Ontario Energy Board **Commission de l'Énergie de l'Ontario**

Ontario

EB-2007-0785

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Sioux Lookout Hydro Inc. for an order approving or fixing just and reasonable rates and other charges for the distribution of electricity to be effective May 1, 2008.

BEFORE: Paul Sommerville
Presiding Member

Ken Quesnelle
Member

September 11, 2008

DECISION AND ORDER

BACKGROUND

Sioux Lookout Hydro Inc. (“Sioux Lookout” or the “Applicant”) filed an application with the Ontario Energy Board (the “Board”) on October 3, 2007, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the rates that it charges for electricity distribution to be effective May 1, 2008. Sioux Lookout is the licensed electricity distributor for the Municipality of Sioux Lookout.

Sioux Lookout is one of over 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010 (the “Plan”). In an effort to assist distributors in preparing its applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year, by electricity distributors.

On May 4, 2007, as part of the Plan, the Board indicated that Sioux Lookout would be one of the electricity distributors to have its rates rebased in 2008. Accordingly, Sioux Lookout filed a cost of service application based on 2008 as the forward test year.

Sioux Lookout requested a revenue requirement of $1,747,569 to be recovered in new rates effective May 1, 2008. The application indicated that the existing rates would produce a revenue deficiency of $215,122 for 2008. The resulting requested increase was estimated as 26.7% on the distribution component of the bill for a typical residential customer consuming 1,000 kWh per month.

The Board assigned the application file number EB-2007-0746 and issued a Notice of Application and Hearing dated October 18, 2007. There were no intervenors. Board staff posed interrogatories and made a submission. Sioux Lookout filed a reply argument (“Reply”) on February 7, 2008.

The full record is available at the Board’s offices. The Board has chosen to summarize the record to the extent necessary to provide context to its findings.

THE ISSUES

The following issues were raised in the submission filed by Board staff:

- Operating, Maintenance & Administrative Expenses
- Capital Expenditures and Rate Base
- Service Reliability
- Asset Condition and Asset Management
- Smart Meters
- Payment in Lieu of Taxes
- Cost of Capital
- Line Losses
- Deferral and Variance Accounts
- Cost Allocation and Rate Design

OPERATING, MAINTENANCE & ADMINISTRATIVE ("OM&A") EXPENSES

The following table is derived from Board staff's submission and sets out amounts contained in Sioux Lookout's evidence and confirmed by Sioux Lookout to be accurate:

Table 1
Controllable OMA&G Expenses

	2006 Approved	Variance 2006/2006	2006 Actual	Variance 2007/2006	2007 Bridge	Variance 2008/2007	2008 Test	Variance 2008/2006
Operation	337,710	2,843	340,553	61,886	402,439	19,388	421,827	81,274
Maintenance	89,819	-16,952	72,867	17,888	90,755	-3,474	87,281	14,414
Billing and Collections	242,157	55,898	298,055	9,759	307,814	39,012	346,826	48,771
Community Relations		2,218	2,218	-2,218				-2,218
Bad Debt	2,814	48,926	51,740	-11,740	40,000	-20,000	20,000	-31,740
Property Insurance	25,446	282	25,728	448	26,176	524	26,700	972
General Advertising	785	-239	546	254	800	200	1,000	454
Administrative & General	222,888	24,103	246,991	4,317	25,1308	-18,116	233,192	-13,799
Controllable OM&A	921,618	117,080	1,038,698	80,594	1,119,292	17,534	1,136,826	98,128
Percent Change		**12.7%**		**7.8%**		**1.6%**		**9.4%**

The increase from the actual controllable OM&A expenses for 2006 to the proposed 2008 is $98,128 or 9.4%. When assessing the magnitude of the above increases, Board staff noted that in the case of Operation Labour the largest component of this increase was due to an adjustment related to a liability in the amount of $50,729 for accrued sick leave which was incorrect. This was a one-time only adjustment that was made in response to the discovery of this issue during the company's 2006 external audit.

In Reply, Sioux Lookout confirmed Board staff's observation and also pointed out that:

> *"…there should have been an entry to normalize meter reading costs of approximately $17,000 under customer billing. Therefore denial of this amount would be appropriate."* [1]

This is due to the performance of meter reading by company personnel for a period of time in 2006 that have a higher compensation level than that of the meter reader.

Sioux Lookout also pointed out in Reply:

> *"An amount of $12,000 is included in the 2008 budget for fees paid to a third party to perform collection calls."*[2]

Board Findings

The Board accepts the explanation of the extraordinary 2006 base year amount in account 5020 related to the accrued sick leave liability. The Board also considers the expense related to the collection activity to be reasonable.

Based on the company's submission that there should have been a recognition of the previous circumstances that resulted in higher than normal meter reading costs in 2006, and that this was a one-time occurrence, the Board has determined that the revenue requirements for OM&A be built on the amount of $1,119,826 for controllable OMA&G expenses. This is a reduction of $17,000 from the amount claimed in the application.

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[1] Sioux Lookout Hydro Inc. Reply to Staff Submission EB-2007-0785, Page 1
[2] ibid

CAPITAL EXPENDITURES AND RATE BASE

Increase in Capital Expenditures

Sioux Lookout projects a 2008 capital expenditure level of $651,890 and a corresponding rate base of $6,667,607. This increase is 450% over the 2006 actual level of capital expenditures. In Reply, Sioux Lookout pointed out $270,000 of the 2008 increase was attributable to its plan for the implementation of the Government's Smart Meters initiative. It also pointed out:

> *"In years prior to 2006, SLHI budgeted $400,000 for capital expenditures funded by cash. This was decreased in 2006 in order to be able to fund the charges from Hydro One for historic LV charges. The amount budgeted in 2007 more closely reflects what has been budgeted in the past."*[3]

Board Findings

In this area, as in a number of other aspects of this application, the evidentiary process was erratic. First the Applicant included as part of its capital expenditure budget approximately $90,000 in capital contributions, which ought not to have been included. As the 2006 EDR handbook makes clear in Chapter 4.5, capital contributions are not to be included in rate base, and therefore must be deleted from the Applicant's claim.

In addition, the Board staff submission identified a discrepancy with respect to the total of 2006 budgeted expenditures amounting to approximately $20,000. In its Reply the Applicant explained the discrepancy as the difference between what had been budgeted for capital expenditures in 2006, and what had been actually spent.

A further anomaly appears when one considers the extremely large increase sought by the Applicant in its proposal. For example, the Applicant seeks an eightfold increase in sustainment capital expenditures as between 2006, the historical year, and 2008. The Applicant seeks no less than a fourfold increase in development capital.

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[3] ibid

Increases of this magnitude require the most compelling and detailed kind of evidence. No such evidence has been provided by the Applicant. The Board is left with a dilemma as to what is a supported and realistic approach to capital spending for this utility.
In such a circumstance the Board looks to the historical spending norms established over the recent past. The following table, which is from the Board staff submission, provides some important data that can assist the Board in its consideration of rates for 2008, and in particular the appropriate amount of capital spending that ought to be approved for the 2008 rate year.

Table 2

Sioux Lookout Financial Data ($ 000)

	2002	2003	2004	2005	2006	2007	2008
Net Income	$ 295	$ 308	$ 77	$ 59	$ 129	$ 109	$ 262
Actual ROE%	7.36%	7.58%	1.92%	1.47%	3.20%	2.72%	8.68%
Allowed ROE%	9.88%	9.88%	9.88%	9.88%	9.00%	9.00%	8.68%
Retained Earnings	$ 362	$ 538	$ 483	$ 409	$ 253	$ 253	$ 253
Dividends	$ 88	$ 133	$ 133	$ 133	$ 285	$ 109	$ 262
Total Capital Expenditures	$ 423	$ 451	$ 384	$ 312	$ 209	$ 344	$ 652

The above Table 2 provides data respecting this utility’s operations over the period 2002 through 2007. For example, average capital expenditures over the period amount to about $354,000 per year.

Elsewhere in this decision the Board has denied the Applicant's proposal with respect to Smart Meters, which has the effect of reducing the Applicant's remaining claim by some $270,000 for 2008. When taken together with the other adjustments related to capital contributions, the discrepancy noted above respecting the actual and budgeted capital expenditures for 2006, the apparent net capital spending proposal for the company amounts to about $295,000.

Notwithstanding the Board’s concern with the paucity of the evidence supporting the capital plan, the Board does not want to unduly impair the Applicant’s ability to maintain its ongoing asset sustainment and development programs that is evidenced by the historic spending patterns.

Accordingly, the Board will approve a capital expenditure budget encompassing all areas of capital expenditures in the amount of $330,000. The Board expects that future rate applications will contain comprehensive capital spending plans supported by cogent analysis.

Reliability Performance

Service reliability figures are measures of performance of the system as seen by customers. SAIDI and SAIFI provide information as to the duration and frequency respectively of interruptions experienced by customers on the system averaged over the total number of customers. CAIDI represents the average duration of interruption averaged over the number of customers that are interrupted.

The pre-filed evidence indicated deterioration in all three service reliability indices. Board staff invited Sioux Lookout to quantify any external factors that contributed to the deterioration of the system performance. In its Reply, Sioux Lookout provided a more detailed breakdown of the nature of the contributing factors to the reliability of the system.

Board Findings

The Board does not consider the record of reliability statistics to be adequate to support any trend conclusions, but notes that granularity of the data collected by Sioux Lookout is more exhaustive than that required by the Board as part of the RRR filings. This enabled Sioux Lookout to provide a more informative analysis than otherwise would have been the case. The Board has communicated in the Code Amendment process dealing with service quality (EB 2008-0001) that it intends to amend the RRR filing requirement related to this area with a view to the possible future codification of reliability standards. The Notice of Proposal in that proceeding cited a required improvement to the data gathering exercise. That improvement should include the same type of segmentation of causes of outages that Sioux Lookout currently performs. The Board expects that in future applications the highest level of detail available to the Applicant in matters as important as system reliability would be included as pre-filed evidence, and not introduced in the reply submission stage.

Asset Condition and Asset Management

Sioux Lookout provided a description of its asset inspection program. It submitted that the program was recently adopted in response to Ontario Regulation 22/04. In particular, the asset inspection program is derived from the combination of its 2005 and 2006 audits required by the Regulation and the inspection sheets and schedules for equipment inspection that are based on Appendix “C” of the Distribution System Code. Board staff queried if Sioux Lookout had considered implementing Asset Condition Assessment Programmes. In Reply, Sioux Lookout stated that it has considered that step, but due to the small size of the utility, it was concluded that such a program was not necessary. All of the assets employed by Sioux Lookout can be assessed on a yearly basis. They also pointed out that an Asset Management Plan to prioritize and establish work plans to maintain and operate its assets is currently being developed.

Board Findings

The Board considers that any asset condition assessment activity needs to be sized appropriately, taking into account the size of the utility and the concomitant number of assets within its system.

What is crucial is that every utility establishes a method of determining the relative condition of the various portions of its plant that it relies on to provide service to its customers. It is the Board’s view that the objectives of an asset condition assessment activity are not materially driven by the size of the system. However, it is the Board’s view that the size of the utility will have a bearing on the manner in which the assessment activity is performed. The variant driver is related to the correlation of increased data management requirements to the number of assets to be monitored.

The key consideration is that the utility must be in a position to provide a competent confirmation respecting the condition of its plant in cogent evidence supporting the proposed maintenance and equipment replacement plans.

The Board considers the manner in which Sioux Lookout performs its assessment of asset condition to be reasonable at this point in time. Sioux Lookout has stated that it is in the process of developing an Asset Management Plan. A consideration of how the knowledge gained through asset condition assessment informs the Asset Management Plan is required to determine the ultimate effectiveness of Sioux Lookout's process.

The Board is of the view that Sioux Lookout should periodically assess the functionality, scalability, and cost of data management programs for asset condition assessment in order to substantiate its claim that its current process provides the most prudent approach.

The Board expects Sioux Lookout to use the same value assessment in the procurement of other programs designed to assist in data management related to asset management.

SMART METERS

While it states elsewhere that it has not included any smart meter costs, Sioux Lookout has proposed to include in its 2008 revenue requirement amounts related to capital and operating expenses for Smart Meter implementation. The amount is $270,000 for smart meter capital expenditures. Sioux Lookout's evidence is that it will incur capital expenditures of nearly $947,500 to fully implement its smart meter program over the next three years.

Sioux Lookout was not one of the thirteen named distributors authorized to undertake smart meter activities and it is not named in the combined Smart Meter proceeding conducted by the Board in 2007 under file number EB-2007-0063.

Sioux Lookout has not previously filed a smart meter plan in an application before the Board. In its decision on Sioux Lookout's 2006 EDR application, the Board authorized Sioux Lookout to collect a smart meter rate adder amount of $0.25 per month per metered customer.

Sioux Lookout is participating in the London Hydro consortium on a Request for Proposals to select qualifying vendors for smart meter procurements that comply with the government's technical requirements for minimum functionality. It expects to be able to select a vendor and begin smart meter installations when that process is complete, which is expected shortly.

Board staff notes that Sioux Lookout's evidence includes smart meter capital expenditures of $50,000 in 2007 in addition to the $270,000 in 2008. Staff also noted that Sioux Lookout confirmed, in response to an interrogatory, that it is seeking to maintain the smart meter rate adder of $0.25 per month per metered customer.

Board staff questioned the appropriateness of Sioux Lookout's proposal to include smart meter capital expenditures in the absence of authorization from the provincial government.

In reply, Sioux Lookout stated that it is participating in the London Hydro consortium and expects to begin smart meter deployment this year. It stated that it is important to include smart meter expenditures as part of its rate application.

In fact, in the period between the closing of the evidentiary portion of the proceeding and the issuance of this Decision the Government has enacted changes to the regulations governing the implementation of its Smart Meter Initiative. O. Reg. 427/06 as amended on June 25, 2008 extends authorization for the procurement and installation of smart meters to distributors who have procured smart meters pursuant to and in compliance with a specific Request For Proposal ("RFP") issued by London Hydro Inc dated August 14, 2007. The adoption of this Regulation means that any distributor, including the Applicant, procuring pursuant to and in compliance with that RFP is authorized by the Government to install smart meters within its service territory.

<u>Board Findings</u>

The Applicant's proposal contains very considerable expenditures and provisions related to the implementation of the provincial government's smart meter program. In the Board's view the most appropriate approach with respect to these costs is to continue to track them in their respective deferral and variance accounts for later review and disposition. This approach is sensible given the fact that, while the Applicant may be able to bring itself within the scope of the London Hydro Inc. RFP referenced above, it is unclear exactly when it will do so and when smart meter expenditures will be incurred starting in 2008. It is also true that the Board will not authorize the disposition of unaudited deferral or variance account balances, except in the most compelling case.

The Applicant is directed to remove $270,000 related to smart meter implementation from its capital expenditures in 2008 but to track such expenditures in deferral/variance account 1555. The Applicant should also ensure that the smart meter capital expenditures of $50,000 in 2007 are similarly removed. The Applicant's 2008 rate base and revenue requirement should be adjusted to reflect these directions.

Most local distribution companies, including the Applicant, have been authorized to impose a smart meter rate adder in the amount equivalent to $0.30 per month per residential customer. The Board authorized this collection in order to allow distributors to accumulate some funds which could be used for smart meter deployment, when the provincial government authorized it. In this way, future rate shock could be avoided, and the utilities would be at least partially funded for the initial stages of their rollout.

The Board considers it to be prudent to permit the Applicant to collect an increased amount by way of the smart meter rate adder in anticipation of Sioux Lookout becoming compliant and therefore authorized. In the Board's view, increasing the rate adder to $1.00 per month per metered customer going forward will provide the Applicant with sufficient funds to support its initial rollout and to avoid any potential rate shock when full deployment occurs.

If the Applicant does become authorized pursuant to the amended Regulation, it can lawfully commence installation within its franchise area. If the funds accumulated through the rate adder mechanism are not sufficient to support a portion of the rollout, the Applicant may wish to bring an application to seek incremental funding in advance of its next rebasing. The Board notes, however, that in the normal course, utilities are expected to fund capital additions of this kind without such recourse.

PAYMENT IN LIEU OF TAXES (PILS)

Sioux Lookout filed its Tax Calculations with supporting CCA Calculations.[4, 5] In response to an interrogatory, Sioux Lookout claimed that it was in error using Class 1 in 2006.[6] In Reply it corrected this error.

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[4] Exhibit 4/Tab 3/Schedule 1
[5] Exhibit 4/Tab 3/Schedule 2
[6] Board staff interrogatory 10.27 b

Board staff in its submission, pointed out that the combined income tax rate applicable to the Applicant has declined to 16.5% with effect from January 1, 2008. In its Reply, Sioux Lookout applied the effect of this change in tax rate.

The combined effect of these two changes, as stated in Reply, would result in a decrease in PILs expenses from $52,135 to $45,471 (with gross up) for 2008.

Board Findings

First, the Applicant has acknowledged that its application did not incorporate changes to the applicable income tax rate which came into effect on January 1, 2008.

The Applicant has also acknowledged its error in applying the wrong capital cost allowance class in its calculation of depreciation.

The consequential rate order arising from this proceeding will reflect these corrections.

COST OF CAPITAL

The Board's guidelines for the cost of capital are set out in its Report of the Board on *Cost of Capital and 2nd Generation Incentive Regulation of Ontario's Electricity Distributors* (the "Board Report").[7]

Sioux Lookout's proposed capital structure is 53.3% debt (49.3% long-term debt and 4.0% short-term debt) and 46.7% equity.

Sioux Lookout's debt consists of third-party debt at prime, carrying an interest rate of 6.00%. However, this rate is variable, as the bank's prime changes from time to time. Board staff noted that the Board Report requires that variable rates be adjusted at the time of rebasing, pursuant to section 2.2.1 and Appendix A of the Board Report. Sioux Lookout in Reply stated that they would conform to this approach.

Similarly, Sioux Lookout used a short-term debt rate of 4.77% and a return on equity of 8.68%, but stated that these would be updated in accordance with the Board's Report.

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[7] *Cost of Capital EB-2006-0088 and 2nd Generation Incentive Regulation Mechanism EB-2006-0089*

Board Findings

The Board has issued a guideline respecting cost of capital methodology. That guideline is contained in the Board Report. While the Board Report is a guideline, departures from the methodology contained in it are expected to be adequately supported. Sioux Lookout's proposal with respect to cost of capital is part of Exhibit 6 of its application. The following table captures the company's cost of capital proposal

Table 3
Cost of Capital

Cost of Capital Parameter	Sioux Lookout Hydro's Proposal
Capital Structure	53.3% debt (composed of 49.3% long-term debt and 4.0% short-term debt) and 46.7% equity
Short-Term Debt	4.77%, Confirmed that this is to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	6.00%, as the current interest rate on a demand installment loan with a commercial bank. The rate is variable and equal to the prime business rate for the year.
Return on Equity	8.68%, but to be updated in accordance with the methodology in Appendix B of the Board Report.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	7.20% as proposed, but subject to change as the short-term debt rate and ROE are updated per the Board Report at the time of the Board's Decision.

As the Board staff submission acknowledges, with the exception of the long-term debt rate, which is discussed below, Sioux Lookout's approach for cost of capital is consistent with the Board Report.

Sioux Lookout proposed[8] that the embedded cost of long-term debt for setting its 2008 revenue requirement would be 6.00%, in light of a demand loan held by an unaffiliated commercial bank.

In response to a Board staff interrogatory Sioux Lookout provided documentation with respect to this demand loan.[9] The loan attracts interest at the average prime rate over

[8] Exhibit 6/Tab 1/Schedule 1
[9] Board staff Interrogatory 3.4

the year. The prime rate at the time of application was 6.0%, which also happens to be the chartered Bank administered interest rate prime business for most of 2007 as documented on the Bank of Canada's web site. However, it is clear that the interest rate governing this loan is variable.

The Board Report addressed loans of this nature, that is, loans with variable rates as follows:

> *"For all of variable rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate. When setting distribution rates at rebasing these debt rates will be adjusted regardless of whether the applicant makes a request for the change."* [10]

In its Reply the Applicant acknowledged that its long-term debt rate will conform to section 2.2.1 and appendix A of the Board Report. Therefore the Board expects Sioux Lookout to use the deemed rate of 6.1% for long term debt.

LINE LOSSES

Sioux Lookout is seeking approval for a total loss factor ("TLF") of 1.0642 based on an underlying distribution loss factor ("DLF") of 1.0594 and a Supply Facilities Loss Factor ("SFLF") of 1.0045. In response to an interrogatory, Sioux Lookout replied that it based this proposal on the average of loss factors over the 2002 to 2006 period. [11]

Board staff submitted that since Sioux Lookout is embedded within the Hydro One Networks Inc. ("Hydro One") distribution system, it should be asked to provide a breakdown of losses that occur within the Sioux Lookout and Hydro One distribution systems respectively, separately. In its Reply, Sioux Lookout submitted that the losses calculated by Sioux Lookout are based solely on losses within Sioux Lookout's distribution system. It also indicated that it will continue to purchase high efficiency transformers to aid in the lowering of line losses but that it should be noted that they have a relatively low density that contributes to its line losses.

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[10] *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*, December 20, Section 2.2.1

[11] Board staff interrogatory 6.1

Board Findings

The Board accepts that low customer density on a given distribution system can result in an increased incidence of losses. The magnitude of the impact of density level is not easily discernable, but the Board accepts that there can be such an effect. In future applications, it would be helpful if the Applicant could provide more detailed information on this effect.

The Applicant's intention to continue to purchase high efficiency transformers to lower line losses is a reasonable approach at this time, but, again, the Board would expect that in future applications data showing the overall cost benefits of such an approach will be provided.

The Board has recently commented on Distribution line losses through the issuance of CDM guidelines. In the accompanying report the Board stated that it considered that the management of line losses is best dealt with in the realm of distribution system design. That would include considering system loss control within the review of Asset Management practices.

Recognizing that this is an area expected to evolve on an industry-wide basis, the Board accepts the Applicant's proposed TLF but expects that it will consider the issue of system loss in the prudent application of system design including, but not limited to, its intended use of high efficiency transformers.

DEFERRAL AND VARIANCE ACCOUNTS

The following table shows the deferral account balances Sioux Lookout is seeking to recover, as per the revised Exhibit 5/Tab 1/Schedule 3 included with the Reply.

Table 4
Deferral and Variance Accounts, April 30, 2008

1508 Other Regulatory Assets,	$84,982
1518 RCVA – Retail,	$9,205
1550 LV Variance,	$269,015
1565 CDM Expenditures and Recoveries,	$30,630
1566 CDM Contra,	($30,630)
1570 Qualifying Transition Costs,	$1,516
1572 Extraordinary Event Losses,	$6,607
1580 RSVA – Wholesale Market Service Charge	$10,203
1584 RSVA – Retail Transmission Network Charges,	($27,491)
1586 RSVA – Retail Transmission Connection Charges	($174,418)
Total	$179,619

Treatment of 1590 Transfers

Sioux Lookout is proposing to clear most of the deferral and variance accounts noted above and its December 31, 2006 balances with interest forecasted to April 30, 2008 and adjusted for a June 2007 transaction. Sioux Lookout received approval for clearing its December 31, 2004 variance and deferral account balances in May 2006 through a rate rider. However, the amounts approved for recovery were transferred to account 1590 in mid June 2007 instead of May 2006. If the Board were to dispose of the December 31, 2006 deferral and variance account balances to 1590 without adjustment for the June 2007 transaction, then the balances up to the end of 2004 would be collected a second time. However, the Applicant's proposal is to reflect the transaction of June 2007 in the December 2006 amount to be cleared to eliminate double collection.

Board Finding

The Applicant's proposal to reflect the transaction of June 2007 in the December 2006 amount is appropriate.

RSVA and RCVA Accounts – 1518, 1580, 1584, 1586, 1588

Account 1588 RSVA – Power is reviewed by the Board through a separate process. In its Reply, Sioux Lookout withdrew its request to clear account 1588 in this proceeding. Sioux Lookout also changed the balances reflected in its application in accounts 1518 RCVA – Retail, 1580 RSVA – Wholesale Market Service Charge, 1584 RSVA – Retail Transmission Network Charges, 1586 RSVA – Retail Transmission Connection Charges, and 1588 RSVA – Power. Balances in accounts 1518, 1580, and 1584 were changed by small amounts. The change in balance in account 1586 is discussed below. The account 1588 balance was changed moderately but the company is no longer seeking disposition of this account.

Under section 78 (6.1) of the *Ontario Energy Board Act 1998,* the Board is obligated to review once each quarter the balance in Account 1588, RSVA – Power. The Board has recently announced[12] that it intends to launch an initiative for the review and disposition of Account 1588 and that it will consider the use of "disposition triggers". The Board also indicated it will consider whether to extend this initiative to all of the RSVA and RCVA accounts

Board Findings

This was an area that presented considerable evidentiary issues throughout the course of the proceeding. It is clear from the record that the company's initial filing with respect to deferral and variance accounts was particularly problematic. The result was that there were significant changes to the company's evidence right up to the point where it filed its Reply. It appears as though there was a generally productive exchange of information between Board staff and the Applicant, which has resulted in a series of proposals respecting deferral and variance accounts which are coherent and can be relied upon with confidence. Except as noted below the Board accepts the ultimate proposals adopted by the company with respect to its accounts.

As noted above the Board will address the treatment of account 1588 through a separate process. The Board has also indicated that it may extend this initiative to all of the RSVA and RCVA accounts. Accordingly, the Board will make no findings with respect to accounts 1518, 1580, 1584 and 1588, pending developments in this area.

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[12] *Letter February 19, 2008, EB-2008-0046*

Account 1570

Sioux Lookout is seeking disposition of account 1570 Qualifying Transition Costs, with a balance of $1,516 as at April 30, 2008. This balance was not in evidence in the original filing and was only brought forth for disposition for the first time in the Applicant's Reply, and therefore was not reviewed by Board staff.

Board Finding

In light of the fact that the proposal for the disposition of this account was made for the first time in Reply, the Board denies the proposal. I n order to be relied upon for disposition, amounts must be available for an appropriate measure of scrutiny. Introducing the proposal to dispose of the account in Reply made that impossible.

Accounts 1550 and 1586

Board staff noted in its review of accounts 1550 LV Variances and 1586 RSVA - Retail Transmission Connection Charges that Sioux Lookout was not accounting for these accounts in accordance with Board guidance. Board staff was unclear how historic Phase I and Phase II Hydro One regulatory asset charges were accrued and which accounts were impacted. Board staff also had questions on how Sioux Lookout accounted for the 2006 EDR rate mitigation plan and the transfer of the approved regulatory asset balances to account 1590.

Sioux Lookout originally sought disposition of $384,051 in account 1550 and ($658,591) in account 1586 as at April 30, 2008. Sioux Lookout corrected its accounting in its reply submission and is now seeking disposition of balances of $269,016 in account 1550 and ($174,417) in account 1586.

Board Finding

In the course of developing the evidentiary record some very serious anomalies appeared with respect to Account 1586. In its initial filing the Applicant indicated that this account had a credit balance of $927,797 as at December 31, 2006 and $658,591 credit balance as at April 30, 2008. This is a very large amount for a utility of this size. As the evidence evolved over the course of the proceeding adjustments were made that had the effect of reducing the amount in this account to a credit balance of about $175,000. Part of this adjustment was related to a rate mitigation program that will not continue beyond the 2007 rate year.

The Board is concerned at the initial size of 1586, and the uncertainties surrounding Sioux Lookout's history with this account.

On February 19, 2008, the Board announced an initiative for the review and disposition of commodity account 1588 (RSVA-Power). The Board noted that, as part of this initiative, it will consider whether to extend this initiative to other accounts that are similar in nature, and named certain RSVA and RCVA accounts. The Board finds that it would be more appropriate to await developments in that process than to dispose of account 1586 at this time. The Board finds it appropriate to dispose of account 1550 at this time as the Board can rely on this balance with a level of confidence.

1565 and 1566

Sioux Lookout proposed to clear account 1565 CDM Expenditures and Recoveries and 1566 CDM Contra. These accounts track the expenditures for CDM, and together equal zero. These accounts were set up as a means to track the expenditures on conservation activities.

In an earlier proceeding (RP-2004-0203), distributors were granted approval to increase rates to recover the final one third of its market based rate of return ("MARR") as long as they committed to spend the equivalent amount of one year's worth of that one third of MARR on conservation programs. The approved amount for spending for Sioux Lookout was $43,447. Spending to date has been $30,630. It was unclear if the clearance of these accounts meant that Sioux Lookout had completed its spending commitment on conservation activities. In Reply, Sioux Lookout confirmed that it had completed its CDM spending commitments.

<u>Board Findings</u>

The Board will not order disposition of these accounts. These are monitoring accounts related to third tranche CDM spending. Reporting on these expenditures is done through an annual process separate from this rate proceeding.

COST ALLOCATION AND RATE DESIGN

The following issues are dealt with in this section:

- Revenue to Cost Ratios
- Monthly Service Charge
- Low Voltage Rate Adder
- Transformer Ownership Allowance
- Retail Transmission Rates – previous overcollection
- Adjustment for the 2007 changes in Wholesale Transmission Rates

Revenue to Cost Ratios

Board staff submitted that the ratios are within the ranges contained in the Board's November 28, 2007 report *Cost Allocation for Electricity Distributors* (the "Cost Allocation Report") with the exception of Streetlighting. The proposed ratio for Streetlighting is 7.3%, while the bottom of the range in the Board's report is 70%. The application increases the monthly service charge and the volumetric rate to Streetlighting by 14%, the same as for all of the other classes. However, Board staff notes that, according to the application, the bill impact is a decrease of 18.0% when considered on the Streetlighting's total bill.

In Reply, Sioux Lookout stated that it proposes not to change Streetlighting pricing until the issue of cost drivers has been resolved on a provincial level. They pointed out that to follow the Board policy would result in a substantial rate impact on the customer.

<u>Board Findings</u>

The following table shows the revenue to cost ratios contained in Sioux Lookout's informational filing in the Cost Allocation consultation and the revenue to cost ratios for the test year:[13]

[13] *Review of the Electricity Distributors' Cost Allocation Filings, Board File No. EB-20007-0667*

Table 5
Revenue to Cost Ratios (%)

Customer Class	Target Range	Informational Filing Run 2	Proposed Rates
Residential	85 - 115	97.2	95.9
GS < 50 kW	80 - 120	106.4	95.1
GS > 50 kW	80 - 180	150.6	173.0
Streetlighting	70 - 120	10.41	7.3
Unmetered Scattered Load	80 - 120	100.5	94.7

As the table discloses, with one exception, the ratios are within the ranges contained in the Board's cost allocation report[14].

However, in the case of Streetlighting there is a very wide disparity between the proposed ratio (7.3%) and the target range (70%) provided for in the Board's cost allocation report. The Applicant's proposal to maintain this ratio so far below the target range is rooted in two observations:

First, the Applicant suggests that the issue of cost drivers has not been definitively resolved. It suggests that to change this ratio now is premature. Second, the Applicant is concerned about the substantial rate impact such an adjustment would have on the effected customer.

The Board's approach to revenue to cost ratios is evolutionary. It recognizes that definitive statistics respecting these ratios are not currently available. While the Board has confidence that the ratios represented in the Cost Allocation Report are reasonable, the fact that the report provides for ranges is an indication that the Board considers that some further analysis may be needed to make specific ratios mandatory.

But the disparity here is so striking that a measure of uncertainty with respect to the data does not justify retention of a ratio that is so far removed from the target range.

[14] *Report of the Board, Application of Cost Allocation for Electricity Distributors EB-2007-0667 November 28, 2007*

In addition, the Board notes that part of Sioux Lookout's proposal in this application is an increase in the monthly service charge and the volumetric rate to Streetlighting equivalent to 14%, the same increase as for all other classes of customer. With this change, the overall bill impact to the Streetlighting customer is a decrease of 18%. This undermines the Applicant's concern about moving the revenue to cost ratio toward the target range.

The Board will not insist that the ratio be fully corrected at this time. Instead, the Board will require the Applicant, in addition to the other changes referenced in this section, to move the revenue to cost ratio to the lower end of the target range which is 70% in equal increments over the next three years.

Monthly Service Charges

Sioux Lookout's application relied upon its Cost Allocation Informational filing EB-2007-0003. The monthly service charges approved in 2006 are compared for each rate class to costs from the cost allocation model. The model identifies a floor and a ceiling within which the monthly service charge should fall. The floor and ceiling were established in the Board's cost allocation report. The monthly service charges approved for Sioux Lookout are consistent with Board policy except for the GS 50 to 4,999 kW class. For this class, the ceiling in the informational filings was $63.43 per month for GS>50 kW, which is considerably lower than the current monthly service charge of $414.94, and the proposed 2008 rate of $473.17.

In Reply, Sioux Lookout pointed out that the Miscellaneous Service Revenue is allocated to fixed charges and in the case of GS > 50 kW the amount is unreasonable.

<u>Board Findings</u>

The Board finds that Sioux Lookout's proposal as it relates to the monthly service charge applied to the GS > 50 kW rate class is in keeping with the Cost Allocation Report on Cost Allocation.

> *"In the interim, the Board does not expect distributors to make changes to the MSC that result in a charge that is greater than the ceiling as defined in the Methodology for the MSC. Distributors that are currently above this value are not required to make changes to its current MSC to bring it to or below this level at this time."*[15]

Low Voltage Rate Adder

In the Board's Decision in EB-2007-0576 the Board directed Sioux Lookout to "file a detailed plan proposing a remedy for its under-collection of ongoing Low Voltage charges levied on it by Hydro One Networks Inc."

Board Staff submitted that Sioux Lookout has complied with the Direction. Staff further submitted the allocation of low voltage cost was not exactly according to Board policy, but that the outcome is very close to the same allocation.

In its application, Sioux Lookout has calculated the Low Voltage adders to recover an estimated cost of $340,000.[16] This was confirmed in an interrogatory response.[17] The estimate was based on the charges in the previous year.[18] Hydro One has filed an application that would result in new charges to embedded distributors. The record does not contain an estimate of Sioux Lookout's costs with the rates that would apply if the Board approves Hydro One's application. Most of the rates are lower than those currently in effect, but there are also new rates proposed for certain services.

<u>Board Findings</u>

It appears that the Applicant has substantively complied with the Board's direction.

The Board finds that Sioux Lookout shall re-estimate the cost of the Low Voltage services that it receives from Hydro One, using the proposed Sub-Transmission rates in

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[15] *Application of Cost Allocation for Electricity Distributors, EB-2007-0667, November 28, 2007, pages 12-13.*
[16] Exhibit 9 / Tab 1 / Schedule 1 / page 6
[17] Board staff interrogatory 8.9(b)
[18] Exhibit 1 / Tab 1 / Schedule 13

Hydro One's application.[19] The Low Voltage Charges proposed by Sioux Lookout shall be adjusted by a uniform factor to recover the total cost of the Low Voltage services, based on the assumption that the Board will approve the rates proposed by Hydro One. The Board notes that the Low Voltage Variance Account will reflect any disparity between the ultimately approved Hydro One charges and the charges arising from the rates that are approved for those services. The Board will require documentation of the adjustment in support of Sioux Lookout's draft rate order.

Transformer Ownership

Sioux Lookout applied for approval of a monthly Transformer Ownership Allowance of $0.305 per kW based on a separate calculation which they developed independently from the costing in its Cost Allocation Informational filing. The currently approved allowance is $0.60 per kW, which is a long-standing allowance used by most distributors.

The Informational Cost Allocation model provides a calculated value of the average costs for transformation on the distribution system. This average cost is used to allocate the costs of distribution transformers to customer classes. It is also used as an estimate of the avoided costs to the utility for customers that have their own transformers. The value in Sioux Lookout's Informational filing for customer owned transformers was $0.3741 per kW.

Board staff questioned Sioux Lookout's method for determining the proposed $0.305 per kW credit. In Reply, Sioux Lookout revised its proposed credit to be that from the Information Filing of $0.3741 per kW.

<u>Board Finding</u>

The Board accepts the Applicant's revised evidence reflecting a monthly Transformer Ownership Allowance of $0.3741 per kW.

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[19] EB-2007-0681, Exhibit G2 / Tab 94 / Schedule 1 / page 2

Retail Transmission Rates – Adjustment for Previous Over-collection

In the Decision in EB-2007-0576 the Board noted that Sioux Lookout had been over-collecting Retail Transmission Service amounts, as evidenced by the credit balance of $927,797 in the variance account 1586 as at December 31, 2006 in the original application. The Board directed Sioux Lookout to file a remedy for its over-collection in its next cost of service application. In this connection, it is important to note that the existing rates charged by Sioux Lookout are consistent with the standard retail transmission service rates that all distributors were directed to implement by the Board in October 2001.

Several anomalies were found in the Applicant's original application regarding account 1586, as discussed in the Deferral and Variance Accounts section of this Decision. Adjustments were made and noted in the Applicant's Reply submission for account 1586. After these adjustments, the projected balances in the variance accounts at April 2008 are credits of $27,491 and $174,418 for Network and Connection respectively. These balances are dealt with by means of the Regulatory Asset Rate Rider.

Sioux Lookout provided a schedule of Retail Transmission Service Rates that adjust the existing rates to reduce the differential between Sioux Lookout's costs and its revenues. The schedule is shown in the following table. Sioux Lookout pointed out in its Reply that as an embedded distributor, it has costs different from those of distributors that are billed by the IESO. The adjustment factors are 0.920 for Network charges and 0.315 for Connection charges, which were determined, based on Hydro One's actual yearly charges to Sioux Lookout, using current rates.

Table 6
Retail Transmission Service Rates

Class and RTS Rate		Existing	Proposed
Residential			
Network	¢/kWh	0.0057	0.0052
Connection	¢/kWh	0.0050	0.0016
GS < 50 kW			
Network	¢/kWh	0.0052	0.0048
Connection	¢/kWh	0.0045	0.0014
GS> 50 kW			
Network	$/kW	2.1218	1.9521
Connection	$/kW	1.7882	0.5633
GS> 50 kW Interval Metered			
Network	$/kW	2.2535	2.0732
Connection	$/kW	1.9603	0.6175
GS Interval Metered > 1000 kW			
Network	$/kW	2.2508	2.0707
Connection	$/kW	1.9763	0.6225
Unmetered Scattered Load			
Network	¢/kWh	0.0052	0.0048
Connection	¢/kWh	0.0045	0.0014
Street Lighting			
Network	$/kW	1.6002	1.4722
Connection	$/kW	1.3824	0.4355

Retail Transmission Rates – 2007 Wholesale Transmission Rate Change

Sioux Lookout has forecasted an amount of $597,037 for Account 4714 ‘Charges – NW’ for the test year, compared to $569,058 in the bridge year. Similarly, the forecast amount for Account 4716 ‘Charges – CN’ for wholesale connection cost is $511,895 compared to $488,473. Board staff pointed out that the forecast wholesale cost appears to be based on constant wholesale prices.

Sioux Lookout's host distributor Hydro One is currently applying for significant changes in its rates to embedded distributors, in particular a decrease of approximately 20% in the Network Service Rate. Staff in its submission asked the Applicant to comment on whether a proactive adjustment should be made to the Network Retail Transmission Service Rates as a result of the Hydro One application. Sioux Lookout in its reply stated that it believed no further adjustment should be made, beyond the adjustment described in Table 6 above.

Board staff noted that the proposed Retail Connection rates are lower than the current approved rates by percentages ranging from 66.5% to 68.6%, which is a substantial adjustment. Sioux Lookout in its Reply stated its belief that no further adjustment should be made.

Board Findings

In its previous rates case the Board directed Sioux Lookout as follows:

> *"In its next cost of service rate application, Sioux Lookout shall file a detailed plan proposing a remedy for its under-collection of ongoing Low Voltage charges levied on it by Hydro One Networks Inc., and a remedy for its over-collection of Retail Transmission Service charges."* [20]

This direction was made because the relevant variance account, account 1586, contained a credit balance of $922,000, a very substantial amount given the size of this utility. After adjustments were made to account 1586 as noted above, the projected balances in the variance accounts at April 2008 are credits of $27,491 and $174,418 for Network and Connection respectively.

The Board considers that Sioux Lookout's proposed Retail Transmission Service Rates are responsive to its direction with regard to the issue of the previous pattern of over-collection.

With respect to the proposed reduction in the rates charged by Hydro One to Sioux Lookout, the Board does not agree with the Applicant that no further adjustment is

[20] *Decision EB-2007-0576*

warranted in Network rates. The Board directs Sioux Lookout to make a further adjustment to the Retail Transmission Service – Network rates in Table 6 to reflect the reduction in the rate that is proposed by Hydro One for Embedded Distributors. The current monthly rate is $2.52 per kW, and the proposed rate is $2.01 per kW.

The Board agrees with Sioux Lookout that no further adjustment is warranted in the Retail Transmission Service – Connection rates, and it accepts the Connection rates as proposed by Sioux Lookout that are listed in Table 6 above. The Board notes that the Account 1586 will reflect any disparity between the ultimately approved Hydro One charge for Connection service and Sioux Lookout's revenues arising from the rates that are approved for those services.

IMPLEMENTATION

The Board has made findings in this Decision which change the revenue deficiency and change the deferral and variance account balances for disposition, and therefore the proposed 2008 distribution rates. These are to be properly reflected in a Draft Rate Order as though the effective date for the new rates were May 1, 2008. However, the Board will not make the new rates effective on May 1, 2008.

The Board issued an Interim Rate Order on April 22, 2008, which allows for an effective date as early as May 1, 2008. However, as Sioux Lookout was late in filing its application, and additional time was required for the evidentiary portion of the hearing due to delays in responding to interrogatories, the Board has determined that an effective date of July 1, 2008 is appropriate in the circumstances of this case. The current, interim rates are in effect until the Board approves the final Rate Order. The incremental revenue to be collected by Sioux Lookout for the period between the effective date (July 1, 2008) and an implementation date will be calculated and a rate rider will be put into effect until April 30, 2009 to recover this amount. The Draft Rate Order must clearly indicate how these calculations were done.

In filing its Draft Rate Order, Sioux Lookout should also file detailed supporting material, including all relevant calculations showing the impact of this Decision on Sioux Lookout's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Sioux Lookout should also show detailed calculations of the revised retail transmission rates and variance account rate riders reflecting this Decision.

A Rate Order and a separate cost awards decision will be issued after the relative processes set out below are completed.

THE BOARD THEREFORE ORDERS THAT:

1. Sioux Lookout shall file with the Board a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The Draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.

2. Board staff shall file any comments on the Draft Rate Order with the Board and forward to Sioux Lookout within 20 days of the date of this Decision.

3. Sioux Lookout may file with the Board responses to any comments on its Draft Rate Order within 26 days of the date of this Decision.

4. Sioux Lookout shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, September 11, 2008.
ONTARIO ENERGY BOARD

Original Signed By

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Paul Sommerville
Presiding Member

Original Signed By

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Ken Quesnelle
Member