ESTABLISHING 2006 ELECTRICITY DISTRIBUTION RATES

USE OF "COMPARATORS"

1. Comparators & Cohorts

How would you identify anomalies? They could be numerous and have varying impacts on results. They could range from customer size, voltage sizes, service area size, growth – non growth, shared activities, internal labour or contract out, SQI levels, weather related, shareholders direction, etc. The process of identifying, explaining, and justifying anomalies between LDC comparators could outweigh any benefit of streamlining the review of the rate application process.

Any comparator type of measure should not only look at a measurement per customer, but also measurements per consumption (kW.h, kW).

Should the size of LDCs be a factor in groupings of peers for comparison? Does this defeat the process of rationalization? If the theory of size driving efficiencies therefore lower costs/lower rates is true, should not any potential standardization of rates be for all LDCs. If some LDCs have amalgamated or acquired other LDCs in the hope of driving efficiencies and other LDCs have decided to be stand-alone should one or the other be held to a different standard?

REVENUE REQUIREMENTS

2. Test Year for establishing Rate Base / Revenue Requirement

Suggestion would be to target latest year information available. If the rate effective dates are now going to be May 1, the previous years yearend reporting should be available in time for the rate application and review. (Ex. For May 1, 2006, Dec 31, 2005 information should be available).

3. Load Forecast

Use prior year's load data.

4. Test Year Adjustments

Potential adjustments in historical or future test year data would be consistent handling of unbilled revenue adjustment, difference between approved loss factors and actual loss factors, growth factors, weather normalization.

5. Weather Normalization

We do not see any need to reduce the ROE if weather normalization is included in the test data (assumption is concerning loads). If loads were weather normalized, your ROE may be more consistent but over time should equal out to non-normalized data.

6. (Maximum) Return on Equity for 2006

Our strategic business decisions have been based on a 9.88% ROE, therefore this should not be lowered.

7. Debt/Equity Structure

Deemed debt/equity structure and the LDC's actual debt/equity structure should be reconciled somehow in the rate process. The rate of return and debt rate included in the rate structure is based on the deemed debt/equity split. LDCs that are not at their deemed debt/equity split will always have a different actual ROE as the rates only support the ROE on the deemed debt/equity split. This causes confusion when reporting results at the LDC Board of Directors level and also at the Shareholder level. If the deemed ROE rate and Debt rate could be applied to the previous year-end actual debt/equity structure this would allow for more realistic comparisons.

8. Debt Rate / Cost of Capital

Some consideration needs to be given to the matter of raising debt. What options exist to LDCs to raise debt through different mediums, the effect of rating agency's ratings on the cost of private debenture offerings, the ability of LDCs to even access the bond market. Some of these factors need to be taken in to consideration when setting the rate as opposed to only the long term Canadian bond rate.

9. Depreciation Rates

The issue of implementing any changes to currently depreciating capital could be a very time consuming issue, with a cost/benefit analysis result of the cost outweighing any benefit. For new capital going forward if one area was to be examined that of computer software and hardware may be one to consider due to the rapid changes in this area and the CIS systems implemented for market opening.

10. Transfer Pricing and Shared Corporate Services

We feel that this issue needs to be defined as to what rules will be implemented going forward. Services such as Water & Sewer Billing, Street Lighting maintenance & construction, Water Heaters and others have been and are an integral part of activities within LDCs and their newly created affiliates. These activities provide a natural sharing of resources between LDCs and their affiliates in which to share fixed costs and obtain economies of scale. Specific guidelines as to whether these types of shared functions can be performed within the LDC company or an affiliate, or if shared staff can perform these functions or not, need to be identified.

Transfer pricing should be based on cost recovery plus an identified return. We have found that obtaining market pricing can be difficult for activities and that market pricing does not take into consideration the opportunity that exists with affiliates to share some LDC's fixed costs, thereby reducing costs for our LDC customers.

11. Low Voltage & Wheeling Costs

Suggestion would be that low voltage charges be treated similar to DRC charges. LDCs would charge their customers a specific charge on the customer's bill for LV charges; this amount would be remitted to Hydro One. We feel there would be less administration than some type of variance account pass through.

12. 2006 Taxes/PILS

Currently the PILS variance account tracks PILS amounts collected through Distribution Rates to the original PILS amount calculated in the SIMPIL worksheet. Currently there is no requirement to true up to actual taxes paid. If this will be a requirement in the future it needs to be identified as it could have a significant cash flow effect on the LDCs.

Concerning the point regarding the confirmation of LDCs maximizing tax deductions, if there will not be any requirement to true up PILS collected to actual PILS paid then the cost or benefit of maximizing tax deductions would only effect the LDC, not their customers. If at some point in time LDCs will be truing up to actual taxes paid then this would become an issue (maximizing tax benefits) that would affect distribution rates. The process to verify if an LDC was maximizing tax benefits could become a very time consuming reporting and audit process for both the OEB and the LDC's. Our position would be to continue the present process; each year in the rate process set the PILS amount to be collected and base the variance account on this amount. The matter of an LDC being proactive and maximizing tax benefits would become an internal management matter. Any savings received through this proactive process would either increase shareholder wealth or be passed back to customers through rates, but this would be a management and shareholders decision.

DISTRIBUTION RATE BASE ISSUES

13. Definition of Distribution Rate Base

A simplistic view of rate base would be to use the previous year-ends "Shareholders Equity" and "Long Term & Short Term Debt" as the "Rate Base" and avoid a complicated combination of accounts etc. As per point #7, use the previous year-ends Shareholder Equity plus Debt as rate base; base the deemed OEB ROE and Debt Rate on these actuals. Assuming the ROE and Debt Rate is at different amounts the above scenario would see in theory LDC's with the same rate base but different debt/equity structures receive different total returns. The logic behind this would be that all LDC's have different relationships with their shareholders; some have promissory notes held by the shareholders, some are paying dividends, etc. The above scenario would enable LDCs and their shareholders to manage shareholder value through different vehicles (promissory notes, dividends, etc.). It would also allow for potentially the decision by the LDC and shareholder to direct returns back to the customer through rate reductions.

A different scenario would be to use the simplified "Rate Base" calculation identified above, but develop a combined ROE and Debt rate (Ex roe 9.88%, Debt rate 7% = combined rate 8.44%). Apply this combined rate to the rate base; in other words treat debt and equity at the same rate. This scenario would see LDCs with the same actual rate base have the same return regardless of their actual debt/equity split.

14. Rate Base Measurement Date(s)

As noted above the timing between year-end Dec 31 and rate effective date of May 1 should allow for the latest year-end actuals to be used in the rate application (ex. For May 1, 2006 rates year-end 2005 data could be used). A case in point was the last rate application effective April 1, 2004. Statistical data from year-end 2002 was used in this process, which did not allow for up-to-date information being used in the process.

The process of changing year-ends to coincide with the rate year would cause difficulties with municipal shareholders year-ends.

15. Working Capital Component of Rate Base

As mentioned in #7 and #13 above, a suggestion would be to use "Shareholders Equity" and "Long & Short Term Debt" as the rate base, not use a combination of a number of accounts**.**

16. Capitalizing Expenses

The most critical point here is standardizing the process. If any kind of comparators or benchmarks are going to be implemented everyone must be measured under the same criteria. The mechanics behind what or what not will be capitalized is not as important as ensuring there are rules and guidelines that are put in place and enforced to ensure everyone is following the same process.

17. Capital Projects

We feel that this is not an area that the OEB should be regulating. Each LDC has different priorities, directions, growth rates that would affect the timing and amount of capital expenditures. While acknowledging that large capital expenditures could affect rates through the rate base, we feel that prioritizing capital expenditures as to rate effects, system reliability, shareholder requirements, development community requirements would best be left to the LDC.

18. Contributed Capital

We feel that this is an audit function to verify depreciation is being recorded correctly and that new capital assets & contributions in grant are being recorded correctly and depreciated in the appropriate manner. This would be a function currently performed by our external auditors.

19. No-Cost Capital

No comments at this time.

20. Rate-Setting Treatment of Capital Gains

We feel that this would be a decision of the shareholder as to how any gains would be used.

OPERATING EXPENSE ISSUES

21. Distribution “Wires Only” Expenses

We feel it is important that clarification occurs concerning the rules and guidelines of ongoing non-distribution functions. Will they be able to be performed within the LDC company? Will they have to be performed in an affiliate company? See #10 above.

22. Post-Retirement Benefits and Pensions

We are following the CICA handbook and having an actuarial performed.

23. Site Restoration and Removal Costs

No comments at this time.

24. Insurance Expense

Leave it up to LDC’s to ensure they are prudently acquiring appropriate insurance.

25. Bad Debt Expense

No comments at this time.

26. Employee Compensation & Staffing

We feel that any attempt to regulate this would be extremely time consuming and difficult. Again, it is the responsibility of the LDC and shareholder to manage this, within the context of overall costs.

27. IT Costs

See #26 above

28. Advertising, Entertainment, etc.

See #26 above

New/Economic Evaluation

A review of the effect on LDC's due to the economic evaluation process in the Distribution System Code should be performed as part of the rate review. With some history now being available from the economic evaluation process the effect of this on rate base, cash flow, and a 25-year forecast of rates should be examined.

New/RSVA and Regulatory Asset Recovery

The process of recovering RSVA amounts through Distribution Rates and not through the appropriate non-competitive electricity rates through which they were originally designed to be collected needs to be reviewed and changed. The recovery of approved regulatory assets also needs to be discussed as to the logic of adding it to distribution rates or developing a new category of rates through which to collect this.

2006 RATE DESIGN MATTERS

29. Specific Service Charges

There needs to be direction as to what items should be in Specific Service Charges and what items should be recovered through rates. This may be a more important issue than a common charge throughout the province. If LDCs are handling the recovery of different types of functions in different ways then any type of standardization of rates or comparators will not be valid. (Ex. disconnect/reconnect, meter translation, collection charge; are some LDCs including this recovery in distribution rates, are some charging a Specific Service Charge for the same function).

The standardization of rates would be difficult to implement, but would provide an incentive for LDCs to drive efficiencies to provide services at a lower cost thereby increasing return.

30. Unmetered Scattered Loads

We currently deal with these as a <50 KW customer. It would be a worthwhile process to standardize the treatment of these between all LDC's, so that any comparative information would have meaning. (Ex. Are these customers being treated as different rate classes among LDCs, do some LDCs look at each connection as a separate customer or do some aggregate many connections as one customer).

31. Time-of-Use Rates

We have integrated any TOU rates into our existing classes. Large General Service customers >50KW who have an interval meter are a separate rate class and are at the Spot Market Price.

32. Fixed/Variable

We feel that this item will definitely need to be addressed, but that the more appropriate time will be with the Cost Allocation Study of which this item should be a major component of that study. As it is clarified which costs are variable with load and consumption and which costs are fixed, therefore not dependent on load and consumption, we believe that this will flow naturally into the distribution rates from the Cost Allocation Study.

While DSM is not being addressed at this time, the discussion of Rate Design will need to be addressed concerning this initiative. As conservation is to be encouraged the LDCs recognize that the variable portion of their distribution revenues will be adversely effected. It is recognized that one way to keep LDC's whole in this process is to move the LDC's distribution revenue mix from the current fixed/variable split to a higher fixed % of the total distribution revenue. We believe that through the Cost Allocation Study those costs that are truly fixed and those costs that are truly variable and increase or decrease solely on load and consumption will be identified and the appropriate fixed/variable charges will be identified at that time. We also recognize the theory that if "Rate Base" remains constant but load and consumption decreases that the regulated return and debt recovery amount that is recovered through the variable distribution component of the rates will increase to enable the LDC to recover the same return. The principle of the LDCs remaining whole through the conservation process can be maintained through these options.

33. 2006 Rate Mitigation

While the "bill comparison" sheets in the rate application tools are a valuable indicator of rate effects on different size and classes of customers perhaps this area needs an expanded view. Historically rate mitigation has looked at the % increase of individual customers within classes. An expansion of this would be to weigh the dollar ($) increase as well as the %. As well, bill comparisons generally have been looked at as the total bill including distribution charges and competitive and non competitive charges; since LDCs are only responsible for the distribution charges the focus of rate comparisons for customers should focus on this aspect alone for the LDC's. Also any change in the fixed and variable split should be looked at as well during any rate mitigation process.

New/Prudence of Making Major Distribution Rate Methodology Changes in 2006

In the OEB 's letter of June 16th, 2004 regarding this process for establishing 2006 electricity distribution rates, it indicates that the Cost Allocation Study and its effect on rates would be incorporated in the 2007 rate application (presumably May 1, 2007). The attachment with this letter also indicated that any changes in rate design to incorporate the DSM initiative would be looked at outside of this process as well any requirement to review the distribution loss factor. As well, in one of the "New" points above we have identified the fact that we feel that the way the RSVA and Regulatory Asset amounts are being recovered needs to be reviewed. In light of the above we feel that it may be prudent to discuss and review all potential rate items with the target of implementing all changes with the 2007 rates, as opposed to implementing some in 2006 and some in 2007. To help in the process of having more consistent rates as of 2007 which would benefit both the customers, LDCs, and OEB we would propose the following; that the recovery of RSVA and Regulatory Asset amounts be accelerated to be recovered over a three year period as opposed to the currently proposed 4 years, this would allow for recovery of these amounts before the new 2007 rates came into effect. The new distribution rates effective in 2007 would be calculated under the new methodology and would not be distorted by the continued recovery of RSVA and Regulatory Assets that were substantially incurred in 2001 & 2002.

We feel that the customers would be better served to have all the distribution rate changes due to market opening and the initial years of market operations cleared up before the start of a new rate structure. To implement new methodologies over a number of years (2006 & 2007) while still collecting RSVA and Regulatory Asset amounts up to 2008 would seem to open the possibility of continued rate fluctuation and confusion for not only the customer, but LDCs and the OEB as well.