EB-2008-0235

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 London 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, 2009.

BEFORE: Cynthia Chaplin
Presiding Member

Paul Sommerville
Member

DECISION AND ORDER

August 21, 2009

BACKGROUND

London Hydro Inc. (“London” or the “Company”) filed an application (the ”Application”) with the Ontario Energy Board (the “Board”) on December 8, 2008. The Application was filed under section 78 of the *Ontario Energy Board Act, 1998*, S.O 1998, c. 15 (Sched. B) (the “Act”), seeking approval for changes to the rates that it charges for electricity distribution to be effective May 1, 2009. London is the licensed electricity distributor serving approximately 145,000 customers in the City of London.

London is one of over 80 electricity distributors in Ontario 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 January 30, 2008, the Board indicated that London would be one of the electricity distributors to have its rates rebased for the 2009 rate year. Accordingly, London filed a cost of service application based on 2009 as the forward test year.

The Board assigned the application file number EB-2008-0235 and issued a Notice of Application and Hearing dated December 24, 2008. The Board approved five interventions: the Vulnerable Energy Consumers’ Coalition (“VECC”); the School Energy Coalition (“SEC”); Energy Probe Research Foundation (“Energy Probe”); London Property Management Association (“LPMA”); and the Consumers Coalition of Canada (“CCC”). No letters of comment were received by the Board regarding the Application.

Procedural Order No.1 was issued on January 26, 2009. The Board made provision for written interrogatories and a transcribed technical conference. On April 23, 2009 the Board issued Procedural Order No.2, replacing the technical conference with a supplemental round of interrogatories and providing dates for submissions. In Procedural Order No. 2, the Board also invited submissions on the need for an oral hearing. The intervenors filed submissions on June 2, 2009 and London filed a reply submission on June 5, 2009. With the exception of SEC, all parties were satisfied that the Application be considered solely through written process. The Board decided that an oral hearing was not required.

On June 10, 2009, the Board issued Procedural Order No. 3, establishing the process for written final submissions. London filed its Argument-in-Chief (“AIC”) on June 15, 2009. All intervenors filed interrogatories and made submissions in this proceeding. Board staff also posed interrogatories and made submissions. London’s reply submission was filed on July 16, 2009.

London originally requested a revenue requirement of $64,108,653, which represents an 18% increase over the 2006 Board approved amount of $54,316,006. The proposed rates were set to recover a revenue deficiency of $7,943,577. The requested revenue requirement excludes the proposed disposition of regulatory assets (a credit to be returned to customers estimated at $2.138 million, smart meter funding adder revenues of $1.75 million, and transformer allowance credit recoveries of $943K). The resulting requested rate increase was estimated as 13.1% on the delivery component of the bill for a residential customer consuming 1,000 kWh per month.

In its AIC, London proposed a reduction to its revenue requirement to $63,895,,330, reflecting adjustments primarily to rate base, operating expenses, PILs and Cost of Capital. These reflected corrections and clarifications arising from responses to interrogatories as well as announced changes to transmission and Regulated Price Plan (“RPP”) rates, and Cost of Capital parameters.

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 submissions of Board staff and intervenors, and are addressed in this Decision:

- Load Forecast;
- Operating, Maintenance & Administrative Expenses;
- Payments in Lieu of Taxes;
- Rate Base and Capital Expenditures;
- Cost of Capital and Capital Structure;
- Cost Allocation and Rate Design;
- Deferral and Variance Accounts;
- Smart Meters; and
- Implementation Date.

LOAD FORECAST

The following issues are addressed in this section:

- Load Forecast Methodology; and
- Customer Forecast

Load Forecast Methodology

London's load forecast was developed in three steps:

1. The Company developed a multivariate regression analysis of monthly wholesale purchases for the distribution system from 1996 to 2007.
2. The forecast was adjusted for losses and to produce a weather-normalized forecast using average weather conditions over this period. London explained that the total system weather-normalized load forecast was developed based on a multivariate regression model that incorporated historical load, weather, and economic data.
3. The forecasted demand for each customer class was developed using customer counts. These forecasts were then adjusted, based on the relative weather sensitivity of each class, so that the sum of the individual class forecasts equalled the total system billed kWh forecasts developed in the first two steps.

London's proposed load forecast for 2009 is summarized in the following table:

Load Forecast [1]

Rate Classes	GWh
Residential	1,091
GS<50 kW	422
GS>50 kW	1,651
Large User	200
Cogeneration	36
Streetlights	24
Sentinel Lights	1
Unmetered Load	5
TOTAL	**3,432**

LPMA and VECC were the only parties to make submissions on this matter.

[1] London's Reply Submission, page 5, para. 22, July 16, 2009

LPMA argued that using a single multivariate regression model falsely assumed all rate classes were influenced by the same set of variables and to the same degree. LPMA also argued that adding an additional explanatory variable based on the number of customers would establish a more accurate relationship to total system purchased energy. VECC concurred.

LPMA submitted that the load forecast methodology used by London also assumed the weather adjustment was proportional to each weather sensitive class, but that weather sensitive-classes, such as Residential, GS < 50kW, and GS > 50kW, would be expected to have different levels of sensitivity to the weather.

LPMA and VECC submitted that the methodology demonstrated no relationship between customer counts and the total weather normalized billed energy forecast.

For forecasts in subsequent rate applications, LPMA recommended the Board should direct London to develop more sophisticated approaches, including relating class-specific load to the number of customers in the class, and to develop normalized average use based on econometric equations.

VECC submitted that the Board should accept the results for London's 2009 load forecast, but not the methodology. VECC also submitted that the Board should direct London to work with other distributors to develop more comprehensive and integrated approaches to load forecasting, similar to the Board's direction to Toronto-Hydro Electric System Limited ("Toronto Hydro") in that distributor's previous rate application (EB-2008-0680).

In its reply submission, London submitted that its 2009 load forecast was higher than the 2008 actual load by 3.1%, and higher than the 2007 actual load by 1.3%. London submitted that the 3.1% increase from 2008 actuals may now be "overly optimistic", and requested the Board not make any further upward adjustment to its forecast.

After consideration of the submissions of Board staff and intervenors, London recommended that the Board should consider initiating a process to develop a generic load forecasting methodology. London stated that this initiative would have the objective of establishing a tested and approved methodology, similar to what was previously done for Cost Allocation, on which all applicant distributors could rely. Such an approach would contribute to efficiency and cost effectiveness of rate applications and the regulatory hearing process.

Customer Forecast

London's customer forecast was developed using the historical annual growth rate for the period from 1996 to 2007 for residential and GS<50 kW classes. The test year customer forecast for the street lights, Sentinel Lights, and Unmetered Scattered Load classes was based on the average growth rate for the period from 1999 to 2007. For the GS > 50kW, Large User and Co-generation classes, the customer forecasts for 2009 have been held at 2007 levels. London's proposed customer forecast for 2009 is summarized in the following table:

Customer Count Forecast[2]

Rate Classes	No. of Customers / Connections
Residential	131,936
GS<50 kW	12,349
GS>50 kW	1,595
Large User	3
Cogeneration	3
Streetlights	34,187
Sentinel Lights	734
Unmetered Load	1,581
TOTAL	**182,388**

Board staff submitted that the forecasted growth in customer numbers is reasonable when compared with the historical growth rates in total and by class. In their submissions, LPMA and VECC expressed concerns with the load forecasting methodology and how it is related to customer count forecasts, but made no submissions on the customer count forecasting approach.

In its reply submission, London submitted that its proposed 2009 customer count forecast should be accepted by the Board.

Board Findings

LPMA and VECC raised objections to the forecast methodology, but they did not propose any adjustments to the test year forecast. The Board will accept London's load forecast and customer count forecast.

[2] Exhibit 3 / Page 9

LPMA and VECC have raised concerns which are similar to those raised about the load forecast methodologies of other distributors. The Board expects London to consider these matters as it further refines and improves its forecast methodology. There may well be merit in London working cooperatively with other distributors to improve load forecasting, but the Board is not prepared at this time to initiate a generic process in this area.

OPERATING, MAINTENANCE and ADMINSTRATIVE EXPENSES ("OM&A")

The table below presents the components of the proposed OM&A expenses for the 2009 Test Year and compares them with previous years.

	Summary of OM&A *	2006 Board Approved	2006 Actual	2007 Actual	2008 Bridge	2009 Test Year	2008 Actual **
1	Operation	$5,460,125	$5,686,720	$6,465,055	$6,870,259	$7,180,864	$6,639,274
2	Maintenance	$5,279,935	$5,448,857	$5,779,162	$6,068,492	$6,323,653	$6,275,516
3	Billing and Collection	$3,290,054	$3,763,129	$3,815,883	$4,052,567	$4,392,700	$3,823,321
4	Community Relations	$105,686	$357,778	$380,305	$295,558	$316,579	$341,246
5	Administrative and General Expenses	$7,358,471	$8,159,437	$8,724,001	$8,983,591	$9,937,967	$9,299,334
6	**Total**	**$ 21,494,271**	**$ 23,415,921**	**$ 25,164,406**	**$ 26,270,467**	**$ 28,151,763**	**$26,378,691**
7	**year on year increase**			$ 1,748,485	$ 1,106,061	$ 1,881,296	
8	**year on year % increase**			7.5%	4.4%	7.2%	
9	**% increase 2006 to 2009**					20.2%	
10	**% increase 2007 to 2009**					11.9%	
12	* Note: 2006 and 2007 OM&A adjusted for CDM 3rd Tranche spending of $1,783,156 and $172,154 respectively. Amounts for all years exclude charitable donations. 2007 Test Year reflects $17,637 reduction (for regulatory costs) identfied on page 14 of London Hydro's Argument-in-chief.						
13	** Note: functional break-out based on Response to LPMA interrogatory no. 33.						

The proposed 2009 Test Year Total OM&A of $28,151,763 is a 7.2% increase over 2008 Bridge and a 20.2% increase over 2007 actual (after adjustments for CDM). As compared to 2008 actuals, 2009 is an increase of $1,772,000, or 6.7%.

In addition to providing an OM&A summary by function and service, London also broke out its OM&A by major expense category. This is reproduced in the following table:

OM&A by Cost Category (in $ '000)	2006 Board Approved	2006 Actual	2007 Actual	2008 Bridge	2008 Actual	2009 adj. Test Year
Labour and Benefits	$ 15,660	$ 16,703	$ 17,825	$ 18,274	$ 18,761	$ 19,394
Purchased Services	$ 3,628	$ 3,559	$ 3,793	$ 4,162	$ 4,114	$ 4,342
Materials and Supplies	$ 834	$ 957	$ 994	$ 1,041	$ 1,037	$ 1,075
Bad Debts	$ 591	$ 546	$ 535	$ 525	$ 525	$ 535
Propery Tax & Insurance	$ 1,242	$ 1,158	$ 1,115	$ 1,152	$ 1,152	$ 1,222
Facilities Maintenance and Repair	$ 954	$ 1,369	$ 1,438	$ 1,545	$ 1,602	$ 1,532
Office Equipment Services & Maintenance	$ 883	$ 944	$ 945	$ 1,029	$ 1,063	$ 1,324
Postage	$ 848	$ 877	$ 894	$ 925	$ 885	$ 975
Fleet Operations& Maintenance	$ 1,276	$ 910	$ 935	$ 1,057	$ 1,037	$ 1,080
Corporate Training & Employee Expenses	$ 545	$ 585	$ 692	$ 814	$ 640	$ 933
Rental, Regulatory and Other	$ 710	$ 861	$ 1,045	$ 937	$ 906	$ 1,006
Studies and Special Projects	$ 220	$ 86	$ 184	$ 94	$ 47	$ 109
Allocations to Capital, Billable & Other	($1,722)	($1,516)	($1,587)	($1,679)	($1,665)	($1,716)
Cost Recoveries	($4,176)	($3,623)	($3,643)	($3,605)	($3,725)	($3,658)
TOTAL	$ 21,494	$ 23,416	$ 25,164	$ 26,270	$ 26,379	$ 28,152
Source: Exhibit 4 table 7; Response to LPMA interrogatory No. 33; London Hydro Argument-in-Chief page 14						

Board staff and all intervenors, except for Energy Probe, raised concerns with the level of OM&A that London is seeking to recover in 2009 rates. Intervenors and Board staff proposed reductions both on the basis of a line-by-line analysis and from the perspective of the reasonableness of the envelope of total costs; the aggregate analyses also considered benchmarking of cost per customer and cost per Megawatt hour (MW/hr) projections.

The submissions of intervenors and Board staff addressed issues in the following areas:

- Overall Increase in OM&A
- Compensation, Labour and Benefits
- Office Equipment, Services and Maintenance, including information technology investment efficiencies
- Corporate Training and Employee Expenses
- 2009 Regulatory Costs
- Other (Insurance, Celebration Expenses and Charitable Donations)
- Cost Recoveries (including Water Billing)

Overall Increase in OM&A

<u>Envelope Approach</u>

LPMA argued that London's 2009 OM&A should total no more than $27,882,276. This amount is the product of the 2008 OM&A Actuals of $26,379,000 multiplied by the average annual increase in OM&A experienced between 2004 and 2008, which LPMA estimated to be 5.7%.[3] LPMA viewed London's 2009 OM&A as excessive, given the substantial historical increases that had averaged 5.7% annually, while inflation averaged less than 2.2% per year over that period.[4] LPMA noted that its line-by-line reductions, totaling about $549,000, result in an overall 2009 OM&A budget that equates approximately to what would otherwise be calculated using an envelope-based approach with the following parameters: (i) a 4.8% increase over 2008 actuals, with 4.8% being the increase between 2007 and 2008 actuals; or (ii) the application of a 2.3% inflation rate to 2008 Bridge OM&A excluding Labour and Benefits. The reductions from London's proposed OM&A associated with (i) and (ii) are, respectively, $524,532 and $563,329.[5]

Board staff indicated that, over the period from 2003 to 2007, London's OM&A increased by approximately 4.45% annually. Board staff noted that applying this historical annual increase of 4.45% to the 2007 actual generates a 2009 OM&A of about $27,480,000; this is about $670,000 less than what London is seeking.

Board staff also noted that, over the 2007 to 2009 period, the average annual increase is about 5.8%. This is significantly higher than the 1.5% average annual increase in the number of residential and general service customers served by London over the same period. Board staff indicated that, after normalizing for a 3% inflation rate, London's proposed 2009 OM&A shows an annual increase that is about 1.3% higher than the impact of customer additions on costs. Board staff submitted that limiting London's 2009 OM&A to the impact of inflation and customer additions would see a $670,000 reduction to London's 2009 OM&A.

In reply, London questioned the submissions which suggested the use of certain fixed inflation rates or an envelope approach to determine an overall reduction to total OM&A. London submitted that such proposals may be appropriate in certain applications, where the evidence provided is incomplete or not fully explained and supported, or where the evidence suggests that the applicant's OM&A costs are out of line with its peers or the industry in general. London stated such is not the case in this proceeding, noting that it

[3] Response to LPMA IR # 32
[4] Response to LPMA IR # 35
[5] Response to LPMA IRs # 52 and 47

provided extensive and detailed documentation and justification of all of its costs. London submitted that changes in costs occurred for many varied reasons, including inflation, customer growth, regulatory and other industry changes, changes in specific utility programs, succession planning, benefit cost changes resulting from Federal or Provincial legislation, and a number of other factors.

In particular, London disagreed with Board staff's proposal that the 2009 OM&A be reduced by $670,000, on the grounds that, by including the 2003-2005 period, Board staff's analysis failed "to reflect the more current and relative state and condition of the Electricity Distributor operating environment in Ontario since the 2006 EDR rate application process."[6] London argued that the trend analysis relied upon by Board staff is out of date and not reflective of what the Board has been reporting in its annual Yearbook of Electricity Distributors ("Yearbook") since 2005.

London also questioned Board staff's other proposal to reduce the OM&A, which calculated the increase in OM&A between 2007 and 2009 based on the impact of inflation (assumed to average 3% annually) plus the growth in customers added over that period. London viewed the proposal as flawed because: 1) the assumption that all cost increases are directly proportional to changes in the number of customers is incorrect; and 2) there is no such thing as a single inflation rate that can be applied unilaterally to all OM&A costs.

With respect to LPMA's use of the CPI to highlight increases in excess of inflation during the 2004 to 2008 period, London reiterated that the CPI average of 2.2% is substantially below the average OM&A cost increases for the utility industry as a whole in Ontario. London pointed to information published in the Board Yearbooks as showing no direct relationship between the Ontario CPI and the actual cost increases experience in the utility industry over the 2004 to 2008 timeframe.

<u>Cost per Customer and Cost per Megawatt Hour</u>

SEC submitted that "OM&A per customer" is a useful measure to determine the extent to which OM&A increases within a utility are due to growth as opposed to other inflationary factors. SEC argued that London did not fully justify the increases in OM&A per customer costs of 5.68% between 2006 and 2007, 2.88% between 2007 and 2008, and 5.67% between 2008 and 2009.

[6] London, Reply Submission, p. 11, para. 49

VECC noted the change in London's OM&A per customer from below average to higher than average compared to its cohorts over the 5-year period between 2005 and 2009. VECC pointed out that London also has the highest cost per MWh, and noted that this result is consistent with analysis that suggests that London has the lowest consumption per customer of the cohort group. VECC submitted that these comparisons indicate a utility that shows no constraint in difficult economic times and disregards the difficulties faced by its customers.[7] VECC requested that the Board remedy this situation by limiting the 2009 OM&A increase to 3.5%.

In its reply argument, London pointed to the Board's annual Yearbooks, which show that industry-wide OM&A increased by an average of 8.9% annually, from $219.95 in 2005 to $259.00 in 2007. London noted that its corresponding OM&A per customer costs, at $156.00 in 2005 and $177.00 in 2007, show an annual increase of 6.8%, less that the industry-wide average increases. London questioned VECC's assertion that, over the 5 years from 2005 to 2009, London's OM&A per customer has increased from below average to higher than average. Given that the Board has not yet published the comparative information for 2008 and 2009, London's relative standing for 2008 and 2009 cannot yet be known; consequently, London could not determine what data was used by VECC to draw such a conclusion.

With respect to VECC's assertion that London has undertaken no cost constraint efforts in difficult economic times and ignores the difficulties faced by its customers, London submitted that it is and has always been extremely concerned with the difficulties facing its customers. As detailed in its AIC, London has taken significant measures to mitigate the rate impacts on its customers. It views its implementation of energy conservation programs and customer initiatives as among the most successful of Ontario utilities, and notes its customers receive significant financial savings accruing from reduced energy consumption. In 2007 and 2009 London received the Energy Star Utility of the Year – Regional Award for its achievements in its energy conservation initiatives which, while focusing on the low income and assisted and social housing sectors of London's community, have benefited all customers.

In addition, London questioned VECC's use of OM&A per MWh both as a valid cost measure measurement tool in the electricity distribution industry and as a cost driver. Referring to its response to VECC IR # 3, London noted that OM&A per MWh can be

[7] Cost per customer amounts per response to VECC IR # 3

significantly affected by the introduction or the elimination of large consumption customers into or from a distributor's service territory.

Compensation, Labour and Benefits Costs

The table below sets out a comparison of the requested 2009 and historical Fulltime Equivalent Employees ("FTEs").

Full time Equivalent Employees (FTEs)	2006	2007	2008	2009
Executive	5	5	5	5
Directors	7	8	8.8	9
Management	32.9	31.8	31.2	34
Non-Union	38	42.4	46.7	45.5
Union	167.2	160	156.7	165.6
Union PT	9.5	15.8	18.9	19.9
TOTAL	**259.6**	**263**	**267.3**	**279**
Source: Exhibit 4 (updated) p.46 table 17				

With respect to labour and benefits costs, London indicated that its 2009 OM&A factors incorporate an inflationary impact of 3.25% on base wage costs, compared to a 3% annual increase in base wage costs from 2005 to 2008.

Board staff noted that between 2006 and 2009, the number of FTEs increased by 19.4, or 7.4% of London's workforce. Of these 19.4 FTEs, about half are related to London's succession/apprenticeship plan. Having adjusted for these 10 FTEs, Board staff concluded that the increase in FTE's from 2006 to 2009 is about 3.6%, which is consistent with customer growth.

LPMA submitted that the provision for labour and benefits in the 2009 OM&A budget should be reduced by $131,106, as the requested amount is unreasonable, especially in light of the recession. LPMA pointed to base wage increases, which have been in excess of inflation since 2004, and to the forecasted increases in 2009 (3.9% for executives and 3.25% for other employees). LPMA posited that the wage and salary provision in the 2009 OM&A should be calculated by taking the actual 2008 base salary per employee and multiplying the result by 278.9 FTEs and an inflation rate of 2.3%. Utilizing information derived from responses to SEC IR # 7 and LPMA IR # 33, LPMA submitted that this would result in a $131,106 reduction to the 2009 OM&A.

VECC noted that labour and benefits comprise 68.9% of 2009 OM&A; the provision for labour and benefits increased by 6.1%, or $1,119,650, over 2008 Bridge. VECC submitted that London should emulate what other corporations have done when faced with a no-growth situation; that is, introduce hiring constraints to keep 2009 costs at 2008 levels adjusted for inflation at 3.5%. VECC calculated that this would reduce London's 2009 OM&A by $480,059.

London took issue with VECC's suggestion that staffing levels be held at 2008 levels as such constraints would prevent the implementation of succession planning measures necessary to maintain the safety and reliability of the distribution system as its aging workforce retires.

SEC submitted that a significant portion of the $3,733,232 increase in London's labour and benefits costs between 2004 and 2009 is unexplained, and a reduction is justified. SEC noted that increasing the Board-approved labour and benefits in 2004 by the inflation rate (3.25% in 2009 and 3.0% in the other years) accounts for only $2,538,372 of the increase; $1,194,860 appears to be due to employee additions. Based on the responses to SEC IRs #19 and 10, SEC concluded that only 4.2 FTEs (of the 17.7 added since 2004) are actually charged to OM&A. On this basis the net labour and benefits cost for each FTE would be $248,491.

London submitted that SEC's analysis of labour costs is based on incorrect assumptions. In particular, London noted that SEC used an incorrect inflation factor for benefits costs. London pointed to its evidence which indicated that from 2004 to 2009 the actual costs of benefits increased by an average of about 6.44% per year[8], and not the 3% assumed by SEC. London also noted that SEC was inconsistent and selective in its use of the comparative information contained in the pre-filed evidence and interrogatory responses, concerning all of the elements which contributed to the increases in labour and benefits costs between 2006 Board-approved and 2009 test year.

With respect to SEC's and VECC's proposals that labour cost increases be limited to anticipated overall inflation, London submitted that this ignores the reality of unionized wage settlements and benefit cost increases that are in excess of general inflation.

[8] Exhibit 4 / page 9 / Table 14

Office Equipment, Services and Maintenance, including information technology investment efficiencies

London's expenditures on office equipment, services and maintenance increased by 8.9% or $84,687 in 2008, and a further 28.6% or $294,600 in 2009. London explained these increases as being due primarily to increased hardware and software maintenance costs associated with a new Customer Information System ("CIS") and other improvements. In response to Board staff IR #18, London indicated that the new CIS system is expected to allow efficiency improvements that, over time, may reduce staffing level requirements; London did not quantify the savings that would result from these investments.

Board staff and CCC noted that 2009 establishes the base rates going into three years of rate adjustments under 3rd generation IRM. Board staff and CCC submitted that London's 2009 OM&A and/or revenue requirement should be reduced by the efficiencies, productivity gains and benefits that London expects to realize over the four year period during which ratepayers are funding these information technology investments. CCC also pointed to Horizon Utilities' inclusion of similar benefits in its 2008 revenue requirement, considered under Board file number EB-2007-0697, for an analogous, significant IT system investment. CCC further argued that, in the absence of a detailed calculation of the benefits, London's 2009 revenue requirement should be reduced by $500,000. CCC also suggested that, in reply, London could propose an alternative level of reduction.

LPMA asserted that London failed to provide adequate evidence to justify the increases in office equipment services and maintenance costs, including the annual software maintenance costs associated with the new CIS. LPMA asked that the Board require London provide the contracted cost for software maintenance for 2009 in its reply argument. In the event, London did not provide the information, or if the information provided indicated a cost that was significantly lower than what was proposed in the Application, LPMA submitted that the Board should disallow the $294,600 increase in 2009.

In reply, London stated that it expected system efficiencies and improvements will result in improved customer service and a reduced requirement for future staff increases rather than a reduction to existing staffing levels. With respect to LPMA's request for additional information, London referred LPMA to the detailed evidence and the response to Board staff IR # 27.

Corporate Training and Employee Expenses

SEC, LPMA and Board staff expressed concerns with $932,900 for corporate training and employee expenses included in London's 2009 OM&A.

London's Corporate Training and Employee Expenses increased by 18.2% in 2007, 17.6% in 2008 and 14.6% in the 2009 Test Year (increases of $107,000, $122,000 and $119,000, respectively). London attributed these increases to apprenticeship and other development programs. In its responses to Board staff IR #28 and supplementary IR #106, London indicated that about $80,000 of the increase between 2007 and 2009 is related to the apprenticeship program (16 staff at $5,000 each) and the balance of $115,000 is for professional development and supervisory training programs. Board staff submitted that the increase of $115,000 over and above that incurred in 2007 for the development and training of management and supervisory staff could be cut back to mitigate the overall increase in OM&A.

LPMA pointed out that London's actual spending in 2008, as shown in the response to LPMA IR #33, was more than $170,000 less than the forecasted amount of $813,800. LPMA submitted that an increase of $292,743, or 45.7%, from 2008 actuals to the 2009 test year was unjustified. In noting that London had provided an explanation for the 14.6% increase between 2008 Bridge and 2009 Test Years, LPMA submitted that the provision for 2009 should be calculated by applying the same 14.3% increase against the 2008 actual. This would yield a 2009 Test Year provision of $733,620, which is a $199,280 reduction to London's proposed 2009 OM&A.

SEC noted that there was no explanation for the under-spending in 2008 and referencing LPMA's analysis and suggested that the 2009 budget for corporate training and employee expenses should be reduced.

In reply, London submitted that supervisory and management training programs similar to the apprenticeship programs will be required for existing senior staff who will be assuming senior positions vacated through upcoming retirements. As to the proposition that the provision for corporate training and employee expenses in 2009 should be reduced because of under-spending in 2008, London submitted that the underspend in 2008 reflected reduced staff availability and hiring levels and, as a result, spending in 2009 will likely be higher.

2009 Regulatory Costs

CCC submitted that the provision of $220,854 for regulatory costs, amortized over four years of rebasing and 3rd Generation IRM (i.e. $55,213 in the 2009 OM&A) is still overstated, despite London's update. CCC argued that the reduction of $17,000 per year does not fully reflect the avoided costs related to the fact that this Application was considered through a written proceeding, with no Technical Conference, ADR/Settlement Conference or oral hearing. CCC submitted that the adjusted amount of $220,854 should be reduced by a further $50,000.

London submitted that it had provided a detailed analysis of its current and remaining regulatory hearing costs in response to LPMA IR #53. Based upon that analysis, London argued the projected total costs of $220,854 may be understated by approximately $52,520. London noted that LPMA accepted the revised forecast of regulatory hearing costs of $220,854, amortized over four years in the amount of $55,213 per year, and submitted that the Board should approve this amount.

In response to Board staff IR # 3, London indicated that, while the 2009 budget (in account 5630) contains $25,000 for IFRS-related costs, it appears that London may actually incur costs between $50,000 and $75,000. In response to SEC supplementary IR #22, London confirmed that it is not updating its 2009 revenue requirement in this area.

Other (insurance costs, celebration expenses and charitable donations)

<u>Insurance Costs</u>

LPMA, supported by SEC, submitted that the provision for insurance costs in the proposed 2009 OM&A budget should be reduced by $56,103. LPMA pointed to London's response to LPMA IR #37, which indicated that the costs for insurance in 2009 will actually be $444,897 rather the $501,000 estimated in the 2009 budget.

London submitted it would be inappropriate to selectively update the 2009 Revenue Requirement. London stated that it is acceptable to make updates as long as the practice also allows updates which increase as well as decrease the revenue requirement. London provided some examples of factors which would increase the 2009 revenue requirement beyond the Test Year forecast.

Celebration Expenses

LPMA took issue with the inclusion of $30,000 for celebration expenses, related to London's 100th Anniversary, in the 2009 OM&A. LPMA submitted that ratepayers should not be expected to pay for what would appear to be a history lesson, in that London has not demonstrated in evidence that the celebration will provide information on safety and conservation beyond that which London already provides in the normal course of business.

London submitted that the celebration opportunity will be fully exploited to convey safety and conservation information to London's ratepayers. London noted that it has a well established track record on conservation initiatives within the City of London, and there is no reason to believe that this will not continue with the 100th anniversary celebration.

Charitable Donations

LPMA noted that London is planning to spend $50,000 on Charitable Donations in 2009. LPMA submitted that this should be increased to $75,000, to comply with to the 0.12% set out in the in Report of the Board in EB-2005-0150, and the amount should be included in London's 2009 revenue requirement.

In reply, London agreed with LPMA's proposal to increase the amount to $75,000 on condition that London's 2009 OM&A is increased by the $25,000 increment so the amount would be recovered in rates.

Board Findings

Intervenors have proposed adjustments to the level of OM&A based on trend analysis and on the basis of overall measures of cost. London has responded that these approaches are not warranted in the case of its Application, given the extent of its evidence and its cost levels relative to other distributors.

The Board finds it useful to look at OM&A levels from a number of perspectives: the specifics of the test year forecast; trends in spending over time; expectations for inflation and economic conditions; and comparisons with other distributors. London has explained a number of the cost increases it is forecasting for 2009. The Board notes that London's historical cost increases have been lower than what is proposed for the test period. While London has identified a number of current cost pressures, the Board would note that the historical period also involved significant cost pressures and change in the industry. The Board would expect London to continue to maintain a suitable level of cost discipline into the test period.

With respect to Labour and Benefits costs, the Board acknowledges London's evidence regarding the impact of labour settlements and rising benefits costs. However, the Board also expects distributors to mitigate in part the impact of these costs increases, which are higher than the general level of inflation, through other means. One approach would be to modify hiring practices and other wage costs (including executive compensation). London does not appear to have adopted such an approach other than on a limited basis. In addition, London forecasts significant increases for professional development and training in the test year. This is another area where increases could be limited to moderate the impact of wage and benefit increases. The Board finds that some reduction in these areas is warranted.

London is implementing a new CIS system, and the maintenance costs associated with the CIS hardware and software are a primary driver for Office Equipment, Services and Maintenance. London argues that the CIS system will lead to future efficiencies but these were not quantified, and London maintained there would be no impact on current staffing levels. A project of the magnitude of a new CIS system should be undertaken with an expectation of benefits and customers should begin to see those benefits reflected in rates as soon as possible. Although significant costs have been included both in rate base and OM&A for the new CIS system, no explicit benefits have been identified. The Board finds that some benefits should be imputed.

With respect to insurance costs, the Board accepts London's position that selective updating is generally inappropriate. However, it is important to use the best evidence available, and the best evidence is that insurance costs will be lower than forecast. A similar situation arises with respect to IFRS costs, although in this instance the evidence is that the costs may be higher than forecast. However, London has explicitly stated that it is not seeking to recover additional IFRS costs at this time.

The Board's conclusion is that London has not demonstrated sufficient cost control and that its overall increase in OM&A is excessive. The Board will reduce the OM&A by

$350,000. This will reduce the increase over 2008 actual from 6.7% to 5.4%, which is in line with the historical trend and still well in excess of the economy-wide inflation rate.

Cost Recoveries

London's 2009 OM&A includes $3,658,000 in Cost Recoveries, which includes revenues or credits related to Water Billing services provided to the City of London under a shared services agreement, and other miscellaneous items. The following table provides a breakout of London's Cost Recoveries.

Cost Recovery Components	2006 Board Approved	2006 Actual	2007 Actual	2008 Bridge	2009 Test Year
Water Billing	$ 3,500,004	$ 3,000,000	$3,000,000	$3,025,000	$3,050,000
Apprenticeship Tax Credits	$ -	$ 19,803	$12,986	$15,000	$28,000
Other **	$ 675,738	$ 603,481	$ 629,903	$ 565,000	$ 580,000
Total	$ 4,175,742	$ 3,623,284	$3,642,889	$3,605,000	$3,658,000
** Includes plant locate services for City of London, Control Room Servicesand Collection of Overdue Customer Account Fees					

Source: Response to Board staff IR # 32

<u>Cost Recoveries - General</u>

With respect to Apprenticeship Training Tax Credits (the "training credits"), LPMA noted that, although London agreed in its AIC with LPMA's calculation of the amount of training credits that should be included in Cost Recoveries, London did not reflect this adjustment in its revised requirement provided in the AIC.[9] LPMA submitted that the 2009 Cost Recoveries should be increased by $42,000 to reflect the agreed-to amount. LPMA also asked London to clarify why the training credits applied to only seven of the apprentices.

In its Reply Submission, London agreed that the revenue offsets for training credits should be increased from $28,000 to $70,000, and also clarified that five line worker and two control technician apprenticeship positions are eligible for the credit.

Board staff noted that the level of total cost recovery is largely constant at $3,642,000 in 2007, $3,605,000 in 2008 and $3,658,000 in 2009. Board staff submitted that the provision for Cost Recoveries in 2009 should be increased by $220,000 so that, at least

[9] The calculation is found in the response to LPMA IR # 59, and reflects the March 2009 Provincial Budget

directionally and all other things being equal, it corresponds to rate of inflation applicable to the underlying costs to provide the services. Board staff assumed a 3% inflation rate to calculate the proposed $220,000 increase. CCC and VECC concurred with Board staff's submission. SEC also noted London's confirmation that the fee charged for the service, which has not been reviewed since 2005, will be renegotiated in June 2009 at which time inflationary and other factors will be considered.[10]

London disagreed with VECC's and Board staff's submissions that the cost recovery amount in 2009 should track inflation because 83% of total cost recoveries are related to water billing. London argued that water billing revenues should be excluded from the calculation because the rates it currently charges the City of London are already above market. London noted that, by excluding the water revenues and including the agreed to $42,000 increase to the training credit, 2009 recoveries will increase 12% over 2008.

LPMA noted that actual Cost Recoveries in 2008 were about $120,000 greater than what had been forecast for 2008.[11] Compared to 2008 actuals, the Cost Recoveries forecasted for the 2009 Test Year now show a decrease of about $ 67,000. LPMA characterized this decrease as unreasonable and lacking justification. LPMA submitted that the level of 2009 Cost Recoveries should be based on the most recent information available, that being 2008 actuals. On this basis, LPMA submitted that London's 2009 OM&A should be reduced by $67,000.

London explained that the positive variance of $120,000 between 2008 actuals and 2008 bridge year forecast is largely due to a one-time, non-recurring recovery of $108,472 related to year 2005 and 2006 refunds of Scientific Research and Experimental Development costs. London indicated that this should not affect the calculation of 2009 Cost Recoveries forecasts.

Board Findings

The Board acknowledges London's agreement that the revenue offset for training credits should be increased by $42,000. This adjustment is to be incorporated in the draft rate order.

[10] Response to SEC IR # 21
[11] Response to LPMA IR # 33

The other submissions relate to the level of cost recoveries overall, but this is influenced primarily by the treatment of water billing, which is addressed directly in the next section.

Cost Recoveries- Water billing

VECC expressed concern with the provision of shared services by London to the City of London, and in addition argued for a 5% or $125,000 adjustment to the amount of revenues for the fee for service for 2009. VECC urged the Board to require an independent review of the methodology, service level agreement(s) and costing of affiliate services on the basis that: (i) base service costs increased at a lower rate than did London's; (ii) there is no Affiliate Relationships Code cost allocation methodology for determining the appropriate allocation of costs to the City of London's water services, including a return on capital deployed; (iii) there is no evidence that any of the costs for major information technology upgrades will be allocated to water services; and (iv) London's distribution ratepayers are bearing the stranded occupancy costs, of about $200,000 per year, due to the re-location of water services-related staff.

London submitted that the Board should reject VECC's call for an independent review, since the explanations and information provided in the Application demonstrate that the costing methodology and the recovery amounts for 2009 are appropriate. London further argued that its ratepayers should not be burdened with the cost of unnecessary consulting expenditures for a costing review. London based this position on its view that such a review is clearly unnecessary as the evidence establishes that costs are properly allocated, recovery fees are in excess of market rates, and distribution ratepayers continue to receive substantial benefits from the existing shared services agreement.

London also submitted, in response to VECC's comments, that: (i) rates cannot be increased more than they have been given that water billing recoveries are in excess of market and fully allocated cost-based calculations; (ii) the costing methodology is ARC-compliant; (iii) IT capital spending is due to changing requirements of the electricity industry and as such these expenditures are not chargeable to the water billing service; and (iv) the rental space vacated with the loss of $200,000 in rental income has no connection to the water billing activities, nor was it occupied by water billing staff; the space was rented by the City of London for other municipal services.

SEC questioned the validity of the underlying calculations used to prepare the water billing-related Cost Recoveries. SEC, using a cost per bill of $2.50 (or $30.00 for a year) and the 145,886 customers forecasted for 2009, calculated an expected level of cost recovery of $4,376,580. SEC acknowledged that there were fewer water accounts than electricity accounts and invited London to provide a clarification.

SEC expressed concern that London may be under-charging the City of London for the water billing services it provides. Pointing to the Water Management Study (the "Study")[12] that informs the current rate structure, SEC noted an anomaly between London's evidence and the Study, as well as recommendations in the Study that SEC views as inappropriate for rate setting purposes. In the response to SEC IR #21, London indicated that the costs charged to the City of London for water billing services were reduced in 2005, after the Study found that the rates being charged were too high and recommended certain adjustments to the calculation. In summary, taking all of its concerns into account, SEC submitted that the Water billing portion of Cost Recoveries for the 2009 Test Year should be increased by about $890,000.

London submitted that the Board should reject the proposal by SEC to increase the 2009 recovery amount by $890,000, as it is unjustified and would place the fees at approximately 39% above current estimated market rates. London pointed to its response to SEC IR #21, which indicates that London set its fees at a higher level than recommended by the Study; in 2005, London set its fee at $3.0 million while the Study recommended a market rate-based recovery of $2.1 million. London submitted that, even after accounting for inflation, the $3.0 million fee is 8% higher than the current estimated market rate.

London also referred to the response to CCC IR # 5, which provided a current calculation of the 2009 OM&A costs associated with providing the water billing services, based on a review of the associated cost elements. London noted that, while the analysis was not based upon the type of detailed costing analysis undertaken by the consultant in 2004, it does indicate that the 2009 recovery amount of $3.05 million is still in excess of the estimated cost of approximately $2.7 million to provide the service.

[12] In 2004, the City of London or London engaged BMA Management Consulting Inc. to conduct a Water Meter Management Study of the water billing services provided by London. In response to SEC supplementary IR # 32, London filed a copy of the Study on a confidential basis pursuant to the Board's *Practice Direction on Confidential Filings*.

Board Findings

The Board will approve the Company's forecast of cost recoveries associated with the water billing service it provides to the City of London. However, the Board is concerned that these cost recoveries do not seem to have increased in any significant way over the last number of years – a period during which the costs experienced by the Company have increased materially. Accordingly, the Board directs the Company to engage an independent third party to conduct a study to determine the extent to which this arrangement conforms to the *Affiliate Relationships Code* and good cost allocation practices in general. The study should also specifically address the question as to whether the water billing services are being provided at or above market rates for like services.

While the Board will not require the Company to get the approval of the intervenors for the terms of reference for this study, the Company is strongly encouraged to consult with them to ensure that the study is designed to address their concerns. Full results of the study should form part of the Company's application material for its next cost of service application.

Lost Revenue Adjustment Mechanism ("LRAM") and Shared Savings Mechanism ("SSM")

The LRAM is designed to compensate distributors for lost revenues due to CDM activities, while the SSM provides an incentive for distributors to aggressively implement CDM programs.

London is not seeking the recovery of any LRAM or SSM amounts in this application, which it submitted would amount to $617,000 in lost revenue. London also stated that it is not seeking recovery of costs for its Earth Day 2007 campaign from the established deferral account 1508 – Other Regulatory Assets, as the actual costs of $143,000 were less than the estimate of $250,000.

LPMA supported London's proposals on these matters. No other party made submissions on these matters.

Board Findings

The Board accepts London's proposals.

PAYMENTS IN LIEU OF TAXES ("PILs")

London is requesting a PILs allowance of $4,288,828.[13] The amount represents a significant reduction ($1.64 million) or -27.7% compared to 2008 and historical actuals. London's proposed PILs allowance for 2009 is composed of $3,816,043 for combined Federal and Provincial Income Taxes (including gross-up) and $472,785 in Capital Taxes. London explained that the reduction in PILs is due to: tax rate reductions; increased deemed interest due to its deemed capital structure change; lower ROE; and the impacts of class 47 CCA deductions beginning in 2005.

With respect to 2009, London notes that significant non-recurring computer software additions occurring in 2009, combined with the class 12 100% CCA deduction, would result in significant variances in regulatory PILs calculations from 2009 to 2012. London has proposed to address this by normalizing the 2009 PILs provision by reducing the class 12 CCA in 2009 from $6,739,874 to $1,684,969. The impact is thus amortized over four years (2009 rebasing and three years of 3rd-generation IRM).

In its AIC, London provided updated calculation of PILs.[14] London has revised its proposed PILs to $3,969,317, comprised of $3,496,538 grossed up Federal and Provincial Income Taxes and $472,779 Capital taxes. London has explained that the revisions to PILs reflect a correction to CCA of $12,097 (LPMA IR #43), and adjustments to Apprenticeship and Scientific Research tax credits (LPMA IR #59). Changes in net income, due to updated cost of capital parameters, also factor into the revision to PILs.

As noted, London has proposed to amortize the Capital Cost Allowance ("CCA") associated with the new CIS system. London has proposed this approach to "normalize" the PILs expense recovered over the 2009 rebasing year and the following three years of third generation IRM. London's position is that reflecting the accelerated CCA for Class 12 computer hardware and software per 2008 and 2009 Federal budgets would recover the estimated PILs expense in 2009 rates; however, Board staff noted

[13] Exhibit 4 / page 4 and pages 79-84
[14] AIC, p. 14, para. 35 to p. 16, para. 40, p. 22, para. 53 and p. 23, Exhibit 4 – Table 37 Tax Calculations

that base rates would then under-recover the expected PILs liability in 2011 and beyond, when the CCA for the new CIS system would have been used up. Under London's proposal, the CCA related to non-recurring computer hardware and software, largely portions of the new CIS system, would be estimated at $1,684,969 for each year from 2009 to 2012, while actual CCA, per current tax law, would be $3,369,937 in 2009 and 2010, and zero for 2011 and 2012.

Board staff submitted that London's proposed CCA "normalization" to balance out PILs expense is inconsistent with Board practice and policy. While the Board has allowed averaging of costs, such as regulatory expenses, over the period of rebasing and IRM, such treatment has not been allowed for PILs. The Board's practice is that the tax or PILs expense allowed is what the utility is expected to remit to tax authorities for the test rate year based on the estimated revenue requirement. London's proposal would over-recover its 2009 PILs even if, absent other tax changes, it collects about the same as it expects to remit over the four-year period until it next rebases. Board staff noted that the Board has not accepted similar "normalization" of taxes or PILs in other situations for electricity distributors; for example, where a distributor had a loss carry-forward available to reduce tax/PILs liability in the test year, the Board took it into account when setting rates for the test year. Staff also stated that it was unaware of any instances where this "normalization" has been applied to PILs calculation, although it has been applied to OM&A, regulatory assets and, in some cases, capex and efficiency gains.

LPMA also submitted that London's proposed CCA amortization or "normalization" should be rejected as London provided no examples of the Board approving such treatment in other cases. LPMA noted that scheduled tax reductions, if finalized and implemented by Federal and Provincial governments, would reduce London's tax/PILs liability post-2009 by more than the increase due to the proposed "normalization". LPMA noted that the 3rd Generation IRM plan also allows for a sharing in changes in tax rates. Finally, LPMA submitted that, subject to the materiality threshold, London could apply for Z-factor treatment for PILs under-recovery under 3rd Generation IRM.

CCC and VECC concurred with Board staff's submission.

In reply, London disagreed with the submissions of Board staff and intervenors. London noted that the CIS system, as class 12 equipment, will have accelerated depreciation (for tax/PILs purposes) for 2009 and 2010. London noted that the non-recurring amount of expenditures on the CIS system is about $6.7 million out of the total of $9.3 million.

Based on the forecast level of depreciation of $3.35 million for each of 2009 and 2010, which will be no longer available in 2011 and beyond, London estimates that the impact of the accelerated tax write-off would be rates would under-recover PILs by $829,910 in each of 2011 and 2012.

London reiterated its proposal which would spread the write-off over the four years of rebasing and 3rd Generation IRM. London stated "with the exception of annual capital expenditures, the principle and concept of normalization is a generally accepted and commonly applied principle in the derivation of the revenue requirement for rebasing applications."[15] London submitted that not adopting the proposed normalization would expose the Company to severe financial penalties (i.e. under-recovery of PILs in 2011 and 2012) beyond the ability of management to control.

Board Findings

The Board finds that, with respect to capital taxes and income taxes or PILs, London has applied Board policy and practice in an acceptable manner, with the exception of CCA amortization.

The Board will not accept London's proposal to "normalize" the PILs allowance to reflect the one-time nature of the CCA allowance for the CIS system. Normalizing or amortizing expenses over an IRM period should be an exceptional activity. The Board has routinely done it for regulatory expenses but that is because the regulatory expenses for the rebasing proceeding relate to some extent to the entire IRM period. The CCA amortization proposed by London is of a different nature. London seeks to amortize the CCA because it forecasts that its PILs in the balance of the IRM period will be substantially higher. To do so amounts to forecasting a key element of the revenue requirement beyond the test year. If the Company were to do so, then a comprehensive multi-year revenue requirement forecast would be required. The Board has little or no evidence as to future tax rates, OM&A expenditures, capital expenditures, etc; nor has London requested a multi-year cost of service. The Board finds that there is therefore no basis to grant the relief requested by London and that to do so would be inappropriate.

The Board notes that there may be changes elsewhere in the Decision, particularly with respect to rate base and capital and operating expenses, that could have flow-through impacts on taxable income and hence on the PILs allowance to be recoverable in rates.

[15] London, Reply Submission, p. 34, para. 141, July 16, 2009.

In filing its draft Rate Order, London should incorporate all known income and capital tax changes that have arisen since the application was filed into its PILs calculations for 2009. The Board also directs London to update its PILs allowance to reflect all of the findings in this Decision, and to reflect this in its revenue requirement and proposed distribution rates to implement this Decision. London should provide a summary of the PILs allowance and updated calculations in support of its draft Rate Order.

RATE BASE AND CAPITAL EXPENDITURES

London requested approval of a rate base of $225,126,695 in its Application, composed of $180,909,736 average net fixed assets and $44,214,313 for its Working Capital Allowance ("WCA"). In its AIC, London reduced its requested rate base due to minor adjustments resulting in a revised 2009 Test Year rate base of $225,124,049. This is an increase of $17,216,648 (8.28%) from London's 2007 actual and a $20,495,647 (10.01%) increase from 2006 actual.

London stated that it has completed a number of upgrades to its existing corporate software applications over the past five years including a major initiative to replace its existing CIS, Geographic Information System ("GIS"), Document Management System and an Enterprise Resource Planning ("ERP") solution. London's near completion of this system allowed London to incorporate a capital addition of $9.3 million for computer software into its rate base in 2009. The majority of this addition is due to the transfer of $6.3 million from construction work in progress ("CWIP") to capital addition. Capital spending on this project was $3.7 million in 2009.

The following areas are addressed in this section:

- Capital Expenditures; and
- Depreciation
- Working Capital Allowance

Capital Expenditures

London provided the following information on historical and forecasted capital expenditures:

Capital Expenditure

Year	2006 Actual	2007 Actual	2008 Actual	2009 Test
Total capital expenditures (excluding Smart Meters)	$17,032,522	$25,018,568	$28,309,160	$27,430,000
% change as compared to the prior year		9.64	13.15	(3.11)

London forecast 2009 capital expenditures of $27,430,000. This represents a decrease of approximately 3.11% ($879,160) compared to the 2008 actual level of $28,309,160, and an increase of approximately 9.63% compared to 2007 actual of $25,018,568.[16]

London's evidence outlined its three year capital plan summary[17]. This plan shows capital expenditures projected to be at approximately the $27.4 million level in 2009, falling to approximately $24.5 million in the 2010 test year and approximately $23.3 million in 2011. These amounts exclude spending for smart meters, which is discussed elsewhere in this Decision.

While there was general support for London's proposed capital expenditures, Board staff and intervenors made submissions on the following items:

- Computer Hardware and Software
- Distribution and General Plant – City and Developer Works, Project 9E1

Computer Hardware and Software

Board staff noted that the 2009 capital expenditures for the new CIS system are $3,702,000, which is comprised of $1.04 million for infrastructure and hardware related projects, and $2.66 million for application development projects. As the replacement system was being developed, there were similar expenditures in 2007 and 2008 of close to $3 million per annum. London provided detailed information on the multi-year project in its Application.[18] It stated that total investments for hardware, software and application development amount to $18.9 million between 2004 and 2009.[19]

[16] Response to LPMA IR #9
[17] Exhibit 2, page 56
[18] Exhibit 2 / Appendix B
[19] Exhibit 2, p. 19

LPMA noted that, when combined with the change in CWIP, London's 2009 capital spending is forecast to total $27.43 million. LPMA further noted that this capital spending is, respectively, $3 million and $4 million higher than that forecast for 2010 and 2011. LPMA submitted that the average forecasted capital spending is $25.061 million, and London's 2009 forecast is $2.369 million above this average. LPMA submitted that most of the increase in 2009 capital expenditures from the 2008 forecast and the 2008 actual level of expenditures are related to computer software. LPMA further noted that the 2008 actual level of expenditure in this category was $450,000, while the forecasted level for 2009 is approximately $9,280,000, an increase of about $8.8 million. Consequently, LPMA submitted that the Board should reduce capital expenditures for 2009 by $2.369 million, and that half of this reduction should come from the software projects, which should be delayed to 2010.[20]

London responded that the $9.3 million capital expenditures increase in 2009 related to the new SAP CIS system is a non-recurring capital expenditure, in the sense that it may only happen every 7 or 8 years. Furthermore, London stated that capital spending, by its very nature, is subject to annual fluctuations, particularly when significant expenditures, such as a new CIS system, occur. London submitted that fluctuations in year-over-year capital expenditures and additions have been fully explained throughout the evidentiary process. On this basis, London recommended that the Board reject LPMA's proposal to reduce 2009 capital spending levels by $2.369 million.

Board Findings

The Board notes that there has been confusing use of the terminology of "capital expenditures" and "capital additions" with respect to the new CIS system. Capital expenditures reflect the amounts spent in the year on capital projects, whether the investments go into service in the year or not; in the latter case they are treated as CWIP. Capital additions, on the other hand, reflect the new capital assets that go into service in the year and hence are added to rate base. Capital additions are comprised of capital expenditures that enter service in the same year that the costs are incurred plus transfers from CWIP when those assets enter service and are "used and useful".

The Board notes that the record is clear that the $9.3M for the CIS system is a capital addition in 2009, composed of $3.0M of capital expenditures and $6.3M of transfers from CWIP.

[20] LPMA Final Argument, p. 6

With that clarification, the Board finds that the proposed level of capital expenditures for computer hardware and software is acceptable.

Distributor and General Plan – City and Developer Works

London forecasted expenditures for city and developer works totaling $7,783,000. These expenditures relate to one city works project (Category D ($459,000)) and five developer works projects (Category E ($7,324,000)). London stated that city and developer works are externally driven and are, for the most part, growth-related.

Board staff noted that London's total budget for projects resulting from developer works shows an increase of $2.2 million (43%) from $5.1 million in 2008 to $7.3 million in 2009.[21] In response to Board staff IR # 2, London explained that the increase for this category in 2009 is largely due to project 9E1 – Expansion and Relocation. This project consists of a 27.6 kV line extension to service new industrial development in the City of London's "Innovation Park". The 27.6 kV line extension represents $2.3 million of the $2.8 million budget for the overall project.

VECC submitted that the Board should reduce capital expenditures for this component by $2 million, to historical or 2008 levels. VECC stated that the budget increases in this category are optimistic given the current economic situation.[22] VECC also noted that this projected expansion is inconsistent with London's customer forecast for the GS>50 kW class, since the number of customers for 2008 and 2009 is held constant at the 2007 level.

As mentioned earlier, LPMA recommended that the Board should reduce London's capital expenditures for 2009 by $2.369 million. LPMA submitted that while half of this reduction should be applied to London's software project, there is also room to reduce the capital expenditures associated with distribution and general plant by $1.2 million, as this figure represents only about 5% of the total distribution and general plant expenditures forecasted for 2009.

In reply, London submitted that it has provided detailed support for the 2009 City and Developer Works forecast in its Asset Management plan and through interrogatory responses. London further stated that capital spending projections are fully supported

21 Response to SEC Supplemental interrogatory #23, p. 10

22 VECC stated that capital plans could be subject to cancellation by third parties and hence outside of London's control.

by the Works programs of the City of London for 2009 through announced Government initiatives for municipal infrastructure improvements in Canada. Therefore, London recommended that the Board should reject both the proposal by VECC that this forecast be reduced by $2.0 million, as well as LPMA's proposal to reduce capital spending levels by $2.396 million.

Board Findings

The Board finds that London's forecast in this area is acceptable. London has provided sufficient evidence to justify the inclusion of these projects in the forecast. The Board notes intervenors' concerns that the enhancement associated with the Innovation Park may be optimistic, given current economic conditions. However, the Board considers that, given the planning cycle associated with the project and the detailed evidence provided by the Company, this expenditure should be approved. In doing so, the Board is taking into account the fact that the next cost of service application scheduled for the Company is three full years from now. It would be unfortunate if important system enhancements, which have been subject to a reasonable planning process and which have been supported by evidence as this one has, would languish awaiting the next rate setting cycle.

Depreciation

London has forecast its depreciation expense of $15.919 million for 2009. The average annual percentage change from 2006 actual to 2009 test year is a 6.04% increase.

In general, London has followed the Board's guidelines with respect to depreciation/amortization expense. London has provided explanations where its depreciation expense differs from the general Board guidelines. In response to interrogatories, London has acknowledged that it calculates depreciation expense starting when assets actually enter service rather than applying the "1/2 year rule" that is used by most distributors, whereby assets are generally assumed to enter service mid-year.

Board staff submitted that London's approach is conceptually more accurate but should not generally result in any material difference in depreciation expense. Board staff did not oppose London's proposal.

LPMA noted that, for 2009, the average depreciation rate is 4.6%. Since many distribution assets are depreciated over 25 years, LPMA saw this as being higher than expected, but also acknowledged that London has significant computer hardware and software additions in 2009 which have higher depreciation rates. LPMA concluded that London's depreciation expense was reasonable.

No other parties raised issues regarding London's depreciation expense and methodology. In its reply submission, London acknowledged Board staff's submission.

Board Findings

The Board approves London's depreciation expense, subject to any further revisions which are required as a result of the Board's findings throughout this Decision.

Working Capital

London proposed a working capital allowance ("WCA") of $44,216,959, based on the standard Board methodology of 15% of the sum of Cost of Power and controllable expenses. In its AIC, London reduced the WCA to $44,214,313 as result of reductions in Administration and General expenses, as corrected in interrogatory responses.

Generally, Board staff and intervenors accepted London's proposed WCA methodology as being consistent with Board practice and policy. Board staff submitted that the WCA should be updated at the time of the draft Rate Order to reflect the most current Regulated Price Plan "(RPP") price of $0.06072/kWh announced on April 15, 2009,.

CCC noted London's update of its WCA and that this approach has been accepted by the Board in a number of Cost of Service proceedings for other distributors. CCC accepted London's approach for this proceeding. However, both VECC and CCC noted that, for other larger utilities such as Hydro One Networks Inc. and Toronto Hydro, the WCA formula has been reduced to less than 15% of cost of power and controllable expenses as a result of recent lead-lag studies. CCC submitted that London is a larger utility and that, given that the WCA represents about 20% of rate base, a lead-lag study would be appropriate. VECC made a similar submission, stating that, because of its size, each percentage point of London's WCA formula equates to over $200,000 in revenue requirement.

Energy Probe accepted the approach used by London, as summarized in the AIC, but took the position that the 15% methodology may be overstating the required WCA and recommended that the Board direct London to prepare a working cash lead-lag study for its next rebasing application.

LPMA accepted London's proposed WCA methodology, but like other parties, LPMA submitted that London should conduct a lead-lag study in support of its next rebasing application.

In reply, London noted the general concurrence with its approach. London stated that it preferred not to update the WCA for the most current RPP, but would be guided by the Board's final decision.

London disagreed with the submissions of intervenors on the need for a lead-lag study. London stated that Hydro One Networks Inc. and Toronto Hydro are the largest distributors in Ontario, and each is several times larger than London. It submitted that there is no evidence that the lead-lag studies conducted for either of these distributors has any comparability for London's environment; however, should the Board determine that such a study was necessary, London submitted that a generic industry-wide methodology be developed, to avoid duplication of costs and to ensure consistency in the sector.

Board Findings

The Board concludes that the most accurate data should be used in the calculation of working capital, and notes that all parties agree with this approach. With the exception of submissions on the appropriateness of the general 15% working capital guideline formula, there is general agreement amongst parties on London's proposal for the purposes of setting 2009 distribution rates in this application.

London has followed the Board's *Filing Requirements for Transmission and Distribution Applications* dated November 14, 2006, which allows the Company to apply a 15% factor to derive the allowance for working capital. The Board will require London to prepare a lead-lag study for its next rebasing application. Given the significance of working capital as a component of London's rate base and given the relatively large size of London Hydro, the Board concludes that a lead-lag study is warranted in the circumstances.

The Board directs London to update the cost of power to reflect the price contained in the April 2009 RPP price report, $0.06072/kWh. With respect to the level of wholesale transmission service rates to be used in the calculation, the Board will address this matter later in this Decision under Retail Transmission Service Rates.

COST OF CAPITAL and CAPITAL STRUCTURE

On December 20, 2006, the Board issued the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Board Report"). The Board Report provides the Board's policy guidelines for determining the capitalization and cost of capital to be used for electricity rate-setting.

In Exhibit 6 of its Application, London documented its requested Cost of Capital. This is summarized in the following table:

Cost of Capital Parameter	**London's Proposal**
Capital Structure	60.0% debt (composed of 56.0% long-term debt and 4.0% short-term debt) and 40.0% equity
Short-Term Debt	4.47%, but to be updated in accordance with section 2.2.2 of the Board Report.
Long-Term Debt	6.00%, reflecting the debt rate on an existing third-party debt instrument. In response to LPMA IR #30, London revised its proposal to that $56.069 million of unfunded "notional" debt should attract the updated deemed debt rate of 7.62%, giving a revised cost of debt of 6.72%.
Return on Equity	8.57%, but to be updated in accordance with Appendix B of the Board Report
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	6.97% as proposed, but updated in the AIC to reflect changes to the short-term debt rate and ROE as updated per the Board Report at the time of the Board's Decision, and the revised proposed weighted long-term debt rate of 6.72%.

As noted, London affirmed that the deemed Short-term Debt Rate and deemed Long-Term Debt Rate, as applicable, would be updated based on Bank of Canada, *Consensus Forecasts*, and TSX data for January 2009 in accordance with the methodologies documented in the Board Report.

On February 24, 2009, the Board issued a letter documenting the updated Cost of Capital parameters to be used in determining distribution rates for 2009 cost of service applications. These are documented in the following table:

Cost of Capital Parameter	**Updated Value for 2009 Cost of Service Applications**
Return on Equity	8.01%
Deemed Long-term Debt Rate	7.62%
Deemed Short-term Debt Rate	1.33%

In response to LPMA IR #30, London stated that notional “unfunded” long-term debt should attract the deemed long-term debt rate of 7.62%. Board staff and intervenors requested further explanation of and support for this in supplementary interrogatories.

In its AIC, London reaffirmed that its unfunded “notional” debt should attract the 7.62% rate. London also argued that, while it was only seeking a rate of 6.0% on the existing debt, the note is callable with 367 days notice, and therefore would attract the deemed debt rate of 7.62%. In the AIC, as well as in response to supplementary interrogatories from Board staff and intervenors, London argued that its circumstances differed from those of Hydro One Remote Communities Inc.’s rate application decision (EB-2008-0232) (Hydro One decision”), where the Board rejected the proposal that “notional” debt should attract the Board’s deemed long-term debt rate.

Board staff disagreed with London’s proposal that the “notional” unfunded long-term debt should attract the deemed long-term debt rate of 7.62%. Board staff submitted that London had misconstrued the Board’s decision in the recent Hydro One decision. Staff submitted that London’s proposal was inconsistent with Board practice and policy, and was illogical in its asymmetry. Board staff noted that, while London proposed the 6.0% rate for the existing debt of $70 million, London argued in the AIC that this debt should attract 7.62% on the basis that the note was callable; Board staff was of the view that the record established that the debt instrument was of fixed rate and term and would attract the 6.0% rate. In summary Board staff submitted that the original 6.0% long-term debt rate should apply for all of London’s long-term debt capitalization.

LPMA made similar arguments. It submitted that the existing debt should not in any event attract the 7.62% rate, as it was callable only with 367 days notice. Even if the note were to be called, this would be beyond the timeframe of the 2009 rate year. With respect to the treatment of the unfunded “notional” long-term debt, LPMA submitted that

London's argument, provided in response to Board staff IR #109 and in London's AIC, was not supportable, as the guidelines in the Board Report and the Board's decision in the Hydro One decision were clear "that the deemed long term debt rate does not apply to deemed (unfunded) debt."[23] LPMA submitted that the Board's decisions in the 2009 rate applications for Innisfil Hydro Distribution Systems Limited (EB-2008-0233) and COLLUS Power Corp. (EB-2008-0226) did not support London's proposal, as the circumstances in those applications differed from London's. Finally, LPMA submitted that London's proposal for the treatment of the unfunded debt increases the revenue requirement by $908,349, which is about 80% of the amount that London has proposed to mitigate rate impacts.

Energy Probe made submissions similar to those of Board staff and LPMA. CCC and VECC supported Board staff's submission. SEC made similar arguments that London's debt rate should be 6.0%, both for the third party debt and for the unfunded debt portion. SEC also submitted that London's application of the deemed debt rate of 7.62%, instead of 6.0%, is an increase in revenue requirement of $908,349, which SEC submitted should not be allowed.

In reply, London noted that all parties agreed with the treatment of short-term debt and equity, but disagreed with London's proposed treatment of long-term debt. London reiterated its argument that the deemed long term debt rate should apply for its affiliated callable debt, referencing the Hydro One decision. London states that the $70 million debt is "callable" because the note holder can call the debt payable prior to maturity. London referenced several recent Board decisions as supporting its argument that the existing debt should attract the 7.62% rate. London reiterated its proposal that a rate of 6% be applied on the callable affiliate debt and that the 7.62% rate be applied to the "notional" long-term debt.

Board Findings

The Board finds that, with the exception of long-term debt, London's proposed capitalization and cost of capital complies with the guidelines established in the Board Report. Accordingly, the Board finds that London's 2009 distribution rates will be based on a deemed capital structure of 60.0% debt (56.0% long-term; 4% short-term) and 40.0% equity, in accordance with the Board's established transition process.

[23] LPMA, Submission, p. 32, June 26, 2009

The updated ROE will be 8.01% and the deemed short-term debt rate will be 1.33%, in accordance with the Board's letter of February 24, 2009.

With respect to long-term debt, the Board finds that the cost rate for the affiliate debt will be 6% as proposed by London. Given the specifics of this instrument, the Board agrees with Board staff's characterization of this debt as being of a fixed term and rate. For the notional long-term debt, the Board finds that the cost rate should also be 6%. This is consistent with other Board decisions (including the decisions for Hydro One Transmission and Hydro One Remotes) in which the Board confirmed that the rate to be applied to notional or unfunded long term debt should be equal to the average cost of the embedded debt.

The table below sets out the Board's conclusions for London's deemed capital structure and cost of capital:

Board-approved 2009 Capital Structure and Cost of Capital for London

Capital Component	**% of Total Capital Structure**	**Cost rate (%)**
Long-Term Debt	56.0	6.00
Short-Term Debt	4.0	1.33
Equity	40.0	8.01
Weighted Average Cost of Capital		**6.62**

In preparing its updated revenue requirement arising from this decision and the draft Rate Order to implement this Decision, London should reflect these parameters in its calculations.

COST ALLOCATION AND RATE DESIGN

The following issues are addressed in this section:

- Loss Factors;
- Revenue to Cost Ratios;
- Rate Design;
- Other Distribution Revenue; and
- Retail Transmission Rates.

Loss Factors

London requested approval of a total loss factor ("TLF") of 4.19% for secondary metered customers < 5000 kW, which is slightly smaller than the currently approved TLF for these customers. It provided five years of line loss data (2003-2007) in its application. It later provided certain corrections, and, in its response to LPMA IR #41, augmented the data with 2008 data.

London requested approval of TLFs for primary metered customers and for customers > 5000 kW which are also slightly smaller than the current approved factors.

The TLF is the product of the two factors, the distribution loss factor (“DLF”) and the supply facilities loss factor (“SFLF”). London’s proposed TLFs are based on a methodology of calculating these two factors that avoids using data that it considers abnormal. Board staff and LPMA made submissions in support of longer or shorter data records, in order to avoid outlier data or minimize its impact.

In its Reply Submission, London summarized its reasons for using the average of five years of historical data in general and for using three years of data to calculate the SFLF in this specific instance.

Board Findings

The Board concludes that, since the 2008 data is included in the record, it should be used in the determination of the loss factors. The Board notes that the calculated values of TLF do not differ to a material extent amongst the various submissions.

The Board finds that a six year average (2003-2008) will be used. The most recent data on record will be used, and the longer period will minimize the effect of any outliers in the data. The TLFs are shown in the following table.

Total Loss Factors

Secondary metered < 5000 kW	1.0409
Primary metered < 5000 kW	1.0305
Secondary metered ≥ 5000 kW	1.0141
Primary metered ≥ 5000 kW	1.0041

Revenue-to-Cost Ratios

The following table sets out London’s current and proposed revenue-to-cost ratios. Columns 1 and 2 are representative of the existing ratios. The ratios in column 1 include certain corrections to the original Informational Filing. The ratios in column 2 are a variation of the Informational Filing, excluding the $1,129,656 Transformer Ownership Allowance from costs and from class revenues, as requested in response to VECC IR #42 a). The ratios proposed by London for 2009 are in column 3. The Board's target ranges, as established in the Board Report, *Application of Cost Allocation for Electricity Distributors*, EB-2007-0667, are set out in column 4.

Revenue-to-Cost Ratios

(%)

	1	**2**	**3**	**4**
Customer Class	**Application Exhibit 8 / Table 1**	**Response to VECC IR # 42 a)**	**Proposal (Exhibit 8 / Table 4)**	**Board Policy Range**
Residential	108.6	110.7	107.0	85 – 115
GS < 50 kW	126.3	129.2	120.0	80 – 120
GS 50-4999 kW	75.9	71.2	80.0	80 – 180
GS 50 – 4999 kW Co-generation	247.0	239.7	213.5	80 – 180
Standby Power	84.8	80.0	84.8	80 – 180
Large Use > 5 MW	80.8	62.0	85.0	85 - 115
Street Lighting	16.7	17.3	43.4	70 – 120
Sentinel Lighting	14.2	14.7	42.1	70 – 120
Unmetered Scattered Load	56.6	58.3	68.3	80 – 120

London's proposal for rebalancing is to move any ratio that is outside the range in column 4 half of the way to the nearest boundary in 2009, followed by an equal adjustment to reach the boundary in 2010. The exception is the GS < 50 kW class, which London proposes to move down to its boundary in 2009. As the classes that move upward make a larger movement than do those that move downward in this scheme, there is room to adjust the ratio for the Residential class downward within its range.

VECC supported the intent of London's proposed adjustments. However, it submitted that the starting point for the adjustments should be the ratios in the second column, submitted in response to VECC IR # 42 a). Adjusting toward the Board's ranges from the second column would entail only a small change from London's original proposal for Sentinel Lighting, Street lighting, and USL. Also, the proposal to not adjust the ratio for the Standby Power class could be retained, as it is still within the range in the second column. However, the adjustments required for the Large Use and GS 50–4999 kW classes would be larger than those proposed by London.

Board staff also supported the approach in London's rebalancing proposal. Board staff agreed with VECC that the ratios in column 2 of the table provide a better starting point from which to rebalance. As indicated by VECC, the Large Use class would be affected by adopting the second column as the starting point, as an increase from 62% to 85% is not only a larger increase percentage-wise, but it is also calculated on a smaller base. To a lesser extent, the same is true for the GS 50–4999 kW class.

LPMA also submitted that the second column should be the starting point for adjustments and that all of the classes whose ratios are below their respective ranges should be moved to the lower boundary in 2009, unless the bill impact of so doing would be more than 10% in a year. LPMA supported extending the adjustment to the second year, if necessary, to limit the bill impacts to 10%. It specifically supported the proposed downward adjustments for the GS < 50 kW and the Co-Generation classes.

VECC and LPMA both submitted that, along with the Residential class, the GS < 50 kW class ought to benefit from the additional revenue from the rebalancing of the other classes. LPMA's more detailed submission suggested that these two classes should benefit equally in 2010, such that the Residential ratio would be 106.4% and the GS < 50 kW ratio would be 117.5%.

In reply, London asserted that its Informational Filing does not have the shortcomings identified by VECC, and that the ratios in column 1 of the above table should stand as the starting point for adjustments towards the Board's policy ranges.

Board Findings

The Board is satisfied that the revision argued for by VECC with respect to the exclusion of the transformer ownership allowance from cost and class revenues should be adopted. Upon reviewing the 2006 EDR model and London's Informational Filing, the Board is satisfied that the corrections identified by VECC do apply to the London's cost allocation study. To be more specific, the Board notes that the approved revenue from the Large Use class in 2006 was $1,079,822, which includes $252,325.80 for transformer ownership allowance recovery. A similar adjustment is necessary for the Distributed Generation and General Service > 50 kW classes. The ratios in column 2 of the above table are therefore the starting point for the consideration of changes within and between customer classes.

The Board understands London's Reply Submission to indicate that the revenue actually derived from the Large Use class has been a continuation of the gross revenue in the 2006 EDR model (i.e. $1,079,822), rather than a continuation of the revenue net of the transformer ownership allowance. The Board requires that London confirm how the volumetric rate that it currently charges its Large Use customers was derived. In the bill impact calculations that it will submit with the Draft Rate Order, London shall explain clearly whether the calculation is being made from the current approved rate with or without the currently approved transformer ownership allowance.

It can be seen from the above table that there are several classes that fall outside the respective Board policy ranges. It has been the Board's approach in other cost of service rebasing decisions to migrate non-conforming ratios into the Board's policy ranges over varying periods of time. The Board will adopt this approach in this case as well.

The Board will adopt the general approach proposed by London, namely to move rate classes which are currently outside the Board's target range to the boundary of the target range in one or two years. The Board notes that the Standby Power rate need not be rebalanced based on column 2. The following classes will move directly to their boundaries: GS<50 kW, GS 50-4999 kW. The following classes will move to their boundaries by 2010: GS 50 – 4999 kW Co-generation; Large Use > 5 MW; Street Lighting; Sentinel Lighting; and Unmetered Scattered Load. GS 50 – 4999 kW Co-generation is also addressed separately below.

The Board will also accepts LPMA and VECC's proposal that any additional revenue arising from the rebalancing should be allocated equally to the Residential and GS<50 kW classes.

Rate Design

Fixed/Variable Split

For most classes, London’s Monthly Service Charges were higher than the ceiling amounts in the Informational Filing.[24] The exceptions are Sentinel Lights and USL. London proposes to maintain its fixed/variable split unchanged for six classes, while decreasing it slightly for two classes (Residential and GS < 50 kW). London proposes to increase the fixed portion for the USL class from 15% to 30%. This information is summarized in Exhibit 9 / Table 7 of the Application.

Board staff submitted that London’s proposal is consistent with Board policy and previous decisions. Staff observed that the policy, and London’s proposal, relate specifically to base distribution rates. In London’s application there is also an increase in the Smart Meter adder together with a proposed rebate that is volumetric only, so the impact of the distribution rate change falls more heavily on lower consumption consumers within any rate class.

SEC pointed out that London’s Monthly Service Charge is above the ceiling amount calculated in the cost allocation study, and that maintaining the fixed/variable ratio unchanged perpetuates this inequality. SEC submitted that there is a significant intra-class subsidy in this situation, and argued that the fixed charges for the GS < 50 kW and the GS 50–4999 kW classes should be frozen at their existing levels.

VECC suggested that the Residential fixed charge should be increased by no more than the overall cost adjustment that arises from the Application.

Board staff questioned whether London is actually maintaining the existing fixed/variable split for the Large User class, as the fixed rate appears to be increasing by a larger percentage than the volumetric rate, when calculated on a consistent basis either including or net of the Transformer Ownership Credit.

London proposes to increase the fixed/variable ratio for the USL class by increasing the fixed charge by 186%; however, the proposed Monthly Service Charge is $1.20 per connection, which is within the range calculated in the cost allocation study.

[24] Response to Board staff IR # 43 a), p. 32 of 132

In its reply submission, London reasserted that its application of the cost allocation methodology is correct, and the adjustment proposed by VECC is unnecessary. London notes that, for the Large Use class, there are no “costs” of transformation allocated since all such customers own their own transformers. With respect to Board staff’s submissions, London referenced various explanations provided on the record.

Board Findings

The Board accepts London’s proposals regarding the fixed/variable ratios, namely that the ratios remain unchanged, with the exception of the Unmetered Scattered Load class.

Transformer Ownership Allowance

London proposes to discontinue the transformer ownership allowance for the Large Use class. Its Conditions of Service do not provide for transformation service at 5 MW or above, and it submitted there is no point in continuing the gross rate when all such customers pay the net rate. Board staff submitted that London’s proposal is reasonable. No other parties made submissions on this matter.

Board Findings

The Board approves London’s proposal to discontinue the transformer allowance for the Large Use class, and directs London to reflect this finding in its draft Rate Order and in its Conditions of Service.

Co-Generation Rates

London is one of only a few distributors with a distinct Co-generation customer class. Board staff observed that the Monthly Service Charge for the Co-generation class is more than ten times as high as the charge proposed for a comparable customer without co-generation. Similarly, the volumetric rate is nearly three times higher. These differences are larger than would be expected from the difference in the revenue to cost ratios. The volumetric Standby Charge may apply in some months, and is considerably higher as well. Board staff questioned whether there may be a flaw in the cost allocation model as it applies to customers with their own generation, and submitted that the Board should require London to address this question in its next application for distribution rate re-basing.

LPMA supported London's proposal to move the Co-generation class to the top of its range in 2009. No other parties made submissions on this matter.

In its reply submission, London submits that any flaw in the model would apply to other distributors' results as well, and should be reviewed in a generic industry-wide process.

Board Findings

The Board notes the significant difference in rates between customers with co-generation and other customers in the GS 50-4999 kW class, and that the two classes will be at opposite ends of the Board's target ranges after the current rebalancing is completed in 2010. The Board concludes there is merit in Board staff's suggestion that this issue be examined further. The Board therefore directs London to conduct a study of its cost allocation methodology and rate design proposals as they relate to the cogeneration class and the GS 50-4999 kW class and to provide the results of that study to the Board no later than six months from the date of this Decision and Order.

Other Distribution Revenue

Revenue offsets decrease the need for revenue from distribution rates. In its application, London provided a detailed forecast of its 2009 revenue offset in Exhibit 3 / page 24 / Table 23 – Operating Revenue Summary, totaling $3,707,148. The 2009 forecast was down significantly from the 2007 actual amount, and from the projected 2008 amount. The main factor is a decrease in Rent from Electric Property.

Based on its responses to several interrogatories, London provided a revised detailed forecast of its revenue offset in its AIC, totaling $3,694,100. The revisions are a smaller decrease in Rental revenue, and removal of interest pertaining to deferral and variance accounts which had been a positive net amount. The following table summarizes London's revenue offset, including the changes made in the AIC.

Revenue Offsets

	2009 Test as filed	Adjustments	2009 Test Revised
Other Distribution Revenue	$ 1,074,500		$ 1,074,500
Late Payment Charges	$ 1,000,000		$ 1,000,000
Specific Service charges	$ 832,800		
Adjustment - re-occupancy revenue		$ 15,000	$ 847,800
Other Income and Deductions	$ 799,848		
Ajdustment - re: smart meter deferral account interest income		-$ 331,000	
Adjustment - re: RSVA and other deferral account interest expense		$ 350,000	
Adjustment - re: other deferral account interest income		-$ 47,048	$ 771,800
	$ 3,707,148	-$ 13,048	$ 3,694,100

London originally filed, in Account 4405 – Interest Income, a balance of ($19,000) in the sub-account for interest on deferral and variance accounts.
Board staff and LPMA made detailed comments on the adjustments made by London, and submitted that the Revenue Offset forecast is reasonable. In response to LPMA IR #21, London provided 2008 actual amounts which, in aggregate, are considerably lower than the projected amount but still larger than the forecast for 2009.

Board Findings

The Board finds that London's proposals with respect to Other Distribution Revenue, as revised during the course of the proceeding and reflected in the AIC, are reasonable.

Retail Transmission Service ("RTS") Rates

The Board issued a guideline, *Electricity Distribution Retail Transmission Service Rates* [G-2008-0001] on October 22, 2008 indicating the process to be used by distributors to adjust RTS rates to reflect changes in the Ontario Uniform Transmission rates ("UTR"). The changes in the UTRs are shown in the following table.

Uniform Transmission Rates

	Effective prior to January 1, 2009	Effective on January 1, 2009	Effective on July 1, 2009
	($/kW/month)	($/kW/month)	($/kW/month)
Network Service Rate	2.31	2.57	2.66
Line Connection Service Rate	0.59	0.70	0.70
Transformation Connection Service Rate	1.61	1.62	1.57

London proposed to increase all of its RTS Network Rates by 11.3%, and all of its RTS Connection Rates by 5.5%. These increases parallel the increases in the UTRs that became effective January 1, 2009.

Board staff submitted that London's proposal is reasonable. In particular, Board staff noted that London had submitted evidence that the distinction that London makes between interval-metered and non-interval-metered customers in the General Service 50–4999 kW class is based on a measured cost differential.

Board staff observed that London's calculation of bill impacts assumes that customers who pay the Standby Rate would also pay the RTS rates on the same billing demand.[25] Board staff submitted that the customer's billing demand should be only for power actually delivered to the customer, because London does not have any costs from the IESO that would correspond to the Standby Demand. In its Reply Submission, London confirmed that actual bills are calculated without any flow-through of transmission rates for Standby Service.

VECC supported the proposed RTS rates, which reflect UTRs that are effective as of January 1, 2009. However, it suggested that the timing of this Decision might enable an adjustment to reflect updated rates that became effective July 1, 2009.

Board Findings

The Board finds that London shall adjust its proposed Retail Transmission Service Rates to reflect the UTRs that became effective July 1, 2009, as a result of the Board's Decision EB-2008-0272. The Board also directs London to use the new UTRs in determining the Working Capital Allowance.

DEFERRAL AND VARIANCE ACCOUNTS

In its Application, London provided the account balances representing principal balances to December 31, 2007 and projected interest to alternatively April 30 and August 31, 2009. It provided the audited Financial Statements as of December 31, 2007, which include an itemization of Regulatory Assets and Liabilities[26] at a lesser level of detail. In response to interrogatories, London provided an update to its account

[25] AIC, Bill Impacts – Detail, p. 8
[26] Exhibit 1 / p. 77

balances at December 31, 2008, plus projected interest[27] and the audited Financial Statements as of December 31, 2008[28].

The accounts were split into those that London is submitting for disposition and recovery of in this proceeding[29], and those that it is not requesting disposition of at this time.[30] London's request was for approval to dispose of Account 1508 Other Regulatory Assets (sub-accounts for OEB Cost Assessments and Pension Contributions), Account 1525 Miscellaneous Deferred Debits – Ontario Price Credit Rebate Costs, and Account 1580 Retail Settlement Variance Account – Wholesale Market Service Charges. London proposed rate riders that would rebate the requested balances to ratepayers over a two year period.[31]

The balances of the deferral and variance accounts that are shown in the following table include forecasted transactions and projected interest to April 30, 2009.

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[27] Response to Board staff IR # 110, Appendix
[28] Response to LPMA IR # 6, Appendix
[29] Exhibit 5 / p. 5 / Table 2
[30] Exhibit 5 / p. 4 / Table 1
[31] Exhibit 5 / p. 70 / Table 3

Deferral and Variance Accounts

	Acct. Number	Account Description	Total ($)
1	1508	Other Regulatory Assets – Sub-Account – OEB Cost Assessments	461,647
2	1508	Other Regulatory Assets – Sub-Account – Pension Contributions	1,710,720
3	1525	Miscellaneous Deferred Debits	30,810
4	1580	RSVA – Wholesale Market Service Charge	(8,291,252)
		Sub-Total (rows 1 – 4)	**(6,088,075)**
5	1518	Retail Cost Variance Account – Retail	(198,252)
6	1548	Retail Cost Variance Account – STR	140,300
7	1550	Low Voltage Variance Account	11,192
8	1582	RSVA - One-time Wholesale Market Service	356,380
		Sub-Total (rows 5 – 8)	**309,620**
9	1584	RSVA – Retail Transmission Network Charge	204,454
10	1586	RSVA – Retail Transmission Connection Charges	(1,312,347)
11	1588	RSVA – Power (including Global Adjustment)	(722,788)
		Sub-Total (rows 9 – 11)	**(1,830,681)**
12	1555	Smart Meter Capital and Recovery Offset	(1,122,012)
13	1556	Smart Meter OM&A	385,,569
14	1562	Deferred PILs	673,052
15	1563	Deferred PILs Contra Account	
16	1565	CDM Expenditures and Recoveries	0
17	1566	CDM Contra Account	
18	1590	Recovery of Regulatory Asset Balances	684,589
19	1592	2006 PILs and Taxes Variance	(143,127)
		Sub-Total (rows 12-19)	**478,071**

In its AIC, London provided rate riders that would dispose of accounts 1508, 1525, and 1580, at the 2007 year-end balances plus projected interest to April 30, 2009. The rate riders provided by London were adjusted to match the revised load forecast, and to have a 20-month recovery period to April 30, 2011, based on the assumed implementation date of September 1, 2009.

In response to interrogatories, London also provided calculations of alternative rate riders that would dispose of the balances in lines 1 - 8 and lines 1 – 11 in the table above. Board staff submitted that the Board might wish to evaluate the reasonableness of rate riders which would dispose of all of the deferral and variance account balances in lines 1 – 11 in the table. In support of its submission, Board staff noted that there was little difference in the balance to be disposed of between London’s proposal and disposition of the larger group of accounts.

On the basis that it is preferable to clear the accounts in a timely manner, CCC supported Board staff’s submission that the Board order disposition of eleven of the deferral accounts, and submitted that London should recalculate rate riders reflecting this alternative disposition.

LPMA noted that disposing of the additional accounts would decrease the amount of the rebate, based on the 2007 balances plus projected interest. LPMA was not opposed to Board staff’s suggestion to dispose of additional accounts, and in particular submitted that Account 1550 should be cleared and closed. It also supported London’s proposal that the period for the associated rate riders should be for a period up to April 2011.

In its reply, London accepted the recommendation in Board staff’s submission. London also agreed that the balance in account 1550 – Low Voltage Variance should be disposed of.

Board Findings

While the Board has announced an initiative to consider on a generic basis certain of the deferral and variance accounts, that process is still in the early stages. The RSVA balances are large and the Board finds that these amounts should be disposed of at this time. A rebasing application is an appropriate time at which to consider disposition of each account. The Board finds it appropriate to dispose of all the accounts, except the two PILS accounts (which are subject to a review in a separate proceeding), account 1590 (which the Board has typically not disposed of until the final balance can be verified), and the smart meter and CDM tracking accounts (which will be reviewed at a later date).

The Board finds that the balances at December 31, 2008 shall be disposed of, plus projected interest to the effective date of the 2009 distribution rates.

The Board finds that a period from the implementation date through to April 30, 2011 is appropriate.

The Board directs London to include updated documentation in its Draft Rate Order which shows the account balances at December 31, 2008, the interest calculated from January 1 to September 30, 2009, the allocation of each account to each rate class, and the monthly amount to be refunded including confirmation of the length of the disposition period.

SMART METERS

London proposed to increase the smart meter funding adder from $0.26 per month per metered customer to $1.00. London stated that it was becoming authorized under the amended regulation pursuant to and in compliance with the London Hydro RFP process.

The Government of Ontario filed amendments to three smart metering regulations, namely O. Reg. 427/06 (*Smart Meters: Discretionary Metering and Procurement Principles*), O. Reg. 426/06 (*Smart Meters: Cost Recovery*), and O. Reg. 393/07 (*Designation of Smart Metering Entity*). London stated that it qualified for the increased adder since amendments to O. Reg. 427/06 authorizes metering activities for distributors pursuant to and compliant with the *Request for Proposal (RFP) for Advanced Metering Infrastructure (AMI) – Phase 1 Smart Meter Deployment* issued on August 14, 2007 by London Hydro Inc.

On October 22, 2008, the Board issued its Guideline G-2008-0002, *Smart Meter Funding and Cost Recovery*. Guideline G-2008-0002 outlines requirements for applicants wishing to request a $1.00 smart meter funding adder. The Board noted that the standard $1.00 funding adder would provide funding for distributors which are authorized and clearly intend to install smart meters in the test year. Guideline G-2008-0002 established informational requirements to be provided in support of a request for an increased smart meter funding adder of $1.00 per month per metered customer, and also additional filing requirements where a distributor proposed a unique funding adder amount.

In its Application, London stated that it intends to install approximately 81,000 meters in 2009 and to continue deployment to completion in 2010. For the 2009 test year, London estimates the cost per installed smart meter to range from $150 to $200, with a total capital cost between $12 million and $16 million.

London has not included any capital costs for smart meters in its rate base, nor is it including operating expenses related to smart meters in its revenue requirement. Smart meter funding adders, and capital and operating costs related to smart meters, will continue to be recorded in established deferral accounts 1555 and 1556, for review and disposition in a future application. Pursuant to interrogatories posed to it, London corrected its deferral and variance accounting to record interest costs related to smart meter costs and funding adders in sub-accounts of account 1555; these were previously mistakenly recorded in account 4405.

VECC and CCC expressed concern that, in light of London's forecasted intensive smart meter deployment of 81,000 smart meters in 2009, the proposed increase of the smart meter funding adder to $1.00 would result in a significant under-recovery of costs. In turn, this would result in significant deferred costs to be recovered in future years. VECC submitted that the $1.00 funding adder would recover revenues of $1.7 million annually, an insignificant amount relative to expected levels of around $27 million in smart meter capital expenditures in 2009 and 2010, and operating expenses of $900,000 in 2009 and $2.7 million beginning in 2010. VECC submitted that London should provide an alternative scenario for amortization of smart meter costs and an adjusted 2009 smart meter funding adder. CCC supported VECC's proposal.

Board staff did not oppose London's proposal, but submitted that it would have been preferable if London had provided better estimates of its forecasted costs.

In reply, London submitted that VECC's recommendations, supported by CCC, should be rejected. London stated that, in proposing the $1.00 smart meter funding adder, it had considered rate impacts on its ratepayers as well as complying with the Board's Guidelines. It stated that it intends to file for additional smart meter cost recovery in a subsequent IRM application in 2010 or 2011, once costs become better known and it has achieved at least 50% penetration of smart meters.

Board Findings

Pursuant to the Government's regulations as amended on June 25, 2008, in applications for 2009 distribution rates, the Board has approved increased smart meter funding adders for distributors becoming authorized and filing information, per Guideline G-2008-0002, in support of authorization and active deployment. In the Board's view, increasing the rate adder to $1.00 per month per meter going forward would provide

London with funds to support the rollout in 2009, as planned, and avoid rate shock upon completion of smart meter deployment.

The Board finds that London has complied with legislation and with the Board's Guideline G-2008-0002, and so approves an increased smart meter funding adder of $1.00 per month per metered customer. In so finding, the Board makes no determination of the prudence and reasonableness of London's estimated smart meter costs, which will be reviewed in a future application when London applies for disposition of the smart meter variance account balances.

IMPLEMENTATION

The Board has made findings in this Decision which change the 2009 revenue requirement and, as a result, the distribution rates from those proposed by London.

Effective Date of Rates

In its Application, London requested that its current rates be made interim effective May 1, 2009 in the event that the Board could not issue a Decision and Rate Order by that time. London also requested that, should the Board be unable to render its Decision and Rate Order by September 1, 2009, London's proposed rates be made interim as of that date.

In Procedural Order No. 2, issued April 23, 2009, the Board made London's current rates interim, which allows for an effective date as early as May 1, 2009. London was over three months late in filing its application

In its AIC, London stated that it delayed filing its application until December 2008, in part, to allow work balancing for the Board, which had a number of Cost of Service applications before it. London stated that it "… is not seeking recovery of incremental revenue for the period of May 1, 2009 through August 31, 2009", and as a result will forego incremental revenue estimated at $2,560,000.[32]

LPMA submitted that, since London's reply submission was due in mid-July, it would be unlikely that the Decision and draft Rate Order process could be completed in time for September 1, 2009 implementation. LPMA submitted that London's revised rates should be effective the first day of the month following the Board's final Rate Order. Citing the Board's decision on Peterborough Distribution Inc.'s 2009 rates (EB-2008-

[32] AIC, p. 6, para. 13.

0241), LPMA and CCC submitted that there should be no recovery of foregone revenues to either May 1, 2009 or September 1, 2009. In LPMA's submission, the effective and implementation dates of the new rates should be one and the same.

In reply, London reiterated that its Application, subject to certain adjustments documented in its AIC and Reply Submission, is appropriate, and that the Board should issue a decision directing preparation of a rate order for the revenue requirement effective no later than September 1, 2009. It reiterated its concern about the prospect of an effective date later than September 1, 2009 and requested that proposed rates be declared interim should the Board be unable to issue a Final Rate Order for implementation by September 1, 2009.

Board Findings

The Board has determined that London's new rates will be effective September 1, 2009. If the final Rate Order cannot be issued in time for implementation September 1, 2009, the Board will authorize London to recover the shortfall arising between September 1, 2009 and the implementation date. In such case, London is also directed to calculate rate riders that would recover the foregone revenue. London should propose an appropriate time period for recovery giving due consideration to bill impacts. The current interim rates are in effect until the Board approves the Final Rate Order.

As the 2009 rates will be implemented beginning September 1, 2009 or a later date, for the rate riders to dispose of approved deferral and variance account balances, London is directed to calculate the rate riders to collect (return) the balances from (to) customers assuming clearance of the balances by April 30, 2011.

In filing its Draft Rate Order, it is the Board's expectation that London 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 London to file detailed supporting material, including all relevant calculations showing the impact of this Decision on London's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Supporting documentation shall include, but not be limited to, filing a completed version of the Revenue Requirement Work Form excel spreadsheet, which can be found on the Board's website. London should also show detailed calculations of the revised retail transmission service rates and variance account rate riders reflecting this Decision.

RATE ORDER

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

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. The Board will determine eligibility for costs in accordance with its Practice Direction on Cost Awards. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

All filings with the Board must quote the file number EB-2008-0235, and be made through the Board's web portal at www.errr.oeb.gov.on.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must be received by the Board by 4:45 p.m. on the stated date. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.oeb.gov.on.ca. If the web portal is not available you may e-mail your documents to the attention of the Board Secretary at BoardSec@oeb.gov.on.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's Practice Directions on Cost Awards.

THE BOARD DIRECTS THAT:

1. London Hydro Inc. shall file with the Board, and shall also forward to intervenors, 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 including the Revenue Requirement Work Form in Microsoft Excel format.

2. Intervenors shall file any comments on the Draft Rate Order with the Board and forward to London Hydro Inc. within 7 days of the date of filing of the Draft Rate Order.

3. London Hydro Inc. shall file with the Board and forward to intervenors responses to any comments on its Draft Rate Order within 7 days of the date of receipt of Intervenor submissions.

4. Intervenors shall file with the Board and forward to London Hydro Inc. their respective cost claims within 30 days from the date of this Decision.

5. London Hydro Inc. shall file with the Board and forward to intervenors any objections to the claimed costs within 44 days from the date of this Decision.

6. Intervenors shall file with the Board and forward to London Hydro Inc. any responses to any objections for cost claims within 51 days of the date of this Decision.

7. London Hydro Inc. shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto**,** August 21, 2009

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary