ESTABLISHING 2006 ELECTRICITY DISTRIBUTION RATES
POTENTIAL ISSUES FOR GENERIC METHODOLOGY REVIEW

PRESENTATIONS BY ONTARIO ENERGY BOARD STAFF
JULY 6-7, 2004 – ONTARIO SCIENCE CENTRE

REVENUE REQUIREMENT – GENERAL ISSUES	GUELPH HYDRO RECOMMENDATION
2. Test Year for establishing Rate Base/Revenue Requirement • Merits of historical versus forward/future test year (or combination thereof) • Should one approach apply to all LDC's? • Preferred choice for a specific past test year.	Use latest audited financial data adjusted for projected significant variances (with explanations)
3. Load Forecast • If using a forward test year, acceptable methodologies to be used for the load forecast employed for determining the revenue requirement.	Use previous years purchases adjusted for growth
4. Test Year Adjustments • What types of adjustments in historical or future test year data might be allowable (for example, for anomalies or for known and measurable changes that are expected to persist)? What should be provided in support of proposed adjustments?	No comment
5. Weather Normalization • Is there a need for weather normalization, of future test year data, in the electricity sector? • If yes, then what methodology or methodologies would be appropriate for weather normalization in Ontario?	This is not predictable and should not be attempted. There is no benefit for the cost involved in this initiative.

• Should the allowed ROE be reduced if utilities no longer face weather-related risks?	
6. (Maximum) Return on Equity for 2006 Electricity Distribution Rates • The current formula is based on the same approach as used in the natural gas sector, but with a separate multi-year forecast of interest rates. • Results of application of current formula in light of current interest rates. • Bearing in mind the Board's recent decision on the generic ROE for Ontario gas distributors (RP-2002-0158), are there any adjustments to the electricity distribution ROE formula that warrant serious consideration? • What economic estimates should be used in the ROE formula (e.g. annual vs. multi-year forecasts of long-term Canadian bond interest rates)?	No comment
7. Debt/Equity Structure • Are the current deemed D/E structure(s) still appropriate? If not, what other common approach may be more suitable? • Merits of using actual utility-specific D/E, in lieu of a deemed D/E, when setting rates.	No comment.
8. Debt Rate/Cost of Capital • The current deemed Debt Rates were based on a forecast of long-term Canadian bond rates, and were adjusted based on utility size. • Update of Debt Rate(s) to reflect current economic conditions and interest rates (projected). • Debt Rate(s) to be uniform, size-related, based on ability to	Debt rates should be based on actual so as not to penalize those LDC's that need the most help.

borrow, or other?	
9. Depreciation Rates • Depreciation rates set out in Distribution Rates Handbook were carried over from former regulator. • Appropriate time to undertake a full-scale review of depreciation rates? • Stakeholder views on a limited review of depreciation in 2006, such as: amortization of select assets, salvage valuation, asset verification studies, or updating technical inputs (e.g. composite service life statistics). • Merits of true-up provision requiring differences between theoretical depreciation and booked depreciation in excess of a specific percentage to be amortized over the remaining life of the asset.	Use industry study group – do not attempt to resolve for this rate application. A transition period may be required.
10. Transfer Pricing and Shared Corporate Services • What method(s) will be acceptable for rate purposes when allocating the cost of shared corporate expenses to the regulated utility? • How to review prudence of expenses paid for services outsourced to affiliates (or non-affiliates)?	There are sufficient guidelines in the Affiliate Relationship Code, Revenue Canada Income Tax Act and the Canadian Institute of Chartered Accountants (CICA) Generally Accepted Accounting Principles (GAAP) such that LDC financial staff has an understanding of what is acceptable.
11. Low Voltage and Wheeling Costs • Host distributors are presently providing low voltage and wheeling services, but without recovery in rates. • Treatment in 2006 revenue requirement of Low Voltage charges embedded distributors incur and will pass through to their customers.	No comment

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<tr><td>12. 2006 Taxes/PIL’s
A fair and practical methodology for calculating an allowance for taxes/PIL’s in 2006 rates.
Merits of the use of actual versus deemed figures in regulatory tax calculation.
How to confirm whether LDC’s are maximizing tax deductions?
Impact of any expected changes in 2006 tax rates or rules.
Relevance of discussions in other Canadian jurisdictions on approaches to tax calculation (e.g. use of “flow through” method).
“True-up” of historical PIL’s (2005 or before) will be addressed separately.
Whether taxes should be inside or outside a future PBR envelope, as well as appropriate sharing of benefits of tax planning, will be addressed later.</td><td>As PILs are being used to pay down the stranded debt and if PILs are to be a pass-through cost (and so there is no benefit to the LDC of tax planning) then pick a rate (say 35%) to be applied on net income. This will reduce LDC costs for preparation and filing of tax returns and simplify calculations and forecasting.</td></tr>
<tr><td colspan="2">REVENUE REQUIREMENT - DISTRIBUTION RATE BASE ISSUES</td></tr>
<tr><td>13. Definition of Distribution Rate Base
The Distribution Rate Handbook lists what assets and accounts should be included in the distribution rate base, but there have been some changes to the Uniform System of Accounts over time.
Are there assets for which the classification should be clarified or changed (e.g. treatment of >50 kW transformer assets)?
For assets that are shared between distributors, or assets shared between distribution and non-utility functions, should specific methods be approved for apportioning the appropriate amount to the distribution rate base?</td><td>No comment</td></tr>
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14. Rate Base Measurement Date(s) • Electricity distributors have historically reported data for RRR and rate application filings for the calendar year, while the “rate year” for 2006 is presumed to be May 1, 2006 to April 30, 2007. • What approach should be adopted for dealing with the timing difference between the calendar (report) year and the rate year? • What approach should be taken towards valuing the rate base over a 12 month period (average of monthly values, averaging of start and end date values, end of period value)?	A calendar base measurement date is impractical. Recommend that filings be staggered.
15. Working Capital Component of Rate Base • The previous working capital allowance (WCA) was based on a formula originating when Ontario Hydro regulated the industry and consisted of 15% of controllable costs plus the Cost of Power. • Should a common WCA formula continue to be used? How should it be updated in light of subsequent industry restructuring and rate unbundling? • Should some LDC’s be required to conduct lead-lag studies to empirically establish their working capital requirements? Could the results of these studies be extended to other LDC’s? Should any LDC requesting a WCA greater than that provided by the new formula be required to file a lead-lag study?	No comment
16. Capitalizing Expenses • Reasonableness of an LDC’s policy regarding capitalization of expenses. • Consistency between utilities. • Significance of accounting debates over the merits of incremental vs. full cost approaches towards capitalizing overhead or indirect costs.	This is another area where there are good guidelines through Revenue Canada and the CICA GAAP. Use them – do not create a new set of accounting principles.

17. Capital Projects • How should the prudence of capital expenditures be reviewed? • Merits of project-by-project review versus use of trendlines. • What level of review is appropriate for major projects? Are there filing requirements that can assist review? • Establishing a fair trendline in light of historical trends and planned new investments.	Capital projects get a lot of review at the Board of Directors and Shareholder level. They are not going to approve an investment that does not have an adequate return.
18. Contributed Capital • Distributors are presently allowed to earn a return only on pre-2000 contributed capital and until such assets are fully depreciated. • Prudence review to check that the appropriate amount of contributed capital is allowed to earn a rate of return.	No comment
19. No-Cost Capital • Extent of application of “no-cost” capital concept to Ontario electricity distributors. What specific items should be included (e.g. pension assets)?	Due to their subjective nature most “no-cost” capital items get a thorough review by external auditors. This is another area where the OEB should rely on the CICA and GAAP.
20. Rate Setting Treatment of Capital Gains/Losses • Should a uniform approach be followed for distributing gains from sale of utility assets between shareholders and ratepayers? • Would the same approach apply to sale of shares?	Capital gains and losses are exceptions and should be treated accordingly. They do not belong in the rate base.

REVENUE REQUIREMENT – OPERATING EXPENSE ISSUES	
21. Distribution "Wires Only" Expenses • The Distribution Rate Handbook lists various utility and non-utility expenses (and revenues), but there have been subsequent changes to the Uniform System of Accounts. • Does the classification of any item(s) need to be clarified or changed?	No comment
22. Post-Retirement Benefits and Pensions • Review of economic assumptions used in plan calculations. • What pension costs are allowed into the distribution revenue requirement (e.g. treatment of a pension surplus, shortfall or contribution holiday; valuation measures to reduce volatility)? • Must an LDC move to the accrual method of accounting for post-retirement benefits for rate setting purposes, in light of CICA s. 3461? • If an LDC changes from the cash to the accrual method, regulatory amortization of one-time expense as a result of the changeover. • Prudence of management of pension assets.	Low priority Most LDC pensions are administered by OMERS. This is an independently managed pension plan that complies with all Federal and Provincial pension legislation. Apart from requiring that the pensions be on an accrual and not a cash basis this area should be left to the actuaries. Post retirement benefits calculations are based on actuarial studies and are validified by certified actuaries. As with pensions – leave it to the experts.
23. Site Restoration and Removal Costs • For any LDC to which this applies, what are the rate-setting impacts of compliance with new CICA s. 3110 (effective 2004)?	Low priority Site restoration and removal costs should be treated like capital gains and losses. They should be excluded from the rate base.
24. Insurance Expenses • Determination of appropriate reserves for distributors that self-	Low priority Apart from requiring that LDCs are adequately covered for property and liability insurance. This is an area that can be left to the insurance

insure, or appropriate insurance expenses for distributors that use insurers.	companies.
25. Bad Debt Expense • What is an appropriate amount for uncollectibles, especially considering interaction with other policies (such as the LDC's Security Deposit policy)? • Should a single method be used to calculate the amount? If so, how should it be determined?	The Stelco/ Hamilton Hydro and late payment fees litigation will have an impact on the required level of bad debt expense, as will changes to the deposit and collection policies. Recommend that the adequacy of bad debts reserves be left to the external auditors to satisfy themselves.
26. Employee Compensation and Staffing • Review of reasonableness of total executive compensation (base, incentive plans and supplemental income and benefits). Review of the distribution of the costs of the incentive plans and supplemental income between shareholders and ratepayers (for example, based on who receives the benefits from achievement of corporate targets). Review of allocation of executive salaries within a corporate group. • Merits of a uniform approach in respect of regulatory review of bonuses (such as dividing costs 50/50 between shareholders and ratepayers) versus a case-by-case review of the terms of each incentive plan. • Review of reasonableness of non-management labour costs.	Low priority. The Board of Directors manages senior management compensation closely. Salaries are very conservative compared to similar sized companies in industry. Most LDCs have collective agreements that have been negotiated in good faith and represent compensation levels in the area.
27. IT Costs • Review of prudency of IT costs, including treatment of IT outsourcing costs and of IT project cost overruns.	LDCs have incurred significant IT costs resulting from legislative changes, with more of these costs expected from the impact of Bill 100 and future legislated changes. Much of the work has been done in-house with minimal cost or impact to the customer.
28. Advertising, Entertainment, Charitable/Political Contributions, Employee Dues, Research and Development • What is an appropriate regulatory treatment of expenditures that	Low priority. These types of expenses that are closely monitored by the Board of Directors and the shareholder (in most cases a municipality). There is a high level of scrutiny of these types of expenses.

may benefit the ratepayers only partially?	
2006 RATE DESIGN MATTERS	
29. Specific Service Charges • Specific Service Charges are to be considered as part of establishing the 2006 revenue requirement. • Will also address variability in types and charges for Specific Service Charges across all distributors, with an aim of exploring consistency in definition and application. For example, should there be a single charge for each service across Ontario?	There are a number of service costs; such are notice delivery and account information inquiries for retailers that are not being adequately recovered. These need to be re-examined on a utility- by-utility basis based on cost.
30. Unmetered Scattered Load • Definition and rate treatment of Unmetered Scattered Load (cable TV, payphones, advertising, bus shelters, etc.)	No comment
31. Time-of-Use Rates • Even prior to completing new cost allocation studies, the merits of integrating the former TOU distribution rate classes that appear in the tariffs for various LDC's into more appropriate rate classes. • Design of Time-of-Use rates for large consumers to encourage load shifting.	No comment
32. Fixed/Variable • In advance of new cost allocation studies, it may be desirable to start addressing some of the variability in the fixed (Monthly Service Charge) and variable (demand/energy-related) tariffs across the province. • Should there be partial movement towards a uniform fixed charge for each rate class across Ontario in 2006?	DSM will impact the variable portion of rates. For LDCs it would be prudent to have a higher fixed portion of rates. As the intent here is for a "partial" move towards a more consistent fixed portion we recommend that the OEB confine their focus on large swings from historical fixed rates in the 2006 rate application. The fixed portion of the cost may be impacted by geographic and other considerations that contribute to the differences across the province. Increasing the fixed portion benefits the LDC, but could also have a negative impact on promoting conservation.

33. 2006 Rate Mitigation • Rate mitigation may be used, as it has been historically, to reduce significant rate impacts. Should a common rate mitigation test or methodology be adopted? What test(s) or methodology for mitigating rate impacts are appropriate?	No comment.
USE OF 'COMPARATORS' TO ASSIST PRUDENCY REVIEW OF LDCs' COSTS	
1. Comparators and Cohorts • The Board is interested in using comparators to assist in the review of LDCs' individual rate applications. Board staff would compare various operational and financial statistics between LDC's as a means of identifying outliers and anomalies. Identified anomalies would then be followed up for further explanation. The Board wants useful comparators to be identified, to the extent possible, in advance. • What would be useful comparators to assist in expeditious processing of individual rate applications? For example: costs per customer, billing and collection expenses per customer, growth rates in certain capital and expense categories, etc. • To further aid in the use of comparators as part of the rate application review process, can the various Ontario LDC's be grouped into a smaller number of cohorts or peers (for example, based on size, operating characteristics, structure, or operational and management processes)? • What would stakeholders suggest be a practical segmentation of Ontario LDC's into cohorts or peer groups for reviewing 2006 rate applications?	If the use of comparators and cohorts seems to be to assist the OEB in processing applications then historical comparisons are likely the best indicators that the OEB can use. Where there are variations explanations are appropriate. That said rates are the ultimate comparators. If the OEB were to develop comparators and cohorts to improve productivity and profitability then an industry based quality-type system should be applied.