**Ontario Energy Board**

**Commission de l'énergie de l'Ontario**

Ontario

**EB-2007-0762**

**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 Rideau St. Lawrence Distribution Inc. for an order approving or fixing just and reasonable rates and other charges for the distribution of electricity to be effective May 1, 2008.

**BEFORE:** Gordon Kaiser
Vice Chair and Presiding Member

Cynthia Chaplin
Member

# DECISION

## BACKGROUND

Rideau St. Lawrence Distribution Inc. ("RSL") filed an application with the Ontario Energy Board on November 22, 2007, 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, 2008. RSL is the licensed electricity distributor for the communities of the town of Prescott and the Villages of Cardinal, Iroquois, Morrisburg, Westport and Williamsburg.

RSL is one of over 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 May 4, 2007, as part of the plan, the Board indicated that RSL would be one of the electricity distributors to have its rates rebased in 2008. Accordingly, RSL filed a cost of service application based on 2008 as the forward test year.

RSL requested a revenue requirement of $2,267,241 to be recovered in new rates effective May 1, 2008. The application indicated that the existing rates would produce a revenue deficiency of $269,703 for 2008. The resulting requested rate increase was estimated as 23.9% on the distribution component of the bill for a residential customer consuming 1,000 kWh per month.

The Board assigned the application file number EB-2007-0762 and issued a Notice of Application and Hearing dated December 4, 2007. The Board approved two interventions, one from the School Energy Coalition ("Schools") and the other from the Vulnerable Energy Consumers Coalition ("VECC"). VECC participated actively in this hearing, submitting interrogatories and arguments while Schools submitted argument. Board staff also posed interrogatories and made submissions. RSL's reply argument was filed on March 14, 2008.

The full record is available at the Board's offices. The Board has chosen to summarize the record to the extent necessary to provide context to its findings.

## THE ISSUES

The following issues were raised in the submissions filed by Board staff, Schools and VECC and are addressed in this decision:

- Load Forecast
- Operating, Maintenance & Administrative Expenses
- Payments in Lieu of Taxes
- Capital Expenditures and Rate Base
- Cost of Capital and Capital Structure
- Cost Allocation and Rate Design
- Deferral and Variance Accounts
- Smart Meters

**LOAD FORECAST**

RSL based its load forecast on the 2004 Hydro One data for weather normalized average use and RSL's forecast of customer numbers for 2008. Board staff submitted that RSL's forecast is likely somewhat higher as a result of using a single year of weather normalized data rather than a forecast that incorporates weather normalized data from 2002 to 2006. Schools and VECC concluded that using the 2004 weather normalized data was the best approach to use.

The forecast of customer numbers was based on the trend in customer additions in 2002-2006. This approach was complicated somewhat by the conversion of various residential customers from bulk metering to individual meters in 2005. The forecast shows 0.2% annual growth between 2006 and 2008 compared to 0.5% growth over the period 2002-2006. Board staff concluded that the forecast was fairly consistent with the input data used.

With respect to the resulting load forecast, it was noted that the loss of one large customer (in the GS>50kW class) in 2006 had a substantial impact on the resulting kWh load. The 2004 data was adjusted for this impact.

<u>Board Findings</u>

The Board accepts RSL's load forecast. The Board finds that the use of utility-specific weather normalized average use data, albeit from only one year, is a better method than using the province-wide weather normalized data for a longer period.

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

**Controllable OM&A**

The following table is derived from Board staff's submission and sets out historic and forecast amounts for the following expense categories: operations, maintenance, billing and collection, community relations, and administrative and general expenses. Together, these categories comprise the "controllable" OM&A expenses.

**Controllable OM&A**

| | 2006 Board Approved | 2006 Actual | 2007 Forecast | 2008 Forecast |
|---|---|---|---|---|
| **Operations** | 245,294 | 145,283 | 185,080 | 189,708 |
| **Maintenance** | 91,951 | 197,528 | 291,216 | 401,986 |
| **Billing & Collecting** | 357,668 | 374,843 | 354,708 | 363,576 |
| **Community Relations** | 270 | 242 | 248 | 254 |
| **Administrative & General (excl. LV)** | 463,851 | 643,356 | 595,662 | 631,102 |
| **TOTAL** | **1,159,034** | **1,361,252** | **1,426,914** | **1,586,626** |

These expenses are forecast to increase by 17% between 2006 actual results and the 2008 forecast. Almost all of the increase is attributable to an increase of $204,458 in maintenance expense – an approximate doubling of the level in 2006. Board staff submitted that the increase was mainly attributed to wage and staff changes, elimination of the wholesale meter credit from Hydro One, maintenance of PCB transformers and regulatory expense.

**Shared Services**

Board staff noted that 74% of these costs are incurred through shared services, with the result being that RSL is very substantially a "virtual" utility. Rideau St Lawrence Holdings owns 100% of RSL (the distributor), Rideau St. Lawrence Utilities and Rideau St. Lawrence Services. RSL acquires services from Rideau St. Lawrence Utilities ("Utilities"). The cost of these services has increased by 17.9% since 2006 and is outlined in the table below.

All personnel involved in the provision of distribution services are employed by Utilities. Utilities also provides water and sewer billing services to the Town of Prescott and the Villages of Westport, Williamsburg, Morrisburg, Iroquois and Cardinal, and hot water tank rentals and services.

| Service | 2006 Actual | 2007 Bridge | 2008 Test | % Increase 2008/2006 |
|---|---|---|---|---|
| Meter Reading | $58,500 | $50,466 | $51,693 | -11.6 |
| Billing | $148,216 | $173,212 | $178,669 | 20.5 |
| Collecting | $30,825 | $31,598 | $32,388 | 5.1 |
| Administration | $363,370 | $396,289 | $406,196 | 11.8 |
| Ops, Maint, & Cap | $396,919 | $471,471 | $507,777 | 27.9 |
| **Total** | $997,830 | $1,122,976 | $1,176,723 | 17.9 |

*Shared Services Model*

Board staff submitted that the evidence may not be sufficient to support a conclusion that the shared services model is cost effective or that it results in just and reasonable rates. In Board staff's view, RSL's explanations for costs that are allocated to it do not clearly show how these approaches result in reasonable allocations. Schools submitted that RSL has not provided adequate evidence to support its shared services costs.

RSL replied that rates are lower than they would otherwise be as a result of the shared services model. RSL submitted that the bid it received from Utility Reading and Billing ("URB") for meter reading and billing services was not competitive with the option of having Utilities continue to do the work for the water/sewer businesses. RSL submitted that the URB stand alone price for water/sewer services was $4.09 per bill compared to the Utilities' shared costs price of $3.06 per bill (including a 10% administration charge). RSL concluded that it is beneficial to ratepayers and shareholders for Utilities to have this water/sewer contract because otherwise these costs would have been largely assigned to RSL.

RSL maintained that the costs were appropriately allocated on a fully allocated cost basis.

*Billing*

Board staff noted that the allocation of billing costs increases 20% from 2006 to 2008. A "complexity rating" is used, which assigns hydro bills a factor of 3 and water bills a factor of 1. Staff questioned how this allocation takes into account the fixed costs of the billing system, which are equally applicable to both. Staff noted that additional, "hydro only" costs were added, and questioned why the complexity factor did not already capture such costs.

Schools submitted that the "complexity" factor used to allocate billing costs is arbitrary, in that it is not clear how the factor is determined. Schools submitted that these costs should be reduced by $45,266, on the basis of a 60/40 split between electricity and water, in accordance with their approximate share of the total number of bills. Because this split is slightly higher than the actual split, the result is a 10% premium on the electricity bill cost. Schools submitted that a 10% premium is more reasonable than the 300% premium proposed by RSL.

RSL responded, citing a number of factors which differentiate electricity bills from water/sewer bills and lead to the conclusion that electricity bills are substantially more complicated and costly to prepare. These factors include the number of steps involved in preparing an electricity bill, the more complex rate structure for electricity, and the costs associated with settlement services, the IESO, the OEB and IT support.

RSL also explained that the increase in billing costs from 2006 to 2008 is due to billing staff being off work in 2006 and being replaced with lower paid staff. If this effect is removed, the annual increase from 2006 to 2008 is 3%.

VECC submitted that savings from the upgrading of RSL's billing software should be reflected in the 2008 expenses by the amount of $10,000. RSL is relying on increased operational efficiencies as the basis for the associated capital expenditures and billing and collection costs account for 23% of RSL's total OM&A. RSL did not respond to this proposal.

*Administration*
Board staff also questioned the methodology for allocating fixed administration costs to Utilities, and observed that if the contract value went down, the result of the allocation method would be an increase in costs allocated to RSL. Schools submitted that there is insufficient information on the record regarding these costs, and echoed Board staff's concerns. Schools concluded that these costs should be held to their 2006 actual level, a reduction of $42,826. VECC submitted that there is no sound rationale provided for the use of the 10% mark up which is applied to the costs associated with Utilities' non-hydro activities and noted that this can be contrasted with the level of Administration costs assigned to RSL in relation to metering, billing, collecting and operation, which is 50%. VECC concluded that it had insufficient information from which to recommend a reduction and suggested that the Board could order a formal review be undertaken and a variance account could be used to track any differences which result.

Staff also questioned why only 10% of executive costs are allocated to Utilities.

RSL responded that the allocation of administration costs for meter reading, billing and collection services for water and sewer contracts reduces the administration costs that would be otherwise payable by RSL and its ratepayers.

RSL submitted that no regulatory effort is required for the water and sewer business, and given the maturity of that business, the executives are providing a caretaker role only. Costs are added for the Operations manager's time and for office administration time to supervise the billing clerks. RSL noted that the contract is for 5 years, with an inflation factor; its value is increasing not decreasing.

*Operations, Maintenance and Capital*

Costs for operations, maintenance and capital are based on time sheet tracking. Staff submitted that it was not clear how these costs are allocated to the other entities and noted the 28% increase in this area.

RSL replied that the increases are largely the result of the operations manager being on six months' sick leave and the addition of a lineman to address issues related to RSL's aging workforce. RSL explained that timesheets are kept for non-utility work and these costs are retained within Utilities. RSL submitted that this approach ensures lower distribution rates, because otherwise all of the costs would have to be absorbed by RSL.

Board Findings

The Board, in its 2006 decision, expressed concerns about these shared services, and stated that in its next rate application, RSL "must provide detailed financial information on its operations and details of costs incurred by its affiliates in providing services to the Applicant [RSL]"[1].

The Board concludes that RSL's explanations for cost increases in the 2006 to 2008 period are reasonable. The evidence shows that the changes are largely due to staffing issues, replacement of staff and the addition of new staff.

The Board also concludes that the methods for allocating Utilities' costs to RSL are reasonable. The Board is satisfied that the evidence supports a conclusion that billing for electricity distribution is significantly more complicated than water/sewer billing. Similarly, the Board is satisfied with the time sheet tracking method used for operations, maintenance and capital costs. The Board is also satisfied with the approach used for administration costs, given the relatively more complex environment for electricity distribution (as compared to water/sewer).

Schools noted that based on the information provided, RSL may not be in compliance with the Affiliate Relationships Code requirement in that at least one third of the Board of Directors is to be independent of any affiliate. The Board notes that the current

[1] Ontario Energy Board 2006 EDR Decision dated April 12, 2006 [RP-2005-0020/EB-2005-0414]

proceeding is a rates proceeding, not a compliance proceeding. The Board will, however, pass this concern to its Chief Compliance Officer.

RSL proposed to spread the cost of its 2008 application ($70,000) over three years by including $23,333 in rates for 2008, and in effect amortizing the balance over the period of 3rd Generation IRM. VECC and Board staff supported this approach. The Board accepts this approach for setting the OM&A for 2008.

VECC submitted that amortization expense should be reduced to reflect the postponement of capital spending from 2007 to 2008. This issue is addressed later in this decision in the capital expenditure section.

The Board finds that RSL's forecast OM&A expense for 2008 is reasonable and will be used for purposes of setting rates. (An adjustment will be made for depreciation associated with the delayed capital projects; that is addressed later in this decision.)

**PAYMENTS IN LIEU OF TAXES (PILs)**

Board staff noted that RSL has not included recent tax changes in its calculation of PILs. Schools submitted that the recent change in the federal corporate tax should be reflected in the PILs allowance. VECC agreed and also submitted that the Board should direct all distributors to adopt the appropriate CCA classes so as to minimize current tax expense.

RSL responded that it will make the adjustment to reflect the most recent tax legislation in regard to tax rates and the new CCA.

Board Findings

The Board finds that RSL should incorporate all known income and capital tax changes into its PILs calculations for 2008, as it has proposed. This approach incorporates the most current tax information that is substantively enacted.

In calculating the PILs provision, the Board directs RSL to reflect in its Draft Rate Order the new federal small business income tax rate (reduced to 11%, yielding a combined federal and Ontario small business income tax rate for 2008 of 16.5%), and the new CCA class rates applicable, especially for computer software and hardware. RSL did not apply for Ontario capital tax PILs since its rate base and taxable capital are below the threshold of $15 million.

## CAPITAL EXPENDITURES AND RATE BASE

### Capital Expenditures

Capital expenditures in 2006 were $252,818. The levels forecast for 2007 and 2008 are $416,538 and $347,400, respectively. The increase of over 64% in 2007 is to be followed by an almost 17% reduction in 2008. No spending for smart meters is included in the 2008 capital expenditures.

RSL explained that the higher expenditures in 2007 were related to truck replacement. 2008 expenditures include wholesale metering point upgrades, to the standard provided by IESO, and software upgrades. Staff noted that the cost of one meter upgrade in 2007 was $13,000, while the cost for two upgrades in 2008 is $62,400. RSL replied that the 2007 expenditure was understated by $5,200 related to the stranded asset cost payable to Hydro One. RSL also provided a more detailed breakdown for the 2008 costs and explained that there were additional expenditures arising from the conversion from analog to digital cell phone connections.

Board staff also noted that two projects were carried over from 2007 to 2008 (the truck replacement and the interval meter program) and questioned whether the revenue requirement should be adjusted, perhaps using the half-year rule, to reflect these postponements. Schools submitted that these items (totaling $255,000) should be treated as 2008 capital expenditures, and therefore should be subject to the half-year rule and that depreciation expense should also be adjusted accordingly. VECC agreed. RSL responded that it agreed with this approach.

Board Findings

The Board finds RSL's proposed capital expenditures are appropriate. The 2008 rate base and depreciation expense will be adjusted to reflect the postponement of projects from 2007 to 2008, as RSL acknowledged was appropriate. RSL is directed to include explanatory details related to these adjustments with its Draft Rate Order.

### Assessment of Asset Conditions and Asset Management Plan

Board staff stated that it was unclear whether RSL has undertaken any initiatives related to the development of an asset management plan. Schools submitted that asset condition for major asset classes should be quantified using asset health indices and that an asset management plan is necessary to address reliability and asset condition problems.

RSL responded that it does not have an asset management plan in place, but that it gathers information on asset condition through a pole inventory program and staff inspections and that the loading and conditioning of the sub-transmission stations, poles, wire and rolling stock are assessed on a continuous basis.

Board Findings

The Board believes that asset condition assessments and asset management plans are an important component of capital expenditure proposals, particularly when significant capital expenditures are contemplated. However, the Board also recognizes that work in this area must take account of the particular circumstances of the utility. The Board is satisfied that RSL's approach to this issue is appropriate in the circumstances.

**Working Capital**

VECC submitted that RSL has relied on the April 2007 Navigant forecast of the cost of power, and that the more recent forecast should be used. RSL agreed with this approach in its reply submissions.

VECC also submitted that retail transmission service charges should be reduced given the known reduction in wholesale transmission charges and the anticipated reductions in Hydro One's retail transmission rates. Specifically, VECC proposed that Retail Network Transmission charges be reduced by 10% to reflect half the anticipated change in Hydro One's retail rates for Network Service, and that Retail Connection Transmission charges be reduced by 5% to reflect half the anticipated change in Hydro One's retail rates for Transformation and Line Connection. RSL responded that it is now proposing revised retail transmission rates in light of Hydro One's application.

Board Findings

The Board concludes that the most accurate data should be used in the calculation of working capital and notes that RSL agrees with this approach. The Board directs RSL to update the cost of power to reflect the price contained in the April 2008 RPP price report, \$0.0545/kWh. RSL is also directed to recalculate working capital using the new lower transmission rates as contained in Hydro One's proposed rates. (This adjustment is further described below in the section Retail Transmission Rates.)

**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.

RSL proposed a capital structure of 50% debt (46% long-term and 4% short-term) and 50% equity. RSL proposes not to transition, at this time, to the deemed 60/40 debt/equity structure established in the Board Report. RSL explained that a 60/40 split would move the deemed structure even further from the actual structure of 29/71 debt/equity. The current structure is the result of the transfer bylaw that was passed at the time RSL was incorporated. RSL proposed to address this issue at the time of the next rebasing but maintained that the Board has an obligation to ensure that rates are set so as to allow RSL to earn a reasonable return.

Board staff questioned whether RSL's circumstances justified a deviation from the guideline contained in the Board Report. Board staff noted that the equity component has been increasing since 2000 as third party debt has been replaced with retained earnings. Board staff made the following submission:

> It [RSL] has not demonstrated why this approach of using more expensive equity in place of debt is advantageous and prudent. It has shown no reason, such as specific business risk faced by RSL that would justify treatment different from that of other distributors that are similarly structured but which are adhering to the guidelines in the Board Report.

Schools further noted that RSL has increased its equity since 2006, even though it knows its actual equity was already greater than the deemed rate, and therefore subject to the lower level of return associated with debt. Schools submitted that RSL had provided no evidence to support a higher equity component. VECC submitted that in its determination of cost of capital, the Board must also determine whether the capital structure itself is reasonable. VECC also stated its understanding that the Board Report was a "Board policy that has been established after an extensive public process", and that "strong and compelling evidence would have to be presented before a distributor should be exempted from the policy." [2] VECC concluded that RSL had provided no rationale as to why it should be exempt from the Board policy.

RSL responded that it has managed its finances prudently and submitted that it was prudent to keep a portion of retained earnings within the company rather than declaring earnings as dividend. This has been done in order to make the smart metering implementation financing costs manageable and to facilitate any potential acquisitions of other distribution companies in the future.

RSL proposed that the cost of short-term debt and equity be set in accordance with the Board Report. It proposed a cost of long-term debt of 4.99%.

[2] VECC Submission, pg 10, para 5.2

Board Findings
VECC is correct in its observation that the Board Report is an expression of Board policy and therefore is more than a guideline for distributors. Compelling evidence would be required in order to persuade the Board that an approach different than the policy should be applied in any particular circumstance.

Smart meter implementation is a project which is expected to affect all distributors in Ontario. RSL has provided no evidence that the deemed capital structure of 60/40 is inadequate in light of expected smart meter costs. The Board finds that this explanation is not adequate to justify a change from the Board's policy of a deemed structure of 60/40. Contrary to RSL's speculation that the Board will address smart meter cost recovery after the program is implemented, the Board has already established smart meter rate adders in advance.

The Board also finds that the possibility that RSL might acquire another distributor is also inadequate justification to deviate from the Board's capital structure policy.

The Board agrees with RSL that a managed transition to the deemed structure is appropriate; however the Board finds that there is no reason to delay RSL's transition at this time. The Board finds that RSL's rates will be based on a deemed capital structure of 53.3% debt (49.3% long-term; 4% short-term) and 46.7% equity, in accordance with the Board's established transition process.

The table below sets out the Board's conclusions for RSL's deemed capital structure and cost of capital.

**Board-approved 2008 Capital Structure and Cost of Capital**

| **Capital Component** | **% of Total Capital Structure** | **Cost rate (%)** |
|---|---|---|
| **Long-Term Debt** | 49.3 | 4.99 |
| **Short-Term Debt** | 4.00 | 4.47 |
| **Equity** | 46.7 | 8.57 |
| **Total** | **100.00** | **6.64** |

## COST ALLOCATION AND RATE DESIGN

The following issues are addressed in this section:

- Line Losses
- Low Voltage Costs
- Customer Reclassification
- Revenue to Cost Ratios
- Rate Design
- Retail Transmission Rates

### Line Losses

RSL proposed a total loss factor of 1.0774 for 2008. Based on a supply loss factor of 1.0045, the distribution loss factor ("DLF") for 2008 is 1.0725 and is based on average actual DLF over 4 years (2003-2006). Board staff noted that, because RSL is an embedded distributor, its DLF includes losses on Hydro One's system (3.4%). RSL's losses are forecast to be 3.85% in 2008.

VECC submitted that a three year average should be used, as established in the 2006 EDR process. This would reduce the total loss factor to 1.0764 which would be appropriate given the downward trend in losses. RSL responded that it had no objection to using a three year average and calculated the DLF to be 1.0716 on this basis.

Board Findings

The Board finds that it is appropriate to set the DLF using the three year average. As a result, the DLF will be 1.0716 and the total loss factor will be 1.0764.

### Low Voltage Costs

RSL originally forecast LV charges for 2008 at $168,161. Board staff noted the difference between this level and the actual costs in 2006 of $148,199 and in 2007 of $224,303. Staff also noted that Hydro One is proposing lower charges as part of its current application.

RSL responded that the charges in 2007 reflect the impact of extra charges resulting from a change in supply feed to one of its communities due to either planned or unplanned outages. RSL noted that each occurrence generates charges of approximately $6,000 and that there were three events in 2007. RSL therefore proposed to update the forecast of LV costs using the 2007 actual loads and Hydro One's proposed rates and to adjust the calculation upwards by one-third of the 2007 variance (of $80,000). RSL proposed a forecast of $219,402.

Board Findings

The Board accepts RSL's revised approach, but will not allow the adjustment related to the 2007 variance. Variances in LV costs are appropriately captured in the deferral account; the Board finds that it would be inappropriate to adjust the cost forecast for this factor.

**Customer Reclassification**

RSL proposed to eliminate the Westport Sewage Treatment Plant Rate Class and move the one customer in the class to the GS>50kW class. The customer has an unusual pattern of usage; the original rate class originated as a time of use class and the rate was based on kWh rather than kW. Schools supported this proposal.

Board staff noted that this is likely to have a significant impact on the customer involved due to its load factor and the switch to kW based rates, and a five-fold increase in the monthly fixed charge. Staff estimated the total bill impact to be 30%. Staff pointed out, however, that under the existing class, the revenue to cost ratio was only 16.34% and therefore the customer was facing a significant rate increase in any event.

RSL responded that it was appropriate to treat this customer (which is a RSL shareholder) the same as other customers, and that the reclassification was an appropriate response to the customer's consumption history. RSL explained that in terms of mitigation, it was in the process of installing an interval meter for the customer and that the customer has flexibility to move to spot pricing.

Board Findings

The Board accepts RSL's proposal to reclassify the customer to the GS>50kW class.

**Revenue to Cost Ratios**

The following table sets out RSL's current and proposed revenue to cost ratios. The table reflects the elimination of the Westport Sewage Treatment Plant Rate Class. The proposed ratios are in column 2 . The Board's target ranges, as established in the Board's *Directions on Cost Allocation Methodology for Electricity Distributors EB-2005-0317*, are set out in column 3.

**Revenue to Cost Ratios**

| Customer Class | Informational Filing Run 3 | Application: Exhibit 9 / Tab 1 / Schedule 1 / p. 2 | Board Target Range |
|---|---|---|---|
| Residential | 105.24 | 103.00 | 85 – 115 |
| GS < 50 kW | 65.09 | 91.36 | 80 – 120 |
| GS > 50 kW | 148.27 | 118.89 | 80 – 180 |
| Street Lights | 41.61 | 49.84 | 70 – 120 |
| Sentinel Lights | 49.08 | 79.47 | 70 – 120 |
| USL | 152.26 | 106.93 | 80 – 120 |

VECC submitted that rebalancing was required for the GS<50kW class, the Street Lights class, the Sentinel Lights class and the Unmetered Scattered Load Class. VECC also suggested that consideration should be given to rebalancing the GS>50kW class. VECC concluded that the allocation to Street Lights should be increased and the additional revenues should be used to reduce the ratio for the GS>50kW class and reduce the shift in costs to the GS<50kW.

Schools submitted that under the rules of affiliate pricing, the rates for Street Lighting should be set at 100% of cost.

RSL submitted that the proposed increase to the Street Lights class, while still below the target range, results in a total bill impact of 10%, which is the historical threshold for rate mitigation measures.

Board Findings

The Board notes Schools submission that the Street Light class should move immediately to 100% on the basis that it is an affiliate. The Board finds that the Affiliate Relationships Code is not directly relevant because what is at issue is the rate for a regulated service, and that rate is to be applied to any customer which is eligible for the class. However, the Board finds that the revenue to cost ratio for Street Lights should be raised to 56%. This is half way between the current level and the lower end of the Board's range. The extra revenue will be used to reduce the revenue collected from the

Residential and GS>50kW class. The Board directs RSL to incorporate a further increase to 70% in its 2009 rate application.

**Rate Design**

Schools submitted that the proposed monthly fixed charge for GS>50kW class, at $244.67, is well above the upper bound set out in the Board cost allocation report. Schools submitted that the charge should be lowered; even this is not required under the Board's cost allocation report. Schools submitted that lower volume customers within the class are paying a disproportionate share of the revenue allocated to this class.

VECC noted that RSL stated that its objective was to maintain the current fixed/variable portions but that RSL acknowledged that its model did not have the intended result. VECC submitted that the smart meter adder, LV charges and the transformation allowance should all have been excluded from the 2007 rates used in the methodology.

RSL responded that the model used 2007 in total and that, if the model had appropriately eliminated the LV charges and transformation allowance, the result would be a lower fixed charge and higher variable charge.

<u>Board Findings</u>

The Board finds that RSL's objective of maintaining the fixed/variable split is appropriate. The Board directs RSL to adjust the model by eliminating the smart meter adder, LV charges and the transformation allowance from the 2007 rates, so as to achieve the objective of a consistent split.

The Board will not direct RSL to reduce the monthly charge for the GS>50kW class at this time. The Board concludes that the impact on the volumetric rate which would result from a further lowering of the monthly charge would be excessive. The Board notes that the overall revenue for this class is within the Board's target revenue to cost ratio range.

**Retail Transmission Rates**

RSL is an embedded distributor. Board staff questioned why RSL did not use Hydro One's proposed charges for purposes of determining its own retail transmission service rates. Board staff noted that there is a negative balance in the associated variance accounts. VECC agreed that RSL should have assumed lower transmission rates.

RSL responded that at the time of its application there was not sufficient information available to calculate revised transmission service rates, noting that new wholesale rates had been approved, but not retail rates. RSL noted, in particular, that a change in supply feed due to planned or unplanned outages triggers an additional charge, as the feed is from a different TS. Each occurrence generates additional charges ranging from

$40,000 to $60,000. There were three occurrences in 2007, which is considered a normal year, and the incremental costs were $136,161. Based on Hydro One's application, RSL has calculated new rates that reflect the under/over recovery in 2007 and the implementation of Hydro One's proposed rates. The Network rates are proposed to decrease by 11.4%; the Connection rates by 7.6%.

Board Findings

The Board finds that RSL's proposal is acceptable.

**DEFERRAL AND VARIANCE ACCOUNTS**

The following table sets out the account balances (as of December 31, 2006 with interest forecast to April 30, 2008) which RSL proposes to clear for disposition.

| **ACCOUNT #** | **ACCOUNT NAME** | **BALANCE $** |
|---|---|---|
| 1508 | Other Regulatory Assets | 21,184 |
| 1518 | RCVA – Retail | 8,318 |
| 1548 | RCVA – STR | 17,716 |
| 1550 | LV Variance | 49,547 |
| 1562 | Deferred Payments in Lieu of Taxes | 37,790 |
| 1580 | RSVA – Wholesale Market Service Charge | (36,076) |
| 1582 | RSVA – One Time Wholesale Market Service | 7,214 |
| 1584 | RSVA – Retail Transmission Network Charges | (61,910) |
| 1586 | RSVA – Retail Transmission Connection Charge | (44,124) |
| 1588 | RSVA – Power | 119,152 |
| **TOTAL** | | **118,813** |

The total balance is $118,813. RSL's proposal is to collect these balances over 3 years.

**Account 1562**

Board staff noted that it did not appear that RSL was using this account correctly in that it continued to use it after April 30, 2006 when it should have been closed. Board staff submitted that a more in-depth examination of this account may be required to determine the accuracy of the balance. RSL responded that it had corrected the errors which were found.

Board Findings

The Board will not dispose of this account as part of this proceeding. The Board, by letter dated March 3, 2008, has announced that it will initiate a combined proceeding to determine the methodology that should be used for the calculation and disposition of account 1562.

**RCVA and RSVA Accounts**

Board staff noted that the Board has recently announced that it intends to develop a streamlined approach for the review of Account 1588 RSVA Power and that the process might include all the RSVA and RCVA accounts. VECC submitted that it would be more efficient to dispose of these balances now. RSL responded that it welcomed a streamlined process for future dispositions, but that the current balances should be disposed of as part of this proceeding.

Board Findings

Account 1588 is part of the Board's ongoing "Bill 23" process. The Board has recently announced (by letter dated February 19, 2008) that it intends to launch an initiative for the review and disposition of Account 1588 and that it will consider the use of "disposition triggers". The Board also indicated it will consider whether to extend this initiative to all of the RSVA and RCVA accounts. As a result, the Board will not order disposition of any of these accounts at this time. Given the small net balance in these accounts, the Board finds that there is no compelling reason to dispose of these accounts at this time, in advance of the Board's announced process.

**Account 1508**

Board staff submitted that it was unclear:

- whether RSL ceased accruals to the account as of April 30, 2006 as it was supposed to do under the Accounting Procedures Handbook
- whether RSL is comparing its 2004/2005 and 2005/2006 invoices to the 1999/2000 Board assessment
- whether the appropriate interest rate has been used since May 1, 2006.

RSL responded that it did not cease accruals as of April 30, 2006, but that it will make adjusting entries to cancel principal changes to the balance after April 30, 2006. The corrected balance at December 31, 2006 is $12,361.80 plus interest of $657.31. RSL also confirmed that it did make the comparisons as identified by Board staff and that it used the Board prescribed interest rate from May 1, 2006.

Board Findings

The Board accepts the corrected balance for disposition.

Conclusion

The Board finds that RSL may dispose of the balances in Account 1508 (as corrected) and Account 1550 over the period of 2 years.

**New Proposed Deferral Account**

RSL also proposed that a new account be established for future capital projects. Board staff noted that establishing this account would be analogous to including a capital investment factor in an IRM and observed that the Board has not yet finalized the approach for 3rd Generation IRM and that it may include a capital component. Schools submitted that this proposal was premature and that it was appropriately a matter for the 3rd Generation IRM panel. VECC agreed, and submitted that if such an account were necessary, it should be established on a generic basis.

RSL responded that there is currently no mechanism to make corrections for non-rebasing years.

Board Findings

The Board finds that it is not appropriate to establish an account for future capital projects. The issue of capital expenditures is currently being explored within the 3rd Generation IRM process; it would be premature and inappropriate to establish a deferral account in advance of the completion of that process.

**SMART METERS**

VECC submitted that it would be prudent for the Board to direct RSL to maintain its current smart meter rate adder of $0.26/meter/month, even though RSL has not included any smart metering activity, nor a smart meter adder, in its application. RSL responded that it realizes the importance of a comprehensive plan for smart meter implementation and thus it requested that it be included in any cost recovery related to the smart meter initiative.

Board Findings

The Board finds that RSL's smart meter adder will remain unchanged at the level of $0.26/meter/month.

**IMPLEMENTATION**

The Board has made findings in this Decision which change the revenue deficiency and change the deferral and variance account balances for disposition, and therefore the proposed 2008 distribution rates. These are to be reflected in a Draft Rate Order prepared by RSL. This Draft Rate Order is to be developed assuming an effective date of May 1, 2008, but the Board will not implement new rates on May 1, 2008.

The Board had issued an Interim Rates Order on April 23, 2008 which allows for an effective date as early as May 1, 2008. However, as RSL was late in filing its application, the Board has determined that an effective date as of the date of the final Rate Order is appropriate in the circumstances of the case. The current, interim rates are in effect until the Board approves the final Rate Order.

In filing its Draft Rate Order, it is the Board's expectation that RSL 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 RSL to file detailed supporting material, including all relevant calculations showing the impact of this Decision on RSL's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. RSL should also show detailed calculations of the revised retail transmission rates and variance account rate riders reflecting this Decision.

A Rate Order and a separate cost awards decision will be issued after the processes set out below are completed.

**THE BOARD DIRECTS THAT:**

1. RSL shall file with the Board, and shall also forward to VECC and Schools, 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. VECC and Schools shall file any comments on the Draft Rate Order with the Board and forward to RSL within 20 days of the date of this Decision.

3. VECC and Schools shall file with the Board and forward to RSL their respective cost claims within 26 days from the date of this Decision.

4. RSL shall file with the Board and forward to VECC and Schools responses to any comments on its Draft Rate Order within 26 days of the date of this Decision.

5. RSL shall file with the Board and forward VECC and Schools any objections to the claimed costs within 40 days from the date of this Decision.

6. VECC and Schools shall file with the Board and forward to RSL any responses to any objections for cost claims within 47 days of the date of this Decision.

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

DATED at Toronto, May 6, 2008.

*Original Signed By*

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Gordon Kaiser
Vice Chair and Presiding Member

*Original Signed By*

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Cynthia Chaplin
Member