Chatham-Kent Hydro Inc.

And

Middlesex Power Distribution Corporation

Submission to the

Ontario Energy Board

Process for Establishing 2006 Electricity Distribution Rates

July 12, 2004

Introduction

In response to the Ontario Energy Board's (OEB) letter dated June 16, 2004 titles 'Process For Establishing 2006 Electricity Distribution Rates" Chatham-Kent Hydro Inc. (CK Hydro) would like to provide the following comments.

CK Hydro is providing comments on a number of the issues listed in the OEB letter. CK Hydro believes that all the issues listed are important, the submission is providing comments on what CK Hydro believes are the highest priority.

Issue 1 – Use of Comparators

CK Hydro is of the belief that using comparators for Operation and Maintenance (O&M) costs will be very difficult to do. O&M costs are defined as the core Local Distribution Company (LDC) activities. The difficulty in using O&M as comparators in setting rates is that there are too many variables that can create significant cost drivers between LDCs. Some of the variables are;

Geography – density, terrain, climate

Economic – growth rates

Use of comparators for Administrative and Billing and Collecting costs may provide a better fit in setting rates. These costs do not have as many variables and the cost drivers should not have the same level of variability.

<u>Issue 2 – Revenue Requirement Test Year</u>

CK Hydro is recommending that an historical test year should be used. By using an historical year the costs are audited and there should be fewer questions in the prudency and reasonableness of the costs.

To reduce the concerns about using the "right" historical test year and smoothing out anomalies the OEB could provide a review of three historical years. In setting rates in the gas industry they use a historical year, bridge year and a forecast year, to ensure the trend is reasonable for setting rates, use of three historical years is a similar approach.

<u>Issue 7 – Revenue Requirement Debt / Equity Structure</u>

The debt / equity structure should be consistent amongst similar size of LDCs, which is the current practice in setting rates in Phase 1 Performance Based Regulation (PBR). CK Hydro recommends the use of deemed equity for rate setting. Deemed rates should be used for some of the following reasons;

1. Protect the customers from LDCs having a business strategy that has more equity in the LDC.
2. Protect LDCs that have lower actual equity due to a bad starting position going into Phase 1 PBR, the long timeline of the transition period and due to the rate freeze caused by Bill 210.
3. Deemed equity is consistent with Phase 1 PBR.
4. Deemed equity is consistent with setting rates for the gas utilities.

Issue 8 – Revenue Requirement Debt Rate / Cost of Capital

The debt rate should be LDC specific. Many LDCs have negotiated notes and loans that will have longer-term maturities. To approve a debt rate that is lower than the rates would penalize the LDCs.

The OEB should review all non-arms length notes and loans to ensure that they were negotiated at market based rates.

Issue 9 – Revenue Requirement Depreciation Rates

CK Hydro recommends that a full review of depreciation rate should be undertaken. The rates have been in place for many years and may not reflect the current remaining life of the assets. Some examples of depreciation rates not matching the useful life of the assets are;

- Bucket trucks depreciated over 8 years, actual experience is roughly 12 years
- Information Technology (IT) equipment depreciated over 5 years, actual experience is less in many cases.

Issue 11 – Low Voltage Charges

Low voltage charges should be treated the same as Transmission charges from Hydro One Transmission to the LDC receiving these charges. These costs are incurred in order to have the electricity “transmitted” to the LDC delivery point and therefore should be treated the same as transmission charges. Therefore these costs should not be treated as distribution costs and the LDC should not have their earnings impacted positively or negatively. These costs should be part of variance accounts and be trued up with customers on an annual basis.

The OEB is also reviewing efficiency and rationalization in the LDC sector, if and when CK Hydro has an opportunity to expand to their municipal boundaries the low volume charges would be significantly reduced. CK Hydro has 12 non-contiguous service territories, with an expansion to the municipal boundary many of these service territories would no longer be charged the low voltage charge.

Issue 14 – Distribution Rate Base Measurement

Rate base should be valued as close to the date of implementing the new rates. Using the most current rate base values is being recommended because the LDC sector may be in a period of significant capital additions for the following reasons;

- Meeting Demand Side Management (DSM) initiatives that are required by the Ministry of Energy
- Implementing interval meters to all general service customers from 50 kW and above.
- Wholesale metering requirements

Rate base should also include asset investments that are shared between neighboring LDCs and should include any contributions that an LDC must make to Hydro One Transmission to upgrade and improve the transmission system.

Issue 15 – Rate Base Working Capital

CK Hydro recommends that the current working capital calculation of 15% of controllable costs and cost of power should be replaced. This calculation has been in place for sometime which was before the current deregulated market and therefore may not be a good amount to have in rate base for working capital.

Issue 22 – Operating Expenses Post-Retirement Benefits

The employee future benefit costs are recorded on the accrual basis for financial statement purposes and they can fluctuate based upon costs of benefits, inflation rates and discount rates. The amount of costs recovered in rates should be the same method.

Issue 25 – Operating Expenses Bad Debt

Bad debt expenses should not be the same for all LDCs. Each LDC has different customer mix and therefore different risk profile for bad debt. Therefore each LDC should justify their level of bad debt recovery.

The bad debt risk should be shared with the other major market participants being the retailers, transmitters and generators. Having the distributor manage this risk will increase the risk profile of the distributor which in turn increases the costs. From the beginning of the deregulated market the distributor was not to be responsible for the default of the commodity costs however in reality the distributor is carrying too much of this risk.

Issue 26 – Operating Expenses Employee Compensation and Staffing

Employee compensation should not be reviewed on a detailed basis. The employee compensation is set to meet the local market that the LDC operates in. The costs are also "regulated" by the Board of directors and the municipal shareholders.

Also, if the OEB uses the administration costs as a comparator they are indirectly approving the compensation costs for senior management.

Issue 32 – Rate Design Fixed / Variable

In setting rates there should not be the same fixed service charge for each rate class for all LDCs. CK Hydro recommends that the same percentage of fixed revenue be recovered for each rate class for all LDCs. This will have the same amount of variable revenue for each LDC, that way each LDC will have the same risk profile.

Additional Issue – Rate Design Allocation of Revenue Requirement

The current process is to review the costs of all distributors to identify their revenue requirement. Once the revenue requirement has been identified how will this revenue be recovered from the customers. The costs allocation process is expected to be implemented in 2007 however the rate change to reflect the revenue requirement will be implemented in 2006.

CK Hydro would recommend that the change in revenue requirement be allocated based upon the current practice, which is based upon the distribution revenue by class.

Summary

In setting the 2006 rates the OEB should;

- Focus on getting the base rates “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 the rate year as possible
- Use of deemed equity