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By E-mail and Courier

December 11, 2006

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

Dear Ms. Walli:

Re: Multi-Year Electricity Distribution Rate Setting Plan Cost of Capital (EB-2006-0088) and 2nd Generation Incentive Regulation Mechanism (EB-2006-0089)

These are the submissions of the London Property Management Association with respect to the Draft Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors and Associated Guidelines.

General Comments

In general, LPMA believes that the Draft Report is well balanced in that it protects ratepayers while ensuring the financial stability of the distributors. However, as noted below, this means that the recommendations in the Draft Report need to be taken in the context of an entire package. Changing one component without changes to others could destroy the balance achieved in the current Report.

Transition

The Draft Report is a transition plan, which should allow for the rebasing of all electric distributors by the year 2010. The Board has recommended that this rebasing be done based on a forward test year cost of service basis. LPMA strong endorses this recommendation and sees it as a fundamental element in any third generation incentive regulation plan. Indeed, the transitional nature of the current plan is the response to the desire by the Board, distributors and ratepayers to ensure that rates are just and reasonable. A forward test year cost of service filing, combined with the application of cost allocation and rate design will lead to this for all ratepayers of all distributors.

While it is clear that the incentive regulation component of the current Draft Report will be replaced with a third generation, it is unclear if the cost of capital recommendations contained in the Report are transitional in nature. The Board should clearly indicated in its Report that the cost of capital plan is also transitional in nature, and clearly state a timetable and process to determine appropriate capital structures, debt rates and return on equity that would be place for many years to come, similar to what it did for the gas utilities in the province through the use of the Ontario Energy Board Draft Guidelines on a Formula-Based Return on Common Equity for Regulated Utilities. These guidelines have been used for the gas utilities for many years and provide certainty for the distributors, ratepayers and the financial community.

Cost of Capital

The retention of the Cannon methodology is appropriate for the transition period. LPMA supports the comments of Dr. Booth that an appropriate ROE level would be under 8.0%, but accepts the continuation of the current methodology for the transition period.

Based on the October, 2006 Consensus Forecasts and the Bank of Canada data for the relevant period, the Long Canada Bond Forecast for 2007 would be 4.24%. This figure has been provided by Enbridge Gas Distribution in Exhibit I, Tab 5, Schedule 15 of their current rates proceeding (EB-2006-0034).

Based on the formula found in Appendix B to the Draft Report, this would result in an ROE for 2007 of 8.41% [9.35% + 0.75 x (4.24% - 5.50%)]. This is virtually identical to the 8.39% ROE for Enbridge and thus appears to be reasonable.

LPMA notes that in Appendix A to the Draft Report, the specific series to be used for the long-term corporate bond yield and the 30 year Government of Canada bond yields have been identified. LPMA recommends that the Board do the same thing for the variables $_{30}CB_{i,t}$ (30 year Government of Canada bond yield at the close of day i during the month corresponding to time t) and $_{10}CB_{i,t}$ (10 year Government of Canada bond yield at the close of day i during the month corresponding to time t) in Appendix B. These series are V39056 and V39055, respectively. This adds clarity and certainty to the calculation.

LPMA accepts the cost of both short and long term debt as appropriate for the transition period.

In terms of the capital structure, LPMA has two comments. First, an equity ratio of 40%, combined with the ROE as proposed seem to be on the rich side for the distributors, but as noted above, is acceptable for the transition period. While the ROE for the electric distributors would virtually be identical to that for Enbridge in 2007, as noted above, it should be understood that Enbridge has a common equity component of only 35%, as compared to the 40% for the electric distributors. LPMA submits that if the Board were to alter its report to allow for a higher ROE, then the equity component of the capital structure should be lowered and similarly, if a higher common equity component were to be higher than 40%, then a lower ROE would be required. This approach goes back to the general comments above, in that as a package, the ROE/capital structure recommendations provide a balanced result. A change to any component of the package would destroy the balance and require an adjustment elsewhere in the package.

LPMA also accepts, for the transition period, the 4% short term component of the capital structure. LPMA believes that the short term component should be roughly equal to the working capital component of rate base. This may vary from utility to utility. It is hoped that with full cost of service filings for future rates, this aspect can be reviewed further.

LPMA strongly believes that a premium for infrastructure investment is not warranted under a price cap incentive regulation plan and is happy to see that the Board has not been convinced of the need for this premium.

Incentive Regulation

LPMA supports the overall incentive regulation plan as appropriate for the transition period. LPMA has concerns over the low level of the X factor, at 1%, but given the short duration of this transition plan for most utilities, believes it is acceptable.

LPMA believes the use of the Canada Gross Domestic Product Implicit Price Index for final domestic demand is appropriate for the reasons outlined in the Draft Report. LPMA also supports the use of the annual figure rather than the 4^{th} quarter over 4^{th} quarter approach for calculating the percentage change in the index. Further, similar to comments provided above in relation to cost of capital related information, LPMA believes the Board should specify the series name for the GDPIPI Final Domestic Demand index (V3860249) for clarity.

The Board has found that there is not a need for a capital investment factor in the incentive regulation mechanism because a comprehensive incentive regulation plan is intended to encompass both capital and operating costs. LPMA strongly agrees with this conclusion. Utilities are expected to manage capital expenditures in the same way as they manage OM&A expenditures. Good cost management encompasses both types of expenditures not just one or the other.

The limited Z-factors are, in the view of the LPMA, appropriate for the transitional plan.

Large Corporations Tax

The Board has determined that the large corporations tax, which was repealed retroactive to January 1, 2006, will be removed from the base rates in 2007. LPMA supports this adjustment. LPMA also supports the adjustment of all other taxes under the price cap.

All of which is respectfully submitted.

Sincerely.

Randy Aiken

Randy Aiken
Aiken & Associates