Ontario Energy Board

Commission de l'Énergie de l'Ontario

Ontario

EB-2007-0693

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 Wellington North Power 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

DECISION AND ORDER
August 11, 2008

BACKGROUND

Wellington North Power Inc. ("Wellington North" or the "Applicant" or the "Company") is an electric distribution utility that operates in west-central Southern Ontario with a service area of approximately 14 sq km. It serves a population of 9,000 in three urban communities – Mount Forest, Arthur and Holstein. It has 3,435 customers (2006) and it is embedded within the Hydro One Networks distribution system.

Wellington North is one of over 80 electricity distributors in Ontario that are rate 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. In an effort to assist distributors in preparing their 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 Wellington North would be one of the electricity distributors to have its rates rebased in 2008. Accordingly, Wellington North filed on October 31, 2007, a cost of service application based on 2008 as the forward test year.

Wellington North requested a revenue requirement of $2,260,402 to be recovered in new rates effective May 1, 2008. The application indicated that the existing rates would produce a revenue deficiency of $680,735 for 2008. The resulting rate increase was estimated as 58.1% on the distribution component of the bill for a residential customer consuming 1,000 kWh per month.

The Board assigned the application file number EB-2007-0693 and issued a Notice of Application and Hearing dated November 19, 2007. The Board approved three interventions in the proceeding: one from Energy Probe Research Foundation ("Energy Probe"); another from the School Energy Coalition ("SEC"); and the third from the Vulnerable Energy Consumers Coalition ("VECC"). All three were active in submitting interrogatories and arguments. Board staff also posed interrogatories and made submissions. Wellington North's reply argument was filed on March 28, 2008.

The complete 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 submissions filed by Board staff, Energy Probe, SEC and VECC:

- Load Forecast
- Operating, Maintenance & Administrative Expenses
- Payments in Lieu of Taxes
- Capital Expenditures and Rate Base
- Cost of Capital
- Cost Allocation and Rate Design
- Deferral and Variance Accounts

LOAD FORECAST

Wellington North's load forecast for weather-sensitive loads was developed by multiplying a consumption estimate and a customer number forecast. Wellington North used the 2004 normalized average use per customer ("NAC") by customer class based on data provided by Hydro One Networks Inc. ("HONI").

Average Use

Board Staff noted that Wellington North's model utilized weather-corrected load for 2004 and invited Wellington North to comment on the appropriateness of using only a single year of historical load to develop a load forecast. In its reply, Wellington North acknowledged that, while a multi-year weather-normalized NAC may be helpful, the cost would be prohibitive and may involve a significant delay in getting the results. Wellington North stated that it believed the approach it used was reasonable and yielded plausible results.

Customer Numbers and kW Load

Wellington North's average annual customer growth was 1.0% from 2006 to 2008 compared to an annual average of 0.7% growth during the 2002 to 2006 period.

Board staff submitted that the forecasted growth was lower than expected based on the input data. VECC submitted that the forecasted number of customers in the GS 50-999 kW class was low when compared with 2007 actual values, and that Wellington North's 2008 load forecast should be updated to reflect both the updated customer count in this class and the increased consumption in the GS 1000-4999 kW class.

Energy Probe accepted Wellington North's forecasts except for the low number of customers in the GS 50-999 kW class and the resulting lower load. Energy Probe submitted that the revenue forecast should be revised upwards accordingly. In its reply, Wellington North acknowledged that an error had been made in the 2007 estimate for a number of classes and submitted a new 2007 estimate. Wellington North indicated that all estimates were reasonable except for the GS 1000-4999 kW class and the additional consumption in this class would not continue as a very large industrial customer continued to cut back on demand. Wellington North submitted that its filed load forecast should be accepted.

Board Findings

The Board is prepared to accept, for the purposes of this rebasing, the Applicant's load forecast. However, this approval should not be construed as specific approval of the methodology employed by the Applicant in arriving at its load forecast.

Wellington North has used a methodology that relies upon a single year of weather normalized historic load to determine future load. Wellington North noted that additional weather normalization could be undertaken for this application, but concluded that it would be too costly and time consuming. The Board's view on conclusions of this nature is that they should be included in the Applicant's evidence complete with the supporting cost to benefit analysis. This analysis has not been provided. The Board notes that the Applicant continued to supply key information in its reply argument related to the expected demand of a large customer. Supporting information central to the Applicant's proposals should be included in the pre-filed evidence as opposed to being revealed in response to interrogatories or in final submissions.

The Applicant's load forecast methodology includes little forward looking analysis of the underlying drivers. The load forecast analysis is based almost entirely on historic data. A forward test year application should include evidence that the Applicant has considered potential outcomes beyond that of the projection of its empirical knowledge. An inventory of land development proposals or the lack thereof is one example of readily available information. The inclusion of this type of information as well as the projected effects of local and provincial conservation and demand management initiatives irrespective of the degree to which it alters the forecast, demonstrates that key variables have been considered thus increasing the credibility of the forecast.

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

Wellington North's total controllable operating, maintenance and administrative expenses are summarized in the table below, which is derived from Board staff's submission:

Wellington North
Controllable Operating, Maintenance and Administrative Expenses
($)

	2006 Board Approved	2006 Actual	2007 Bridge Year	2008 Test Year
Operations	164,359	210,555	294,951	456,076
Maintenance	126,456	145,572	244,417	249,134
Billing and Collecting	283,217	257,643	239,326	262,936
Community Relations	882	1,877	5,641	5,754
Administrative and General Expenses	299,316	392,543	408,266	474,664
Total Controllable Expenses	**874,230**	**1,008,190**	**1,192,601**	**1,448,564**

The test year total controllable OM&A expenses forecast is $1.448 million, an increase of 43.7% from 2006 actual spending.

Board staff submitted that the proposed increase of 43.7% for the 2008 test year, as compared to the 2006 actual level, was the highest percentage increase requested by any of the utilities that have filed cost of service applications for 2008 rates.

In reply, Wellington North said that the cost driver review, submitted in response to a Board staff interrogatory, truly represents costs that flow from 2004 through to forecast costs in 2008 or a total of 4 years of transactions.

The Board staff submission included the following table which highlighted the five main contributors to the increase in OM&A:

Cost Drivers	Sum of 2007 and 2008 Increases
Meter Expenses	$155,985
Staffing Change	$ 67,791
Employment Equity	$ 42,136
Economic Change	$ 40,188
Regulatory Expenses	$ 35,278

The Board notes that these five cost drivers account for 77.5% of the 2008 versus 2006 increase in total controllable OM&A expenses.

Meter Expenses

Wellington North has included amounts in its 2008 revenue requirement for smart meter installation. The amount included for OM&A expenses related to smart meters is $149,792 in 2008. A full discussion of the meter capital plan, including the Board's main decision on Wellington North's smart meter plan, is included under the Smart Meters heading in the Rate Base and Capital Expenditures section of this decision.

Staffing Change

Wellington North identified a total increase in OM&A costs for 2007 and 2008 of $67,791 related to staffing changes. The utility stated that this increase was related to the creation of three additional positions: Student and Regulatory Compliance/System Analyst positions in 2005 and a Journeyman/Apprentice position in 2006. Wellington North explained that the Journeyman/Apprentice position was created in anticipation of future employee retirements.

Employment Equity

Wellington North submitted that it does not believe it will be able to attract or retain qualified people if its compensation rates are not competitive with the market.

In its application, the utility provided evidence on its Employment Equity Plan ("Plan") and it stated that its Board of Directors had retained the services of Barcon Consulting to undertake an Employment Equity Review, the results of which recommended increases to current employee salaries. The three phase implementation of the Plan resulted in a total proposed increase of $42,136 in OM&A costs from 2006 to 2008.

In response to a Board staff interrogatory, Wellington North filed the Plan in confidence and provided a redacted version to parties involved in this proceeding. By letter dated January 15, 2008, Wellington North requested that the Plan be treated as confidential, in accordance with the Board's Practice Direction on Confidential Filings.

In its Decision on Wellington North's request that the Plan be held under the Board's confidentiality protection, the Board noted that Wellington North had filed a new redacted version of the Plan in an attempt to accommodate Board staff and VECC through a progressive narrowing of its confidentiality claim and the aggregation of certain information so that individual inputs could be protected without any loss in the probative value of the material. The Board determined that it was prepared in the very narrow circumstances of this case to accede to the utility's request to extend the protection of confidentiality to areas of the Plan specified in the Decision.

In its submission, Board staff stated that, in comparing Wellington North's adjusted wages to the "Minimum of Comparators" as provided in Appendix C of the Plan, its wage rates are higher in each classification, and in two cases as much as 18% and 24% higher than the minimum of the comparators. Board staff noted that a comparison based on the minimum of comparators is appropriate due to the similarities between Wellington North and the minimum comparators in terms of both utility size and number of employees.

VECC agreed with Board staff's observation that the pay equity adjustments appeared to be higher than required based on the comparators.

In its reply submission, Wellington North did not respond directly to comments of parties, but stated that, although the comparator information for all positions was included in the report, only the lineman job rate was used. Wellington North said that this was done since the lineman rate was the only position for which it was confident that its employees' responsibilities were comparable to the comparators. The entire pay equity scale was adjusted upwards so that the lineman rate was the average of the comparators to create the internal equity salary scale.

Economic Adjustment

Wellington North has projected economic adjustment increases of 3% and 4% for 2007 and 2008 resulting in increases of $17,025 and $23,163 in OM&A costs respectively.

In its submission, Board staff noted that it was not clear whether the economic increases in 2007 and 2008 represented only labour costs or were applicable to OM&A costs as a whole.

Intervenors also expressed concerns over the utility's economic increases. Energy Probe said that Wellington North's salary and wage increases were significantly above inflationary levels for

2005 through to 2007. In Energy Probe's view, an increase of 4% is not appropriate. Instead, Energy Probe argued that the Board should approve a 2% increase which it considered equal to the rate of inflation for that time period. VECC agreed that Wellington North's proposed increases in compensation costs appeared excessive but did not propose a specific adjustment. SEC also agreed that the adjustments were excessive and expressed the concern that no explanation as to the rationale for the level of the economic adjustments was provided.

In its reply submission, Wellington North did not respond directly to intervenor comments, but clarified that the economic increase is only related to labour costs. The utility further stated that, in an attempt to attract and retain employees, it is utilizing industry benchmarks to establish compensation levels.

Regulatory Expenses

Wellington North has requested a recovery of regulatory expenses of $35,148 in 2008. This amount is one third of the total forecasted regulatory costs for the present proceeding which will be recovered over three years. VECC and Energy Probe both stated that they agreed with the utility's proposal to spread the cost of the current application over three years.

In its reply submission, Wellington North noted that it did not anticipate the number of intervenors in this proceeding, the degree of their involvement, or the volume of interrogatories that resulted, as well as having had to retain legal representation regarding the procedural orders. As a result, Wellington North submitted that it may have underestimated the costs associated with this application.

<u>Other Expenses</u>

Intervenors also raised a number of other concerns regarding specific aspects of Wellington North's expense claims:

2007 Actual Expenses

Energy Probe expressed an overall concern that Wellington North's 2008 OM&A forecast amounts were too high. Energy Probe noted that Wellington North had forecast its 2008 OM&A expenses based on its 2007 forecast. However, in response to one of Energy Probe's interrogatories, Wellington North submitted that its actual 2007 OM&A costs were $66,059 less than its 2007 OM&A forecast amounts. Energy Probe submitted that any difference between actual 2007 OM&A costs, as compared to the forecast, should be used to adjust the 2008 forecast.

Wellington North responded that it was inappropriate to assume the variance between the 2007 forecast and 2007 actual should be used to adjust the 2008 Test Year forecast and that the 2008 forecast was not solely based on the 2007 Bridge Year projection. Wellington North's view was that the forecast amounts outlined in its application were the best estimates available at the time of its application.

Travel Expenses

SEC expressed concern regarding the 2006 increase in travel expense ($7,522) which is carried forward to 2007 and 2008, with slight inflationary increases in each of those years. In response to a Board Staff interrogatory, Wellington North explained that the costs were for various processes including 2006 EDR workshops, cost allocation, smart meters, and organized meetings dealing with the consistent filing of Reporting and Record Keeping Requirements. However, SEC noted that no explanation was given as to why travel expense would continue at an elevated level in 2008. Accordingly, SEC submitted that 2008 travel expense should be reduced by $7,522.

Wellington North responded that there are ongoing Board initiatives that its staff are expected to attend including third generation IRM, rate design, and electricity service quality. The utility submitted that its 2008 travel expenses should not be reduced, as it does not expect travel costs to decline.

Vehicle Repair and Maintenance Expenses

Energy Probe submitted that there should be a reduction in repair and maintenance costs associated with vehicles because of the replacement in 2007 and 2008 of aging vehicles that are fully depreciated. Energy Probe claimed that the OM&A costs associated with the new vehicles should be less than those for the aging vehicles that are being replaced. However, Energy Probe stated that since maintenance and repair costs are not tracked separately, it could not provide an estimate of the reduction in OM&A costs that should be made. Energy Probe requested that the Board ask Wellington North to provide the historical information needed in order to determine a reduction in these costs.

Wellington North responded that vehicle expenses, including regular routine maintenance, insurance, licensing as well as fuel costs, are not expected to decline with the acquisition of replacement vehicles. Therefore, the utility submitted that OM&A forecasted costs associated with rolling stock should not be adjusted.

Capitalization of Labour Costs

Energy Probe observed that Wellington North has forecasted a significant reduction in the percentage of its labour costs that are capitalized. Based on the response to an Energy Probe interrogatory, the percentage of capitalized costs dropped from 18.0% in 2006 to 8.6% in 2007 and then increased slightly to 10.2% in 2008. Energy Probe noted that the response also provided an updated estimate for 2007 of 14.3%. Energy Probe submitted that the Board should adjust the capitalization forecast for 2008 to reflect the same percentage as shown in the 2007 updated estimate, or 14.3%, thereby reducing the 2008 revenue requirement.

In its Reply, Wellington North noted that it is only following the direction given by the Board in its Accounting Procedures Handbook and that following Energy Probe's direction would be arbitrary.

Board Findings

The Board does not consider the nature and quality of the evidence contained in the original application to be commensurate with what is expected to support the magnitude of the increase in revenue requirement sought. The record in this case was created largely through the interrogatory process and in reply submission. This is not an efficient or productive manner in which to establish the revenue requirement of an applicant. The Board is of the view that the process would have been considerably enhanced had the pre-filed evidence contained in the application been assembled with the expectation that a full probing of the reasonableness of the planned spending would occur.

Throughout Wellington North's submissions, references are made to the role of its Board of Directors. The role is characterized as having responsibility for spending control and being customer focused. The Board does not opine on the role assumed by an applicant's Board of Directors except to say that it does not consider the expressions of their intentions to in any way diminish the need for a full and cogent record to support the applicant's planned activities. The regulatory construct for electricity distribution in Ontario is based on a legislated framework that oversees the performance of the distribution activities by commercial for-profit entities which in turn are regulated by the Ontario Energy Board. This construct is based on an expectation that the Boards of Directors of the local distribution companies will assume the usual role for commercial Boards of Directors and will carry out the responsibilities contemplated by the *Ontario Business Corporations Act.* The Board of Directors for the utility has its distinct role to play. It does not, in any degree, replace or supplant the Board's independent statutory role to regulate the utility according to the requirements of the *Ontario Energy Board Act*.

Utilities bringing cost of service applications should ensure that the evidence they provide in support of their proposals is focused, competent, and detailed with respect to each element of the application. Otherwise they must expect to be unsuccessful in their proposals.

Insofar as this is the Applicant's first attempt at a forward year cost of service application, and because it falls within this early stage of the incentive rate mechanism plan, the Board is prepared to extend some latitude, with the qualifications expressed here.

For OM&A spending, applicants should develop detailed evidence supporting spending plans which include as much detail as is available for factors underpinning forecasts. For example, when advancing a proposal respecting wages and salaries, applicants should be prepared to file with their applications specific factors, incidents, and conditions relied upon to support forecast increases. Similarly, forecast spending on maintenance should be supported by detailed analysis and operational plans. Such information and analysis is required for each element of proposed spending.

The Board’s view is that in general, spending should be relatively smooth from year to year and supported by well defined needs. Where there are exceptions to the smooth pattern of spending, these variations need to be fully explained. Wellington North provided detailed submissions on the events that resulted in what it characterized as significant financial challenges and the need to postpone initiatives due to inadequate revenues. While such an occurrence may establish the basis for an increase in spending, it does not in and of itself support the actual activity that drives the increase in costs. Again, the record in this case was largely compiled through the interrogatory phase in the proceeding. The Board expects that Wellington North will strive to attain a relatively smooth pattern going forward and will fully explain any and all exceptions to this pattern in its next rebasing application.

To the extent that the record ultimately adduced is substantially supportive of the applicants planned spending, the Board will approve an increase in OM&A costs of an amount equivalent to 8.5% per year over and above the 2006 actual amount. The approved amount for 2008 OM&A is therefore $1,186,866. The Board notes that given its use of 2006 as the base year for its determination, there are no operating expenses associated with the utility’s smart meter plan captured in this 2008 OM&A allowance. This is consistent with the Board’s findings on smart meters provided elsewhere in this decision.

The Board will not stipulate how the overall OM&A budget ought to be spent, but rather will approve the amount as an envelope to be generally managed by Wellington North. The utility will be accountable for the decisions it makes in prioritizing its spending plans within the envelope as it supports its historic spending as a basis for its proposed going forward revenue requirement in its next rate application. The findings below are therefore not intended to represent specific disallowances, but rather provide the Board’s views on the specific elements of the applicant's proposals. Again, the Board has awarded a revenue requirement as an envelope and it is for the utility to determine its spending priorities within that envelope as a whole.

Metering Costs

For 2008 the Applicant is seeking an increase in metering costs in excess of $140,000. This relatively large increase is directly attributable to the Company's expectation that the metering expenses associated with smart meters will be dramatically larger than those experienced with conventional meters. Insofar as the Board has declined to approve expenditures related to smart meters until a utility has been specifically authorized by the Government to implement the smart meter program, these expenses shall not be reflected in the Company's 2008 rates.

Staffing Change, Employment Equity, and Economic Change

Wellington North's labour related costs account for over 50% of its controllable operations maintenance and administration spending. Leaving aside for the moment the question of the addition of three new positions within the company, the year-to-year increases implemented by the utility are relatively large. In 2007 there was a 15% increase in labor costs which Wellington North associated with implementation of its employment equity plan. In addition to the employment equity portion, there have been increases in salary levels over a two-year period amounting to 14%. These increases, outside of the employment equity plan, were described by the utility as "economic change".

The utility indicated that these increases are necessary to enable it to compete for skilled workers, and that it had used salary levels from neighboring utilities as a guide. With respect to employment equity the utility has presented evidence in this case reflecting the work of its consultant in arriving at what it considered to be an appropriate employment equity adjustment for 2008.

A review of the employment equity material shows that this utility appears to be the high wage payer when compared to the minimum of comparators depicted in the consultant's report. This undermines to some extent the utility's assertion that it must increase its wage rates in order to attract skilled employees. A key component in any wage comparison for utilities is the relative size of the utility compared to their geographic location, and their history. In reviewing the consultant's report, the Board concludes that the Applicant's proposals for increases associated with the general increase in wages are excessive. The Board will not make a specific disallowance with respect to this item of spending because it has determined an overall envelope amount, but it expects its concerns to be noted by Wellington North.

As noted above, a portion of the utility's proposal relates to the creation of three new positions within the utility. The Board does not opine on the need for the positions but has determined that any associated cost related to their existence fall within the overall OM&A approved envelope.

Regulatory costs

The regulatory costs incurred with respect to the instant application are unlikely to be repeated in subsequent years, prior to the scheduled rebasing. In this regard, the Board notes that Wellington North has proposed a 3-year amortization of the forecasted total amount, representing about $35,000 each year. The Board views the 2008 OM&A envelope as being inclusive of these regulatory expenses.

Capitalization

There are two types of labour costs that are normally capitalized. The labour directly involved in a capital project should be capitalized. The other component is indirect overhead that many LDCs also capitalized.

Hydro Ottawa, in its recent cost of service proceeding (EB-2007-0713), submitted evidence from several large accounting firms to justify the reduction in its capitalization rate. In that case, the dollar amount of the reduction was about $6 million. That is, there was an increase in OM&A of $6 million in 2008 compared to the prior periods. Ottawa’s experts supported the argument that under IFRS to be adopted in Canada by 2011, the amount of indirect overhead that can be capitalized will be severely restricted. The Board agreed.

In its pending 2008 application, Hydro One has also applied for a much lower capitalization rate. In 2006 they used 17% supported by a study from Rudden. The proposed 2008 capitalization rate is around 6%. HONI calculates a variance related to actual versus budget for the dollar amounts capitalized. In the Board’s 2006 decision it identified that HONI would come back to the Board in a future proceeding to deal with the variance for 2006. There is a 2 year lag in the reconciliation process. The variance appears in the 2008 application.

Wellington North has proposed to significantly decrease the percentage of salaries and wages which are capitalized in 2007 and 2008. From a 2006 level of 18%, the percentage of salaries and wages capitalized in 2007 is slated to fall to 8.6% in 2007 and 10.2% in 2008. In an interrogatory response the Company revised its 2007 Bridge year percentage to reflect a 14.3% capitalization of salary and wages.

In light of the Board’s decision in the Hydro Ottawa case cited above, the Board approves the Applicant’s proposal with respect to capitalization rate.

Travel expenses

Wellington North has indicated that its travel expenses were primarily related to the preparation of the instant application. The Board considers that the active participation of utilities in regulatory consultations and industry initiatives is an important ongoing element of utility business. Accordingly, the Board believes there should be an ongoing budget for such expenses.

Vehicle expenses

The utility has embarked on a program of renewing its rolling stock. Its existing vehicular equipment has reached a point where it has been fully depreciated and, in the opinion of the utility, is in need of replacement. The utility has in fact made purchases of particular equipment, and plans to make one additional purchase in 2008 for $130,000. It is simply counterintuitive that the purchase of this new rolling stock will have no measurable effect on the maintenance costs associated with these vehicles. On the other hand, the Board notes that some of the other expenses associated with the vehicles, most particularly fuel costs, have increased recently. In its submissions, Energy Probe suggested that the Board seek further information from the Applicant with respect to the detailed justification for these costs.

The Board notes that the evidentiary portion of this proceeding had closed at the time of the Energy Probe request and so it will not compel the Applicant to provide further information at this time. The Board, however, considers that the Company should expect to spend less on the maintenance of these new vehicles than has been the case in recent years with the old vehicles. The increase in fuel costs will offset this decrease to some extent, but the approved OM&A envelope shall be inclusive of a decrease in vehicle expenses.

PAYMENTS IN LIEU OF TAXES (“PILS”)

Energy Probe, SEC, VECC and Board staff made submissions on the appropriate federal income tax rate for 2008, the utilization of loss carry-forwards, and interest expense deductibility. In its reply submission, Wellington North provided revised figures for its 2008 PILs. The original application sought a grossed-up PILs proxy of $25,687 to be included in rates. The revised request is $14,243.

In calculating PILs amounts, the starting point is the derivation of regulatory net income based on a Board-approved rate base, the equity component, and the return on equity. To this number there are many possible additions and deductions to arrive at taxable income. Wellington North revised several of the additions and deductions in reaching its final number.

For the 2008 test year, Wellington North revised regulatory net income, interest expense, capital lease interest and payments, and capital cost allowance.

Income Tax Rate

The applicant has used a federal income tax rate of 11% in the revised test year estimate of its PILs expense. In the original evidence it had used 11.5%.

Board Findings

The Board will accept the revised federal rate of 11%, which when added to the Ontario rate of 5.5% produces a combined income tax rate of 16.5%. The Board finds that Wellington North should incorporate all known income and capital tax changes into its PILs calculations for 2008. This approach incorporates the most current information.

Non-capital Loss Carry-forward and Carry-back

In its original evidence, Wellington North showed a 2007 non-capital loss of $286,598. In responses to interrogatories, the utility said that it did not expect to record a loss in 2007. In its reply, Wellington North revised the amounts to show that a smaller loss for tax purposes of $45,113 will be incurred in 2007.

Wellington North, in its reply, stated that it will carry back the 2007 tax loss of $45,113 to 2004 to reduce taxes paid in that tax year. It stated that there will be no loss carry-forward since the full amount of the 2007 loss will be utilized in 2004. Additionally, the applicant added the comment, “These are prudent steps to manage the tax costs of Wellington North Power with reasonable due diligence.” (Reply Submission, page 59)

In its recent decision on an application of Veridian Connections Inc. (“Veridian”), EB-2007-0879, the Board considered the carry-back of a non-capital loss. Veridian bought a licensed distributor, Scugog Hydro (“Scugog”) in 2005. Veridian applied to harmonize rates of Scugog and its main service area in the 2008 Incentive Rate Making (“IRM”) application. On the date of acquisition in 2005, Scugog had non-capital losses related to prior tax years. Veridian was able to use these non-capital losses and chose to carry-back the loss to its 2005 regulatory tax year to reduce taxes paid. The utilization of the tax losses in 2005 changed its PILs proxy incorporated into the 2006 and 2007 rates on which the 2008 IRM adjustment was based. In the decision it states:

> The Board finds that the request for an adjustment to current rates to reflect the reduction of the loss carry-forwards present in the 2006 rates is tax-related and is an anomaly. The request to rectify it does not constitute any deviation from the

letter or the spirit of Z-factor adjustments permitted by the Board as documented in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*. The Board therefore approves Veridian's proposal.

Board Findings

The Board accepts Wellington North's proposal to use the 2007 loss in its 2004 amended tax return.

Interest Expense Deduction

Rate base is deemed to be financed by debt and equity. Interest expense is considered to be a flow-through cost, or a component of the blended cost of capital, or return on rate base. Regulatory taxes are based primarily on the shareholder return on the deemed equity portion of rate base. The shareholder return is deemed to be the regulatory net income after interest and taxes. Therefore, interest is added to the return in the calculation of revenue requirement; it is not a deduction from this return.

In the 2006 EDR Handbook and the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* ("Board Report"), the interest expense deemed to have been deducted in the calculation of regulatory net income was the maximum of the deemed or actual interest. To the extent that actual interest exceeded deemed interest, the excess was used as an additional deduction in the PILs income tax calculations. (Handbook section 7.2.6 and schedule 7-3, 2006 EDR PILs model, Tab Test Year Taxable Income, line 395.)

In March 2007, the Ontario government introduced tax measures to limit the deduction of interest expense in computing the PILs payments to be made to the government. While the regulations have not been released to enact these changes in tax rules, it is more likely than not that the proposed changes will become law. The government's interest deduction limitation seems to reflect the Board's deemed interest concepts.

Wellington North calculated one example of the deemed interest in this application to be $188,037 and its forecast actual interest to be $150,530. However, in its pro-forma 2008 income statement the forecast interest expense totals only $127,468.

Deemed interest will be based on the Board's findings on rate base, capital structure, and debt rates for the long and short term debt components of the capital assumptions in this case. From the current evidence, the maximum deduction that would be allowable in the calculation of actual PILs appears to be $188,037. The forecast interest is less than this amount.

Board Findings

In the absence of precise instructions from the Ontario government, the Board will consider the deemed interest resulting from its decision in this case to be the deemed interest to be used in the derivation of PILs income tax expense. There will be no excess interest penalty in the PILs proxy calculations since excess interest cannot be deducted in the actual PILs calculations under the rules proposed by the government. In addition, Wellington North's forecast interest is less than deemed.

In the revised evidence provided in the reply submission, the Company has deducted more interest than it added back. The Board does not approve of this approach.

In other 2008 decisions, the Board has directed the applicant to remove the interest expense addition and deduction in the PILs calculations. (see for example, Oshawa Revised Rate Order Decision EB-2007-0710). The Board so directs Wellington North. The Board's policy is explicit in Chapter 7, and on Schedule 7-3, of the 2006 EDR Handbook.]

Capital Lease Interest Expense and Payments

Wellington North introduced capital lease interest expenses and payments to the 2008 test year PILs calculations. Wellington North added back the interest expense related to capital leases but did not deduct the capital lease payments.

Board Findings

The Board has no evidence to rely on and therefore will not accept the addition of $7,717 in the PILs calculations.

Tax Returns

Wellington North indicated in its reply submission that it intends to file amended tax returns with the Ontario Ministry of Finance for at least the 2004 tax year in order to utilize a loss carry-back arising in 2007. In its Capital Cost Allowance evidence for actual 2006, the Company indicated it did not use class 47 for additions to the distribution system even though class 47 has been available since February 23, 2005. Since the Company intends to file amended tax returns for prior year(s), it should consider the additional deductions possible from using class 47 in 2005 and in 2006. This may change the evidence filed in the instant proceeding.

Board Findings

The Board reminds Wellington North that it should maximize the tax deductions available. The Board requires Wellington North to file with the Board all its amended tax returns, associated schedules, and financial statements for every year that it files amended tax returns with the Ontario Ministry of Finance. While this information cannot be used in the instant proceeding, the Board considers it useful to have this information available for future proceedings. Wellington North shall send copies of the amended tax returns and related documents to the Chief Regulatory Auditor immediately when available.

RATE BASE AND CAPITAL EXPENDITURES

Wellington North has forecasted capital expenditures (excluding smart meters) of $977,025 in 2008. This amount is more than double the expenditure in 2007, but of a similar order of magnitude to the amount in 2006. In each of years 2003, 2004 and 2005, the utility's annual capital expenditures were significantly lower, at about one third of what is proposed for 2008. The earlier lower expenditures fall in a period which Wellington North characterizes as one of significant financial hardship for the Company.

Rate Base

VECC noted that the rate base depends on working capital, which in turn is determined by the cost of power, and that Wellington North has not used the Board-adopted cost of $0.0543/kWh. Energy Probe made similar comments on this matter.

In its reply, Wellington North agreed to update the working capital allowance calculation to reflect the most current information of the average cost of power of $0.0543/kWh.

Energy Probe submitted that the Board working capital allowance was "overly generous" and should be reduced by the level of customer deposits held by the Company. Wellington North replied that the working capital allowance was calculated in accordance with the 2006 EDR Handbook, there is a low level of customer deposits held in trust, and that it would be an inappropriate use of the customer deposits to further reduce the working capital allowance.

VECC also noted that the Company had not adjusted its forecasted working capital allowance for the reduced cost of Hydro One's wholesale transmission charges.

Wellington North had originally planned to purchase a used digger truck in 2007. In fact, that purchase has yet to be made. VECC submitted that, because the planned digger truck had not been acquired in 2007, the amount of $130,000 should be removed from the opening balance for 2008. In response, the Company agreed to remove the amount for the truck from the opening balance, but submitted that the expenditure should be added to the 2008 Capital Expenditures, as it intends to proceed with the purchase of a suitable used vehicle if and when one becomes available. It further stated that finding a suitable used vehicle is not easy. The alternative is to purchase a new vehicle at an additional capital cost of $120,000. In its reply to VECC, Wellington North stated that an older vehicle would probably adequately meet its requirements.

Board Findings

Elsewhere in this decision, the Board has addressed the Applicant's proposal for smart meter implementation. As a result, none of the proposed additions to rate base associated with the smart meter program will be approved. This reduces the Applicant's proposal for increases to 2008 rate base by approximately 10%.

The working capital allowance proposed by the Applicant represents more than 20% of the total rate base forecast. This forecast has been calculated by the Applicant using the 15% factor applied to controllable expenses and power supply expenses. Of these two, the power supply expenses account for nearly 83% of the working capital allowance claim. Reductions in the OM&A expenses will have the effect of reducing the working capital allowance amount.

In addition, the Board notes that Wellington North has used a $57 per megawatt hour forecast in calculating its cost of power component. This figure is not consistent with the most recent forecast presented to the Board in April 2008, which was approximately $54.50 per megawatt hour. The working capital allowance will be reduced to reflect a $54.50 per megawatt hour cots of power. This is the same factor that has been used in other recent cases.

The Board also notes that Wellington North has applied a growth factor of 1.5% in calculating its working capital allowance. The Board finds that the working capital allowance shall be reduced to reflect a growth factor of 0.4%, which is consistent with the Applicant's evidence found at Exhibit 3, Tab 2, Schedule 3.

Another component of the power supply portion of the working capital allowance calculation relates to the costs incurred by the Company with respect to network and connection transmission services provided by Hydro One Networks. In its decision in October 2007, the Board reduced transmission rates by an average of 12%. As an embedded distributor, these reductions will be reflected in charges imposed by Hydro One arising from its current distribution rate application (EB-2007-0681). While that application has not been decided at the time of writing this decision, the Board requires the Company to reflect Hydro One's proposal for its new distribution rates in its forecast. The Company is directed to capture in a variance account any differences between the applied-for rate, and the rate that is ultimately approved by the Board in Hydro One's distribution rates case.

In its submissions, Energy Probe argued that customer deposits should be applied so as to reduce the amount of working capital allowance. The Board does not agree that it is appropriate to follow this approach. In the Board's view, the customer deposits represent a discrete category of funds which ought not to be intermingled with the company's working capital.

With respect to the 2008 capital plan, Wellington North’s application states that it applies a systematic and comprehensive planning process for all of its capital additions. However, the application does not contain any details as to what that the process entails beyond this descriptor. The application outlines a procedure for capital project approvals that takes place through Wellington North’s Board of Directors. However, this is only a procedure. None of the details of the individual capital projects proposed to take place in 2008, including the economics of these projects, was shared with the Board in the initial application. While disclosing a procedure is interesting and somewhat informative, it is inadequate for a regulator to make an informed judgment on the need for the capital. Through interrogatories, some of the details of the capital projects emerged, but this type of basic information should be provided up-front in the application. This Board needs to see these details in order to make an informed judgment as to the appropriateness of the capital budget’s inclusion in the revenue requirement which forms an important foundation for the 2008 rates.

In the circumstances of this case, the Board is prepared to accept Wellington North’s proposal for its 2008 capital budget and concludes that no adjustment is required. Going forward, the Board expects Wellington North to pay heed to the Board’s comments in this section.

Reliability Performance

The System Average Interruption Duration Index (“SAIDI”) and System Average Interruption Frequency Index (“SAIFI”) are measures of reliability performance. Wellington North filed annual reliability numbers for the years 2003 through 2007.

Board staff expressed concerns about the quality of data for the reliability performance indicators provided. However, most of the original figures were subsequently confirmed and additional figures were provided.

The figures indicate that, for 2007, SAIDI and CAIDI are outside of the range of performance of the previous three years.

	SAIDI	SAIFI	CAIDI
2007	0.152911	0.07683	1.989405
2006	0.037348	0.020266	1.84257
2005	0.015176	0.010264	1.478571
2004	0.084545	0.086061	0.982394
2003	0.124394	0.089697	1.386824
2002	N/A	N/A	N/A

Board staff noted that there was no evidence of the Company's efforts to maintain reliability. Wellington North responded that it monitors its performance in accordance with the Board requirements, as currently outlined in the 2006 Electricity Distribution Rate Handbook. Further, the Company indicated that it intends to use its alliance with the Cornerstone Hydro Electric Concepts ("CHEC") group to assess its reliability performance relative to other distributors of similar size.

The Company has not indicated what steps it is currently taking to improve operational reliability.

Board Findings

The Board does not consider the record of reliability statistics filed by the Company to be an adequate basis upon which to draw any specific conclusions. 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 ultimately codifying reliability standards. There are often concerns respecting the nature of the data used to develop the outcomes, and it is not clear that any of these provide anything more than guidance with respect to reliability issues.

As service reliability is most important to customers, the Board expects the Company to be vigilant in the future about its service reliability performance and data quality of the performance indicators that it gathers and to ensure service reliability indicators are used for prioritization of capital expenditures. 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.

Assessment of Asset Condition and Asset Management Plan

Board staff submitted that it was unable to assess the adequacy of the Company's plan to maintain its infrastructure and improve its performance, and it was unable to determine if it has established an Asset Management Plan on the basis of the evidence and the interrogatory responses. VECC shared the same concern.

Wellington North clarified that a report of asset condition by an external consulting firm, AESI, was conducted and completed in 2007. The Company also stated that inspections are conducted regularly and considered in its assessments. It also discussed how underground infrastructure is assessed. Wellington North stated that although it has not had an external consultant to conduct a comprehensive asset study, it nevertheless believes that it has a comprehensive process and procedure in place regarding asset management planning.

Board Findings

In other recent cases the Board has commented on the adequacy of asset management plans and programs. There is no single protocol that can serve this purpose for all utilities. Some utilities, simply because of their size, may require sophisticated data management tools to effectively track the status of their plant. In other cases, such systems are not required.

What is clear is that the primary obligation of the utility is to maintain a system that can be expected to deliver electricity within its service area safely and efficiently in a manner consistent with good utility practice and prevailing engineering standards.

The Board is satisfied on the evidence provided that the Applicant has a reasonable approach to the assessment of its plant, and that no extraordinary measures appear to be necessary at this time. The Board expects the Applicant to be informed of industry practices in this area. The Board further expects that the Applicant will include an adequate illustration of its processes intended to optimize the usefulness of its assets in its pre-filed evidence of its next cost of service application.

Smart Meters

Wellington North has proposed to include in its 2008 revenue requirement amounts related to capital and operating expenses for Smart Meter implementation. The amounts are $1,051,201 for smart meter capital expenditures and $149,792 for operating expenses.

Wellington North is 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.

Wellington North filed a smart meter plan in its 2006 EDR application and the Board authorized Wellington North to collect a smart meter rate adder amount of $0.26 per month per metered customer.

Wellington North is participating in the Cornerstone Hydro Electric Concepts (“CHEC”) and Ontario Utility Smart Meter (“OUSM”) groups. The Company stated that it intends to achieve full deployment of smart meters to all of its residential and general service < 50 kW customers by the end of 2008. While the utility does not have explicit authorization from the Ministry of Energy for smart meter deployment, it indicated that, based on a meeting of CHEC group representatives with staff from the Ministry of Energy, it expected receiving a directive from the Ministry of Energy prior to Board approval of its 2008 rate application.

Wellington North’s position is that the current smart meter rate adder of $0.26 per month is inadequate to fully fund smart meter implementation. The Company is expecting to incur third-party debt to fund its smart meter deployment in 2008, and needs adequate recovery to cover interest and principal payment of the required debt financing. The Company stated that smart meter costs should be treated no differently than any other investment in its distribution network.

Energy Probe noted that the 2008 costs related to smart meters account for over a 10% increase in Wellington North’s rate base in 2008, and that the increases should be phased in over the three-year period to 2010. Wellington North replied that, given its size, it is more cost-effective and efficient to deploy smart meters over its customer base all at one time.

Energy Probe noted that Wellington North’s operating expense forecast for 2008 assumed that the meters were in place the full year. However, the Company anticipates installing smart meters only in the last part of 2008, and hence they will be in service for an average of two months. Energy Probe suggested that allowed expenses be prorated for four months in 2008; this would allow not only operating expenses for the period when smart meters were in service, but also cover any start up and testing costs. Energy Probe also noted the 2008 smart meter expense forecasts also include expenses for 2007. SEC supported Energy Probe’s submissions.

Absent authorization to undertake smart meter activities, VECC submitted that it is premature for the Board to approve a 2008 revenue requirement assuming a significant (in this case, full) deployment of smart meters in 2008. VECC submitted that the Board should authorize a smart meter rate adder for 2008 distribution rates and that the Applicant should continue to track costs in the Board-approved deferral/variance account 1555. For an appropriate smart meter rate adder, VECC suggested that it should be determined assuming full deployment in 2008, but then discounted to reflect uncertainty about authorization and completion of smart meter deployment in 2008, and suggested that the discount rate be between 50% and 75%.

In defense of its position, Wellington North said that it needs a rate adder of between 75% and 90% of the full incremental revenue requirement recovery. Otherwise, it said it will be negatively impacted in its ability to finance smart meter costs to cover the purchase, installation and maintenance costs and will face “extreme financial hardship”.

Board Findings

Wellington North's proposal contains very considerable expenditures and provisions related to the implementation of the provincial government’s smart meter program.

The Board also notes that, 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. Regulation 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 of that RFP is authorized by the Government to install smart meters within its service territory.

Notwithstanding the amended regulations which may allow Wellington North to procure and deploy smart meters as it has planned, assuming compliance with the London Hydro RFP process, in the Board's view the most appropriate approach with respect to these smart meter costs is to continue to track them in the established deferral and variance accounts for later review and disposition. This approach is sensible given the fact that it is unclear how and when this Applicant will be authorized pursuant to compliance with the regulations, and when the Applicant may be able to commence or complete its deployment of smart meters within its service area. It is also true that the Board will not authorize the disposition of deferral or variance account balances before they are audited, except in the most compelling case.

The Applicant is directed to remove the full amount in its Application 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 amounts for smart meter operating expenses in 2008 are removed from the revenue requirement. The Applicant’s 2008 rate base and revenue requirement shall be adjusted to reflect these directions.

Previously, 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 smart meter rate adder in anticipation of that authorization and rollout. 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 service area. If the funds accumulated through the rate adder mechanism are not sufficient to support a portion of the rollout, the Applicant may 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.

Depreciation expense

Wellington North, through its interrogatory responses, has adopted a reduction in depreciation expense of some $24,000 related to items other than smart meter-related assets. The 2008 depreciation expense shall be reflective of this reduction and the smart meter depreciation reduction.

COST OF CAPITAL

The Board’s guidelines for the cost of capital are set out in the Board Report. The Board Report sets out the formulas to be used to determine the return on equity and the deemed costs of long term and short term debt and sets out the process by which these figures will be updated.

Wellington North’s proposed capital structure is 53.3% debt (49.3% long-term debt and 4.0% short-term debt) and 46.7% equity.

Wellington North‘s debt consists of affiliated debt owed to the municipal shareholders debt, carrying an interest rate of 6.25%. The Company also stated that it intended to incur new third-party debt of $1,000,000 and also used the 6.25% rate for the new debt. Board staff submitted that, per the policies documented in the Board Report, the updated deemed debt rate should be used for the new debt which is forecast for 2008 but has not yet been set. Energy Probe and VECC also raised questions about the allowable rate for the affiliated debt, and submitted that the updated deemed debt rate of 6.10% announced by the Board on March 7, 2008, should apply. In reply, Wellington North agreed to use the deemed debt rate of 6.10% for affiliated and new debt.

Wellington North used a short-term debt rate of 4.77% and a return on equity of 8.68%, but acknowledged, in response to interrogatories from Board staff and VECC that these would be updated in accordance with the Board's Report. The Board announced updated cost of capital parameters on March 7, 2008, and these are reflected in the updated 2008 capital structure and cost of capital table provided by Wellington North on page 32 of it reply submission.

Board Findings

The Board finds that Wellington North's proposals for the capital structure and cost of capital are in accordance with the Board's Report and are appropriate. The table below sets out the Board's updated costs for the various components of the capital structure, which reflects the Board's recently published cost of capital parameters. Wellington North's weighted average cost of capital for 2008 is 7.19%.

Wellington North
Board-approved 2008 Capital Structure and Cost of Capital

Capital Component	% of Total Capital Structure	Cost (%)
Short-Term Debt	4.0	4.47%
Long-Term Debt	49.3	6.10%
Equity	46.7	8.57%
Preference Shares	-	
Total	**100.0**	**7.19%**

COST ALLOCATION AND RATE DESIGN

The following issues are dealt with in this section:

- Customer Classification
- Revenue to Cost Ratios
- Line Losses
- Low Voltage Costs
- Retail Transmission Rates
- Rate Design

Customer Classification

Wellington North currently has two General Service classes, both in the size range 50 – 4999 kW, distinguished by the feature that one has a time-of-use rate design. The Company has proposed to end the time-of-use feature, and at the same time introduce a size boundary at 1000 kW. The Company submitted optional Run 3 of the cost allocation model which incorporates this definition of classes.

Board staff submitted that the reclassification is consistent with a general trend away from time-of-use rates. Wellington North responded to an interrogatory concerning the impact on the customers involved, and submitted that the impact on the distribution portion of the bill would be 74.8%, but that the impact on the total bill would be 0.4% due to other offsetting changes in transmission and other costs.

Board Findings

The Board approves the Applicant’s proposal to end the time-of-use rate design feature for this rate class, and notes that the total bill impact is modest.

Revenue to Cost Ratios

The following table shows the revenue to cost ratios in Wellington North’s Informational Filing Run 3 and in its application, in columns 1 and 2. The table also shows a set of ratios that Energy Probe says would be a more just and reasonable set of ratios.

Wellington North
Revenue to Cost Ratios (%)

	Informational Filing Run 3 Col 1	Proposed Ratios Exh 8 / 1 / 2 Col 2	Energy Probe Proposed Ratios Interrogatory 39 Col 3	Target Range (Nov 28, 2007)
Customer Class				
Residential	96.5	97.3	96.5	85 – 115
GS < 50 kW	83.7	96.2	96.2	80 – 120
GS 50 - 999 kW	145.2	120.4	117.8	80 – 180
GS 1000 - 4999 kW	132.5	122.1	117.8	80 – 180
Street Lights	18.2	51.2	70.0	70 – 120
Sentinel Lights	32.4	49.7	70.0	70 – 120
Unmetered Scattered Load	107.7	97.8	100.0	80 - 120

Energy Probe’s submission includes leaving the ratio for the Residential class at the current level shown in the Informational Filing. Wellington North submitted that its proposal is intended to phase in the move to a ratio of 100%, which is a principle of the Board’s report on Cost Allocation.

SEC submitted that the ratio for the GS < 50 kW class is within the Board’s policy range in the Informational Filing, and that the proposal to increase the ratio should be rejected. SEC noted that the impact on the distribution portion of the customer’s bill is 92.4%, and 12.9% on the total bill, which is considerably higher than the impact on Residential bills.

SEC submitted that the ratio for the GS 50 – 999 kW class should be moved to 100%, instead of 120% as proposed. VECC supported the idea that the ratio for this class and also the class of larger customers should be lower, but did not provide a ratio. Energy Probe supported a ratio lower than the one in the application but still above 100% for both of the larger General Service classes, as shown in the table above.

Energy Probe suggested that increasing the ratio for Street lighting to the lower boundary of the Board's recommended range (70%) is reasonable because the owners of the streetlights are affiliates of the utility. Energy Probe stated that the additional revenue could be deployed to decrease the ratios for General Service classes with ratios above 100%, and also to the benefit of the Residential class, as noted in column 3 of the table.

SEC submitted that the ratio for Street lighting should be set at 100%, and that the additional revenue should be used to decrease the proposed revenue from the GS 50- 999 kW class with the result being a ratio of 100% for that class instead of 120% as proposed by Wellington North.

Wellington North pointed out that its proposal to increase the Streetlight Light rates to yield a ratio of 51.2% has an impact of 75.8% on the total bill, and that increasing the ratio to 70% would imply an impact of 155.9%.

All parties were supportive of the proposal to increase the ratio for Sentinel Lights, and Energy Probe made the specific submission that the ratio should be set at 70%. Wellington North noted that its proposal to increase the rates to yield a ratio of 49.7% has an impact on the total bill of 177.2%, and that Energy Probe's recommendation would have an impact of 385.4%

Concerning the Unmetered Scattered Load class, Energy Probe did not support the proposal to move the ratio from above 100% to below 100%. VECC made the same observation, and said that the ratio should be left unchanged from the status quo.

Board Findings

This aspect of the application has understandably been heavily influenced by the Report of the Board on *Application of Cost Allocation for Electricity Distributors* issued on November 28, 2007 ("Board's report on cost allocation"). The Board has adopted a practice in virtually all of the rebasing applications for 2008 rates where utilities have been obliged to move revenue-to-cost ratios to points within the ranges depicted above, wherever practicable, and closer to the range in circumstances where achieving the range would result in what is considered to be an unreasonable rate impact.

An important element in the Board's report on cost allocation was its express reservation about the quality of the data underpinning cost allocation work to date. The report frankly indicated that the Board did not consider all of the data underpinning the report to be so reliable as to justify the application of the report's findings directly into rate cases. For this reason, among others, the Board established the ranges depicted above and mandated the migration of revenue to cost ratios currently outside the ranges to points within the ranges, but not to unity. In short, the ranges reflect a margin of confidence with the data underpinning the report. No point within any of the ranges should be considered to be any more reliable than any other point within the range. Accordingly, there is no particular significance to the unity point in any of the ranges.

As is noted above, with the exception of the street lighting and sentinel lighting classes, all of the Applicant's proposed revenue to cost ratios fall within the range as provided in the Board's report on cost allocation. The Board will not approve any further movement within the ranges as requested by a number of the intervenors in this proceeding, and by the Applicant itself with respect to the Residential class.

The Board notes from the table that the only revenue to cost ratios that do not fall within the Board target range are those respecting Street lighting and Sentinel lights.

The Applicant proposes to increase the distribution rates for its Street Lighting customer, such that the total bill would increase by approximately 76%. This would have the effect of reducing the extent to which this class under contributes to the revenue requirement, from a current revenue to cost ratio of 18% to 51%. This change would still be below the Board target range of 70%.

The Board is concerned at the continuing under contribution of the Street lighting customer. The rates for 2008 shall be set so that these ratios move by 50% toward the bottom of the Board's target range. The Board accepts the Applicant's proposed ratio of 51% in 2008 and expects the Applicant to achieve the remaining adjustment in equal increments in the years 2009 and 2010. The same line of reasoning applies to the Sentinel lights customer class. The Board is concerned by the continuing under contribution of the Sentinel lights customer. The rates for 2008 shall be set so that these ratios move by 50% toward the bottom of the Board's target ranges. The Board expects the Applicant to achieve the remaining 50% move by equal increments in years 2009 and 2010.

The Board finds that the increased allocation to, and hence increased revenues deriving from the Street lighting and Sentinel lights rate classes, may be applied by Wellington North to the other rate classes as it wishes.   The Draft Rate Order, however, must clearly show how this allocation was done.

Line Losses

Wellington North proposed a Distribution Loss Factor ("DLF") of 1.0651 for 2008 based on an average of the actual DLF for the two-year period from 2005 to 2006. The resulting Total Loss Factor ("TLF") is 1.0699 and is based on a Supply Facilities Loss Factor ("SFLF") of 1.0045.

Wellington North is embedded in the Hydro One Networks Inc. ("HONI") distribution system. Board staff questioned whether the proposed DLF includes losses that occur in the HONI distribution system. Wellington North noted that the proposed DLF does not include HONI losses. Board staff pointed out that in this case, Wellington North's TLF after including losses that occur in the HONI distribution system (typically 3.4%), becomes 1.1063. Board staff expressed concern that the DLF associated with a distributor with a compact service territory as is the case with Wellington North could be as high as 1.0651.

In its reply submission, Wellington North corrected its earlier statement regarding HONI losses and confirmed that upstream losses of 3.4% are indeed included in its proposed loss factor.

Board Findings

In its reply submission, the Applicant corrected the record and confirmed that losses attributable to the HONI distribution system were in fact included in its loss calculation. This appears to resolve any outstanding issue respecting the Applicant's loss factor. The Board approves the proposed TLF for 2008 of 1.0699 as filed.

Low Voltage Costs

Wellington North forecasted a cost of $165,107 for low voltage. Board staff submitted that the cost estimate is based on the existing Hydro One Shared Line rate which is $0.633 per kW, and that this rate would be replaced with a rate of $0.58 per kW if Hydro One's current 2008 distribution rate application is approved. Wellington North stated that it does not want to presume the outcome of Hydro One's application. Both parties said that the LV variance account would be used to record discrepancies with the result that Wellington North would be held harmless either with the forecast cost or with a reduced forecast using the lower proposed rate.

Board Findings

In a number of other 2008 Cost of Service cases the Board has decided to apply the low voltage rates applied for by Hydro One in its pending distribution rates application. The Board will follow that course here. As noted above, this will result in a reduction of the low voltage rates attributable to the Hydro One connection. In the event that the Hydro One low voltage rates proposal is not approved, the difference will be recorded in a variance account and disposed of at the next appropriate opportunity.

Retail Transmission Service Rates

Board staff noted that Wellington North applied for no change in its Retail Transmission Service Rates for any class, and that the forecast cost of wholesale transmission service does not consider the fact that the host distributor Hydro One has applied for lower Retail Transmission

Service Rates that would apply to Wellington North. VECC submitted that the lower rates that Hydro One has applied for should have been assumed in Wellington North's cost forecast for at least part of the year. Energy Probe submitted that Wellington North should assume that the lower rates will be in effect through the year, and stated that the reduction would be approximately $145,000. Energy Probe's submission was made in the context of a reduction in the requirement for working capital.

Wellington North responded that the rates in question have not yet been approved. Furthermore, it said that the results of revised Hydro One rates will be reflected in variance accounts until there is an opportunity to adjust Wellington North's Retail Transmission Service Rates, for example in the 2009 IRM application.

Board Findings

As noted above there is an application by Hydro One Distribution currently before the Board for new distribution and other rates effective May 1, 2008 (Board file EB-2007-0681). Although the Board has not yet approved Hydro One Distribution's new rates, the latest available information about what Wellington North and other embedded distributors may be charged in the 2008 test year are the retail transmission rates contained in Hydro One Distribution's application.

The Board directs Wellington North to reduce its current RTS – Network Service Rate by 18% and its current RTS – Line and Transformation Connection Service Rate by 5%. Those percentages are based on the reductions in wholesale transmission rates that were effective November 1, 2007 and are similar to the reductions proposed by Hydro One Distribution in its current rates case.

RATE DESIGN

Monthly Service Charges

The proposed Monthly Service Charges are above the ceiling amounts in the Informational Filing for two classes, General Service 50 – 999 kW and General Service 1000 – 4999 kW. Board staff noted that Wellington North is proposing not to increase the Monthly Service Charge above its current approved level for the General Service 1000-4999 kW class. The comparison for the other class is affected by the proposal to re-classify customers. Board staff submitted that the Monthly Service Charge proposed for the General Service 50-999 kW class would likely be above the ceiling, if a cost allocation study were done with the new class definitions, including the 2008 costs.

SEC submitted that the proposal should be rejected with respect to the GS 50 – 999 kW class. First, SEC said that the bill impacts are higher than indicated in the application, and that the total bill impact would be 11.1%. Further, SEC said that the proposed re-classification of customers affects impact calculations and that the customers currently in the GS > 50 kW class with non-interval meters would have larger impacts than the other customers in the proposed new class. To avoid the effect of the previous (existing) classification, SEC submitted that the proposed distribution revenue from the GS 50 – 999 kW and GS 1000 – 4999 kW classes would increase by 42%, whereas for the customers in the previous GS > 50 kW Time-of-Use class, the corresponding impact is only 6.5%.

Wellington North provided a table showing how the proposed Monthly Service Charge of the GS 50 – 999 kW class is derived as a weighted average of the existing Monthly Service Charges that currently apply to the customers in the new class. The combined revenue from Monthly Service Charges from the two classes involved in the reclassification is equal to the revenue from the same customers at their existing Monthly Service Charges. The utility submitted that the resulting rate is due to the re-classification of customers.

Board Findings

The Board finds that formation of the new GS 50 – 999 kW class in a single step yields an unacceptably large impact on the customers that previously were in the GS > 50 – Regular class. The Board therefore directs that the Monthly Service Charge for the new GS 50 – 999 kW class receive a one-year phasing during 2008. In 2008, the Monthly Service Charge will be allowed to rise 50% of the way to the new level. For example, the charge has been proposed as $259.89 and the current charge is $143.89 for the GS > 50 – Regular class. The 2008 Monthly Service Charge for customers currently paying a charge of $143.89 would be $201.89 in the new GS 50 – 999 kW class. Similarly, for one year, the Monthly Service Charge for those customers moving into the new GS 50 – 999 kW class that are currently paying $1,613.17 per month would be $936.53. For the 2009 rate year, the Monthly Service Charge will be set at the full amount in the proposal.

DEFERRAL AND VARIANCE ACCOUNTS

The following table shows the deferral account balances Wellington North is seeking to recover.

Wellington North
Deferral and Variance Accounts Proposed for Disposition
(balances as at April 30, 2008)

Account #	Account Name	Balance Requested for Disposition $
1508	Other Regulatory Assets	47,692
1518	RCVA - Retail,	51,318
1525	Miscellaneous Deferred Debits	3,506
1548	RCVA - STR	671
1550	LV Variance	9,382
1562	Deferred Payments in Lieu of Taxes	116,893
1580	RSVA - Wholesale Market Service Charge	(47,203)
1584	RSVA - Retail Transmission Network Charges	(27,092)
1586	RSVA - Retail Transmission Connection Charges	(366,380)

The total balance is a credit of $211,213. Wellington North's proposal is to dispose of these balances over two years. As a result of the Board's findings below, the only accounts to be disposed of are accounts 1508, 1525 and 1550. The amounts in these accounts will be cleared by the Company, but over the period starting with the implementation date of the new rates and ending April 30, 2009.

Account 1562

Board staff submitted that that a more in-depth examination of this account may be required to determine the accuracy of the balance for disposition. Wellington North responded that it would be prepared to defer the disposition of its balance. Energy Probe noted that before the amount is recovered from ratepayers, the Board should audit the calculation. In response to Energy Probe, the Applicant stated that it had retained the services of a consulting firm to audit and determine the accuracy of account 1562 and that it feels it is appropriate to dispose of the account at this time. However, it stated that it would also be prepared to defer the disposition of the balances in this account as the Board has initiated a review of account 1562 (PILs - EB-2007-0820).

Board Findings

The disposition of this account will be deferred pending the outcome of the Board's review in the cited proceeding.

Accounts 1518, 1548, 1580, 1584, 1586, 1588

Wellington North requested the disposition of these accounts, including account 1588, RSVA power. Account 1588 is part of the Board's ongoing "Bill 23" process. The Board has announced (by letter dated February 19, 2008) 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 an extension of this initiative to all of the RSVA and RCVA accounts. Wellington North, in response to concerns raised by Board staff in regards to the February 19, 2008 letter, withdrew its application to have account RSVA 1588 disposed. However, Wellington North is still seeking disposition of the other RCVAs and RSVAs.

Board Findings

The review and disposition of the RCVA and RSVA accounts will be deferred pending the Board's review pursuant to be Bill 23 process referenced above.

Accounts 1550, 1584 and 1586

Board staff noted that it was not clear that the underlying balances in accounts 1550, 1584 and 1586 were correct. Board staff's concern was that there may be a misclassification by the utility (Board staff Interrogatory 34). The main concern is the treatment by Wellington North of historic LV charges prior to May 1, 2006 in the variance accounts. VECC submitted that the balances in these accounts should not be approved and cleared for disposition until the Board is satisfied that they are correct.

Wellington North responded that the information was misstated in the response to Board staff Interrogatory #34. It revised the interrogatory response in its reply. Wellington North said that the utility was following Board guidance and historic LV charges prior to May 1, 2006 were recorded in account 1586. In addition, the difference between the LV charges in account 4750 and LV charges billed in account 4075 was recorded in account 1550 as of May 1, 2006. Wellington North also noted that these accounts have been audited annually and no discrepancies have been found.

Board Findings

Given Wellington North's clarification, the Board is satisfied with the amount proposed for disposition in account 1550 and approves that balance for disposition.

Request for New Deferral Accounts

Wellington North originally proposed to establish three new accounts:

1. Late Payment Class Action Suit
2. Meter Data Management Repository Account
3. Future Capital Projects

Wellington North withdrew its request for the first two accounts.

Board staff submitted that requests for new accounts should be considered in light of the four regulatory principles: materiality, prudence, causation, and management's ability to control. Board staff noted that, within the electricity sector, deferral and variance accounts are generally established on a generic basis rather than on a utility-specific basis.

Future Capital Projects

Wellington North requested an account to record the annual cost of service for new assets (including depreciation and return, but not PILs). Board staff submitted that this account is analogous to including a capital investment factor in an IRM year. Board staff noted that this request may be premature as the mechanism for 3rd Generation IRM has not yet been finalized and may include a capital component.

SEC, VECC and Energy Probe agreed with Board staff. VECC also said that it is premature to approve new accounts at this time, and that such accounts should be established on an industry wide basis with a common set of rules established for the use of the accounts. Energy Probe, on the other hand, submitted that it is not clear that capital should be given special treatment during the incentive regulation period and that comprehensive incentive regulation should cover both capital costs and OM&A. Energy Probe stated that if the Board does approve a deferral account for non-rebasing years it should be symmetrical and comprehensive. Energy Probe also stated that Wellington North should not be asking for a variance account around capital expenditures for 2008.

Wellington North stated that the request for a capital projects deferral account remains necessary as the future capital expenditure mechanistic calculation for 3rd Generation IRM has not been finalized. Wellington North said that it would not use the proposed deferral account if the 3rd Generation IRM addresses this issue.

Board Findings

The Board will not approve the creation of a deferral account to capture future capital projects. As noted in the submissions of a number of the parties, the Board has embarked on an industry wide consultation respecting the third-generation IRM architecture. An important element of that consultation involves the treatment of capital spending in the context of an incentive rate mechanism. It is premature at this point to establish a deferral account in light of the Board's consultation on incentive regulation. The Board also notes that the creation of such an account should not be undertaken in the context of a single, isolated application, but only after the industry as a whole has had an opportunity to express its views.

IMPLEMENTATION

The Board has made findings in this Decision which change the revenue deficiency and the deferral and variance account balances for disposition, and therefore the proposed 2008 distribution rates. These are to be reflected in a Draft Rate Order prepared by Wellington North. This Draft Rate Order is to be developed assuming an effective date of July 1, 2008 for the new rates. The Board will order the new rates to be implemented once it issues its final Rate Order.

The Board issued an Interim Rate Order on April 24, 2008, which allows for an effective date as early as May 1, 2008. However, as Wellington North was late in filing its application, and additional time was required for the evidentiary portion of the hearing due to the sparseness of the pre-filed evidence, the Board has determined that an effective date of July 1, 2008 is appropriate in the circumstances of the case. This means that the revenue deficiency arising from this Decision from the May 1, 2008 to June 30, 2008 period is not recoverable from customers. The current interim rates will remain in effect until the Board issues a final Rate Order. The incremental revenue entitled to be earned by Wellington North for the period between the effective date (July 1, 2008) and the 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. Given the above effective date, the rate riders in connection with the disposal of the balances in the deferral/variance accounts shall be calculated in such manner so that they will reflect full recovery of the balances from September 1, 2008 to April 30, 2010.

In filing its Draft Rate Order, it is the Board's expectation that Wellington North will not use a calculation of the revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects Wellington North to file detailed supporting material, including all relevant calculations showing the impact of this Decision on its proposed revenue requirement, the allocation of the approved revenue requirement to the rate classes and the determination of the final rates. Wellington North should also show detailed calculations of the revised retail transmission rates and all rate riders reflecting this Decision. The Draft Rate Order shall also include customer rate impacts.

A Rate Order will be issued after the processes set out below are completed.

1. The Company shall file with the Board, and shall also forward to Energy Probe, SEC and VECC, 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.

2. Energy Probe, SEC and VECC may file with the Board and forward to the Company any responses to the Company's Draft Rate Order within 20 days of the date of this Decision.

3. The Company shall file with the Board and forward to Energy Probe, SEC and VECC, responses to any comments on its Draft Rate Order within 26 days of the date of this Decision.

A cost awards decision will be issued after the steps set out below are completed.

4. Energy Probe, SEC and VECC shall file with the Board and forward to the Company their respective cost claims within 26 days from the date of this Decision.

5. The Company may file with the Board and forward to Energy Probe, SEC and VECC any objections to the claimed costs within 40 days from the date of this Decision.

6. Energy Probe, SEC and VECC may file with the Board and forward to the Company any responses to any objections for cost claims within 47 days of the date of this Decision.

The Company shall pay the Board's costs of, and incidental to, this proceeding upon receipt of the Board's invoice.

DATED at Toronto, August 11, 2008.

ONTARIO ENERGY BOARD

Original Signed By

Paul Somerville
Presiding Member

Original Signed By

Ken Quesnelle
Member