

## Filing Requirements for 2008 Incentive Regulation Mechanism Distribution Rate Adjustments

These filing requirements set out the Board's expectations for filings by distributors applying for distribution rate adjustments for May 1, 2008 based on the 2nd Generation Incentive Regulation Mechanism ("IRM") policies set out in the Report of the Board on Cost of Capital and 2<sup>nd</sup> Generation Incentive Regulation Mechanism (the "Board Report" or the "Report") dated December 20, 2006. Distributors not filing on this basis will need to file a Cost of Service rate application in accordance with the Board's Filing Requirements for Transmission and Distribution Applications, based on a forward test year.

Rate adjustments for the cost of capital and 2<sup>nd</sup> generation incentive regulation mechanism policies are scheduled for May 1, 2008. The 2008 rate adjustments will include the 2nd Generation IRM price cap adjustment; and the removal of the regulatory asset recovery, as applicable.

The price cap adjustment will be applied to distribution rates (fixed and variable) net of the Smart Meter funding increment, regulatory asset recovery, and incremental 2007 CDM funding. The price cap adjustment will reflect inflation less the expected productivity improvement, and, beginning in 2008, an adjustment for the transition to the common deemed capital structure of 60% debt and 40% equity. The price cap adjustment will not apply to the regulatory assets rate rider, Specific Service Charges or other non-distribution charges. While the Smart Meter funding will continue to be recovered in rates, the approved incremental 2007 CDM funding will be removed from rates.

A model has been developed to be used by distributors applying for rate adjustments for the 2008 rate year (the "2008 IRM Model" or the "Model"). The 2008 IRM Model is based on the 2007 IRM Model and is available for downloading from the Board's website. Distributors will be required to make a

number of data entries from their approved 2007 IRM Model and 2006 EDR Model. These steps are detailed below.

### ***Manager's Summary***

Each application should include a completed Model and a brief Manager's Summary explaining all rate adjustments applied for. Any deviations should be thoroughly documented. Where necessary, support for applied adjustments, such as continuation of rate riders or for Z-factors, should be provided.

To assist those who will use the Model to prepare the rate application, the following sections provide an overview of the inputs required and a description of how the various sheets of the Model should be completed.

### ***2007 EDR Tariff Sheet as Approved by the Board***

All distributors must enter all approved distribution 2007 rates. Distributors must also input the 2007 Smart Meter funding increment that was added to their Monthly Service Charge.

### ***Regulatory Asset Recovery***

For those distributors which had an approved regulatory asset recovery in their 2006 distribution rates, the Model will remove the rate riders to reflect the end of the regulatory asset recovery period, unless the Board has granted an extension for recovery as part of the rate mitigation plan.

### ***The Smart Meter Adder***

Smart Meter funding is currently included in the Monthly Service Charge for metered customers, in accordance with the Board's Decision RP-2005-0020/EB-2005-0529 and as approved in the Board's Decision and Rate Order for each distribution rate application. The current rate adder must be removed and then re-incorporated into the 2008 rate.

Based on the methodology set out in Appendix “E” in the Board’s Decision EB-2007-0063, prescribed distributors are required to calculate their Smart Meter adder for 2008. This amount should be entered into the Smart Meter Adder sheet.

***Incremental Approved 2007 CDM Funding***

CDM funding approved in rates for 2007 must be removed from the 2008 rates. This adjustment does not apply to funds approved under the third tranche of the Market Adjusted Revenue Requirement, approved in rates in 2005.

***Adjustment for the transition to the common deemed capital structure (K-Factor)***

In the Board Report, the Board determined that a common deemed capital structure of 60% equity and 40% debt would be used for rate-setting, replacing the four capital structures in use since 2000. Section 4.1 and Table 5 of the Report set out an approach to assist in the transition from four capital structures to a single common capital structure (the “capital structure transition”). The capital structure transition will take from one to three years (depending on the current deemed capital structure of a distributor), beginning with the 2008 rate adjustments. The Board also determined that the capital structure transition will apply to both Cost of Service and IRM rate applications.

While the capital structure transition can be dealt with directly in Cost of Service applications, the capital structure transition for 2008 IRM rate adjustments is incorporated in a K-factor being introduced this year. The value of the K-factor is unique to each distributor and will be reflected in the price cap adjustment.

The approach for calculating the K-factor is based on a limited number of data inputs from the distributor’s Board-approved 2006 EDR model and the corresponding PILs spreadsheet. The calculated K-factor represents the percentage change in revenue requirement (including taxes/PILs), and hence

distribution rates, due solely to changing from the distributor's current deemed capital structure to the 2008 transitional capital structure appropriate for that distributor (the "K-factor adjustment").

The K-factor adjustment will be continued for IRM rate adjustments in 2009 and 2010, depending on the size of the distributor. The specifics of the K-factor will be adjusted to reflect the later year capital structure transitions and updated Cost of Service information for distributors that rebase in 2008.

### ***Price Cap Adjustment***

As outlined in Section 3.4 of the Board Report, distribution rates are to be adjusted under the 2<sup>nd</sup> Generation IRM plan each year for two factors: a price escalator and a fixed X-factor of 1%. In 2008, the price cap formula will also include an adjustment for the transition to the common deemed capital structure for rate-setting purposes.

The Board determined that GDP-IPI for final domestic demand is to be used as the price escalator for the 2<sup>nd</sup> Generation IRM. The Board expects applicants to use, as a proxy, the current value of 1.9% in their applications. The IRM Model will include this proxy as a reasonable estimate of the index result. The GDP-IPI, the X-Factor of 1.0%, and the K-factor will then be applied to derive the price cap adjustment. The price cap adjustment is applied to fixed and variable distribution rates net of the 2007 smart meter funding increment and incremental 2007 CDM funding. Furthermore, the price cap will not apply to rate riders or to Specific Service Charges or to non-distribution rates such as Retail Transmission Services, Rural and Remote Rate Protection or Wholesale Market Service Charges.

When the final 2007 data are published by Statistics Canada around the end of February 2008, the Board will adjust the inflation index in each distributor's rate application model to ensure this final published number is used to adjust rates for all distributors. The Board will issue the adjusted model to the distributors. The

distributors will be required to review the model and confirm its completeness and accuracy with the Board.

### ***Rate Rider Adjustment***

On July 31, 2007, the Board issued its Decision with Reasons approving rate adjustments to 2007 distribution rates for several distributors related to storm damage costs (EB-2007-0514 / EB-2007-0595 / EB-2007-0571 / EB-2007-0551). Those distributors who received the rate adjustment are required to enter the rate riders in the Rate Rider Adjustment sheet (Sheet 9).

### ***Estimated 2008 Tariff of Rates and Charges***

When all adjustments are completed, the IRM Model will generate a proxy tariff sheet, which will assist the distributor in preparing the proposed tariff sheet it must file with the Board for approval. This is explained further under the Tariff Sheets and Rate Order section below.

### ***Bill Impacts***

The IRM Model will include a bill impact analysis, which will provide bill impacts of the distribution rate change only. This analysis is similar to that used in assessing rate applications in recent years.

The Board acknowledges that Regulated Price Plan (“RPP”) prices could also change on May 1, 2008 and therefore the IRM Model will include an additional bill impact analysis that will be used when any RPP change is released in mid-April 2008.

### ***Decision***

Rate adjustments for 2nd generation IRM policies are scheduled for May 1, 2008. The Decisions for 2008 IRM applications will be issued as they are processed by the Board beginning around middle of March 2008.

### ***Tariff Sheets and Rate Order***

The distributor's proposed tariff sheet must be filed with the Board for approval. Within seven (7) days of the receipt of the Board's Decision, the distributor will need to prepare and file its draft tariff sheet ("draft rate order") with the Board and intervenors. Intervenors wishing to comment on the draft rate order are to file submissions with the Board and the applicant within seven (7) days of the filing of the draft rate order. Any revision to the draft rate order must be re-filed with the Board within three (3) days. Should there be material errors or issues with the draft rate order, the applicant may have to revise its draft rate order and re-file. This may delay the issuance of the approved rate order.