Establishing 2006 Distribution Rates

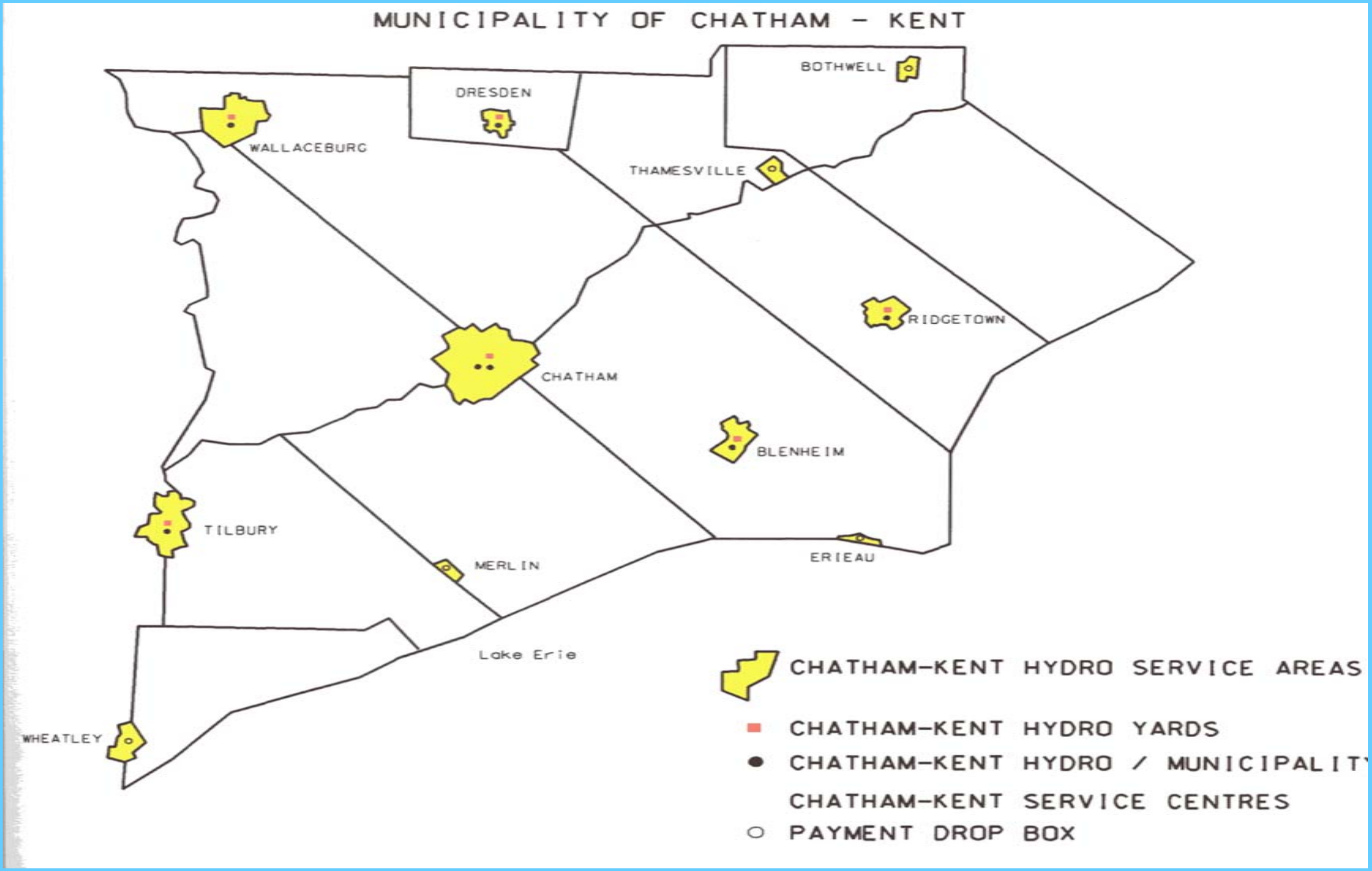
Chatham-Kent Hydro

And

Middlesex Power Distribution Corporation

July 6, 2004

Chatham-Kent Hydro Service Territory



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Use of Comparators

- O & M costs would be difficult to use as a comparator
  - Geography
    - Density, terrain, climate
  - Economic
    - Growth Rates

Use of Comparators

- Possible use of comparators for the costs
  - Administrative Costs
  - Billing and Collecting Costs
- These costs represent approximately 40% to 50% of the distribution charges

Revenue Requirement

- Test year
  - Use of historical year
  - Use a historical three rolling average
  - 2006 rate change - use 2003, 2004, 2005
  - Smoothes out any significant anomalies

Revenue Requirement

- Debt / Equity Structure
  - – Structure should be consistent amongst similar size LDCs
  - – Use of deemed equity
    - Protects customers from having too much equity in LDC
    - Some LDCs have lower actual equity due to the significant variability of the transition period

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Revenue Requirement

- Debt Rate
  - LDC specific
  - Many LDCs have negotiated notes and loans
  - Rates moving forward should reflect their actual experience
  - OEB should review related party notes and loans to ensure they reflect market rates

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Revenue Requirement

- Cost of Capital
  - ROE rates should be uniform by size of LDC
  - Formula approach is well understood
  - Focus should be on the risk profile of the LDC and the appropriate risk premium

Revenue Requirement

- Depreciation Rates
  - Full review should be undertaken by each LDC
  - Depreciation rates should be adjusted on a going forward basis
  - Distribution rates should reflect the updated depreciation rates

Revenue Requirement

- Low Voltage Charges
  - Should be treated the same as Transmission costs to the embedded LDC
  - Should not be distribution costs
  - Should be included in variance account
  - True up with the customers

Revenue Requirement

- Low Voltage Charges
  - Further rationalization will reduce the impact of low voltage charges

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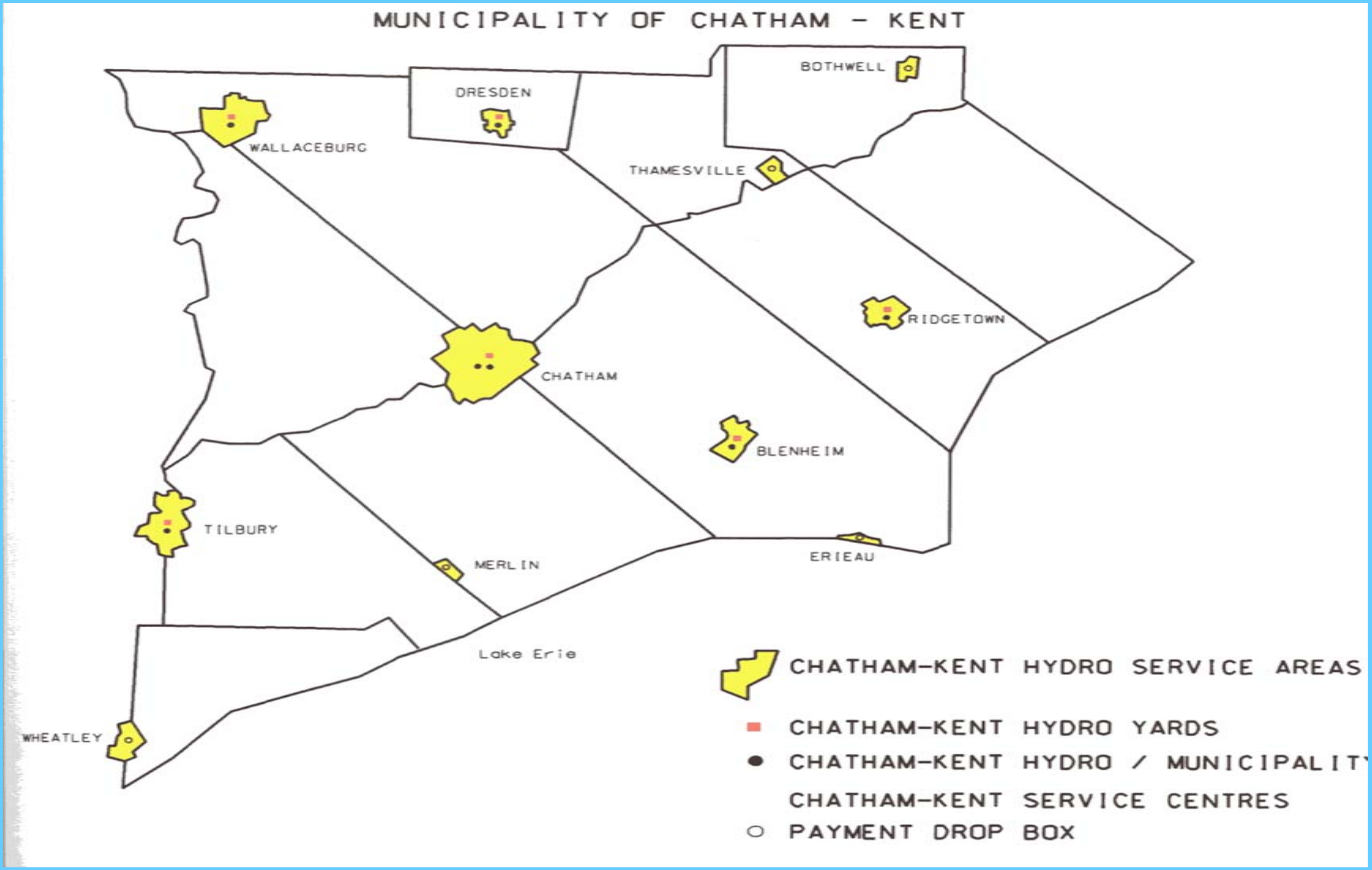

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Distribution Rate Base

- Rate Base Measurement
  - Should use assets valued as close to the beginning of the rate year as possible
  - Should include assets that could be shared between neighboring LDCs
  - Include DSM assets

Distribution Rate Base

- Working capital
  - Need to replace the 15% of controllable costs and cost of power
  - Should be LDC specific
  - Lead-lag studies should be conducted
    - Billing schedules and customer profiles are different for each LDC

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Operating Expenses

- Post-retirement costs
  - Should be on accrual method for rate setting purposes
- Bad Debt Expense
  - Should be on LDC specific

Operating Expenses

- Employee Compensation
  - Should not be reviewed on a specific basis
  - The compensation rates will vary by area
  - The compensation rates are currently "regulated" by the Municipal shareholder
  - If use administration costs as comparator, these costs will already be reflected

Rate Design

- Fixed / Variable
  - All LDCs should have same fixed % of revenue for each rate class
  - All LDCs should not have same fixed service charge for each rate class
    - This will generate different variable revenue by LDC
    - Cause a different risk profile

Light Handed Regulation

- Board should review
  - Rate base
  - Debt / equity ratios
  - Maximum ROE
  - Z factor for large variances
  - SQI
  - Detail analysis only required when ROE is exceeded or SQI targets not met

Summary

- Focus must be to get the base rate "right"
- Use of comparators may be difficult
- Use of historical year or years as "test year"
- Rate base valued as close to the beginning of rate year as possible
- Use of deemed equity

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