Ontario Energy Board | **Commission de l'énergie de l'Ontario**

Ontario

EB-2009-0267

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 Kitchener-Wilmot 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, 2010.

BEFORE: Pamela Nowina
Presiding Member

Ken Quesnelle
Member

CORRECTED DECISION AND ORDER

April 7, 2010

THE APPLICATION

Kitchener-Wilmot Hydro Inc. ("KW Hydro" or the "Company") filed an application (the Application") with the Ontario Energy Board (the "Board") on August 31, 2009. 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 and other charges, to be effective May 1, 2010. KW Hydro is the licensed electricity distributor serving approximately 85,000 customers in the City of Kitchener and the Township of Wilmot, located in southwestern Ontario.

KW Hydro 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. The Board issued a revised Chapter 2 Filing Requirements on May 27, 2009.

On January 29, 2009, the Board indicated that KW Hydro would be one of the electricity distributors to have its rates rebased for the 2010 rate year, and this was confirmed by way of a letter issued by the Board on March 5, 2009. Accordingly, KW Hydro filed a cost of service application based on 2010 as the forward test year.

The Board assigned the Application file number EB-2009-0267 and issued a Notice of Application and Hearing dated September 14, 2009. The Board approved three interventions: the Vulnerable Energy Consumers Coalition ("VECC"), the School Energy Coalition ("SEC"), and Energy Probe Research Foundation ("Energy Probe"). No letters of comment were received by the Board. Waterloo North Hydro Inc., a distributor partially embedded to and served by KW Hydro, was served notice but did not participate.

Procedural Order No.1 was issued on October 15, 2009. The Board made provision for written interrogatories. On December 2, 2009 the Board issued Procedural Order No.2, allowing for a supplemental round of interrogatories and providing dates for submissions. On December 10, 2009, the Board issued Procedural Order No. 3, providing for revised dates for KW Hydro's Submission-in-Chief (the "Argument-in-Chief") and subsequent written submissions by parties.

KW Hydro filed its Argument-in-Chief on January 13, 2010. All intervenors filed interrogatories and made submissions in this proceeding. Board staff also posed interrogatories and made submissions. KW Hydro's reply submission was filed on February 10, 2010.

In the original Application, KW Hydro requested a revenue requirement of $40,631,182, including recovery of a revenue deficiency of $6,157,264 for the 2010 Test Year.

In its Argument-in-Chief, KW Hydro proposed a reduction to its revenue requirement to $40,186,169, reflecting adjustments primarily to rate base, operating expenses, PILs and Cost of Capital, as a result of corrections and changes to the evidence through the discovery phase, as well as announced changes to transmission and Regulated Price Plan ("RPP") rates. KW Hydro also provided a breakdown of its revenue requirement, confirming changes proposed between the time it filed the original application and the closing of the interrogatory stage of this hearing. The updated proposed rates are set to recover a revenue deficiency of $5,576,034. Certain other proposed impacts, such as those due to updated Cost of Capital parameters were not reflected at the time as these were not known by the close of record. However, KW Hydro had proposed to comply with the guidelines in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.

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
- Harmonized Sales Tax ("HST")
- Payments in Lieu of Taxes
- Depreciation
- Rate Base and Capital Expenditures
- Cost of Capital and Capital Structure
- Cost Allocation and Rate Design
- Deferral and Variance Accounts
- Smart Meters

- LRAM and SSM; and
- Implementation

LOAD FORECAST

The following issues are addressed in this section:

- Load Forecast Methodology
- Weather Normalization; and
- Customer Forecast

Load Forecast Methodology

KW Hydro's weather normalized load forecast is developed using a three-step process:

1. A total system-wide weather normalized energy forecast is developed using a multivariate regression model that incorporates historical load, weather, and economic data from 1997 to 2005. KW Hydro stated that it omitted the last three years of actual data (2006 to 2008 inclusive) from the regression estimation due to poorer model fit, which it attributed to the economic downturn and reduced consumption due to successful CDM. 2009 Bridge and 2010 Test Year forecasts were then estimated by the model and then adjusted for weather normalization, using 12-year heating degree days and cooling degree days.
2. This energy forecast is adjusted by historical loss factors to derive the system-wide billed energy forecast.
3. The system-wide billed energy forecast is allocated by rate class using a forecast of customer numbers and historical usage patterns per customer and trending average consumption to reflect CDM impacts, economic growths and economic and technological impacts affecting customers' typical (or average) consumption, in each class.

KW Hydro is seeking Board approval for a test year load forecast as follows:

Load Forecast[1]

Rate Class	(kWh/kW)
Residential	650,038,341 kWh
GS<50 kW	235,461,608 kWh
GS>50 kW	2,231,346 kW
Large User	140,928 kW
Streetlights	46,815 kW
Unmetered Scattered Load	3,287,380 kWh

[1] Response to VECC IR #15 d)

Interrogatories were posed by Board staff and intervenors to understand KW Hydro's approach and to explore alternative models.

Board staff raised concerns over KW Hydro's regression modeling approach. In particular, Board staff was critical of the focus on getting a forecasting model that has a high R^2 as the main criterion of the fitness of the model.[2] Board staff was also concerned over KW Hydro's decision to omit the last three years of actual data, and of the Company's explanation of poorer model fit when the recent data was used was attributable to the economic downturn and successful CDM. Board staff commented that ascribing impacts to CDM when the model does not include price is questionable. While commenting that KW Hydro's modeling efforts were not ideal, Board staff noted that KW Hydro's CDM impact estimates were moderate in comparison with those of some other distribution rate applications. In summary, Board staff did not consider KW Hydro's estimates unreasonable. However, Board staff submitted that KW Hydro should improve its methodology for its next rebasing application.

Energy Probe supported Board staff's submission with respect to the regression modeling. Energy Probe submitted that KW Hydro's estimates of the average normalized consumption decline in 2009 and 2010 of, respectively, 1.0% and 0.5% and which KW Hydro has attributed to CDM, is not supported. Energy Probe submitted that an average decline of 0.6%, as the average annual decline in consumption per residential customer from 2004 to 2008, should be used; this would increase residential kWh by nearly 2 million kWhs. Energy Probe noted that KW Hydro had used the average kW/kWh ratios for determining load growth in the GS > 50 kW, Large Use and Streetlighting classes, but submitted that KW Hydro should instead use a trend analysis as had been done for the Residential and GS < 50 kW classes. Energy Probe noted that its analysis would not affect distribution revenues for customers in the former classes, but would reduce the working capital allowance ("WCA") by about $86,000, as shown in response to Energy Probe IR # 14 c).

VECC noted that KW Hydro's multivariate regression approach was similar to that of other distributors, but differed in cutting off the regression range at 2005. VECC disagreed with KW Hydro's approach, and, similar to Board staff, commented that the approach was not ideal and that inclusion of more data would provide a more robust

[2] The R^2 (R-squared) is a statistical measure of how much of the variation in the variable being modelled (in this case, system demand) is explained by the estimated model and the explanatory variables, including income/economic activity, population, seasonal variables, etc. R^2 ranges from 0% to 100%, with a higher R^2 indicating better explanatory power and model fit. It is a common, but not the only, measure of the goodness of fit for statistical models.

model estimate. VECC also submitted that weather-normalized 2008 results would be a better starting point for KW Hydro's forecast. VECC also expressed concerns with some of the assumptions underlying KW Hydro's trend analysis. As one example, VECC submitted that growth in 2010, when the economy has begun its recovery, should be expected to be higher than for 2009, at the height of the economic downturn.

VECC also submitted that an average annual per Residential customer consumption decrease of 0.5%, rather than the 1.0% for 2009 and 0.5% for 2010, would be reasonable.

In reply, KW Hydro stated its belief that its load forecasting methodology is sound and provides reliable results and that it plans to continue to improve its forecasting techniques. KW Hydro also noted that its 2009 bridge year results suggest that the 2009 and 2010 forecasts are higher than realized, although KW Hydro acknowledged that the 2009 actual data provided in its Argument-in-Chief is not weather-normalized. KW Hydro also stated that its customer counts and average consumption per customer have decreased based on 2009 actuals, and thus submitted that the forecasts in the Application are likely higher than it will realize.

Weather Normalization

KW Hydro has normalized both revenues and consumption for weather and has documented that the following class sensitivities are based on the Hydro One Networks' study for KW Hydro, done as part of the 2006 Cost Allocation Informational Filing:

Residential and GS < 50 kW	100% weather sensitive
GS > 50 kW	64% weather sensitive
Large User, Street lighting and USL	0% weather sensitive

VECC argued that it was not appropriate for KW Hydro to assume that the residential and GS < 50 kW volumes are 100% weather sensitive and submitted that a substantial portion of the volumes for those classes is independent of weather. VECC submitted that a more reasonable assumption is that 50% of volumes consumed by Residential and GS < 50 kW customers are weather-related. No other parties commented on KW Hydro's weather normalization approach.

In its reply submission, KW Hydro stated that Hydro One's weather sensitivity ratios are the best proxy currently available, although it expects that improved data as a result of Smart Meter deployment will allow for better rate class-specific ratios in the future.

Customer Forecast

KW Hydro is seeking Board approval for a total test year customer count forecast of 110,747 customers/connections. This represents an increase of 1.3% per annum, compared to the growth between 2006 and 2008 of 2% per annum, and has provided explanations for the forecasted growth rates for each customer class.

KW Hydro has forecasted residential growth at 1.5% for 2009 and 2010, slightly reduced from historical growth. GS < 50 kW and streetlighting classes are assumed to grow by 1.0% per annum. GS > 50 kW and Unmetered Scattered Load classes have almost no growth, while there is a 50% reduction in Large Use customers from 2008 to 2010. For the latter, KW Hydro has explained the loss and reclassification of customers as the drivers for the customer reductions.

Customer Count Forecast

2010 Test Year	
Rate Classes	No. of Customers
Residential	78,139
GS<50 kW	7,484
GS>50 kW	1,003
Large User	2
Street Lights (connections)	23,299
Unmetered Load (connections)	820
TOTAL	**110,747**

Board staff noted that there could be arguments for streetlighting and GS < 50 kW to have similar growth rates to that of the residential class, but the difference is small (1% annual growth rate versus 1.5%). Board staff took no issue with KW Hydro's forecasts for other classes and explanations of variances.

VECC submitted that the residential growth rate should be increased to 2% per year, based on the historical trends and expected population growth of 1.56% in the service area. VECC also submitted that GS < 50 kW should be increased to 1.5% as it is linked to residential growth. VECC submitted that the growth rate for GS > 50 kW is reasonable but noted that, while the estimated reduction for 2009 was forecasted to be 0.5%, Year-to-Date September 2009 data showed a reduction of almost 1.0%.

Energy Probe and SEC made no submissions on KW Hydro's customer forecast.

In its reply submission, KW Hydro stated that 2009 actual data show that 2009 customers and average consumption are lower than both 2008 actuals and 2009 forecasts. KW Hydro has forecasted residential growth at 1.5% but submitted that actual growth was only 1.2%. As a result, KW Hydro submitted that the proposals by

VECC, to alter the customer growth, and to adjust average consumption, as proposed by VECC and Energy Probe, are unreasonable.

Board Findings

At the outset, the Board wishes to caution KW Hydro and all parties about introducing new information through submissions and reply submissions. KW Hydro has introduced substantial information about its 2009 actuals, in support of its 2009 and 2010 load forecasts. This data has primarily been introduced in KW Hydro's reply submission. As such, this information has not been tested, and cannot be tested unless the Board was to re-open the proceeding for further discovery. The Board believes that the evidence on the record is sufficient for it to render its decision and will not re-open the record of the proceeding to address the new material in KW Hydro's reply submission. The Board has given no weight to new material introduced in KW Hydro's reply submission with respect to 2009 customer counts and load.

With respect to customer counts, the Board accepts KW Hydro's forecasts as submitted. Historical trends are an important predictor of future expectations, but they are not the only consideration. The Board considers that KW Hydro has, in this Application, provided reasonable estimates of system demands in the test year, and the associated costs which should be recoverable in rates. In the Board's view, the submissions by the intervenors that suggest further refinements to KW Hydro's analysis seek a level of precision that, due to the lack of overall materiality, is unwarranted.

The Board notes that forecasts done using the NAC methodology are not on the record in this case. However, the Board also notes the submissions of Board staff, and supported by Energy Probe, that KW Hydro's forecasts are reasonable. The Board has remarked on the limitations of that methodology in prior proceedings and noted the improvement that regression analysis can provide.

The Board concurs with the submissions of Board staff and intervenors that better efforts to use the 2006 to 2008 data in the regression modeling should have been made. This recent data likely contains valuable information on customer demand, particularly on trends for economic and demographic changes including CDM impacts which would have been useful in developing and supporting the 2009 and 2010 forecasts. While noting KW Hydro's explanations, including its efforts at modeling and its explanations of CDM initiatives that it has undertaken with its customers, quantitative support through modeling would have been preferable.

KW Hydro could also have better documented its methodology, including the truncation of the regression range and the forecasting from 2006 to the 2010 test year. That being said, the Board accepts KW Hydro's load forecast for the 2010 test year. Customer growth and consumption pattern forecasts are comparable to historical actuals, and the Board accepts KW Hydro's explanations for its trending approaches. The variations proposed by various intervenors are relatively small adjustments to forecast assumptions that would not produce material impacts.

The Board encourages KW Hydro to undertake further work in the area of load forecasting, for purposes of its next rebasing, in order to better capture the impacts of CDM and local economic factors, and to take advantage of new data, such as interval data that Smart Meters and TOU pricing will make available. As one example, the Board expects that KW Hydro will have improved data on class-specific weather sensitivity as interval data and CDM impacts are gathered in future years.

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

General OM&A

For the 2010 Test year, KW Hydro is requesting approval of $14,190,476 in OM&A expenses, excluding income and capital taxes, donations and amortization expenses. Total operating expenses for the 2010 test year are forecasted at $25,476,819. This is an increase of 13.79% over KW Hydro's 2008 actuals and 35.94% over 2006 actuals. KW Hydro's 2010 Test Year OM&A also represents an 8.02% increase over the 2009 Bridge year. KW Hydro's OM&A and operating expenses by year is summarized below:

Operating Expenses
Exhibit 4/page 2/Table 1

	2006 Board Approved	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test	Average annual variance
							2006 to 2010
Operations	$ 2,315,938	$ 2,585,870	$ 2,733,252	$ 3,016,284	$ 2,799,800	$ 3,051,200	4.22%
Maintenance	$ 2,736,940	$ 3,602,257	$ 3,605,546	$ 3,968,318	$ 4,342,200	$ 4,761,500	7.22%
Billing and Collecting	$ 2,434,491	$ 2,676,674	$ 2,772,666	$ 2,864,738	$ 3,006,500	$ 3,003,200	2.92%
Community Relations	$ 150,090	$ 702,223	$ 791,303	$ 207,677	$ 208,800	$ 256,376	-22.27%
Administrative and General	$ 2,487,622	$ 2,585,071	$ 2,634,695	$ 2,572,119	$ 2,974,400	$ 3,118,200	4.80%
Total OM&A	$ 10,125,081	$ 12,152,095	$ 12,537,462	$ 12,629,136	$ 13,331,700	$ 14,190,476	3.95%
Property Tax	$ 518,048	$ 510,416	$ 527,008	$ 506,522	$ 529,300	$ 550,500	1.91%
Amortization Expense	$ 8,098,266	$ 8,510,357	$ 8,901,061	$ 9,253,850	$ 9,723,672	$ 10,735,844	5.98%
Total Operating Expenses	$ 18,741,395	$ 21,172,868	$ 21,965,531	$ 22,389,508	$ 23,584,672	$ 25,476,820	4.73%

In its Argument-in-Chief, KW Hydro has documented the following adjustments to OM&A, a total of ($163,976):

- ($49,976) due to removal of forecasted LEAP costs due to the uncertainty of the LEAP initiative at this point in time;
- ($43,000) to remove the 2010 IFRS implementation expenses, which KW Hydro will now track in the authorized deferral account; and
- ($74,000) to remove costs for an oral hearing component of this 2010 Cost of Service hearing, as the application is being dealt with by way of a written process.

This results in a revised OM&A of $14,487,000, inclusive of property taxes. The revised Total Operating Expenses including amortization/depreciation but excluding PILs of $25,222,844.

In its original Application KW Hydro also provided a table indicating the "drivers" of OM&A increases year over year in Exhibit 4/page 6/Table 3, as replicated below.

Exhibit 4/page 6/Table 3
OM&A Incremental Cost Driver Table

OM&A	**2006 Actual**	**2007 Actual**	**2008 Actual**	**2009 Bridge**	**2010 Test**
Opening Balance	$10,836,360	$12,662,510	$13,064,470	$13,135,656	$13,861,000
OMERS	$506,079	$29,114	$53,016	$34,749	$56,700
CDM Activities	$410,346	$94,023	-$600,395	-$77,708	-$1,600
LEAP Donations	$0	$0	$0	$0	$46,976
A/R Credit Insurance	$0	$10,800	$53,254	-$4,054	$10,000
IFRS	$0	$0	$0	$66,650	$43,000
Rebasing Regulatory Expense	$0	$0	$0	$0	$57,000
Inflationary Payroll Increases	$170,981	$174,240	$180,432	$170,698	$175,435
Other Payroll Changes	$3,600	$1,000	$0	$232,000	$0
Inflation (labour removed)	$86,793	$101,706	$115,511	$121,688	$130,255
PBO Benefit Expenses	$302,941	$18,178	$188,769	$117,537	$20,000
Increase in Bad Debts	$112,099	-$32,496	-$4,469	$43,246	$10,000
Payroll-Related Benefit Costs	$61,548	$54,721	-$3,728	$65,193	$67,260
"Catch up" meter maintenance	$0	$0	$0	$0	$100,000
Increased OT	$348,252	$144,925	$401,416		
Closing Balance	$12,838,999	$13,258,721	$13,448,275	$13,905,656	$14,576,026

In its original application KW Hydro used an estimated inflation factor of 2.25% for non-labour expenses. In response to Energy Probe interrogatory # 23, KW Hydro concurred "that the year-to-date inflation factor for 2010 for non-labour expenses should be used as an adjustment when the Board makes its Decision."

Board staff noted, but took no issues with, KW Hydro's OM&A as proposed and adjusted through discovery.

Energy Probe noted that the 2010 OM&A expense increase over the 2009 bridge year forecast was 6.4%. In its Argument-in-Chief, KW Hydro reduced its OM&A expenses, but Energy Probe submitted that this was still a 5.2% increase over 2009. Energy Probe noted that, in response to Energy Probe IR #38 b), KW Hydro provided an updated 2009 OM&A forecast of $12,866,500, with the reduction largely due to four power line technician positions that were not filled until December 2009. Energy Probe submitted that a 4% annual increase would be reasonable and estimated a 2010 OM&A expense of $13,241,700, net of $90,000 in charitable donations; this is $329,000 less than KW Hydro's proposed forecast.

Energy Probe made the following submissions on adjustments for specific OM&A expenses:

- Concurs with the elimination of $43,000 for IFRS and establishment of a deferral account for tracking incremental costs for IFRS implementation;
- Removal of $74,000 for regulatory rate rebasing costs as there is no oral component to this application, and amortization of recovery over four years, however, it submitted that KW Hydro's estimated legal and consulting costs are excessive, and proposed a reduction of costs of $40,000 (or $10,000 per year over the four years of rebasing and 3rd Generation IRM);
- Reduction due to PST elimination of $60,000. (This issue is dealt with in the next section of this Decision dealing with the Harmonized Sales Tax);
- Concurs with the elimination of LEAP costs;
- Proposes that wage increases for non-unionized employees be at 2% rather than the 3% as proposed;
- Reduction of meter maintenance costs from $100,000 to $37,500 as a "normalized" incremental cost over the four-year period, based on KW Hydro's responses to Board staff IR # 8;
- Application of the annual percentage change in the GDI-IPI (Final Domestic Demand) for estimating inflation adjustments for non-labour expenses.

In summary, Energy Probe estimated reductions of $323,476 in its submission.[3]

SEC noted that KW Hydro's 2010 OM&A is 8.4% higher than for 2008, and reflects annual increases of 3.4% (for 2009 over 2008) and 4.8% (for 2010 over 2009). However, SEC submitted that KW Hydro's OM&A estimates were overstated and cited that KW Hydro's 2009 September Year-to-Date expenses were $477,260 lower than for

[3] Energy Probe submission, January 28, 2010, page 19

the corresponding period in 2008. SEC proposed that 2010 OM&A should be further reduced by $575,392, comprised of the following:

- ($401,346) for over-time, on the basis that 2008 actual was higher due to severe storm-related work that should not be normally expected to recur;
- ($10,000) on bad debt on the basis that 2009 expenses already include the effects of the economic downturn and a further increase of $10,000 is not supported;
- ($40,825) as the savings in PST for six months due to the implementation of the HST on July 1, 2010. Energy Probe calculated this as half of 10% of average OM&A expenses from 2006 to 2008, estimated to be $816,515.

VECC noted that KW Hydro has agreed that the inflation rate for non-labour expenses should be based on the Implicit Price Index for national Gross Domestic Product (Final Fixed Demand) ("GDP-IPI (FDD)").[4] This is the same inflation factor used for electricity distribution IRM applications, and it has been used as the inflation adjustment for non-labour expenses in other Cost of Service applications. VECC also noted that KW Hydro has estimated that a 10 basis point reduction in the change in the GDP-IPI (FDD) is equivalent to about $5,789 in OM&A.

VECC also expressed concern with KW Hydro's revised proposal for an amortized (or normalized) recovery of about $230,000 for Regulatory Costs. VECC concurred with Energy Probe that 2010 rebasing costs should be reduced from $228,000 to $188,000, or a reduction of $10,000 in the normalized Regulatory Costs. VECC also submitted that OM&A costs should be reduced by about $60,000 as an estimate of the impact of the HST implementation on July 1, 2010.

In reply, KW Hydro accepted Board staff's proposal with regard to the determination of the inflation factor for non-labour expenses, based on GDP-IPI data available at the time of the Board's decision. KW Hydro submitted that the 2008 over-time costs were not solely or primarily due to storm-related recovery efforts, and that its 2010 estimates are reasonable. KW Hydro also stated that "most overtime costs are non-discretionary and outside the control of KW Hydro."[5]

KW Hydro stated that its service territory has been adversely affected by the recent economic recession, and rejects SEC's argument that no further increase of $10,000 in bad debt expenses in 2010 is needed. KW Hydro also rejects Energy Probe's

[4] In response to Energy Probe IR #24
[5] KW Hydro, Reply submission, page 33.

submission that rebasing costs are too high, and cited statistics from 2009 cost of service applications in support.

KW Hydro agreed to the reduction of $134,438 to its 2010 forecasted property taxes to an amount of $410,656.

KW Hydro submitted that the $100,000 meter maintenance costs in 2010 are not one-time, but incremental and related to planned maintenance activity in the GS > 50 kW class after KW Hydro has completed its Smart Meter deployment. With respect to the elimination of PST, KW Hydro stated that it had concerns with the submissions of all intervenors. KW Hydro addressed this in the related discussion of the HST.

Board Findings

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. The Board approves KW Hydro's proposed OM&A envelope, subject to updates through discovery and documented by KW Hydro in its Argument-in-Chief.

On March 5, 2010, the Board announced the annual percentage change in the GDP-IPI (Final Domestic Demand) for 2009 over 2008, as released by Statistics Canada on March 1, 2010. The annual percentage change is 1.3%. KW Hydro is directed to update its non-labour expense forecasts for 2010 using this as the inflation adjustment factor.

The Board accepts KW Hydro's proposed non-unionized wages adjustment of 3%. This is no more than what is forecasted for KW Hydro's unionized staff, and is in line with adjustments approved in other recent rate applications by the Board.

The Board accepts KW Hydro's estimate of regulatory costs associated with this application, and will allow the proposed amount of $57,500, as $228,000 in expenses amortized over the four years of 2010 rebasing and 3rd Generation IRM. The data shown in Energy Probe's submission and KW Hydro's reply submission show a wide range of regulatory costs, including some that exceed KW Hydro's estimate. The level of regulatory expenses will depend on many factors, including the type of process involved and the issues. The Board finds no reason to consider KW Hydro's expense estimates excessive, and notes that KW Hydro has reduced these already in this proceeding. The Board considers that further reductions proposed by VECC and Energy Probe are unsupported and arbitrary, and will not order any further reduction.

The Board notes that KW Hydro has provided explanations for its overtime expense forecasts historically, as documented in the response to SEC IR #4. The Board notes that some level of overtime is justifiable and even efficient, because of some volatility and cyclicality of work. KW Hydro has documented that storms are one factor driving overtime expenses, while work outside of normal working hours to accommodate customers' service requests or for work associated with construction and roadwork is another major factor. The Board accepts KW Hydro's forecasts of overtime expenses for the 2010 test year.

The Board accepts KW Hydro's estimate of bad debt expenses for 2010, and rejects the reduction of $10,000 proposed by SEC. The Board considers that SEC is ascribing unwarranted precision to the forecasts, and has not provided adequate support as to why the proposed 2010 test year estimate proposed by KW Hydro is unreasonable.

The Board finds that KW Hydro's explanation that the $100,000 in meter maintenance costs will be recurring past 2010 reasonable, as it may take more than one year to "catch up" with activities that have been deferred from past years due to smart meter deployment.

The Board finds the revised property tax estimate of $410,656, as agreed to by KW Hydro, reasonable.

The Board notes that the Board has established a deferral account which KW Hydro shall use to track incremental costs related to conversion to IFRS. As noted in October 2009 FAQ[6] for the *Accounting Procedures Handbook*, the Board has approved account 1508, Other Regulatory Assets "Sub-account Deferred IFRS Transition Costs" for this purpose.

The Board addresses the elimination of the PST effective July 1, 2010 under the discussion of the Harmonized Sales Tax below.

Harmonized Sales Tax

The issue of harmonization of the Provincial Sales Tax ("PST") and federal Goods and Services Tax ("GST") into a single Harmonized Sales Tax ("HST") arose during the

[6] http://www.oeb.gov.on.ca/OEB/_Documents/Regulatory/APH_FAQs_October2009.pdf

hearing. In accordance with legislation introduced and passed by the Ontario Government,[7] the HST will come into effect on July 1, 2010.

KW Hydro has not made any changes to its capex or opex forecasts for 2010 to reflect the implementation of the HST and the associated elimination of the PST.

In its Argument-in-Chief, KW Hydro acknowledged that the introduction of the HST will affect both its capital and operating expenditures, primarily through input tax credits ("ITCs"). However, KW Hydro submitted that this is a change that affects all distributors, and that a generic approach determined by the Board is appropriate. KW Hydro did not support treatment of the HST in the rate applications of individual distributors.

While acknowledging that intervenors provided estimates based on data that was on the record, KW Hydro submitted that the estimates should not be relied on. The HST has not been implemented and the Company felt that there is little reliability on any estimates of associated costs and savings at this time. KW Hydro concurred that distributors should be able to generate savings from the tax harmonization, but also stated that there will also be one-time costs for HST implementation in 2010.

In its Argument-in-Chief, KW Hydro did not oppose the establishment of a deferral account to track both costs and savings associated with the implementation of the HST on July 1, 2010, particularly on an industry-wide basis.

Board staff submitted that, in the absence of good information on the incremental costs and any savings resulting from tax harmonization, establishment of a deferral account to record savings from HST implementation may be appropriate.

Energy Probe submitted that the HST will operate similar to the GST and will result in OM&A expenses and capital expenditure costs savings related to the PST. Energy Probe and VECC submitted that an estimated OM&A expense reduction of $60,000 and of $340,000 to 2010 capex would be appropriate. Energy Probe further submitted that establishment of a variance account would be appropriate. Energy Probe also submitted that the methodology that KW Hydro discussed in its response to Board staff supplemental IR # 27 b) may address concerns that KW Hydro has expressed on this matter.

[7] Bill 218, *Ontario Tax Plan for More Jobs and Growth Act, 2009*, received Royal Assent December 15, 2009

SEC made similar arguments to those of Energy Probe, and submitted that 2010 OM&A expenses and capital expenditures be reduced by, respectively, $40,825 and $367,431. SEC's estimates are calculated as 6 months of the average historical PST expenses paid, with 90% allocated to capital, based on the responses to interrogatories.

In its reply submission, KW Hydro submitted that it recognizes that the implementation of the HST will affect both capital expenditures and operating expenses by reducing them as a result of ITC credits. Nonetheless, KW Hydro reiterated its view that this is an industry-wide issue which should be generically consulted upon to consider all viable alternatives and to allow the best to be chosen. In the event that the Board directs all distributors to capture savings in capital and operating costs due to tax harmonization, KW Hydro supported the implementation of a deferral account to track incremental savings and costs. However, KW Hydro did not support establishment of the deferral account in individual rate applications.

While KW Hydro did provide information in response to interrogatories, KW Hydro stated that it is difficult to calculate estimated cost reductions as the HST has not been yet implemented. KW Hydro submitted that the cost reduction estimates provided by intervenors are "arbitrary" and would require additional "true-up" later on. KW Hydro submitted that the proposals of the intervenors should be rejected and that a deferral account to track any net savings due to HST implementation be established.

Board Findings

The Board acknowledges that the harmonization of the PST and GST into the HST, effective July 1, 2010, is a matter that affects all distributors. This is a matter that has arisen subsequent to KW Hydro filing its Application. KW Hydro could not reasonably have anticipated the timing of the HST implementation at the time that it originally filed its Application.

While noting that this is a more generic issue, the Board is in the position of having to make decisions on the individual rate applications, including this one, that are before it. A generic consultative process or a generic hearing to deal with this matter would entail further delays and add further work to a busy schedule for the Board, the industry and stakeholders.

The Board also notes that a generic or common approach to this matter is unlikely. For example, in Burlington Hydro Inc.'s 2010 Cost of Service application, the Board panel determined that no variance account was necessary and included an estimated impact of the tax change on the revenue requirement and rates based on the evidence.[8] In this Application, KW Hydro has expressed concern with the estimates provided by intervenors.

The Board will not direct reductions to 2010 OM&A and capital expenditures, but will establish a deferral account whereby KW Hydro will record incremental savings due to the implementation of the HST. KW Hydro will use deferral account 1592 PILS and Tax Variances, "Sub-account HST/OVAT Input Tax Credits" for recording this information. The Board does not consider it necessary to make allowances for minor implementation costs. The Board finds that it would not be onerous for KW Hydro to track the Input Tax Credit amounts as KW Hydro will need to file this information in GST/HST returns which will be subject to review by the tax authorities.

Distributors will record the actual Ontario Value Added Tax ("OVAT") ITCs claimed after June 30, 2010 on those costs and expenses that would normally be considered for inclusion in rate base or revenue requirement in a cost of service application. The distributors will retain copies of their GST/HST returns as part of RRR and for evidence in future rates proceedings.

PAYMENTS IN LIEU OF TAXES ("PILs")

KW Hydro requested a PILs allowance of $2,971,055, which is comprised of $2,748,885 for grossed-up income taxes and $222,170 for capital taxes. In its Argument-in-Chief, KW Hydro proposed revised PILs of $2,691,869, comprised of $2,580,802 for Federal and provincial income taxes and $111,067 for Ontario Capital Tax. Revisions were made to reflect the elimination of the Ontario Capital Tax effective July 1, 2010, as well as adjustments for Federal and Provincial Apprenticeship Training Tax Credits ("ATTCs") and an estimated Provincial Cooperative Education tax credit.

Board staff submitted that KW Hydro's proposed PILs methodology and estimate, as amended through responses to interrogatories, is reasonable and complies with Board practice and policy and with known tax legislation, but also noted that other changes to KW Hydro's revenue requirement are possible, due to the Board's decision on KW Hydro's rate base, capital and operating expenditures. These changes would also have an effect on the PILs allowance. Board staff submitted that KW Hydro should flow through applicable changes in operating and capital costs, and update the PILs allowance in its draft Rate Order filing to reflect the Board's Decision.

[8] Decision and Order, Board File No. EB-2009-0259, page 16

Energy Probe agreed with the general Federal and Provincial Tax Rates that KW Hydro has used for estimating its 2010 PILs. Energy Probe identified that, on July 1, 2010, changes to the small business tax rate and surtax will take effect, and that these changes would result in a reduction in income taxes payable of $18,750 in 2010, as the difference between the small business reduction and the claw back associated with the surtax. Energy Probe also submitted that KW Hydro should revise its PILs estimate to take into account the impact of the ATTCs on PILs calculations, including their impact on net income. Energy Probe noted that the Federal tax credit is included in income in the following year, while the Provincial Apprenticeship Training and Cooperative Education tax credits are included in the current year. Energy Probe submitted that KW Hydro's calculation of Capital Cost Allowance appeared to be accurately calculated. In summary, Energy Probe submitted that KW Hydro should update its PILs allowance to reflect the above as well as other impacts arising from the Board's Decision.

VECC concurred with KW Hydro's proposal in its Argument-in-Chief to update its PILs calculations for a number of specific issues identified through the interrogatory process. SEC made no submission on this matter.

In reply, KW Hydro acknowledged that it had not reflected the two Provincial Tax Credits in the calculation of regulatory taxable income for 2010, but submitted that it will do so in the draft Rate Order. This would add $106,000 to its taxable income in 2010, increasing taxes or PILs payable.

Board Findings

The Board finds that, with respect to capital taxes and income taxes or PILs, KW Hydro has generally applied Board policy and practice in an acceptable manner. In particular, the Board notes the concurrence of KW Hydro and all parties on the methodology and on the reasonableness of the derived estimates. Discovery and submissions have resulted in corrections and adjustments to the estimate, but there has been little if any contention in what is a complicated area of tax accounting and law.

The Board accepts KW Hydro's approach to the determination of its PILs allowance, as modified by the submissions of Energy Probe and agreed upon by KW Hydro in reply. The Board notes that the level of the PILs allowance will be determined on the basis of the Board's findings regarding other cost components and directs KW Hydro to provide sufficient detail regarding the PILs calculation in its draft Rate Order.

RATE BASE AND CAPITAL EXPENDITURES

KW Hydro is requesting approval of $163.1 million for its 2010 rate base. This is an increase of $8.6 million (or 5.6%) from KW Hydro's 2008 actuals and $11.0 million (or 7.2%) from 2006 actuals. KW Hydro's historical and proposed rate bases are summarized in the following table[9].

Rate Base

	2006 OEB Approved	2006 Actual	2007 Actual	2008 Actual	2009 Bridge Year	2010 Test Year	Average Annual % Increase 2006 to 2010
Average Net Book Value	$ 127,809,252	$ 129,802,566	$ 131,627,740	$ 131,883,761	$ 131,457,815	$ 139,816,100	1.88%
Working Capital Allowance	$ 21,196,329	$ 22,348,539	$ 23,286,277	$ 22,622,717	$ 23,361,797	$ 23,297,338	1.04%
Rate Base	$ 147,725,922	$ 152,151,106	$ 154,914,017	$ 154,506,478	$ 154,819,612	$ 163,113,438	1.75%

The increase in net fixed assets, about $19.5M, is primarily due to the Wilmot Township Transformer Station No. 9, a multi-year project, which is scheduled to go into service in 2010. In its Argument-in-Chief, KW Hydro has acknowledged a reduction in rate base to $163,088,842, corresponding to adjustments to distribution expenses which in turn affect the working capital allowance.[10] It has not adjusted its Net Fixed Assets.

Board staff expressed general satisfaction with KW Hydro's proposed capital expenditures, but did express caution that the 2010 test year represented a "high water mark", significantly above both historical and future forecasts of capital expenditures. Board staff submitted that KW Hydro should address forecasts against actuals and address year-over-year variances in capital expenditures planning in its next Cost of Service rate application.

Energy Probe noted that KW Hydro had revised its internal 2009 capex budgets for 2009, with a reduction to 2009 additions of more than $800,000. Energy Probe also submitted that KW Hydro's updated 2009 internal budgets, which have been entered in evidence through interrogatory responses[11], contain more current estimates and should be used in determining the 2009 and 2010 rate bases and the 2010 revenue requirement and rates.

VECC submitted that KW Hydro's 2010 capital expenditures should be updated to reflect revised customer and demand forecasts for 2009 and 2010 provided through the interrogatory process.

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[9] Exhibit 2/pg.1 – Summary of Application
[10] Argument-in-Chief, pp. 7-8, para. 20
[11] Response to Energy Probe supplemental IR # 38

All intervenors made submissions proposing reductions to 2010 capital expenditures due to the Input Tax Credits which will apply to corporations, including electricity distributors like KW Hydro, effective the implementation of the HST on July 1, 2010. The Board has addressed this elsewhere in this Decision.

In reply, KW Hydro stated that it would update its 2009 and 2010 capital expenditures and rate base based on its most recent capital budget forecasts, as submitted by Energy Probe, if so directed by the Board. However, KW Hydro submitted that its capital forecasts in its initial Application were the best information available at the time of filing.

KW Hydro noted the lumpiness in its capital expenditures but stated that this was typical of the sector, particularly for a distributor that constructs and owns its own transformer stations. KW Hydro stated that such major projects require significant lead time and each can equate to a full year of capital expenditures. KW Hydro also provided analyses to support its submission that, net of major TS additions in 2004 and 2010, capital expenditures are relatively stable and 2010 is not the highest level of expenditures.

The Company stated that it would provide comparisons of capital expenditure forecasts to actuals and variance analyses in future rate applications if so directed, but submitted that its capital programs were well-documented and the addition information was not necessary. KW Hydro addressed its concerns with HST implementation, whether for capex or opex, elsewhere in its Reply Submission.

Board Findings

The Board is of the view that capital programs should generally be stable over time to ensure overall rate stability, and that if an overall increase is required then that should be planned for on a staged basis in a way which smoothes the rate effects. The Board also recognizes that periodically a distributor will undertake capital projects at significant cost which are beyond the regular level of activity. KW Hydro’s capital program has varied over the period 2006 to 2009, but the level forecast for 2010 is significantly higher than the average, taking inflation into account. The in-service addition of the Wilmot TS is the main project which causes 2010 to be higher than for historical or near-future years. The need for and the prudence of the Wilmot TS is not in question here, nor are other capital projects proposed by KW Hydro being contested.

The Board recognizes that a major project like a distribution station requires significant lead-time for planning, approvals and construction, and represents a major investment. With its obligations to provide adequate, safe and reliable distribution services, the utility must forecast its growth and plan its system replacement, reinforcement and expansion in advance. The Board accepts that KW Hydro has made adequate efforts in this regard, both for this major project and for other capital projects planned for this year.

The Board accepts that KW Hydro's proposed Capital Expenditures and Rate Base contained in its original Application represented the best information available at the time of filing. However, estimates for the bridge and test years may be subject to updating during the course of the proceeding; these changes can occur due to corrections and clarifications of the evidence or equally due to actual events. KW Hydro provided updated information on its 2009 and 2010 capital expenditures and net plant in response to Energy Probe IR #38. In reply, KW Hydro did not dispute these numbers, and has agreed to incorporate these updates if so directed by the Board. While the Board notes that the changes are relatively minor, as shown in the following table, the Board finds it appropriate to use the most current information on the record and which has been tested. Accordingly, the Board directs KW Hydro to reflect the updated 2009 and 2010 capital expenditures and net fixed assets as documented in Energy Probe IR # 38.

Comparison of Changes in Gross Fixed Assets

	Exhibit 2/Tables 15 and 16		Energy Probe supplemental IR # 38 (Tables 15 and 16 revised)	
	2009	**2010**	**2009**	**2010**
Gross Fixed Assets				
Opening	$ 250,925,565	$ 259,667,530	$ 250,925,565	$ 258,843,093
Closing	$ 259,667,530	$ 279,213,064	$ 258,843,093	$ 277,691,263
Accumulated Depreciation				
Opening	-$ 119,897,299	-$ 127,780,165	-$ 119,897,299	-$ 128,021,045
Closing	-$ 127,780,165	-$ 131,468,229	-$ 128,021,045	-$ 131,917,167
Net Fixed Assets				
Opening	$ 131,028,266	$ 131,887,365	$ 131,028,266	$ 130,822,048
Closing	$ 131,887,365	$ 147,744,835	$ 130,822,048	$ 145,774,096
Average	$ 131,457,816	$ 139,816,100	$ 130,925,157	$ 138,298,072
Change from original application			-0.4%	-1.1%

Depreciation

KW Hydro has proposed a depreciation expense of $10,735,844.[12] KW Hydro has affirmed that it uses depreciation/amortization rates in accordance with the Board's guidelines, as documented in Appendix B of the *2006 Electricity Distribution Rate Handbook* (the "2006 EDRH").

In its original Application, KW Hydro stated that it normally uses a full year's amortizations on capital additions during the current year, but that it used the half-year rule for the 2010 test year.[13] In response to Board staff supplemental interrogatory # 28, KW Hydro corrected the evidence, stating that its 2010 depreciation expense "has been calculated in the same manner that it would use for its internal reporting." In that interrogatory response, KW Hydro stated that it would be disadvantaged by the half-year rule because the of the significant capital investment represented by the Wilmot TS, and that application of the half-year rule would reduce depreciation by about $412K and under-recover $823K over four years of rebasing and 3rd Generation IRM.

Board staff submitted that KW Hydro's practice was inconsistent with the Board's standard policy and practice. With respect to KW Hydro's statement that it was unaware of any Board documentation on this matter, Board staff referenced the 2006 EDRH and the accompanying Report of the Board issued on May 11, 2005. Board staff also documented that the situation is due, in large part, to the significant and "lumpy" capital expenditures in 2010. KW Hydro's Application shows that 2010 capital expenditures are higher than in previous years, and also higher than are forecasted for 2011 and 2012. Board staff submitted that allowing for a full year's depreciation expense in 2010 would overstate depreciation expense in subsequent years, when capital expenditures, ignoring any due to the *Green Energy and Green Economy Act*, are expected to be lower. Board staff submitted that KW Hydro should use the half-year rule, consistent with Board policy and practice, for the 2010 test year.

VECC noted that the estimated impact of applying the half-year rule, as noted in the response to VECC supplemental interrogatory # 56, would be ($517,066). Energy Probe noted KW Hydro's reference to a recent decision on Greater Sudbury Hydro's 2009 distribution rates, but noted that the Board's decision in that case regarded the depreciation expense of computer hardware and software, which have relatively short economic lives and hence would be largely amortized by the end of the IRM period. In

[12] Exhibit 4/page 2/Table 1. Also RRWF, Argument-in-Chief, pg. 14/Table 7
[13] Exhibit 4/page 53

VECC's submission, the capital additions for KW Hydro have much longer lives, with amortization rates of 2.5% (i.e., 40 years).

VECC, SEC and Energy Probe supported Board staff's submission that KW Hydro should use the half-year rule for calculating depreciation expense for new capital additions.

In reply, KW Hydro disagrees with the submissions of Board staff and intervenors. KW Hydro noted that the Board has not applied the ½ year rule in all circumstances. KW Hydro submitted that the Board allowed Greater Sudbury Hydro a full year's depreciation expense on its new CIS system "… to <u>avoid creating the deficiency</u> discussed in the [*Report of the Board on Third Generation Incentive Regulation for Ontario's Electricity Distributors* dated September 17, 2008 (EB-2007-0673)]. The deficiency is created based on its original capital cost and not the length of its amortization period. [Emphasis in original][14]

KW Hydro submits that it should be allowed the full-year depreciation expense as calculated. If the Board were to direct that KW Hydro apply the ½ year rule for capital additions, KW Hydro requested that the amortization of the new Wilmot TS be treated separately and that a full year's amortization expense be allowed for this asset in its year of entering service.

Board Findings

The only matter under this issue is whether the ½ year rule should be applied for calculating the depreciation expense of capital assets in the year that these assets enter service. As documented in Board staff's submission, the Board has articulated the ½ year rule in the past. In cost of service applications for 2008 and 2009 distribution rates, most distributors have documented compliance with ½ year rule.

The Board finds that KW Hydro should use the ½ year rule for calculating depreciation expense for 2010 capital additions. This is the general policy that the Board has used previously. As has been noted by KW Hydro, the Board has allowed deviations from this policy in specific circumstances where warranted. KW Hydro has specifically made reference to the Board's decision on Greater Sudbury Hydro's 2009 Cost of Service application, and also to the Incremental Capital mechanism under 3rd Generation IRM. KW Hydro asserts that the Board made its finding in Greater Sudbury Hydro to allow accelerated amortization recovery on the new CIS system to avoid any deficiency in

[14] Argument-in-Chief, February 10, 2010, page 31

recovering the depreciation expense, irrespective of the amortization period of a major capital investment.

The Board notes that its Decision on Greater Sudbury Hydro's application states the following:

> … The Board understands Greater Sudbury's position and agrees that it would under-recover over the life of the asset if it was to apply the half-year rule to the new CIS. Considering the circumstance of the Applicant wherein a significant asset with a short amortization period has been acquired in the Test Year, the Board will allow Greater Sudbury to amortize the CIS on the following basis…
>
> With respect to all other assets added to the 2009 rate base, the standard half-year rule will apply [15]

The Board does not accept KW Hydro's request to allow a full year's depreciation expense recovery for the Wilmot TS even on a stand-alone basis. The Board notes that the Wilmot TS has an expected economic life of 40 years (2.5% amortization rate)[16], and thus does not have a "short life" as discussed in the Decision on Greater Sudbury Hydro. The Board is of the view that there is every expectation that KW Hydro will be able to recover its initial investment over the life of the asset. The Board also considers KW Hydro's request to allow a full year's depreciation on the Wilmot TS in 2010, for factoring into base rates somewhat asymmetric, in that the 2010 depreciation expense also includes legacy assets, some of which may become fully amortized in the period before KW Hydro next rebases. There is no proposal for removal of assets, and associated depreciation expense, that retire in the interim. It is the Board's view that its policy for calculating depreciation expense, which includes allowing a ½ year's depreciation on capital additions in the test year, is appropriate.

The Board directs KW Hydro to recalculate its 2010 depreciation expense using the ½ year rule for new additions in that year, subject to any further revisions which are required as a result of the Board's findings elsewhere on this Decision with respect to KW Hydro's 2010 rate base and capital expenditures and additions. KW Hydro is expected to file its calculations in sufficient detail to support the revised depreciation expense in its draft Rate Order filing.

[15] Decision with Reasons, Greater Sudbury Hydro Inc., 2009 Distribution Rates, [EB-2008-0230], January 19, 2010, pp. 28-29.
[16] Exhibit 4/page 54/Table 22

Working Capital

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

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, but otherwise accepted KW Hydro's proposed WCA methodology as being consistent with Board policy and practice.

Energy Probe has submitted that KW Hydro should use a split between RPP and non-RPP customers and prices for determining the commodity component of the WCA base. Energy Probe submits that doing so will reduce the estimated WCA from $117,865,885 to $114,478,726, based on calculations shown in Energy Probe IR # 40 b) and d). This is a reduction of 2.9% or nearly $3.4 million, which translates into a reduction in the WCA and rate base of $508,000. Energy Probe also submitted that the migration of customers from RPP to non-RPP status as a result of RPP eligibility changes effective November 2009 should be factored into the determination of the cost of power component for the WCA derivation; this is estimated to be about 2.5% of sales. VECC and SEC also supported that the WCA should be derived based on both current RPP and non-RPP prices and customer splits, as shown in the response to Energy Probe IR # 40.

In reply, KW Hydro disagreed with Energy Probe and other intervenors as to the use of separate prices for RPP and non-RPP volumes for the estimation of the WCA. KW Hydro stated that it may be difficult to accurately estimate the consumption volumes for both RPP and non-RPP customers due to the recent exit of the MUSH sector from the RPP group. KW Hydro stated that additional data on its customer base (RPP and non-RPP) would need to be examined before the volumes could be applied to a RPP/non-RPP-specific WCA formula, and for this application, deriving the WCA based on the RPP price as has been previously used in and accepted by the Board in previous distribution rate applications for other distributors.

Board Findings

Working Capital

KW Hydro 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, and this is accepted by all parties for the purposes of this application. 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.

The Board acknowledges that the RPP price has previously been used as the common proxy for the commodity price estimate in the WCA calculation in past applications, and has been accepted as such by the Board in decisions. However, and notwithstanding the Board's agreement that a more general review of the WCA methodology may be warranted, the Board agrees with Energy Probe and finds that the WCA should be determined in a way that recognizes the split between RPP and non-RPP customers. The precise split will vary from time to time, but the magnitude of the variation is unlikely to be significant while the current approach of assuming 100% RPP volumes is clearly inaccurate. However, the Board does not accept Energy Probe's proposal to update the RPP/non-RPP split to reflect the November 1, 2009 RPP eligibility criteria changes. The Board prefers that the split between RPP and non-RPP be based on actual data, such as was provided in the response to Energy Probe IR # 40.

In accordance with the Board's findings elsewhere in the Decision with respect to Retail Transmission Rates, the Board finds that KW Hydro should reflect the Uniform Transmission Rates approved by the Board in its January 21, 2010 Decision under Board File No. EB-2008-0272.

The Board expects KW Hydro to provide sufficient detail in its draft Rate Order filing to demonstrate that the WCA incorporates each finding in this Decision.

Lead-lag Study

KW Hydro has proposed to conduct a lead-lag study in the preparation of its next cost of service rebasing application. The Board finds this proposal timely and appropriate; the Board notes that KW Hydro will have implemented smart meters and Time-of-Use ("TOU") rates by that time. The standard 15% formula is dated and has not been reviewed for a while, and there have been many changes in utility operations, and changes in technology and productivity.

The Board notes that the appropriateness of the level of working capital is also being raised in other applications, and that the Board may initiate a generic proceeding/consultation on determining a new working capital methodology in advance of KW Hydro's next cost of service filing. In such case, the Board expects that KW Hydro will participate in such a process and will take into account the outcomes of such a process. The Board expects that KW Hydro will support its cash working capital allowance in its next rebasing application based on the outcomes of this Board-led process or based on the lead/lag study that KW Hydro stated it would individually undertake.

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 "2006 Report"). The 2006 Report provided the Board's policy guidelines for determining the capitalization and cost of capital to be used for electricity rate-setting.

In Exhibit 5 of its Application, KW Hydro documented its requested Cost of Capital. This is summarized in the following table:

Cost of Capital Parameter	KW Hydro'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	1.33%, but to be updated in accordance with section 2.2.2 of the 2006 Report.
Long-Term Debt	7.62% as the then current deemed long-term rate applicable to existing promissory notes due to the City of Kitchener and the rural Township of Wilmot, but to be updated in accordance with the methodology in the 2006 Report.
Return on Equity	8.01%, but to be updated in accordance with Appendix B of the 2006 Report.
Return on Preference Shares	Not applicable
Weighted Average Cost of Capital	7.52% as proposed, but to be updated to reflect updated Cost of Capital parameters per the methodologies in the 2006 Report.

In 2009, the Board conducted a consultative process to review the Cost of Capital for all rate regulated entities in the Ontario energy sector under its jurisdiction. Based on its findings arising from that consultative process, on December 11, 2010, the Board issued the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the "2009 Report").

In its Argument-in-Chief, KW Hydro acknowledged the issuance of the 2009 Report, and submitted that the cost of capital parameters be updated based on January 2010 information in accordance with the methodologies documented in that report. As the Board had not announced the updated parameters by the close of record, KW Hydro submitted that the updated parameters be reflected in the determination of rates to become effective May 1, 2010.

On February 24, 2010, the Board issued a letter documenting the updated Cost of Capital parameters to be used in determining distribution rates for 2010 cost of service applications, based on the methodologies documented in the 2009 Report. These are summarized in the following table:

Cost of Capital Parameter	**Updated Value for 2010 Cost of Service Applications**
Return on Equity	9.85%
Deemed Long-term Debt Rate	5.87%
Deemed Short-term Debt Rate	2.07%

In Exhibit 5 of its application, KW Hydro noted that its existing debt consisted of a promissory note to the City of Kitchener with a principal of $70,997,576 and a promissory note with the rural Township of Wilmot with a principal of $5,964,566. Both notes have similar terms, executed on November 27, 2001, and earning the rate established by the Board effective January 1, 2003. The notes are callable on demand. There are no constraints against KW Hydro repaying at any time. KW Hydro noted that its debt has earned the Board's deemed long-term debt rate at the time of its cost of service rate application, the applicable being 6.00% as the deemed debt rate applicable to a distributor of similar size to KW Hydro as documented in the 2006 EDRH.

KW Hydro has indicated that it is seeking external debt to assist with smart meter funding for an amount around $10 million, but has not progressed with securing any new debt at this time.

Board staff submitted that KW Hydro's proposals on cost of capital, as amended through discovery, comply with the guidelines documented in the 2009 Report.

Energy Probe submitted that the evidence in this proceeding regarding the level of the WCA indicates that the 4% deemed level of short-term debt is too low and that the incremental costs, as a result of the WCA attracting the higher long-term rate, are neither just nor reasonable. Energy Probe pointed to the Board's comments in the 2006 Report to the effect that the term of the debt should mirror the life of the assets that the debt is used to finance. Energy Probe expressed its view that the WCA, which represents about 14.3% of rate base, should attract only the deemed short-term debt rate. Energy Probe noted that the actual percentage has averaged about 14.9% from 2006 to 2008 and has been relatively consistent over that period.

Energy Probe submitted that the 9.75% ROE set by the Board in the 2009 Report includes an implicit 50 basis points for transactional costs and asserted that the component is only applicable in cases where a distributor releases new stock or issues debt. Energy Probe acknowledged that this implicit component for flotation and transactional costs is long standing within Ontario and across North America, but stated that the inclusion of the implicit 50 basis points for transactional costs is not appropriate for KW Hydro because there is no evidence that it will incur any transaction costs in the test year and that, to allow the recovery of the amount, would result in rates which are not just and reasonable.

SEC submitted that KW Hydro's promissory notes are not callable, since the terms of the notes, documented in Exhibit 5/Appendix A, state that repayment can be demanded upon 18 months notice; hence the notes are not callable within the 2010 rate year. SEC noted that there are no impediments to KW Hydro repaying and replacing the current notes, and submitted that it could secure third party financing at rates much lower than the then current deemed rate of 7.62%. SEC noted that the 2009 Report states that the deemed debt rate as a ceiling on what should be allowed. In SEC's submission, the allowed rate should be lower or, as an alternative, the notional debt (the difference between the actual debt of $76,962,142) and deemed debt ($91,343,525) should attract a lower rate.

SEC supported Energy Probe's proposal that the allowed ROE be reduced by 50 basis points to reflect the absence of flotation costs. SEC also submitted that a table showing the revenue requirement impact on each customer class due to any higher ROE be communicated in the Board's order to ensure customers are aware of what they are paying for in their rates.

VECC noted that the ROE and short-term debt rate are to be updated. VECC made a similar submission that the promissory notes are not callable as defined in the 2009 Report, since demand requires 18 months' notice, but submitted that they attract the deemed long-term debt rate per the terms of the notes. VECC noted KW Hydro's planned debt for smart maters; in the absence of specific details of the debt, VECC submitted that a weighted cost of debt also incorporate this new debt at a rate of 5% issued half way through 2010 in addition to the existing debt.

In its reply submission, KW Hydro disagreed with Energy Probe's argument of aligning the short-term debt capitalization to the working capital. KW Hydro stated that its proposed WCA is calculated for the purposes of determining the rate base for rate-setting purposes, but does not, nor should not, correlate or act as a proxy for actual short-term debt. KW Hydro submitted that its proposed capital structure complies with Board policy, as documented in the 2009 Report. KW Hydro also submitted that Energy Probe has erred in assuming that all working capital is funded by short-term debt; KW Hydro submitted that this is not the case in reality, and that for corporate financing purposes, firms need both a long-term (or permanent) and a short-term or cyclical component for cash working capital.

With respect to Energy Probe's proposal to reduce the allowed ROE by the 50 basis points for flotation and transaction costs, KW Hydro submitted that:

> Energy Probe's approach creates an entirely new and unexpected burden of proof that would open the floodgates to numerous arguments about all aspects of the allowable ROE – requiring utilities to hire costly consultants to justify a proposed ROE and subjecting the Board to lengthy administratively cumbersome proceedings on disputed ROE allowances. KW Hydro submits that the Board should reject Energy Probe's approach and affirm KW Hydro's use of a 9.75% ROE pursuant to the December 2009 Report.[17]

Board Findings

Return on Equity

The Board will make not make the adjustment to the method of determining the ROE proposed by Energy Probe. The Board notes the following from page 63 of the Cost of Capital Report:

> The Board will apply the methods set out in this report annually to derive the values for the ROE and the deemed long-term and short-term debt rates for use in cost of service applications.

[17] KW Hydro, Reply Submission, February 10, 2010, page 44.

This approach is qualified by the Board at page 13 of the Cost of Capital Report:

> The final “product” of this process, of course, is a Board policy. This was not a hearing process, and it does not – indeed cannot – set rates. The Board’s refreshed cost of capital policies will be considered through rate hearings for the individual utilities, at which it is possible that specific evidence may be proffered and tested before the Board. Board panels assigned to these cases will look to the report for guidance in how the cost of capital should be determined. Board panels considering individual rate applications, however, are not bound by the Board’s policy, and where justified by specific circumstances, may choose not to apply the policy (or a part of the policy).

The issue is whether the Board should apply the policy or whether it should adjust the application of the policy for the specific circumstances of KW Hydro. The Board concludes that the policy should be applied unadjusted.

The Board notes that the argument advanced by Energy Probe, namely the removal of 50 basis points from the ROE on the basis that KW Hydro does not issue equity in the market, is the same as that advanced by Energy Probe in Burlington Hydro Inc.’s 2010 Cost of Service application. The Board in fact notes that KW Hydro’s situation exactly corresponds with that of Burlington Hydro in its application. For the same reasons as are articulated by the Board in its decision on Burlington Hydro’s 2010 distribution rates application[18], the Board finds that KW Hydro has complied with the requirements of the Cost of Capital Report and of the Board’s filing requirements, and that no adjustment to the ROE is warranted or supported.

The Board finds that it would be inappropriate to adjust the operation of the formula without evidence as to the appropriateness of such an adjustment in terms of the overall methodology in the context of KW Hydro’s circumstances. This evidence would need to address, for example, whether such an adjustment for KW Hydro is appropriate under the “stand alone” utility principle and whether the allowance is related only to specific transactional costs or whether it has broader application, and that no adjustment to the ROE is warranted or supported.

The emphasis in the Cost of Capital Report regarding the need to support an application refers particularly to long-term debt and the proper application of the Board’s policy, an area which has drawn considerable attention in several Cost of Service applications in

[18] Decision with Reasons, Burlington Hydro Inc., [EB-2009-0259], pp. 25-28

the past few years. With respect to adjustments to the ROE, such as that proposed by Energy Probe, the Board expects the party proposing a departure from the policy to supply the supporting evidence. Depending upon the circumstances, this could be either the applicant or an intervenor.

Cost of Long-term Debt

The Board finds that KW Hydro's cost of long-term debt should be 5.87%, reflecting the current deemed long-term debt rate announced in the Board's letter of February 24, 2010 for May 1, 2010 rates.

The Board does not accept VECC's proposal to consider the $10,000,000 of forecasted debt for Smart Meters. The record indicates that, while KW Hydro is forecasting that it will incur this debt, the details (timing, debt rate, transaction costs, etc.) are not known at this time. The 5% rate suggested by VECC, even if reasonable, is not supported by evidence. The Board also notes that KW Hydro's smart meter investments are not currently in rate base but are tracked in established deferral/variance accounts. As such, the Board agrees with KW Hydro that this loan, if and when it materializes, should be used in the determination of Smart Meter rate adders, or disposition riders, rather than in the calculation of the base 2010 distribution rates.

Capital Structure

The Board will make no adjustment to the deemed capital structure of 56% long-term debt and 4% short-term debt. As acknowledged by all parties, the Board's uniform deemed capital structure and the uniform approach to setting the WCA have both been in place for considerable time. The Board is not prepared to depart from these policies on the basis of the record in this proceeding.

Energy Probe has asserted that the WCA should align to short-term debt in the capital structure, but it has not provided any evidence to support this contention, theoretically or practically; nor has KW Hydro had the opportunity to respond with rebuttal evidence. However, KW Hydro has submitted in reply that, for corporate financing purposes generally, working capital has both long-term and short-term components. In other words, working capital is not fully funded by short-term debt as Energy Probe contends. The Board finds KW Hydro's argument reasonable.

However, as indicated earlier, the Board may review the formulaic approach to determine the WCA and, in the context of such a review, it may be appropriate to examine the levels of WCA across utilities and consider whether any refinement to the deemed capital structure is warranted.

Weighted Average Cost of Capital

The table below sets out the Board's conclusions for KW Hydro's deemed capital structure and cost of capital for the purposes of setting its 2010 revenue requirement and distribution rates:

Board-approved 2009 Capital Structure and Cost of Capital for KW Hydro

Capital Component	% of Total Capital Structure	Cost rate (%)
Long-Term Debt	56.0	5.87
Short-Term Debt	4.0	2.07
Equity	40.0	9.85
Weighted Average Cost of Capital		**7.31**

In preparing its updated revenue requirement arising from this decision and the draft Rate Order to implement this Decision, KW Hydro 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;
- Specific Service Charges;
- Transformer Ownership Allowance;
- Embedded Distributor;
- Other Distribution Revenue;
- Retail Transmission Rates; and
- MicroFIT Generator Service Classification and Rate.

Loss Factors

In its application, as clarified in the response to Board staff IR # 20, KW Hydro has proposed a small decrease to its total loss factor ("TLF") from the current approved 3.29% to 3.20% for secondary metered customers < 5000 kW. Similar decreases are also proposed for other customer classes. The TLF is the product of the two factors, the distribution loss factor ("DLF") and the supply facilities loss factor ("SFLF").

As corrected in the response to Board staff IR # 20, KW Hydro provided historical data for its Distribution Loss Factors ("DLF") and Supply Facilities Loss Factor ("SFLF") from 2004 to 2008. The proposed factors are equal to the respective averages over the initial 5-year period.

Board staff sought clarification on KW Hydro's proposed TLFs. The table is replicated below, as corrected in KW Hydro's reply submission:

Total Loss Factors

Secondary metered customer < 5000 kW	1.0320
Secondary metered customer ≥ 5000 kW	1.0154
Primary metered customer < 5000 kW	1.0226
Primary metered customer ≥ 5000 kW	1.0053

VECC submitted that the historical loss factor is reasonably stable and that KW Hydro's proposal should be accepted. SEC and Energy Probe made no submissions on this matter.

Board Findings

The Board approves KW Hydro's proposed loss factors, as updated through discovery and clarified in its reply submission.

Revenue-to-Cost Ratios

KW Hydro is requesting approval of distribution rates that would move its revenue to cost ratios toward the Board's policy range. KW Hydro's application involves a re-balancing of class revenues to better reflect the results of the cost allocation model.

KW Hydro provided updated summaries in Tables 12, 13 and 14, on pages 25 and 26 of its Argument-in-Chief, and also filed its final Cost Allocation model as a separate Microsoft Excel spreadsheet. KW Hydro stated that the embedded distributor class is omitted from the cost allocation, as it believes that it can not be properly reflected in the study. It states that any impact is immaterial, as the embedded distributor's revenue requirement is only about $70K out of 2010 distribution revenues of $35.5 M. The following table shows the Revenue-to-Cost ratios as proposed in the initial Application and revised in the Argument-in-Chief:

Revenue-to Cost Ratios - Exhibit 7/pg. 3/Table 1

Customer Class	From Cost Allocation Model (Run 2)	Column 1 Revised (Transformer Allowance Removed)	From 2010 Cost Allocation Model before Proposed Adjustments	Proposed for Test Year	Revised Proposal (AIC, page 26/Table 14)	Board Target Range
Residential	92.86%	90.28%	88.55%	95.75%	93.90%	85 - 115
GS<50kW	98.06%	95.34%	102.23%	102.23%	102.55%	80 - 120
GS>50kW	131.71%	136.53%	122.09%	107.65%	111.94%	80 - 180
Large User	101.15%	117.46%	112.26%	106.24%	100.22%	85 - 115
Street Lights	29.02%	26.15%	127.28%	107.80%	107.66%	70 - 120
USL	153.04%	150.06%	158.46%	108.03%	110.81%	80 - 120

Board staff submitted that the proposed ratios are all within the range of ratios outlined in the *Report of the Board: Application of Cost Allocation for Electricity Distributors*, EB-2007-0667, issued November 28, 2007, and took no issue with KW Hydro's proposed cost allocation and revenue-to-cost ratios, as updated.

Energy Probe noted and supported KW Hydro's proposal to reduce the revenue-to-cost ratio for the USL class to 110.81%. Energy Probe submitted that this brings rates for this class closer to those of other classes, while having little impact on other classes. As such, Energy Probe supported KW Hydro's proposed cost allocation.

VECC submitted that KW Hydro's proposed updated cost allocation was not performed as requested through interrogatories posed by VECC. VECC submitted that the Distribution Revenues used in the Cost Allocation in response to VECC IR # 61 and in the Argument-in-Chief differ materially ($33.105 M compared to $38.255 M) from the revised base distribution Revenue Requirement. VECC also submitted that KW Hydro had not reduced the revenues for the GS > 50 kW and Large Use classes to account for the transformer ownership, as required by the filing requirements. VECC provided a table outlining 2010 cost allocation results based on its own analysis. It submitted that both the Streetlighting and USL classes have R/C ratios above the ceilings and should be reduced to the 120% ratio. VECC submitted that the shortfall in revenues arising from its proposal should be recovered from the Residential class, but that this would only have a marginal impact on this class. VECC submitted that R/C ratios for other classes should not be adjusted.

SEC made no submission on KW Hydro's cost allocation.

In reply, KW Hydro provided the following table summarizing the proposals of itself and VECC:

Rate Class	Existing Rates		Final Proposed	
	KW Hydro	VECC	KW Hydro	VECC
Residential	93.83%	90.70%	93.90%	Add shortfall
GS < 50 kW	102.59%	104.60%	102.55%	No Change
GS > 50 kW	111.95%	116.90%	111.94%	No Change
Large User	96.75%	96.00%	100.22%	No Change
Street Lighting	108.91%	128.10%	107.66%	120.00%
Unmetered Scattered Load	135.53%	159.50%	110.81%	120.00%

KW Hydro submitted that its proposed cost allocation should be accepted. It noted that its proposal was acceptable to all parties except VECC. KW Hydro stated that it accepts, but does not recommend VECC's proposal to maintain the Streetlighting and USL R/C ratios at the ceiling of 120%.

Board Findings

The Board notes that KW Hydro could have better documented its evidence on Cost Allocation. In Exhibit 7, the Company filed relatively little information, particularly given some of the unique aspects of its proposal such as proper treatment of the Transformer Ownership Allowance, adjustments to the eligibility for the Transformer Ownership Allowance, and the treatment of streetlighting connections. Several interrogatories, primarily by VECC, were posed to solicit further information on the record. As a result of the interrogatory phase, there are a number of different Cost Allocation spreadsheets that have been filed on the record. In its submission, VECC has raised concerns regarding certain assumptions and cost treatment in the Cost Allocation analyses that KW Hydro is relying on for its proposed rates. The Board is concerned that there may be confusion on the record regarding the appropriate assumptions and calculations in the model. It is understood that Cost Allocation is a complex area of assumptions and technical details, but this also means that parties should make greater effort to understand, and to make understood, the evidence upon which they are relying.

That said, the Board has reviewed the record and is of the view that VECC's submission on cost allocation should be accepted. As VECC has documented, the R/C ratios from its analysis are comparable to what is shown in the Application[19]. The Board finds that VECC has documented a comprehensible derivation of the revenue-to-cost ratios, and related them back to KW Hydro's original evidence. As such, the Board directs KW Hydro to use the R/C ratios documented by VECC, and to adjust the class R/C ratios as

[19] As VECC noted in its submission, January 28, 2010, on page 16, para. 7.4, the R/C ratios as similar to the column labelled "From 2010 Cost Allocation Model Before Proposed Adjustments" in Exhibit 7/Table 1

proposed by VECC in its submission. These are shown in the table above under the columns labeled "VECC".

The Board has some concerns with KW Hydro's Cost Allocation methodology. KW Hydro has defined its streetlighting connections, distinguishing between individually-controlled and grouped-controlled streetlights. In its Application[20], KW Hydro describes its approach. It has documented that 187, or about 1% of streetlights are individually connected to KW Hydro's distribution system, while 99%, or 22,590 of streetlights are connected through 1398 relay/service entrance switches. In effect, each connection is a "daisy-chain" of a number of streetlights, averaging about 16 (22590 streetlights/1398 connections). The City or Kitchener and the Municipality of Wilmot own the streetlighting assets, and KW Hydro provides capital and maintenance services for them, as documented elsewhere in the Application.[21] The Streetlighting Service Agreements constitute a material source of revenues, forecasted at $1.26 million for 2010.

The Board considers KW Hydro's approach reasonable in terms of delineating the connections and the assets and services in KW Hydro's distribution network serving streetlights. In the Board's view, this manner of treating streetlighting connections for Cost Allocation purposes is markedly different than that used by many other distributors. It may be that given the connection arrangements and possibly the demarcation point for ownership, this may be a realistic way of modeling the allocation of costs. However, due to the uniqueness of the arrangement, the Board expects a more complete explanation of the cost allocation approach to this class to be included in KW's next cost allocation filing. KW Hydro has documented that it has also used the 0.1 weighting factor for USL and streetlighting because the customers receive summary bills.[22] The Board also notes that KW Hydro has used the 0.1 weighting factor for services for streetlighting. Given that each connection now represents, on average, about 16 streetlights which, in turn, represents a significant load, the Board questions the 0.1 service weighting for streetlighting. KW's use of weighting factors should also be addressed in its next cost allocation filing.

KW Hydro has also excluded the embedded distributor class from its Cost Allocation methodology, although it documents that the embedded distributor is included in certain Cost Allocation analyses on the record. KW Hydro indicated that inclusion of the

[20] Exhibit 7/pp. 11-12
[21] Exhibit 3/page 69
[22] Exhibit 7/page 9/ll. 26-28

embedded distributor class was not reliable and that the revenues involved (under $100,000) are not significant. While the Board accepts that the amount of revenues is not very significant, it is not that much smaller than the revenues for the Unmetered Scattered Load class, which is included in the model. In principle, all customer classes should be included, and the Board would have more comfort in the cost allocation results if this had been done. The Board accepts the exclusion of the embedded distributor class for this Application, but expects that KW Hydro will make efforts to include it in any future cost allocation work.

It is expected that KW Hydro will provide an updated Cost Allocation study in support of its next cost of service rebasing application. In conducting such a study, KW Hydro is expected to address matters raised in this Decision, including:

- Integration of the embedded distributor class within the cost allocation study;
- Appropriateness of separating GS > 50 kW in separate classes for Transformation 50-1349 kW and above 1350-4999 kW; and
- Weighting factors for connections for daisy-chained streetlighting.

Rate Design

KW Hydro's existing and proposed (original Application and revised per its Argument-in-Chief) distribution rates are documented in the following table:

Existing and Proposed Distribution Rates
(Excluding Smart Meter Funding Adder)

	2009			2010			2010 (Revised - SIC, Table 15)		
Class	**Fixed**	**Volumetric**		**Fixed**	**Volumetric**		**Fixed**	**Volumetric**	
	(less SM)	**kWh**	**Kw**	**(no SM)**	**kWh**	**Kw**	**(no SM)**	**kWh**	**Kw**
Residential	$ 9.55	$ 0.0123		$ 12.05	$ 0.0162		$ 9.55	$ 0.0182	
GS < 50 kW	$ 25.17	$ 0.0090		$ 25.17	$ 0.0125		$ 25.17	$ 0.0119	
GS 50 to 4,999 kW	$ 232.71		$ 3.5202	$ 232.71		$ 3.7221	$ 232.71		$ 3.8201
Large Users	$ 14,195.83		$ 1.4316	14.195.83		$ 1.8968	14.195.83		$ 1.5946
Streetlighting (per connection)	$ 0.78		$ 4.3948	$ 0.78		$ 4.4012	$ 0.78		$ 4.2889
USL (per connection)	$ 12.59	$ 0.0090		$ 8.34	$ 0.0125		$ 8.34	$ 0.0131	
Embedded Distributor (Waterloo North Hydro)									
- Shared Line (per kW)			$ 0.0999			$ 0.1400			$ 0.1400
- Dedicated Line (per kW)			$ 1.1290			$ 1.2900			$ 1.2900
Standby Power (interim approval)	Applicable volumetric kW rate per contracted demand			Applicable volumetric kW rate per contracted demand			Applicable volumetric kW rate per contracted demand		
Transformer Discount			-$ 0.60			-$ 0.70			-$ 0.70

In its original application, KW Hydro proposes to reduce the monthly fixed charge in the USL class, and increase the monthly fixed charge in the residential class, based on findings of the 2010 cost allocation study. Monthly service charges for other classes remain unchanged (after backing out the smart meter funding adder). The Monthly Service Charges are within the cost allocation range for all classes, except for GS < 50 kW (which is above the range), Large Use (far above the range), and USL which is above.

In its Argument-in-Chief, KW Hydro has adjusted its Residential Monthly Service Charge to $9.55/month per the response to VECC IR #35,[23] and has also updated its rate model based on revised distribution revenue shares as a result of the discovery process.[24]

Board staff submitted that KW Hydro's rate design proposal, as adjusted through the proceeding, is reasonable and is consistent with Board policy as articulated in the Board's Cost Allocation report and in previous decisions.

SEC noted that KW Hydro has proposed to keep the Monthly Service Charge frozen at current levels, net of the Smart Meter rate adder. SEC submitted that the fixed/variable ratio falls as a result and that this will create an inequitable rate increase for the GS < 50 kW, as cost increases are recovered through the variable rates. SEC submitted that, for the GS < 50 kW class, the monthly service charge should increase proportionate to the class revenue requirement change for the rebasing, and then should be frozen for the IRM term. In SEC's submission, this would make increases more gradual for this class.

VECC submitted that KW Hydro's proposal to fix the monthly service charge at existing levels is reasonable, except for Residential and Unmetered Scattered Load classes. VECC noted that KW Hydro's proposal is consistent with the Board's guidelines. However, VECC submitted that a more reasonable approach would arise from applying the approved 2009 rates to the 2010 forecast billing determinants for each class, subject to no results exceeding the corresponding ceiling in the Board's guideline.

Energy Probe made no submissions on this matter.

In reply, KW Hydro submitted that its proposal should be accepted. It further submitted that the lower monthly charge, and hence the increased variable charge, will encourage conservation, although the impact of its fixed/variable split affects some customers more so than others.

[23] Argument-in-Chief, page 24/para. 55
[24] Argument-in-Chief, pp. 26-28/paras. 58-59

Board Findings

The Board accepts KW Hydro's proposal to freeze the monthly service charge for each customer class as acceptable. KW Hydro's proposal is different from that generally proposed by other distributors and approved by the Board. However, the Board does not consider that this proposal discriminates against any customers. As a result, any incremental revenue requirement will be recovered in changes to volumetric distribution rates for all customers.

KW Hydro is expected to reflect the Board's findings with respect to KW Hydro's Transformer Ownership Allowance, articulated later in this Decision, in the proposed rates, along with adequate documentation, in its draft Rate Order.

The Board accepts KW Hydro's proposal to maintain its existing standby rate on an interim basis as a continuation of its existing approval.

Specific Service Charges

KW Hydro has proposed the addition of three new specific service charges[25], as follows:

- Collection of Account Charge – No Disconnection ($30.00)
- Meter Dispute Charge plus Measurement Canada Fees (if meter found correct) ($30.00)
- Meter Removal without Authorization ($60.00)

KW Hydro is proposing no other changes to its existing Specific Service Charges.

In response to VECC IR # 24, KW Hydro provided its support for the estimation of the Collection of Account Charge – No Disconnection. The cost analysis would derive estimated causal costs of $27.31, which KW Hydro has rounded up to $30.00.

Board staff noted that the proposed charges for the new Specific Services Charges are equal to the default values as documented in the 2006 EDRH.

VECC acknowledged the need for the Collection of Account Charge, but submitted that KW Hydro should make efforts to ensure that customers are aware of such charge on the first visit. VECC also suggested that KW Hydro should not attempt to recover the

[25] Exhibit 3/pp. 63-64

charge if the bill is paid at that time. No other parties made submissions on this matter, and KW Hydro did not address this in its reply submission.

Board Findings

The Board approves KW Hydro's proposed new Specific Service Charges. The Board assumes that KW Hydro will make appropriate efforts to ensure that customers are aware of the new Specific Service Charges, and may wish to consider the suggestions in VECC's submission.

Transformer Ownership Allowance

KW Hydro has proposed to discontinue the Transformer Ownership Allowance credit for customers who own their own transformers over 1,500 kVA (approximately 1,350 kW). This proposal is based on the Board's approval of a similar proposal for Guelph Hydro in a prior application (Board File No. EB-2007-0742). KW Hydro has also proposed to increase the credit amount from ($0.60/kW) to ($0.70/kW). Despite the increase in the credit rate, the forecasted credit payments is estimated to decrease to $426,772 from the $959,968), due to the lower number of higher demand customers that would be entitled to the transformer allowance credit.[26]

Board staff took no issues with KW Hydro's proposal, and noted that the Board has also accepted a similar proposal for London Hydro Inc. in the Board's Decision and Order issued August 21, 2009 under Board File No. EB-2008-0235. No other parties made submissions on this matter.

Board Findings

The Board considers that KW Hydro's proposal to eliminate the Transformer Allowance Credit for certain larger customers is analogous to the situations for Guelph Hydro-Electric System Limited ("Guelph Hydro") and for London Hydro Inc. ("London Hydro"), as approved by the Board in Decisions under, respectively, Board File Nos. EB-2007-0274 and EB-2008-0235. However, there is one difference in KW Hydro's situation compared to the cases of Guelph Hydro and London Hydro, relating to the threshold. In the cases of Guelph Hydro and London Hydro, the threshold for not providing transformation or the Transformer Allowance Credit aligns with the boundary between two customer classes (1000 kW for Guelph Hydro and 5000 kW for London Hydro). In

[26] Exhibit 3/pp. 58-59

this Application, KW Hydro is proposing that the threshold would occur in the middle of the GS 50-4999 kW class; this is acknowledged by KW Hydro in its initial Application.[27].

Aligning at the boundary between two customer classes is preferable, as it allows transformation costs to be assigned to the class or excluded, as the case may be, for both cost allocation and for rate design. In KW Hydro's proposal, the GS 50-4999 kW class would have a common rate design and volumetric rate. In the Board's view, this creates an asymmetrical arrangement. A customer with its own transformer > 1500 kVA would pay the same volumetric rate as a customer with a 1200 kVA transformer, while the latter would receive the Transformer Ownership Allowance credit and the former would not.

One approach would be for KW Hydro to establish separate rate classes for General Service 50-1349 kW and 1350-4999 kW customers. In the absence of this, the Board believes it reasonable for KW Hydro to establish different volumetric rates such that the volumetric rate for the General Service 1350-4999 kW sub-class is $0.70/kW less than that for a General Service 50-1349 kW customer with transformation (i.e. step-down transformation provided by KW Hydro). In its draft Rate Order submission, KW Hydro should calculate and document updated rates to reflect this.

With the above finding, the Board approves KW Hydro's proposal to discontinue the transformer allowance for the customers with their own transformers over 1500 kVA, and directs KW Hydro to reflect this finding in its draft Rate Order and in its Conditions of Service. The Board also approves KW Hydro's proposal to increase the transformer allowance credit to $0.70/kW for other customers to which the credit will apply.

If KW Hydro feels that it is unable to implement the above split of the volumetric rates for the GS 50-4999 kW class at this time, then the Board denies KW Hydro's proposal. KW Hydro should maintain the existing Transformer Allowance Credit for all customer classes, at the existing charge of $0.60/kW.

KW Hydro should explicitly identify which option it is choosing, and should provide adequate support for the rate derivation in its draft Rate Order.

Embedded Distributor

KW Hydro is a partial host distributor to Waterloo North Hydro Inc., through both a shared LV line and a dedicated LV line; each line has a distinct rate.

[27] *Ibid.*

KW Hydro has estimated LV expenses to be recovered of $70,145K, an increase from $61,407 in 2007 and $59,513 in 2008. It has also proposed updated embedded distributor rates for Waterloo North Hydro, in accordance with the methodology that was proposed, and subsequently approved by the Board, in the 2006 EDR application RP-2005-0020/EB-2005-0387. The proposed rates are $1.29/kW for the Dedicated (or Specific) line and $0.14/kW for the Shared line. These are increases from existing rates or about $1.13/kW and $0.10/kW for the Dedicated and Shared lines. KW Hydro provided further explanation of the embedded distributor rate treatment and calculation in response to Board staff IRs # 21 and 22. While the proposed tariffs show material increases for each of the embedded distributor rates, and specifically a 40% increase for the Shared line rate, the increase in revenues expected from the embedded distributor is much less.

In the response to Board staff IR # 21 c), KW Hydro concurred that the embedded distributor rates should be updated at the time of the draft Rate Order to reflect the changes in the Cost of Capital parameters, tax rates or other findings of the Board's decision on this application; KW Hydro also confirmed this in its reply submission. While the embedded distributor rates are calculated separately from those of the other customer classes, this treatment would ensure consistent treatment of the rates for this customer compared to rate adjustments to other classes.

KW Hydro calculates the rates for the embedded distributor separately from those for other distributors. Its methodology was approved in KW Hydro's application for 2006 distribution rates, considered under Board File No. RP-2005-0020/EB-2005-0386.

Board staff did not oppose KW Hydro's methodology, but submitted:

> The current methodology for establishing rates is based on an approach first accepted by the previous regulator, Ontario Hydro. KW Hydro's embedded distributor rate design was one of the first considered by the Board in the 2006 EDR applications. Subsequently, the Board has dealt with applications for embedded distributor rates using other approaches. The Board's policy to treat embedded distributors as a distinct class is evolving as experience and knowledge is gained by the Board and the industry. Board staff considers it important that KW Hydro similarly evolve its rate treatment of the embedded distributor rates consistent with Board policy and practice. Board staff suggests that this is important for KW Hydro to fully integrate the embedded customer into any future cost

> allocation study because of the shared line, which costs should be properly allocated between Waterloo North Hydro and KW Hydro's retail customers served by that line.[28]

VECC noted that KW Hydro's methodology does not assign all costs and use the same factors as are used in the cost allocation for other customer classes, and supported Board staff's submission. SEC and Energy Probe made no submissions on this matter.

In reply, KW Hydro agreed to update the embedded distributor rates consistent with the Board's findings in this Decision.

Board Findings

The Board accepts the current methodology for determining embedded distributor rates, and directs KW Hydro to update its proposed embedded distributor rates, consistent with the Board's findings on Cost of Capital, tax rates and other findings in this Decision which affect the embedded distributor's rates. The Board expects that KW Hydro will file sufficient information showing the updated rate derivation in its draft Rate Order submission.

The Board agrees with the submissions of Board staff and VECC on the need to integrate the embedded customer class in any subsequent Cost Allocation work. As such, the Board expects that KW Hydro will integrate the embedded distributor class along with all other customer classes in any Cost Allocation studies filed in support of subsequent distribution rate applications.

Other Distribution Revenue

Revenue offsets decrease the need for revenue from distribution rates. KW Hydro provided a breakdown of its revenue offsets in Exhibit 3/page 2/Table 1 – Operating Revenue Summary table. Further details of historical and forecasted Other Revenues, and explanations for variances, are provided in Exhibit 3/pp. 62-74. KW Hydro's proposed revenue offset, in its original Application, is $1,740,295, down from $2,565,890 for 2006, $3,493,786 for 2007 and $2,869,204 for 2008. Decreases in "Revenues from Non-Utility Operations" and "Interest and Dividend Income" account for the majority of the overall decrease.

[28] Board staff submission, January 22, 2010, page 29

In its Argument-in-Chief, KW Hydro has amended its forecasted Other Revenues to $1,861,512, to reflect the following:

- Increased forecasted Late Payment Charge revenues of $14,820, per Energy Probe IR #44;
- Increased forecasted Miscellaneous Service Revenues of $11,113 for revenues due to the proposed new Specific Service charges; and
- Increased revenues of $110,284 to gross-up PILs and adjust the rate of return used for Streetlighting revenues received for services provided to the City of Kitchener and the Township of Wilmot.[29]

Board staff submitted that KW Hydro's estimates for Other Revenues, as amended through discovery, is reasonable. No other submissions were made by intervenors.

Board Findings

The Board finds that KW Hydro's proposals with respect to Other Distribution Revenue, as revised during the course of the proceeding, 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 guideline was updated on July 22, 2009.

KW Hydro has proposed adjustments to Retail Transmission Service Rates ("RTSRs") to correspond with the July 1, 2009 changes to the Uniform Transmission Rates ("UTRs"), subject to any modification per the Hydro One Transmission rate application that, at the time of application, was before the Board. KW Hydro has proposed a 5% reduction to the RTSR – Network and a 22% reduction to the RTSR – Connection. KW Hydro noted that it had reduced its RTSRs in 2008 and increased them in 2009. KW Hydro documented that the current cost-to-revenue ratio is 0.92 for Network and 0.81 for Connection; i.e., it is over-recovering transmission services costs. The proposed changes should bring the cost-to-revenue ratios to unity. KW Hydro notes that the proposed rates may be altered based on the Board's phase two decision on Hydro One's 2010 Transmission rate application, for which the Board issued its Decision on December 16, 2009.

[29] Argument-in-Chief, page 15/paras. 33-36

Board staff did not oppose KW Hydro's proposal. VECC supported KW Hydro's proposal. SEC and Energy Probe made no submissions on this matter.

In its reply submission, KW Hydro proposed to update its application to reflect the new UTRs in accordance with the Board's Decision of January 21, 2010 under Board File No. EB-2008-0272.

Board Findings

The Board finds that KW Hydro has appropriately applied the Board's guidelines for the derivation of the RTS rates. However, the Board notes that an order was issued on January 21, 2010 setting new UTRs effective January 1, 2010. The changes in the UTRs are shown in the following table:

Uniform Transmission Rates

	Effective on July 1, 2009	Effective on January 1, 2010
	($/kW/month)	($/kW/month)
Network Service Rate	2.66	2.97
Line Connection Service Rate	0.70	0.73
Transformation Connection Service Rate	1.57	1.71

The Board directs KW Hydro to update its RTS rates accordingly in its draft Rate Order. The Board also directs KW Hydro to use the new UTRs in updating the WCA.

MicroFit Generator Service Classification and Rate

Ontario's Feed-In Tariff (FIT) program for renewable energy generation was established in the *Green Energy and Green Economy Act, 2009*. The program includes a stream called microFIT, which is designed to encourage homeowners, businesses and others to generate renewable energy with projects of 10 kilowatts (kW) or less.

In its EB-2009-0326 Decision and Order, issued February 23, 2010, the Board approved the following service classification definition, which is to be used by all licensed distributors:

> **MicroFIT Generator**
>
> *This classification applies to an electricity generation facility contracted under the Ontario Power Authority's microFIT program and connected to the distributor's distribution system.*

In addition, the Board approved the establishment of a single province-wide rate to be applied by all distributors. The Board also adopted September 21, 2009 (the date of the establishment of the interim rate) as the effective date for the new rate. Based on cost element data provided by distributors, the Board announced on March 17, 2010 that the MicroFIT rate will be established at $5.25 per month.[30]

As part of its draft Rate Order material, KW Hydro shall identify the MicroFit Generator service classification on its Tariff of Rates and Charges and include the approved monthly service charge documented above.

DEFERRAL AND VARIANCE ACCOUNTS

KW Hydro has requested disposition of the balances of a number of its deferral/variance accounts. Due to historical over-collections, mostly with the RSVAs, KW Hydro documents an amount of $5,773,603 (audited December 31, 2008 balances with carrying costs to April 30, 2010). Exhibit 9/page 14/Table 2 of the Application is replicated below. KW Hydro has proposed to refund the amounts over four years. The refund would apply to all customer classes except the embedded distributor, where the previous rate riders did not apply when the rates were established in KW Hydro's 2006 distribution rate application.

In its Application, KW Hydro proposed disposition of the proposed deferral/variance account balances by way of one rate rider per customer class and applicable to all customers in that class. In its Argument-in-Chief, KW Hydro has continued its proposal for the single rate rider per class, but has suggested that the deferral and variance account balances be returned to customers over 24 months (i.e., the 2010 and 2011 rate years) rather than over 48 months as originally proposed. This revision is proposed in order to mitigate rate impacts in 2010. KW Hydro states that the proposed rate riders would double in quantum by halving the time period. Other than this, KW Hydro has documented no changes to its proposed deferral and variance account disposition.

[30] Rate Order, Board File No. EB-2009-0326, March 17, 2010

Exhibit 9/page 14/Table 2

Interest Calculation to April 30, 2010 on Deferral and Variance Account Balances

Account Description	Account Number	Principal Amounts as of Dec-31 2008	Interest to Dec31-08	Interest Jan-1 to Dec31-09	Interest Jan1-10 to Apr30-10	Total
RSVA -Wholesale Market Service Charge	1580	-$ 4,915,630	-$ 213,016	-$ 27,036	-$ 9,012	-$ 5,164,694
RSVA -One-time Wholesale Market Service	1582	$ 107,336	$ 17,767	$ 590	$ 197	$ 125,890
RSVA -Retail Transmission Network Charge	1584	-$ 2,529,128	-$ 326,927	-$ 13,910	-$ 4,637	-$ 2,874,602
RSVA -Retail Transmission Connection Charge	1586	-$ 1,770,743	-$ 174,492	-$ 9,739	-$ 3,246	-$ 1,958,220
RSVA - Power	1588	$ 3,032,091	$ 60,685	$ 16,676	$ 5,559	$ 3,115,010
	Sub-totals	-$ 6,076,074	-$ 635,983	-$ 33,419	-$ 11,139	-$ 6,756,616
Other Regulatory Assets - Sub-Account - OEB Cost Assessments	1508	$ 187,866	$ 27,025	$ 1,033	$ 344	$ 216,269
Other Regulatory Assets -Sub-Account -Pension Contributions	1508	$ 925,984	$ 130,394	$ 5,093	$ 1,698	$ 1,063,168
Retail Cost Variance Account -Retail	1518	-$ 100,945	-$ 7,140	-$ 555	-$ 185	-$ 108,825
Retail Cost Variance Account -STR	1548	$ 51,063	$ 5,090	$ 281	$ 94	$ 56,528
Misc. Deferred Debits	1525	$ 14,493				$ 14,493
Conservation and Demand Management Expenditures and Recoveries	1565		$ 269	$ -	$ -	$ 269
Recovery of Regulatory Asset Balances	1590	-$ 628,662	$ 374,384	-$ 3,458	-$ 1,153	-$ 258,888
	Sub-totals	$ 449,799	$ 530,022	$ 2,394	$ 798	$ 983,014
Totals per Column		**-$ 5,626,275**	**-$ 105,961**	**-$ 31,025**	**-$ 10,341**	**-$ 5,773,602**
Accounts Excluded from Disposition						
Smart Meter Capital and Recovery Offset Variance - Sub-Account -Recoveries	1555	-$ 390,339	-$ 36,447	-$ 2,147	-$ 716	-$ 429,649
Smart Meter OM&A Variance	1556	$ 15,403				$ 15,403
Deferred Payments in Lieu of Taxes	1562	-$ 2,085,921	$ 22,183	-$ 11,473	-$ 3,824	-$ 2,079,034
PILs Contra Account	1563	$ 2,305,252	-$ 10,361	$ 12,679	$ 4,226	$ 2,311,796
2006 PILs & Taxes Variance	1592	-$ 219,331	-$ 11,822	-$ 1,206	-$ 402	-$ 232,761
Other Deferred Credits	2425	-$ 50,779				-$ 50,779
	Sub-totals	-$ 425,715	-$ 36,447	-$ 2,147	-$ 716	-$ 465,024
Totals per Column		**-$ 6,051,990**	**-$ 142,408**	**-$ 33,172**	**-$ 11,057**	**-$ 6,238,626**

In its Argument-in-Chief, on page 7, KW Hydro notes that it is seeking Board approval to use account 1595 – Disposition and Recovery of Regulatory Balances to record disposition of and recoveries of approved deferral and variance account balances.

In its submission, Board staff noted that this is the established account for tracking distribution of approved balances per the Board's accounting practices. Board staff took no issue with KW Hydro's proposal to shorten the refund period to 24 months, and noted benefits of lessening intergenerational impacts and possibly mitigating rate impacts in subsequent rate applications.

Board staff noted that the Board must decide whether there should be a separate rate rider to dispose of the balance in the Account 1588 Global Adjustment sub-account, applicable only to non-RPP customers. Board staff also submitted that KW Hydro should address the capability of its billing system to implement a separate rate rider only applicable to non-RPP customers.

Energy Probe supported KW Hydro's proposal with respect to the amount of the balance to be disposed and the proposal that disposition be over two years. Energy Probe submitted that the Board should adopt a separate rate rider for recovery of the Global Adjustment sub-account whenever the distributor is able to apply separate rate riders to different customers within a class, as this would follow the established principle of cost causality. Energy Probe expressed concern that generally applying the Global Adjustment sub-account balance to all residential customers would result in RPP customers subsidizing non-RPP customers in the 2010 year. Energy Probe was also concerned with the costs for establishing a separate rate rider in the 2010 test year. However, Energy Probe acknowledged that the Global Adjustment sub-account is an ongoing issue, and suggested that the Board should establish a consultation on the practicality and the costs and benefits of establishing separate rate riders for disposition of the Global Adjustment sub-account balance to non-RPP customers only.

SEC and VECC made no submissions on KW Hydro's proposed treatment of deferral and variance accounts.

In its reply submission, KW Hydro provided tables showing the calculation of rate riders applicable for a 24-month period beginning May 1, 2010 for the following:

- Disposition of all proposed accepts except for the Global Adjustment sub-account; and
- Disposition of the Account 1588 Global Adjustment sub-account.

KW Hydro stated that it estimated the cost of implementing a separate Global Adjustment kW/kWh rate rider would be about $3,000 incrementally, or $8,500 if the rate rider was solely to apply to non-RPP customers as of December 31, 2008. The utility noted that these costs were not factored into its application and requested, should the Board approve a separate Global Adjustment rate rider, that these additional costs be recoverable.

Board Findings

The Board finds that the proposed balances for disposition, at December 31, 2008 shall be disposed of, plus projected interest to the effective date of the 2010 distribution rates. The Board finds that a period from the implementation date through to April 30, 2012, as proposed, is appropriate.

The Board will adopt the proposal of Board staff that a separate rate rider be developed for the Global Adjustment sub-account and that this rider will apply to the non-RPP customers, including those in the MUSH sector. The Board acknowledges KW Hydro's observation that this increases the administrative complexity of the disposition, but it is appropriate to recover the account balances as accurately as is practical. Recovery should occur from the customer group that drove the variance (non-RPP customers in this case), and should not involve customers already paying their share of the Global Adjustment through the semi-annual RPP price adjustment. While customer migration makes this an imperfect solution, a separate rate rider applied only to non-RPP customers going forward will achieve this objective to a greater degree than recovering the Global Adjustment sub-account balance, along with the other account balances, from all customers. The Board accepts KW Hydro's proposal that this rate rider be in effect for 24 months. However, the Board does not consider the incremental costs that KW Hydro has estimated at $3,000, to be material and so will not allow specific recovery as requested. The Board considers that these costs will be recovered in the overall envelope of OM&A expenses approved in this Decision.

The Board reminds KW Hydro that the necessary accounting entries to reflect the Board's decision and order in this proceeding with respect to the disposition of deferral and variance accounts should be recorded as soon as possible, and certainly no later than June 30, 2010, for Reporting and Recording-keeping Requirement purposes.

SMART METERS

KW Hydro has a current Board-approved smart meter funding adder of $1.00 per month per metered customer. KW Hydro is not proposing any adjustment to the funding adder in this Application. The Company stated that it has become authorized for smart meter deployment under the amended regulation pursuant to and in compliance with the London Hydro RFP process, and was approved a smart meter funding adder of $1.00 per month per metered customer in its 2009 distribution rates application.[31] KW Hydro is not seeking approval for capital and operating costs incurred to date or in 2010 in this application, but will track actual costs, and revenues received for the funding adder, in established deferral accounts for review and disposition in a subsequent application.

[31] Exhibit 9/pg. 20

In its Application, KW Hydro filed supporting documentation in accordance with section 1.4 of the Guideline G-2008-0002: Smart Meter Funding and Cost Recovery (the "Smart Meter Guideline"), issued October 22, 2008. It also provided additional information in response to interrogatories.[32]

Board staff submitted that KW Hydro had complied with the policies and filing requirements of the Smart Meter Guideline and has become authorized under regulation. Actual smart meter expenditures will be subject to review when KW Hydro makes application for disposition of the account balances in a subsequent proceeding. Hence, Board staff did not oppose KW Hydro's proposal. Energy Probe supported KW Hydro's proposal. No other parties made submissions on this issue.

Board Findings

The Board finds that KW Hydro has complied with legislation and with the Board's Smart Meter Guideline, and so approves a continuation of 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 KW Hydro's estimated smart meter costs, which will be reviewed in a future application when KW Hydro applies for disposition of the smart meter variance account balances.

LOST REVENUE ADJUSTMENT MECHANISM AND SHARED SAVINGS MECHANISM

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. The Board's Guidelines for Electricity Distributor Conservation and Demand Management (the "CDM Guidelines") issued on March 28, 2008 outlines the information that is required when filing an application for LRAM or SSM.

In its initial Application, KW Hydro sought LRAM and SSM recoveries of $832,174 ($674,100 for LRAM and $158,074 for SSM), to be recovered over four years. A third-party review of the LRAM and SSM calculations is provided in Exhibit 10/Appendix A.

Following the Board's Decision with respect to Horizon Utilities' application for LRAM and SSM recovery, considered under Board file number EB-2009-0192, and in light of interrogatories posed by Board staff and intervenors, KW Hydro filed updated evidence

[32] Responses to VECC IRs # 38 and 39

on November 17, 2009. The updated evidence was filed as an Addendum to Exhibit 10 and consisted of a re-calculated LRAM and SSM recovery of $846,530.12 ($672,536.83 for LRAM and $173,993.29 for SSM).

Board staff submitted that that KW Hydro's revised proposal for LRAM and SSM recovery is consistent with the CDM Guidelines and the Board's Decision on Horizon's application (EB-2009-0192) for LRAM and SSM recovery.

VECC submitted that, "because of the non-retroactivity provision in the [CDM] Guidelines for SSM claims for third tranche and rate-funded CDM, [it] accepts the SSM claim as filed."[33] While VECC accepts for LRAM purposes the OPA verification of OPA-funded CDM programs[34,] VECC submitted that KW Hydro's proposal did not provide an adequate level of support.[35] In its submission, VECC provided an analysis and submitted that it is unable to verify KW Hydro's revised LRAM result for the GS > 50 kW class.[36] It also submitted that it could not verify the third tranche CDM SSM claim.[37] VECC requested that KW Hydro confirm and verify these figures along with ensure the LRAM has been adjusted for carrying charges and to reflect any adjustments in the final rate order. Energy Probe supported VECC's submission.

In its reply submission, KW Hydro submitted that its LRAM and SSM amounts were correct and had been reviewed by a third party, Enerspectrum. KW Hydro also noted that it had provided an Addendum and revised its proposal in light of the Board's Decision on Horizon Utilities in response to interrogatories. In support, KW Hydro provided additional tables supporting its claim and the calculation of the proposed LRAM and SSM rate riders to recover the proposed amounts. KW Hydro provided confirmation from Enerspectrum regarding all of the information that was requested by VECC and updated its carrying charges for its LRAM claim by applying them by rate class proportionate to the LRAM claim. As a result, KW Hydro provided an updated LRAM and SSM claim in the total amount of $910,937.13 ($736,943.45 for LRAM and $173,993.29), to be recovered over four years. This reflects the addition of $64,407 in carrying charges on the LRAM claim.

[33] VECC's Submission, January 28, 2010, pg. 21, para. 12.9
[34] *Ibid*, pg. 21, para. 12.8
[35] *Ibid*, pg. 20, para. 12.7
[36] *Ibid*, pg. 24, para. 12.19
[37] *Ibid*, pg. 25, para. 12.22

Board Findings

The Board acknowledges that KW Hydro has responded to the requests made by VECC, but there could be concerns about the introduction new material in reply submissions that has not been tested. The carrying charges on the LRAM claim are shown in the response to VECC IR # 40 d) and can be verified based on the principal claimed, the prescribed interest rate and the time period. Other tables presented in KW Hydro's reply submission are, in the Board's view, not new information but a reconfiguration of material that is already on the record. However, it would have been preferable that this material had been presented on the record earlier.

In its submission, KW Hydro stated that "[t]here were no changes made to Exhibit 10 LRAM and SSM through the interrogatory process."[38] However, the Board notes that KW Hydro revised Exhibit 10 as a result of initial interrogatories, and then, in its reply submission, revised the numbers to address VECC's submission. This has created a confusing record for the Board and for all parties. KW Hydro should have made better efforts to document and support its claim throughout the proceeding. This might have avoided numerous interrogatories and submissions on this matter.

The Board finds that KW Hydro's application is consistent with the Board's CDM Guidelines. LRAM and SSM amounts have been calculated in accordance with the Board's CDM Guidelines, and have been reviewed and verified by a qualified third party evaluator. The Board also considers that KW Hydro, in its reply submission, has adequately addressed the issues raised by VECC. The Board approves the updated LRAM and SSM claim of $910,937.13 ($736,944 for LRAM and $173,993.29 for SSM).

IMPLEMENTATION

The Board has made findings in this Decision which change the 2010 revenue requirement and, as a result, the distribution rates from those proposed by KW Hydro.

In filing its draft Rate Order, it is the Board's expectation that KW Hydro 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 KW Hydro to file detailed supporting material, including all relevant calculations showing the impact of this Decision on KW Hydro's revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Supporting

[38] KW Hydro, Submission-in-chief, January 12, 2010, pg. 34

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. KW Hydro should also show detailed calculations of the revised retail transmission service rates and variance account rate riders reflecting this Decision.

KW Hydro applied for rates effective May 1, 2010. The Board approves a May 1 effective date and notes that there is sufficient time to implement the rate on May 1, 2010 as well.

RATE ORDER

A Rate Order will be issued by the Board 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-2009-0267, 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. Parties should 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, parties may e-mail their 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. Kitchener-Wilmot 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 10 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 Kitchener-Wilmot Hydro Inc. within 5 days of the date of filing of the Draft Rate Order.

3. Kitchener-Wilmot Hydro Inc. shall file with the Board and forward to intervenors responses to any comments on its Draft Rate Order within 5 days of the date of receipt of Intervenor submissions.

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

5. Kitchener-Wilmot Hydro Inc. shall file with the Board and forward to intervenors any objections to the claimed costs within 37 days from the date of this Decision.

6. Intervenors shall file with the Board and forward to Kitchener-Wilmot Hydro Inc. any responses to any objections for cost claims within 44 days of the date of this Decision.

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

DATED at Toronto**,** April 7, 2010

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary