year amortization period is not appropriate.

<u>Board Findings</u>

NOTL has acknowledged that an error was made in one of its tables which showed a three year depreciation rate for computer hardware. NOTL stated, however, that all calculations were based on the correct five year rate and no adjustment was necessary. The Board accepts NOTL's explanation.

The Board accepts NOTL's arguments for use of its proposed three year amortization period for computer software and finds the three year period to be reasonable based on the evidence presented.

COST OF CAPITAL and CAPITAL STRUCTURE

The Board's guidelines for the cost of capital are set out in its *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation of Ontario's Electricity Distributors* (the "Board Report"), dated December 20, 2006.

NOTL's evidence, as filed, proposed a weighted debt cost rate for 2009 of 6.77%, which is forecasted to consist of three instruments. One of them is a promissory note in the amount of $6.6 million payable to its shareholder with a proposed rate of 7.25% and no fixed term. Intervenors argued that the Board's deemed long-term debt rate of 6.10% was the appropriate rate to apply to this instrument.

Board staff and other parties asked the Applicant through interrogatories to provide a copy of the loan agreement as well as additional information on these arrangements.

In its responses, NOTL provided a copy of a promissory note dated July 15, 2008, with an interest rate of 7.25% and a maturity date of August 1, 2018. This note is automatically renewable for an additional ten year term upon maturity on the same terms and conditions unless either party gives 90 days written notice that the note shall not be renewed. This note replaces the note dated November 1, 2000.

In its interrogatory responses, NOTL stated that the 7.25% rate had originally been set and approved by the Board, had been in place since its inception in the year 2000, and never been re-negotiated. NOTL further noted in support of its views that the Board's Report states that "The Board has determined that for embedded debt the rate approved in prior Board decisions shall be maintained for the life of each active instrument, unless a new rate is negotiated, in which case it will be treated as new debt." Energy Probe, SEC and VECC expressed concerns about NOTL's proposal to impute a rate of 7.25% on this debt, arguing that the promissory note now in place is actually a replacement note for the affiliate debt and that this was so noted in the Promissory Note dated July 15, 2008. Energy Probe submitted that the 7.25% rate, which was continued in the replacement note was not appropriate because it was not based on any market rate available at the time the replacement note was put in place and that the appropriate rate to use was the 6.10% deemed rate set by the Board for 2008.

VECC noted that the Board's Report states that "for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate".
VECC noted that since a copy of the 2000 note was not provided, there was no information available to conclusively resolve whether the note was best characterized as a long-term note or a demand note. VECC also drew the Board's attention to its 2008 Horizon Utilities Decision where a similar issue arose and the Board found that the "replacement note" was new debt.

SEC expressed similar views regarding this note, stating that there is no information in this proceeding to indicate whether or not the original note was callable on demand. SEC added that in any case the note that is currently in effect is a new note and therefore the Board's deemed long-term interest rate should apply instead.

In its reply submission, NOTL stated that it had reviewed the Board's Horizon Decision, as referenced by VECC. NOTL submitted that this Decision was based on the inference that Horizon had indeed revised the interest rate on the note as part of their 'housekeeping' process. NOTL reiterated its reference to the Board guideline cited above and concluded that a new rate was not negotiated and, accordingly, the deemed rate should remain at 7.25%, in keeping with Board direction.

Board Findings

The Board finds that NOTL should use the Board's deemed rate as of July 15, 2008, or 6.10%, as the imputed rate on its promissory note in determining its cost of debt for regulatory purposes rather than its proposed rate of 7.25%.

In making this finding, the Board notes that NOTL did not provide a copy of the original note which is referred to in its evidence as dated November 1, 2000 and as having a term of "n/a". NOTL instead provided a copy of a replacement note dated July 15, 2008. The replacement note is stated as having a term of just over 10 years with a maturity date of August 1, 2018.

In support of its position, NOTL quoted the portion of Section 2.2.1 of the Board Report that is applicable to embedded debt. The Board is in agreement with the position of intervenors that because a replacement note was issued July 15, 2008, this debt is not embedded debt, but new affiliated debt.

Section 2.2.1 of the Board Report states that "For new affiliated debt, the Board has determined that the allowed rate will be the lower of the contracted rate and the deemed long-term rate." As the contracted rate of 7.25% is higher than the Board's deemed rate at the time of issuance, the deemed rate, or 6.10% would be applicable. The Board directs NOTL to make all necessary adjustments as a result of applying the deemed long-term rate in its draft rate order.
The table below sets out the Board's conclusions for NOTL's deemed capital structure and cost of capital. It incorporates the Board's updated cost of capital parameters.

Table 4 - Board-approved 2009 Capital Structure and Cost of Capital

Capital Component	**% of Total Capital Structure**	**Cost rate (%)**
Long-Term Debt	52.7	6.04

Short-Term Debt	4.0	1.33
Equity	43.3	8.01
Weighted Average Cost of Capital		6.71

COST ALLOCATION AND RATE DESIGN

The following issues are addressed in this section:

- Line losses
- Customer reclassification
- Revenue to cost ratios
- Rate design - monthly fixed charges
- Retail transmission rates

Line Losses

NOTL determined that the average total loss factor for the period 2003 to 2007 was 1.0463. The total loss factor includes the average supply facility loss factor for the period 2003 to 2007 of 1.0055. However, NOTL proposes retaining the current total loss factor of 1.0501 due to the remaining debit balance of $264,801 in account 1588.

VECC submitted that the average loss factor of 1.0463 for the period 2003 to 2007 represents the best information available. VECC disagreed with NOTL's proposal. VECC noted that the average loss factor for the last three years was 1.0445 and that NOTL is undertaking capital spending that will reduce losses in the future. VECC submitted that the Board should approve a loss factor of no more than 1.0445. Energy Probe submitted that the total loss factor should be the five year average of 1.0463. Energy Probe submitted that the debit in the power purchase variance account should be dealt with separately.

In its reply submission, NOTL stated that the fact that the power purchase variance account is currently in a substantial debit balance position is an indication that an incorrect loss factor (too low) was applied at some recent point in time resulting in an under collection from customers.

<u>Board Findings</u>

The Board finds that it is appropriate to base the total loss factor on the average data for the period 2003 to 2007. The Board notes that NOTL accepted the use of a loss factor of 1.0463 for the load forecast calculation. The Board agrees with VECC that setting loss factors arbitrarily high is not the appropriate way to manage the balances of variance accounts. The Board therefore finds the total loss factor for secondary metered customers is 1.0463 and directs NOTL to incorporate necessary corrections into its draft rate order.

Customer Reclassification

NOTL proposes to discontinue its sentinel light class based on its interpretation of the latest version of the Affiliate Relations Code ("ARC") and a decision by NOTL and its affiliate, Energy Services Niagara Inc. ("ESNI"). The plan is to terminate the business and services contract related to sentinel lights on or before April 30, 2009.

NOTL states that some accounts will be moved to the USL rate class, where feasible to the customer, provided that the lights are not on NOTL poles. NOTL provided the bill impact summary shown in Table 5. In addition, the Town of Niagara-on-the-Lake, NOTL's largest sentinel light customer, plans to convert or transfer its sentinel lights to its street light account. The remaining sentinel lights will be disconnected from the NOTL system, and may be rewired to the customer supply.

Table 5 - Bill Impact for Sentinel Light Customer Moving to USL Rate Class

Monthly Rates & Charges	**Sentinel Light Customer With 8 Lights**	**USL Customer**
Service Charge	$2.92 x 8 = $23.36	$47.83
Distribution Volumetric Rate	$5.8909/KW x 2.2 kW = $12.96	$3.36
ESNI Rental	$37.12	N/A
TOTAL	**$73.44**	**$51.19**

In its interrogatories and submissions, Board staff noted that NOTL has incorrectly identified changes in the ARC to justify its proposal to eliminate the sentinel light class.

In its reply submission, NOTL referred to a response to an interrogatory[9] which clarified that its intention to eliminate the sentinel light class was based on the coming termination of its contract with NOTL's affiliate and customer, ESNI on April 30, 2009. According to NOTL, ESNI was exiting the business due to negative growth and low profitability.

[9] Board staff interrogatory response #9.1(b)

VECC noted that NOTL proposes to reassign sentinel light class revenue requirement responsibility to all customer classes. NOTL's rationale for assigning the revenue responsibility to all customer classes is based on the fact that street lighting is already experiencing a large increase. VECC submitted that this is not a justifiable reason and submitted that that the revenue requirement responsibility for the sentinel light class should be consistent with how the customers are being reassigned to customer classes.

In its reply submission, NOTL accepted VECC's point, but suggested a refinement as only about one half of the sentinel lights are being reassigned and the other half will be disconnected. NOTL suggested allocating revenue requirement for disconnected sentinel lights across all customer classes, and allocating revenue requirement for reassigned sentinel lights to the assigned classes.

Board Findings

No party objected to the elimination of the sentinel light customer class. The Board finds that it is a reasonable decision for NOTL to eliminate the class. The Board also accepts NOTL's suggestion to allocate revenue requirement for disconnected sentinel lights across all customer classes, and to allocate revenue requirement for reassigned sentinel lights to the assigned classes.

Revenue to Cost Ratios

Table 6 sets out NOTL's current and proposed revenue to cost ratios. The proposed ratios are in column 3. The Board's target ranges, as established in the Board's *Application of Cost Allocation for Electricity Distributors EB-2007-0667*, are set out in column 4.

Table 6 - Revenue to Cost Ratio (%)

Customer Class	(1) Informational Filing Run 2	(2) Column 1 Revised (Transformer Ownership Allowance)	(3) Application: Exhibit 8 / Tab 1 / Schedule 2 / p. 4	(4) Board Target Range
Residential	88.74	88.59	94.37	85 – 115
GS < 50 kW	91.74	92.47	95.87	80 – 120
GS > 50 kW	183.49	179.01	145.15	80 – 180

Street Lights	14.85	15.07	42.43	70 – 120
Sentinel Lights	23.88	24.24	N/A	70 – 120
USL	97.26	97.90	100	80 – 120

According to the informational filing (column 1), three customer classes, GS>50 kW, street lights and sentinel lights, are currently outside the Board's target range. As noted in the previous section, NOTL proposes to eliminate the sentinel lights class.

NOTL proposes to set street light rates that move the revenue to cost ratio half of the way towards the minimum of the Board target range in 2009 and to the minimum of 70% over the subsequent two years. NOTL proposes to set rates that move the revenue to cost ratio for residential and GS < 50 kW customer classes 50% of the way towards 100% and to move USL from 97.26% to 100%. NOTL proposes that the service revenue requirement from these adjustments balance the revenue to cost ratio for GS > 50 kW from 183.49% to 145.15%.

In its submission, VECC noted the following three concerns with NOTL's distribution of revenue requirement from the cost allocation informational filing:

- The cost of the transformer ownership allowance should be allocated solely to the GS>50 kW class. With this change, the results of the cost allocation informational filing as a reference point for revenue to cost ratio changes are no longer applicable.
- The revenue requirement responsibility stemming from proposed elimination of the sentinel light class should not be assigned to all customer classes.
- NOTL used the class revenue requirement distribution from the cost allocation informational filing to determine 100% cost responsibility for 2009. VECC noted that a number of other utilities (i.e. COLLUS Power (EB-2008-0226) and Bluewater Power (EB-2008-0221)) have reassessed the ongoing validity of their cost allocation informational filing as part of their 2009 rate application.

NOTL agreed with VECC regarding the transformer ownership allowance and provided an alternate run of the cost allocation model that reflects the removal of costs and revenues associated with the transformer ownership allowance. The resulting revenue to cost ratios are listed in column 2.

Based on the ratios in column 2, the street lights class is the only one outside of the Board's target ranges.

VECC submitted that NOTL should adjust its revenue to cost ratio for street lights as proposed by NOTL and that the additional revenues should be used to reduce the revenue to cost ratio for the GS>50 kW class. VECC stated that there is no reason to adjust the revenue to cost ratio for the other classes and supported its position by referencing a number of past Board decisions.[10] Energy Probe agreed with VECC.

SEC submitted that the level of cross-subsidization by the GS>50 kW class was unacceptable and the NOTL should be required to reduce the revenue to cost ratio for this class to 100% over the next two rate years.

In its reply submission, NOTL noted that VECC and Energy Probe submitted that there is no reason to adjust the revenue to cost ratios for the residential, GS<50 kW and USL classes, while SEC submitted that NOTL should be required to reduce the ratio for the GS>50 kW class to 100% over the next two years. NOTL stated that the latter requires offsetting increases from the other classes, contrary to the submissions of VECC and Energy Probe. NOTL submitted that its approach for the revenue to cost ratios remains a reasonable overall strategy.

<u>Board Findings</u>

The Board recognizes the limitations in the cost allocation model with respect to treatment of the transformer ownership allowance. The Board is satisfied that the revenue to cost ratios in column 2 of Table 6 are appropriate for the purposes of reviewing the ratios for 2009. Accordingly, the Board’s findings on revenue to cost ratios are made with respect to column 2. The Board also acknowledges VECC’s position relating to the ongoing validity of the cost allocation informational filing. NOTL has not provided an updated cost allocation and is ordered to do so as part of its next cost of service application.

The Board accepts NOTL’s proposal relating to street light rates, i.e. the revenue to cost ratio shall move half way to the bottom of the Board target range in 2009 and reach the 70% target range by 2011 in equal increments. The Board also accepts NOTL’s proposal to use the additional revenue generated from the street light class to reduce the rates for the GS>50 kW customer class.

[10] Barrie Hydro (EB-2007-0746), Espanola (EB-2007-0901), PUC (EB-2007-0931), Guelph Hydro (EB-2007-0742) and Wellington North (EB-2007-0693)

The Board concurs with SEC regarding the level of cross-subsidization by the GS>50 KW customer class. While previous Board decisions have not approved any further movement for customer classes already within target ranges, there is no other mechanism to mitigate the cross-subsidization by the GS>50 kW customer class. The Board finds that it is within the utility's discretion to move towards revenue to cost ratio of unity as long as the impact can be borne by affected rate classes. Accordingly, the Board finds that NOTL's proposal to set rates that move the revenue to cost ratio for residential and GS<50 kW customer classes half of the way towards 100% and to move USL to 100% is appropriate. The additional revenue shall be allocated to reduce the revenue to cost ratio for the GS>50 kW customer class.

Rate Design - Monthly Fixed Charges

NOTL proposes to maintain the same fixed to variable proportions assumed in the current rates. VECC agrees with NOTL's proposal for 2009.

In its submission, SEC expressed concern that the monthly fixed charges for the GS>50 kW class are too high. NOTL proposed a reduction of the fixed charges from $463.72 to $370.25 for the GS>50 kW class. SEC notes that the upper bound for this class is $72.73 (Customer Unit Cost per month – Minimum system with PLCC adjustment). SEC submitted that the fixed charges should be reduced to $87.23, which is 120% of the ceiling. In its reply submission, NOTL reiterated its position that it is appropriate for 2009 to maintain the same fixed/variable proportions assumed in the current rates.

Board Findings

The Board notes SEC's concern regarding the GS > 50 kW class. SEC determined the ceiling for the monthly fixed charge based on the Board Staff Discussion Paper, EB-2007-0667, of June 28, 2007. The Board notes, however, the subsequent EB-2007-0667 Report of the Board of November 28, 2007, said "The Board considers it to be inappropriate to make significant changes to the ceiling for the MSC [Monthly Service Charge] at this time, given the number of issues that remain to be examined" and that the matter would be within the scope of the Rate Review. The Board further said that "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."

The GS > 50 kW class is the beneficiary of the revised revenue to cost ratios and the monthly fixed charge will drop significantly from $463.72 to $370.25. The Board therefore accepts NOTL's proposal.

Retail Transmission Rates

The Board issued a guideline, *Electricity Distribution Retail Transmission Service Rates [G-2008-0001]* on October 22, 2008 indicating the process to be used to adjust retail transmission service rates ("RTSRs") to reflect changes in the Ontario Uniform Transmission Rates ("UTRs"). The changes are outlined in the Table 7.

Table 7 – Changes in the Ontario Uniform Transmission Rates ("UTRs")

	Current Rate ($/kW/month)	**Effective rate on January 1, 2009 ($/kW/month)**	**Effective increase**
Network Service Rate (NW)	2.31	2.57	11.3%
Line Connection Service Rate (CN)	0.59	0.70	18.6%
Transformation Connection Service Rate (TN)	1.61	1.62	0.6%

NOTL updated its application on November 28, 2008. In accordance with Guideline G-2008-0001, NOTL carried out a variance analysis using two years of actual data. NOTL reported no apparent ongoing trends in the monthly balances were identifiable. NOTL proposed to increase the retail transmission network rate by 9.23% and increase the retail transmission connection rate by 13.20%.

Board Findings

The Board accepts NOTL's proposal as reasonable.

DEFERRAL AND VARIANCE ACCOUNTS

Table 8 sets out the account balances (as of December 31, 2007 with interest forecast to April 30, 2009) which NOTL proposed to collect over 3 years. NOTL proposed to recover 1508 on a distribution revenue basis and to recover 1550 on a kWh consumed basis.

Table 8 – NOTL Proposed Deferral and Variance Accounts for Disposition

ACCOUNT #	ACCOUNT NAME	BALANCE - $
1508	Other Regulatory Assets	$110,104
1550	LV Variance	$20,926
TOTAL		**$131,030**

VECC and Energy Probe submitted that the interest rates to determine the accrued interest should be based on the Board's prescribed values. Energy Probe also submitted that NOTL's 3 year recovery period should be extended to 4 years to match the length of the third generation IRM plan. In its reply submission, NOTL agreed with the intervenors.

Board Findings

The Board accepts NOTL's change in recovery period of account balances 1508 and 1550 from 3 years to 4 years. The amounts to be disposed of are the principal balance as of December 31, 2007 and interest forecast to April 30, 2009, based on the Board's prescribed values.

IMPLEMENTATION

The Board has made findings in this Decision which change the Applicant's proposed 2009 distribution rates. These are to be reflected in a Draft Rate Order prepared by NOTL. This Draft Rate Order is to be developed assuming an effective date of May 1, 2009.

In filing its Draft Rate Order, it is the Board's expectation that NOTL will not use a calculation of the revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects NOTL to file detailed supporting material, including all relevant calculations showing the impact of this Decision on NOTL's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. NOTL should also show detailed calculations of the revised retail transmission rates and variance account rate riders reflecting this Decision.

The Board is concerned with the amount of time and energy that some intervenors are putting into matters of detail that are not matters of principle and are not material. This level of scrutiny has the potential to increase costs to the utility, intervenors and the Board and to increase the overall regulatory burden associated with rate setting, while not meaningfully contributing to the setting of just and reasonable rates.

RATE ORDER

A Rate Order decision will be issued after the processes set out below are completed.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

All filings with the Board must quote the file number EB-2008-0237**,** and be made through the Board's web portal at www.errr.oeb.gov.on.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must be received by the Board by 4:45 p.m. on the stated date. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.oeb.gov.on.ca. If the web portal is not available you may e-mail your documents to the attention of the Board Secretary at BoardSec@oeb.gov.on.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's Practice Directions on Cost Awards.

THE BOARD DIRECTS THAT:

1. NOTL shall file with the Board, and shall also forward to AMPCO, Energy Probe, SEC, and VECC, a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The Draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.

2. AMPCO, Energy Probe, SEC, and VECC shall file any comments on the Draft Rate Order with the Board and forward to NOTL within 7 days of the filing of the Draft Rate Order.

3. AMPCO, Energy Probe, SEC, and VECC shall file with the Board and forward to their respective cost claims within 26 days from the date of this Decision.

4. NOTL shall file with the Board and forward to AMPCO, Energy Probe, SEC, and VECC responses to any comments on its Draft Rate Order within 7 days of the receipt of any submissions.

5. NOTL shall file with the Board and forward AMPCO, Energy Probe, SEC, and VECC any objections to the claimed costs within 40 days from the date of this Decision.

6. AMPCO, Energy Probe, SEC, and VECC shall file with the Board and forward to NOTL any responses to any objections for cost claims within 47 days of the date of this Decision.

7. NOTL shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, March 25, 2009
ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary