



WATERLOO NORTH HYDRO INC.

Input to OEB Process for Establishing 2006 Rates

Presented by: Rene Gatien, President & CEO
Albert Singh, VP Finance & CFO
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OEB Act 1998

Section 1 Board Objectives, Electricity

- To protect the interests of consumers with respect to prices and the reliability and quality of electricity service.
- To promote economic efficiency in the generation, transmission and distribution of electricity.
- To facilitate the maintenance of a financially viable electricity industry.
- To promote energy conservation, energy efficiency, load management and the use of cleaner energy sources, including alternative and renewable energy sources, in a manner consistent with the policies of the Government of Ontario.



Governing Principles Regulation & Rate Setting Process

- Regulation should be “Light-handed”, less bureaucratic, not intrusive.
- Cost of regulation (OEB/IMO/OPA fees) should not be excessively expensive and increase the end rate to the consumer.
- LDCs should be allowed discretion over investment and operating decisions.



Governing Principles Regulation & Rate Setting Process..cont'd

- Rate model should seek to achieve economic efficiencies.
- ROE should be sufficient to assure confidence in the financial viability of the LDC and be sufficient to maintain a credit rating that will allow the utility to raise capital to build new infrastructure to service growth.
- Promote efficient utility operations.



Use of Comparators

Similarities and Differences

- Customers
 - # of Customers may be similar.
 - Urban vs Rural (large rural areas costly to service).
 - Customer Mix (industrial vs residential vs institutional).
 - Customer Density (customers per sq. km).
- Operating Considerations
 - Distribution voltage levels: 4 kv to 27.6 kv.
 - LDC owned transformer stations.
 - Age of plant.
 - Standards for engineering, operations and customer service.
- Municipal considerations
 - Planning Standards.
 - Amount of Road Widening.
 - Economic Development (industry vs residential vs institutional).
- Accounting Practices
 - Capitalization Policy.
 - Income & Expense Categorization.



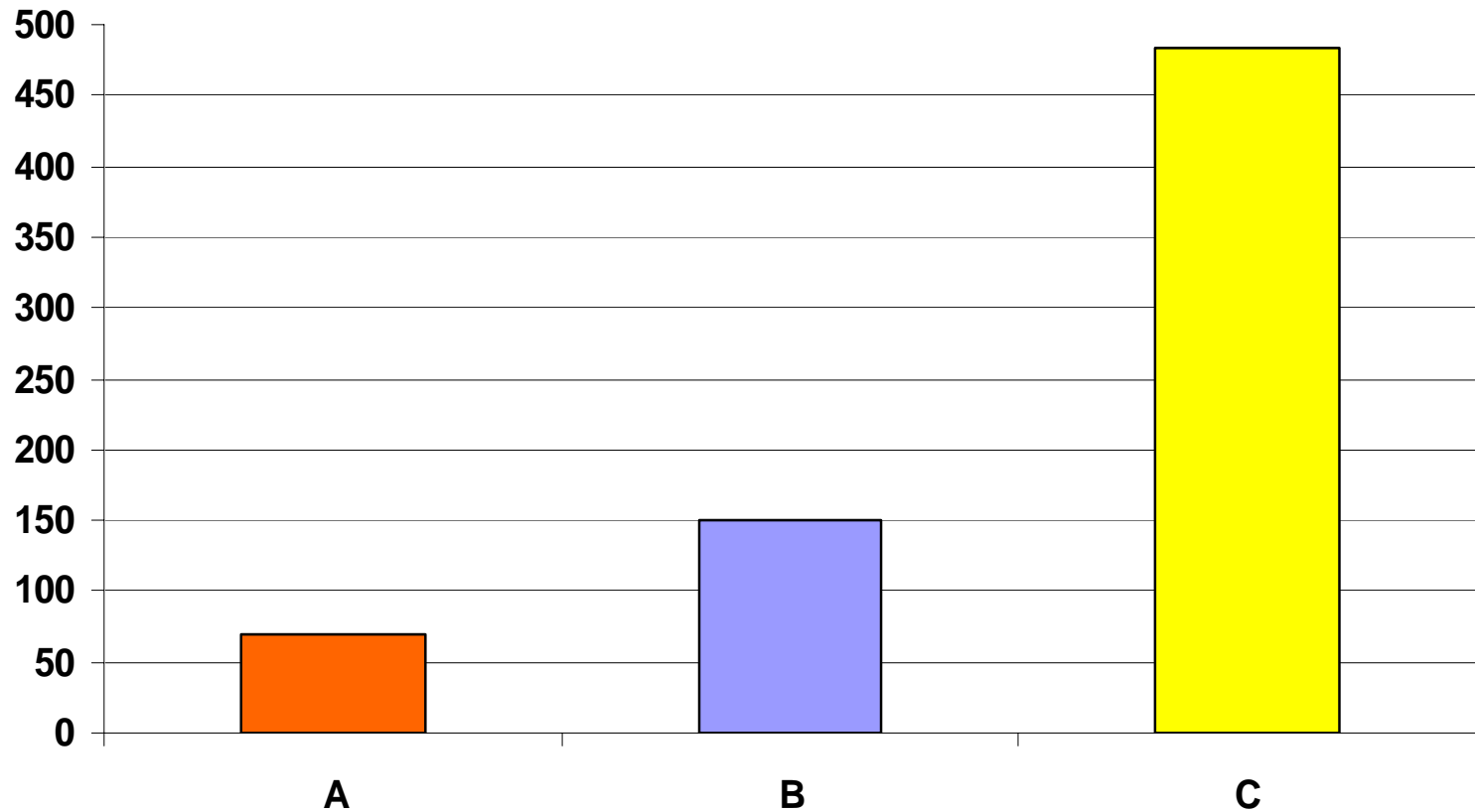
Useful Key Performance Indicators

- Operating Efficiency
 - Controllable Cost per Customer, per MWh, per km of line.
 - Administration & Billing Cost per Customer.
 - Operations & Maintenance Cost per Customer, per MWh, per km of line.
 - Customers per Sq. km (customer density)
 - MWh per Sq. km.
- Investing Efficiency
 - Asset Efficiency (distribution revenue per \$ of plant).
 - \$ of plant to distribute one MWh.



Comparison of Three Utilities (40 - 50 k customers each)

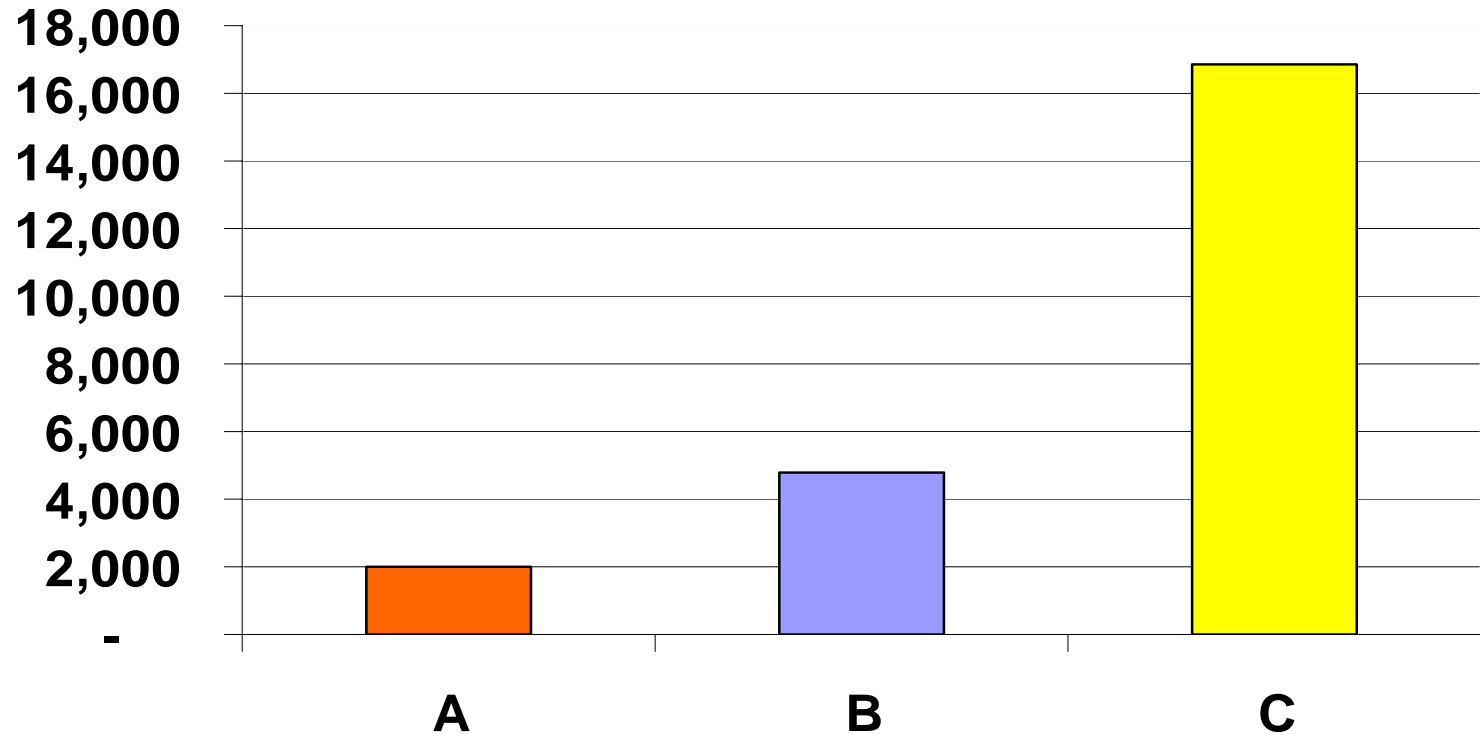
Customer Density per Sq. km





Comparison of Three Utilities (40 - 50 k customers each)

Mwh Density per Sq. km





Comparison of Three Utilities (40 - 50 k customers each)

Controllable Costs per Customer





Comparison of Three Utilities (40 - 50 k customers each)

Controllable Costs per Mwh





Comparison of Three Utilities (40 - 50 k customers each)

Controllable Costs per km of Line





Revenue Requirement - General Issues

- Test Year for Rate Base
 - Recommend 2004.
 - Annual rebasing thereafter.
 - Use same approach for all LDCs
- Load Forecast
 - Use previous year for forecasting revenues (assuming annual rebasing).
- Test Year Adjustments
 - Done on a case by case basis
- Weather Normalization - should not be part of generic process.
 - LDCs normally use a 3-5 year “smoothing” forecast



Revenue Requirement - General Issues

- Return on Equity/Debt Rate
 - Long-term Canadian bond rates are adequate.
 - Multi year forecasts are desirable for rate stability.
 - Debt Rate should be based on size.
- Debt/Equity Structure
 - Current deemed structures are adequate.
 - General Acceptance by Financial Institutions.
 - Use deemed D/E rather than actual.
- Depreciation Rates
 - Recommend an industry led group to review rates that is consistent with useful life.
 - Recommend declining balance vs straight line basis.



Revenue Requirement - General Issues

- Transfer Pricing & Shared Services
 - Already covered in the Affiliate Relationship Code (all services to be at fair market value). Should not be part of generic discussions.
- Low Voltage & Wheeling Costs
 - Revisit work started in August 2002.
- 2006 Taxes/PILs
 - Leave tax planning up to the LDC.
 - Should be settled outside the generic process in a timely manner.



Distribution Rate Base Issues

- Definition of Rate Base
 - Should include all assets + working capital allowance.
 - Allow annual rebasing.
- Measurement Date
 - Use previous financial year as base year
 - File rate application by June 30
 - Rates should be effective on Jan. 1 of following year
 - Allow interest compensation for timing differences
- Working Capital
 - 15% of controllable costs + COP is adequate.
 - Continue to use a common WCA for all LDCs.
 - Require LDC desiring a different WCA to file justification.



Distribution Rate Base Issues

- Capitalizing Expenses
 - USoA does not accurately reflect industry practices. Too prescriptive on some issues and silent on others.
 - Use an industry group to review USoA and recommend capitalization policy.
- Capital Projects
 - Leave investment decisions to the expertise & discretion of LDCs.
 - Look at exceptions only on a case by case basis if rate increases are unreasonable.
- Contributed Capital
 - Assets paid for by capital contributions will eventually need to be upgraded and replaced by the LDC.
 - LDC should be allowed to take a depreciation reserve on these assets to provide for the replacement.
- No-Cost Capital/Capital Gains & Losses
 - Not part of the generic process. Should be based on materiality on a case by case basis.



Operating Expense Issues

- Wires Only Expenses
 - Use industry group to review this issue and make recommendation.
- Post-Retirement Benefits & Pensions
 - CICA s. 3461 provide guidelines on this issue. Conservative accounting approach recommends the accrual method.
 - All municipally owned LDCs subscribe to OMERS. No issues here with managing pension assets.
- Site Restoration & Removal Costs
 - This issue is not material for most LDCs.
 - Follow CICA Handbook if required.



Operating Expense Issues

- Insurance Expense
 - LDCs do not insure most plant (too costly).
 - Unforeseen losses due to weather, accidents are a normal part of doing business and should be included in expenses.
- Bad Debt Expense
 - New OEB regulation re: deposit policy will increase bad debts.
 - LDCs must have the discretion (like any OBCA company) to use all reasonable measures to manage bad debts.
- Employee Compensation
 - Not an issue in municipally owned LDCs
 - Employment contracts are confidential.
 - Compensation levels are based on local market and economic conditions.
 - LDC Boards should exercise prudence in compensation matters.



Operating Expense Issues

- IT Costs
 - OEB staff would need IT and business expertise to be able to determine prudence.
 - Outsourcing is a strategy for controlling costs and should be encouraged.
 - IT cost overruns should be left to LDC Boards to manage.
- Advertising, Entertainment, Employee Dues, R&D
 - All part of doing business as an OBCA company. Not an issue for LDCs.
 - LDC Boards should use discretion in managing these expenses.
- Charitable/Political Contributions
 - Charitable donations for community based initiatives should be allowed.
 - Political contributions are not part of LDC business and should not be allowed in rates.



2006 Rate Design Matters

- Demand-Side Management
 - DSM should be addressed outside the generic process. LDCs should be compensated for loss of revenues to encourage LDC commitment.
 - Distribution Loss Factor should be bundled with energy. Separating this item causes confusion on the part of customers.
 - Implement time-of-use rates for residential and small businesses. This is a simpler and less costly than interval style smart metering.
 - Interval style Smart Metering is only effective if consumers know both quantity and prices for all time periods on a real time basis.
- Specific Service Charges
 - No single charge will be fair to all LDCs.
 - Review charges on a case by case basis.
 - Require LDCs to provide cost justification to determine charges.
- Unmetered Scattered Load
 - Should be reviewed as part of cost allocation exercise.



2006 Rate Design Matters

- Fixed/Variable
 - Should be addressed as part of cost allocation
 - Uniform fixed charge across the province not recommended.
 - Move to a more homogenized approach to the fixed & variable % split.
- 2006 Rate Mitigation
 - LDC cost represent only 15% to 20% of total bill to customer.
 - Bring increases in all at once. Phasing-in is too onerous and confusing to customers.
 - 2001 rate increase is still being implemented in 2005.