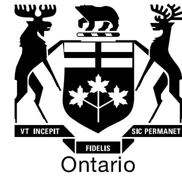
Ontario Energy Board

Commission de l'énergie de l'Ontario



EB-2007-0710

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 Oshawa PUC Networks Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2008.

BEFORE: Paul Vlahos
Presiding Member

Bill Rupert
Member

DECISION

Oshawa PUC Networks Inc. ("OPUCN" or the "Company") is a licensed distributor of electricity providing service within the City of Oshawa. OPUCN filed an application with the Ontario Energy Board, received on October 4, 2007 under section 78 of the *Ontario Energy Board Act*, *1998*, seeking approval for changes to the rates that OPUCN charges for electricity distribution, to be effective May 1, 2008.

OPUCN is one of over 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010. On May 4, 2007, as part of the plan, the Board identified which group of electricity distributors will have their rates rebased in 2008. OPUCN was included in the group for 2008. Accordingly, OPUCN filed a cost of service application based on 2008 as the forward test year.

The Board issued a Notice of Application and Hearing dated October 18, 2007. The evidence filed was made available to the public. The Vulnerable Energy Consumers Coalition ("VECC"), the School Energy Coalition ("SEC") and the Association of Major Power Consumers in Ontario ("AMPCO") intervened in the proceeding. The evidence in the application was tested through written interrogatories from Board staff and intervenors. Board staff, intervenors and OPUCN had an opportunity to file written submissions. Submissions by Board staff and intervenors were received by January 14, 2008 and the Company's reply submission was received on January 25, 2008.

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 found that OPUCN's application, while generally complying with the filing requirements, was unclear in several areas and difficult to follow. The lack of quality and clarity of responses to interrogatories and the company's reply submission, and the errors and omissions, has caused the Board to spend a disproportionate amount of effort to understand the application and the company's positions on certain issues, as they kept changing. The Board expects the company to do a better job in its next cost of service application and to familiarize itself with the Board's regulatory processes for setting rates.

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.

RATE BASE

For a distributor, rate base consists of net fixed assets (gross fixed assets minus accumulated depreciation and any contributed capital) plus an allowance for cash working capital. Net fixed assets are determined as the average of the beginning and the end year values, and reflect capital additions for the test year. The Board's guidelines stipulate a level of cash working capital equal to 15% of the sum of OM&A expenses and the cost of power. The cost of power consists of the commodity cost of power and transmission charges.

In its filing, the Company had proposed a rate base of $64,758,238, consisting of $52,809,618 in net fixed assets and $15,247,548 in cash working capital, which was subsequently revised to reflect a change to the load forecast.
The Board deals below with the following issues: Capital Expenditures; and, Cash Working Capital.

Capital Expenditures

The Company's proposed rate base reflects the impact of $10.99 million in capital expenditures for 2008. The major drivers identified by OPUCN for its capital expenditures are customer growth and maintenance of its aging distribution system. With respect to maintenance, OPUCN produced an Asset Condition Assessment Study conducted by Kinectrics in 2006.

Board staff noted, and VECC concurred, that OPUCN did not submit any evidence on how capital investments were selected and how the improvement programs were prioritized, and that OPUCN may wish to address these in its reply submission.

In reply, the Company provided additional explanations in support of its argument that it has a comprehensive practice for establishing annual capital and maintenance programs.

Board Findings

On the basis of the additional information provided, the Board finds that the Company's "scoring matrix" of prioritizing capital needs is a reasonable approach and accepts the proposed level of capital additions for 2008. In so finding, the Board has noted the Company's relatively poor performance in the reported reliability indices, which is discussed elsewhere in this decision, and the capitals expenditures would improve reliability performance.

Cash Working Capital

OPUCN proposed a working capital allowance equal to 15% of the sum of: the Company's proposed OM&A, forecast cost of power based on a price of $0.0584 per kWh, and transmission costs based on pre-November 1, 2007 transmission charges.

AMPCO noted that the 15% ratio appears rooted in historic Board practice, but the Board has recently approved a ratio of 11.6% for Hydro One as a result of a lead/lag study and it should be this ratio that should apply for OPUCN.

VECC submitted that OPUCN failed to capture the material decrease in transmission charges approved by the Board, already in effect since November 1, 2007. VECC also submitted that OPUCN's assumed cost of power for 2008 ($0.0584) appears high when compared with the most recent Navigant forecast prepared for the OEB in October 2007 to support the November 1, 2007 RPP price.

In reply, OPUCN stated that there is no generally accepted method for forecasting the cost of power and declined to use Navigant's forecast prices. The Company also argued that the 15% ratio comes from the Board's own guidelines and in the absence of an OPUCN-specific lead/lag study, the use of Hydro One's 11.5% would be arbitrary. The Company indicated that its filing was made prior to Hydro One's announcement of the lower transmission charges and incorporation of the new charges would be appropriate.

Board Findings

AMPCO has suggested that OPUCN should compute its working capital allowance based on the results of the Hydro One study rather than use the Board's standard 15% factor. The Board notes that there have been two recent lead/lag studies, one by Hydro One and the other by Toronto Hydro. The results from both studies suggest that the historic 15% allowance may be high. The Board is not prepared to require OPUCN to apply the conclusions of those two lead/lag studies without first considering in some detail whether those studies are fully applicable to the circumstances of a wide range of distributors. Thus, the Board accepts OPUCN's use of the 15% ratio provided for in the Board's current guidelines.

Elsewhere in this decision, the Board directs the Company to reflect the updated costs for transmission. The Board directs the Company to adjust its cash working capital provision consistent with that finding. This will reduce the provision for cash working capital.

In Chapter 2 of the Board's filing requirements for distributors, the Board suggests that, when filing, the cost of power will be that available from the most recent Board-approved RPP. In the Board's view, there are benefits and no cost for the electricity distribution sector and for the Board to have one common cost of commodity power forecast. As long as the Board is required to produce a cost of power forecast in its responsibility to set RPP prices, and to the extent that the Board's forecast covers a period which can subsume in whole or in large part the test period for setting distribution

rates, it makes good sense to utilize that forecast. Applying individual efforts by each distributor can lead to inconsistencies among distributors, can be expensive and is unnecessary. The Navigant forecast used by the Board to set RPP prices for November 2007 onward covers most of the Company's test year filing. The Board finds the use of Navigant's forecast prices appropriate in this case. The Board directs the Company to reflect in its re-calculation of cash working capital an all-in supply cost of $0.054/kWh derived from Board's Price Report issued October 12, 2007. This will further reduce OPUCN's cash working capital provision.

OPERATING COSTS

Operating costs include OM&A expenses, depreciation and amortization expenses, payments in lieu of taxes (PILs taxes), and any transformer allowance payments to customers. PILs taxes are proxies for capital and income taxes that otherwise would have to be paid if the distributor was not owned by a municipality or the Ontario government.

The final PILs tax allowance for ratemaking purposes is determined after the Board makes its findings on other relevant parts of the Company's application.

Operating costs also include interest charges on the Company's debt. These are dealt with in the cost of capital section of the Decision.

The Board deals below with the following issues: OM&A Expenses; and, PILs Taxes.

OM&A Expenses

Table 1 shows the components of OPUCN's forecast OM&A expenses of $10,446,613 for 2008 (as shown in its initial filing). That amount is an increase of $2,209,597, or 26.8%%, over the Company's 2006 actual OM&A expenses.

Table 1: OM&A Expenses

	2006 Actual	2008 Forecast
Operations and maintenance	$ 1,009,058	$ 1,471,408
Billing and collections	2,053,343	2,248,345
Community relations	787,789	1,000,216
Administrative and general expenses	4,164,507	5,429,644
	8,014,697	10,149,613
CDM expenses (Note)	222,319	297,000
Total	**$ 8,237,016**	**$10,446,613**

Note: In OPUCN's application, the 2006 CDM expenses were included in the "Community relations" line item, and the 2008 forecast CDM expenses were include in the "Administrative and general expenses" line.

Board staff questioned whether OPUCN has provided sufficient evidence to support the substantial additional spending requested. In particular, Board staff identified an “unexplained difference” of $930,868 between the 2007 Bridge Year OM&A expenses and 2008 proposed OM&A, and pointed to a number of inconsistencies in the Company’s responses to the interrogatories submitted by parties. Board staff also questioned the inclusion of a $297,000 amount for Conservation and Demand Management (“CDM”).

VECC stated that it shares Board staff’s concerns regarding the material increase in OM&A costs between 2006 and 2008, and the lack of comprehensive explanation for the overall change in costs. VECC also noted that there were inconsistencies between the total OM&A reported by OPUCN in its application and OPUCN’s responses to VECC’s interrogatories. VECC submitted that without any further explanations, the Board should reduce the Company’s OM&A forecast by $1 million.

SEC noted that approximately $1.8 million of the proposed increase in OM&A from 2006 to 2008 appears to be related to wage and benefits for employees, which are not driven by changes in programs or work plans. SEC submitted that the proposed OM&A budget should be reduced by the amount of the $930,868 “unexplained difference” between 2006 and 2008 OM&A identified in Board Staff’s submissions.

In reply, the Company reduced its forecast 2008 OM&A expense to $10,149,613 by removing the $297,000 amount related to CDM expenses. The Company maintained that its OM&A proposals are otherwise reasonable. OPUCN admitted that its evidence was not clear and that there were inconsistencies; however, it stated that the recasting of information provided in its reply submission rectified those problems and left no differences unexplained.

Board Findings

The Board notes that the Company is forecasting an expense of $150,600 for mounting this 2008 rates application but is also seeking a variance account. The Board does not accept the Company's proposal for a variance account. Deferral or variance accounts are reserved for situations where the risks of over or under recovery are greater than what is at risk here. Proliferation of variance accounts for these types of expenses would render the principle of a forward test year meaningless. The Board accepts the proposed expense of $150,600 as reasonable but does not accept expensing the total amount in the test year. In the Board's view, the more appropriate treatment is to amortize these expenses over three years, which is the expected duration of the benefit of this proceeding until the next rebasing. The Board will therefore allow one third of the expense. On the expectation that the 2008 approved revenue requirement will remain in place for three years, the Company will have recovered the full amount by the time it re-bases in 2011. To allow for the time value of money, the Board will allow an expense of $53,000 to be reflected in 2008 rates. The proposed regulatory expense for the test year shall be reduced by $97,600.

After deducting the regulatory expense ($97,600) and CDM ($297,000) adjustments referred to above, OPUCN's proposed 2008 OM&A expenses are $10,052,013, or 25% higher than the amount of 2006 actual OM&A expenses (after removing CDM expenses). That represents a 12% compound annual growth rate.

The Board found that the Company's OM&A presentation was not particularly helpful and understands the concerns expressed by Board staff and intervenors. In its reply submission, the Company presented an analysis that was intended to show there is no "unexplained difference" between 2006 and 2008 OM&A expenses. That analysis, although somewhat helpful to the Board, was submitted too late in the process to be tested by intervenors and Board staff. Accordingly, the Board was able to give only modest weight to the analysis. The Board concurs with the intervenors that the overall level of increase over 2006 is too high and finds that a further decrease of $500,000 is

warranted. The revised forecast 2008 OM&A expenses of $9,552,013 implies a more reasonable, although still significant, compound annual growth rate of 9% over 2006 actual spending.

PILs Taxes

It appeared to VECC that the Company has included capital taxes of $148,936 twice in calculating its 2008 revenue requirement - in total PILs and in account 6105 (Taxes other than Income Taxes). VECC also noted that it is not apparent that OPUCN has reflected in its PILs income tax calculations the new CCA class rate (at 55%) for computer equipment acquired on or after March 19, 2007 and the new CCA class (at 6%) related to buildings.

In its reply submission, OPUCN agreed to remove the duplicate $148,936 capital tax PILs amount, and agreed that the CCA rate to be used for computer purchases should be 55%.

Board Findings

In calculating the final PILS tax provision, the Board directs the Company to reflect in its Draft Rate Order the new federal income tax rate (reduced from 20.5% to 19.5%, yielding a combined federal and Ontario income tax rate for 2008 of 33.5%), the change in the Ontario capital tax exemption amount to $15 million from $12.5 million, and the new CCA class rates as applicable.

CAPITALIZATION/COST OF CAPITAL

Capitalization refers to the financing of total rate base through common equity, preference share capital (if applicable), long term debt and short term debt. Cost of capital refers to the cost rates for debt or preference share capital and the Board-authorized rate of return on common equity.

Table 2 below summarizes OPUCN's proposed capitalization and cost of capital.

Table 2: Proposed Capital Structure/Cost of Capital	
Parameter	**OPUCN Proposal**
Capital Structure	53.3% debt (composed of 49.3% long-term debt and 4.0% short-term debt) and 46.7% common equity
Short-Term Debt	4.77%, but to be updated
Long-Term Debt	6.70%, as a weighted average of 4.90% for third-party debt and 7.25% for a long-term debt with the municipal shareholder (affiliated debt).
Return on Common Equity	8.79%, but to be updated.

OPUCN's proposed rate of long-term debt for 2008 is comprised of existing third-party debt at 4.90% and a demand note to its parent of 7.25%, first arranged on November 1, 2000 (affiliated debt).

Both SEC and AMPCO submitted that the 7.25% cost rate for the affiliated debt should not be accepted for ratemaking purposes and that the Board's approach should be guided by the December 20, 2006 Board Report on cost of capital and 2nd generation IRM. AMPCO suggested that the allowed rate on the affiliated debt be reduced by at least 50 basis points, while SEC submitted that a rate of 6.25% be allowed.

OPUCN did not respond to the submissions of SEC and AMPCO.

Board Findings

The Board agrees with the comments of intervenors that OPUCN has provided limited information on the affiliated debt despite the fact that information was requested through interrogatories. What is ascertainable from the evidence is that it is a demand note with an affiliate and the interest rate is pegged at 7.25%.

As suggested by SEC, the Board is guided by the Board Report. In particular, the Board notes that section 2.2.1 of the Board Report states, in part:

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

Notwithstanding the fixed rate of the instrument, based on the guidelines the Board finds that the allowed cost of debt on the affiliated and callable debt should be the deemed debt rate updated for 2008 in accordance with Appendix A of the Board Report. Based on Consensus Forecasts, Bank of Canada and TSX Inc. data for January 2008, this rate is 6.10%. OPUCN shall reflect this rate for the affiliated debt in determining its revenue requirement.

The Board deals with the updates of the other components of the cost of capital under the "Implementation Matters" section at the end of this Decision.

COST ALLOCATION AND RATE DESIGN

Once the total revenue requirement is determined, it is allocated through various steps to the various rate classes and is used to set rates for each class.

This section deals with Revenue to Cost Ratios, and Retail Transmission Service (RTS) Rates.

Revenue to Cost Ratios

In its original filing, the Company did not propose changing rates to reflect the results of its 2006 Informational Filing Run 2. The Company's rationale is that there was no definitive guidance from the Board on the application of the results of the 2006 cost allocation study. Since the application was filed, the Board has issued such guidance[1]. However, the Company is not proposing to apply the guidelines at this time.

In Table 3 below:

Column A shows the revenue to cost ratios[2] per the Company's Informational Filing based on data in its 2006 rates case;

Column B shows the ratios that flow from the Company's rate proposals;

Column C shows alternative ratios if proposals were to be within the Board-sanctioned ratios; and

[1] Application of Cost Allocation for Electricity Distributors, Report of the Board, Dated November 28, 2007

[2] Revenue to cost ratios are depicted in percentage terms or as factors around unity. For example a ratio of 120 can also be depicted as 1.2

Column D shows the target ranges as set out in the Board Report, *Application of Cost Allocation for Electricity Distributors*, issued November 28, 2007 (“Cost Allocation Report”).

Table 3: Revenue to Cost Ratios				
Customer Class	**2006 Informational Filing Run 2** [A]	**Proposed Rates per Application** [B]	**Alternative Within Target Ranges** [C]	**Board Target Ranges** [D]
Residential	89	88	93	85 – 115
GS < 50 kW	130	134	120	80 – 120
GS > 50 kW to 1000 kW	158	102	108	80 – 180
GS > 1000 to 5000 kW	334	348	180	85 – 180
Large Use > 5000 kW	257	207	115	85 – 115
Street Lighting	23	33	70	70 – 120
Sentinel Lighting	55	60	70	70 – 120
Unmetered scattered load	132	109	109	80 – 120

Board staff noted that it is evident that OPUCN’s rates for some rate classes would need to be changed substantially for the revenue to cost ratios to be within the target ranges. Board staff also noted that it is peculiar that the ratio in Column C for the GS > 1,000 to 5,000 kW rate class is further from 100 than the ratio in Column B.

VECC noted that the model used for the Informational Filing allocates the cost of transformers to the classes in proportion to the loads of the customers who do not own their own transformers only, however the total cost being allocated includes the “cost” of the transformer ownership allowance, resulting in an allocation of some of that cost to those classes where customer ownership of transformers is not found. VECC submits that there are two ways the model could have reflected a valid ratio of revenue to cost:

a. exclude the “cost” of the transformer ownership allowance from the revenue requirement and compare the class revenue requirements with actual revenues net of the allowance; or

b. allocate the “cost” of the allowance directly to the classes that receive the allowance and compare the class revenue requirements with revenues gross of the allowance.

VECC illustrates its point with the response to an interrogatory that shows, for example, that the revenue to cost ratio for OPUCN’s Large User class in the Informational Filing is 2.57, but when recalculated using method a. would be only 2.14. VECC submits that, while an adjustment in rates for those classes with high ratios is appropriate, the adjustment should be more modest than the full-scale adherence to the Board’s guidelines.

Also, it appeared to VECC that, in the case of the Residential class, the rates used inappropriately included the Smart Meter adder in the fixed monthly charge and the Regulatory Asset rider in the variable charge. In response to VECC’s submission, OPUCN clarified that neither the Smart Meter nor the Regulatory Assets rate adders are used in the calculation of base revenues.

SEC submitted that the alternative ratios (shown in Column C) are a “good first step” at reducing the current cross subsidization except in the GS>50 rate class where the ratio moves further from unity.

AMPCO submitted that OPUCN should bring rates for the larger customer classes closer to unity than merely being within the Board-sanctioned ranges, based on the rationale that OPUCN’s information is of better quality when compared to other electricity distributors. AMPCO suggested that for customer groups between 50 and 5000 kW, the data is of sufficient quality to support a tolerance band of 85 to 115. Regarding the issue of transformation allowance, AMPCO suggested that while the correct, principled approach is that customers should not be allocated cost for transformation assets they do not use, until a sound evidentiary basis can establish the underlying facts to implement this, the Board guidelines regarding transformer allowances should be followed.

The Company responded that if the Board were to move to different revenue to cost ratios than proposed by the Company (Column B), the Board should consider mitigating the effects over a period of three or more years.

Board Findings

As the Board has noted in its Cost Allocation Report regarding revenue to cost ratios, cost causality is a fundamental principle in setting rates, however observed limitations in data affect the ability or desirability currently of moving immediately to revenue to cost framework around unity, which is considered ideal. The Board's ranges are a compromise until such time as data is refined and experience is gained.

With respect to OPUCN's application, the Board is prepared to adopt the general principle that, where the proposed ratio for a given class (Column B) is above the Board's target range (Column D), there should be a move of 50% toward the top of the range from what was reported in the Informational Filing 2 (Column A). Under this approach, rates for three classes would be adjusted to achieve the following revenue to cost ratios:

GS < 50 kW	125
GS > 1,000 to 5,000kW	257
Large Use	186

Although the ratios for the GS > 1,000 and Large Use classes would continue to be high, the Board has concluded that an immediate move to the target ranges would result in unacceptable impacts for customers in some of the remaining classes, and some mitigation is warranted. Therefore, the rates for the two classes shall be set so that a move of 50% to the top of the Board's target ranges will be achieved for 2008. The Board expects the Company to achieve the remaining 50% by equal increments in years 2009 and 2010 when it makes applications for rate adjustments.

Where the revenue to cost ratios in the Informational Filing (Column A) are below the Board's ranges (Column D), the rates for 2008 shall be set so that the ratios for these classes shall move by 50% toward the bottom of the Board's target ranges.

Under this approach, rates for three classes would be adjusted to achieve the following revenue to cost ratios:

Streetlighting	46
Sentinel Lighting	62

The Board expects the Company to achieve the remaining 50% move by equal increments in years 2009 and 2010.

As a result of these findings, there will be a higher net revenue requirement that needs to be recovered from the other classes. Of these classes (Residential, GS > 50 kW to 1000 kW, and Unmetered Scattered Load), the Residential rate class will be under-contributing based on the Company's proposal. The Board finds that the higher net revenue requirement shall be recovered from the Residential class so that the under-contribution will be reduced.

The Board expects the Company to maintain this principle when it applies for rate adjustments in 2009 and 2010.

In filing its Draft Rate Order, the Company shall provide the information necessary to establish its compliance with the above directions for 2008 rates.

Retail Transmission Service (RTS) Rates

On October 17, 2007, the Board issued its EB-2007-0759 Rate Order, setting new Uniform Transmission Rates for Ontario transmitters, effective November 1, 2007. The Board approved a decrease of 18% to the wholesale transmission network rate, a decrease of 28% to the wholesale transmission line connection rate, and an increase of 7% to the wholesale transformation connection rate. The combined change in the wholesale transmission line connection and transformation connection rates amounts to a reduction of 5%.

On October 29, 2007, the Board issued a letter to all electricity distributors directing them to propose an adjustment to their retail transmission service (RTS) rates to reflect the new Uniform Transmission Rates for Ontario transmitters effective November 1, 2007. The objective of resetting the rates was to minimize the prospective balance in variance accounts 1584 and 1586 and also to mitigate inter-generational inequities.

The Company did not file a proposal to adjust its RTS rates.

Board staff noted that, in the GS > 50 to 1,000 kW class, OPUCN's existing Tariff contains separate and different RTS rates for interval-metered and non-interval-metered customers. However, the Company has dropped the metering distinction and used the higher RTS rates that applied for interval-metered customers. Board staff submitted

that OPUCN should clarify why it has proposed to continue with only one rate where currently there are two and why it is proposing only the higher of the two sets of rates.

Board staff submitted that the application should be updated to reflect the decrease in transmission rates, as recently approved by the Board for Ontario transmitters, and that this update would apply to all customer classes.

VECC agreed with Board staff's submission that OPUCN should update its application to reflect the decrease in transmission rates for 2008.

In reply, OPUCN agreed to continue the existing distinction between interval-metered and non-interval-metered customers in the GS > 50 to 1,000 kW class and to adjust its RTS rates for all rate classes.

Board Findings

The Board notes that there is a variance account mechanism for all distributors to capture differences between their transmission costs and the charges they levy on their customers. The issue is not whether the distributors or the customers would be financially harmed. Good ratemaking suggests that, to the extent possible and practical, rates and charges at a point in time should reflect the most current information so that any differences captured in variance accounts would be minimized. This would lead to smoother rate making and reduced concerns about inter-generational inequities.

Given the magnitude of the changes in wholesale transmission rates, the Board directs the Company to reduce its RTS – Network Service Rate by 18% and its RTS – Line and Transformation connection Service Rate by 5%.

The Board also directs the Company to continue the distinction that exists in its current rate schedules with respect to interval-metered and non-interval-metered customers. Some of the confusion about what the Company was proposing for these rates arose because the document "Existing Rate Schedules" included in OPUCN's application (Exhibit 9, Tab 1, Schedule 5) is incorrect and contrary to the current Board-approved RTS rates with respect to interval-metered and non-interval-metered customers. This is an example of why the Board had considerable difficulty ascertaining the facts when reviewing the Company's application.

The Board also notes that in Exhibit 9, Tab 1, Schedule 6, entitled “Proposed Rate Schedule”, the Retail Transmission Charge - Network for the GS<50 kW class is shown as zero. This appears to be in error and should be corrected in accordance with the Board’s findings above.

OPERATING REVENUE

For purposes of setting base distribution rates for the electricity sector, the Board determines the operating revenues from sales and subtracts certain revenues associated with certain charges by the distributor.

The Board deals below with the following issues: Load Forecast, and Revenue Offsets.

Load Forecast

The Company’s load forecast was developed using a normalized average consumption (“NAC”) estimate for a given rate class multiplied by a customer count forecast for that rate class. OPUCN’s load forecast is based on a forecast customer count of 63,653 for 2008, an increase of 3.4% over 2006 or an annual average growth rate of 1.69%. The NAC value by class was based on 2004 consumption data and was weather-normalized using factors that had been developed by Hydro One.

In VECC’s view the customer count for the residential customer class is understated and in SEC’s view, the customer count forecasts for both the residential and GS<50 rate classes are understated. VECC noted that the 2006-2008 residential customer count growth rate is assumed by the Company at 1.2% per year but over the 2002-2006 period the average annual rate was approximately 1.7%, which VECC recommended be adopted by the Board. SEC noted that for the residential and GS<50 rate classes, OPUCN is forecasting 2008 customer count increases of just 1.4% and 1.5%, respectively, down from about 2.5% growth observed in 2006. SEC suggested a customer count growth rate of 2% for the residential and general service rate classes, the approximate mid-point between the historical average and the 2006 growth rate.

In reply, OPUCN argued that its customer count growth forecast is appropriate and noted that recent information indicates a customer count growth rate in the residential sector of only 1.5% for 2007, which is below recent historical trends.

Board Findings

The Board has noted the Company's comment in its reply argument that the residential growth rate for 2007 was recently announced at 1.5% over 2006. This would confirm the Company's position that past growth rates may not be sustainable. However, this is new untested information and the Board has given it little weight. On the basis of the Company's other evidence and argument, the Board accepts that past rates of customer growth in the Company's service territory should not be expected to be sustainable in the test year. The Board accepts the Company's customer count forecast for the 2008 test year.

The Board also accepts the Company's updated load forecast for 2008.

Revenue Offsets

In VECC's view, the forecast revenue from the SSS Administration charge is not reflected as an offset to OPUCN's distribution revenue requirement.

OPUCN did not respond to the submissions of VECC.

Board Findings

The Board notes that with respect to Account 4080B in the Uniform System of Accounts, the Accounting Procedures Handbook states that:

> "Distributors shall use this account to record revenues generated from the SSS Administration Charge. Distributors shall use a sub-account to separately track such revenues in light of Board expectations that each distributor will establish a specific utility charge for recovery of SSS administrations costs."

There is no indication OPUCN has done so. The Board directs OCUPN to follow the prescribed treatment outlined in the Uniform System of Accounts noted above and treat the forecast revenue from the SSS Administration charge as an offset to OPUCN's distribution revenue requirement. The Board expects OPUCN to explain how it has reflected this finding at the time it files its Draft Rate Order

DEFERRAL AND VARIANCE ACCOUNTS

OPUCN requested disposition of approximately $2.38 million of deferral and variance account balances as shown in Table 4. Positive balances are amounts due to OPUCN;

negative balances are amounts due to customers. The amounts in Table 3 are based on OPUCN's application, as modified and clarified in its reply to interrogatories and its final submission.

Table 4: Deferral and Variance Accounts – Disposition Requested by OPUCN

Account	Balance	Forecast Changes (to April 30, 2008)		OPUCN's Claim
	Dec. 31, 2006	Recoveries	Interest	
	A	B	C	A+B+C
1508 Other Regulatory Assets	$ (21,501)	$ -	$ -	$ (21,501)
1562 Pre-May 2006 PILs	812,655	-	-	812,655
1580 RSVA – WMSC	(677,570)	-	(42,333)	(719,903)
1582 RSVA – One-time WMSC	63,405	-	3,636	67,041
1584 RSVA – Retail Transmission, Network	2,998,076	-	176,951	3,175,027
1586 RSVA – Retail Transmission, Connection	(1,605,640)	-	(98,127)	(1,703,767)
1588 RSVA – Power	115,716	-	12,885	128,602
1590 Recovery of Reg. Asset Balances	2,097,493	(1,523,352)	71,027	645,168
Total				**$ 2,383,322**

Account 1508 – "Other Regulatory Assets"

The balance in the 1508 account relates to an over-recovery by OPUCN under a Board-approved rate adjustment that was intended to cover lost revenue related to the closing of the facilities of one of the Company's large customers. In its final submission, OPUCN clarified that the balance represents revenues collected during January to March 2005 in excess of the Board-approved amount of $277,500.

Board Findings

The Board accepts clearance of this deferral account. As Table 3 indicates, OPUCN has not forecast interest on this account for the period January 1, 2007 to April 30, 2008. The Board's normal practice for deferral and variance accounts of electricity distributors is to order disposition of the most recent audited balance (December 31, 2006 in this case) together with interest from that date to the commencement of the related rate rider. The Board directs OPUCN to recalculate the balance for disposition by accruing interest at the appropriate rate on account 1508 to April 30, 2008.

Account 1562 – "Pre-May 2006 PILs Variance"

This account is used to capture certain variances between the amount of PILs taxes used to set rates up to April 30, 2006 and the amount of PILs taxes actually paid by a distributor.

Board Findings

Before approving disposition of account 1562 for any distributor, the Board has concluded it is necessary to ensure that distributors have been following a consistent approach to making entries to the account. As announced on March 3, 2008, the Board will initiate a combined proceeding to determine the accuracy of final balances in account 1562 for the seven distributors, including OPUCN, that have applied for clearance of the account in their 2008 cost-of-service filings. Thus, the Board does not approve clearance of account 1562 at this time.

Retail Settlement Variance Accounts (RSVAs)

Board staff noted that account 1588, RSVA – Power, is reviewed quarterly for disposition by the Board as part of the process required by Bill 23 (which is set out in section 78 (6.1) of the *Ontario Energy Board Act, 1998*). Staff suggested the Board consider how ordering the disposition of this account, as requested by OPUCN, might affect the Bill 23 process.

Board Findings

On February 19, 2008, which is after the completion of the argument phase, the Board announced an initiative for the review and disposition of commodity account 1588 (RSVA-Power). The Board noted that, as part of this initiative, it will also consider whether to extend this initiative to other accounts that are similar in nature, and named certain RSVA accounts. The Board finds that it would be best to wait for the outcome of

this initiative and therefore will not order disposition of the commodity or non-commodity RSVA accounts in this proceeding

The Board therefore does not approve clearance of accounts 1588, 1580, 1582, 1584, and 1586 at this time.

Account 1590 – "Recovery of Regulatory Asset Balances"
When the Board approved new rates for distributors for 2006, it also approved recovery of regulatory asset balances on a final basis. The Board approved rate riders to facilitate the recovery of the approved balances over the two remaining years of the four-year recovery period mandated by the Minister of Energy. The regulatory assets rate riders identified on OPUCN's current approved Tariff of Rates and Charges cease to be effective on May 1, 2008.

OPUCN is requesting disposition of its estimate of the forecast April 30, 2008 balance in account 1590 of $645,168 through the current disposition of regulatory deferral and variance accounts. OPUCN's proposed rate riders are constructed using this balance.

Board staff referred to the Board's Phase 2 decision for the Review and Recovery of Regulatory Assets for four large distributors (RP-2004-0117, RP-2004-0118, RP-2004-0100, RP-2004-0069, RP-2004-0064). The Phase 2 decision specified that rate riders associated with account 1590 be removed as of May 1, 2008. Once the residual balance in account 1590 is finalized, the residual balance is to be disposed at a future hearing. Staff noted that the final balance in account 1590 cannot be confirmed until after April 30, 2008.

VECC reiterated staff's concerns about OPUCN's proposal and submitted that the Phase 2 decision was clear about how and when residual balances in account 1590 are to be cleared.

In reply, OPUCN acknowledged the Board's earlier Phase 2 decision but submitted that "the request for disposition of the forecasted amount is made to relieve both the Board staff and OPUCN of the work involved in submitting an additional rate rider application at a later date."

Board Findings

The Phase 2 decision clearly contemplates final disposal of account 1590 once the actual final residual balance is verified after April 30, 2008. The Board will not approve clearance of the expected residual balance at this time.

Recovery Period

OPUCN originally proposed to recover balances in the deferral and variance accounts through two-year rate riders commencing May 1, 2008. Board staff submitted that recovery could be over a shorter period. SEC submitted that a faster recovery is not appropriate given the relatively large distribution rate impacts of OPUCN's application.

In response to staff's submission, OPUCN agreed there was merit to a shorter period of recovery and filed revised proposed rate riders based on a one-year recovery period. In its final submission, the Company stated that it would await guidance from the Board on the appropriate recovery period.

Board Findings

Based on the Board's earlier findings, the balances that the Board approves for recovery at this time total approximately $800,000, much less than OPUCN's request of $2.38 million. The Board approves recovery of the approved balances through class-specific rate riders over one year beginning May 1, 2008. The Board considers it reasonable for OPUCN to recover those balances quickly given that it is possible there might be larger rate riders required in later periods when the Board reviews and disposes of other accounts.

LOST REVENUE ADJUSTMENT MECHANISM ("LRAM") AND SHARED SAVINGS MECHANISM ("SSM")

In its December 10, 2004 decision in proceeding RP-2004-0203, the Board determined that an LRAM and an SSM were appropriate for electricity distributors, and that the mechanisms should apply to CDM expenditures relating to the third installment of distributors' market adjustment rate of return ("the third tranche"). As set out in the Board's Filing Requirements for Transmission and Distribution Applications ("Filing Requirements"), issued November 14, 2006, LRAM balances are determined by calculating the energy savings by customer class, and valuing those energy savings using the Board approved variable distribution charge appropriate to the class. SSM balances are determined as 5% of the net benefits of an approved CDM portfolio.

OPUCN is seeking in this application to recover an LRAM amount of $49,788, and an SSM amount of $97,237. Both amounts relate to fiscal year 2006.

As part of its application, OPUCN filed a report prepared by the EnerSpectrum Group which provided EnerSpectrum's assessment of OPUCN's LRAM and SSM amounts.

Through interrogatories, Board staff requested additional information from OPUCN regarding the calculation of the LRAM and SSM amounts.

In its submission, Board staff noted that having reviewed the EnerSpectrum Report, as invited by OPUCN in its response to Board staff interrogatories, it is unable to determine if the LRAM and SSM claims are calculated using appropriate input assumptions and data, as the EnerSpectrum Report did not contain the requested information. Staff submitted that the following information is needed to determine whether the amounts claimed are just and reasonable and invited OPUCN to respond to these in its reply submission:

- kW or kWh impacts, both net and gross of free riders, for each program and each class;
- Free rider rates for each program;
- TRC costs and TRC benefits for each program;
- Detailed explanation of how the proposed rate riders were determined;
- Duration of program delivery. OPUCN appears to have provided the equipment life in its response to the Board staff interrogatories, but not the duration of program delivery.

Board Staff also noted that OPUCN calculated energy savings using a rate of $0.0119 per kWh but a review of OPUCN's 2006 Board-approved tariff indicates that the volumetric rate for residential customers is $0.0107 per kWh. It also appeared to Board staff that the rate used by OPUCN to calculate the LRAM amount includes the Board-approved rate rider for Regulatory Asset Recovery of $0.0012 per kWh, which would be inappropriate.

VECC stated that it concurs with Board staff's submissions.

In reply, OPUCN provided certain additional information and adjusted the LRAM amounts by using the volumetric rate for residential customers of $0.0107 per kWh.

Board Findings

In reviewing the record, it is the Board's view that OPUCN has not satisfied the Board's procedural and evidentiary requirements, and for these reasons the Board is denying OPUCN's request for recovery of amounts relating to LRAM and SSM as part of this proceeding.

The onus is on an applicant to provide evidence to support all aspects of its application. An integral part of the hearing process is the examination, testing and challenging of that evidence by the intervenors and Board staff. To ensure that the intervenors and Board staff have that opportunity prior to the filing of written argument, an applicant is required to disclose and file all of the evidence on which it intends to rely by the time interrogatories are completed, and certainly before reply argument is submitted. Filing evidence as part of an applicant's reply submission circumvents an important step in the hearing process as it prevents the testing of the new evidence by the intervenors and Board staff. Short of resuming the hearing process, this cannot be rectified. The Board does not intend to resume the hearing and will not to rely upon untested evidence filed well beyond the appropriate timeline.

Moreover, OPUCN's evidence in this matter is still unclear and incomplete. The Board notes that the Company only provided detailed inputs and calculations for one of the four programs for which OPUCN is claiming LRAM amounts. Some information was provided for the other programs, but this information is less detailed, and it is not clear how it is used by OPUCN in the calculation of the proposed LRAM and SSM amounts. For example, the TRC costs and benefits, and a detailed explanation of how the proposed rate riders were determined has not been provided in relation to the LRAM amounts for the "Every Kilowatt Counts (Spring)", "Library Watt Reader", and the "Residential 155 Colborne Replace Bulk with Individual Meters" programs. Further, no information was provided as to which programs are included in OPUCN's SSM claim, as OPUCN provided only the total SSM amount and not the breakdown of how this amount was determined.

OPUCN may, if it wishes, bring forward an application for recovery of LRAM and SSM amounts at its next opportunity for a rate adjustment. The Board expects that any future application by OPUCN for recovery of LRAM and SSM will contain clear and complete information as to the calculations of the amounts proposed for recovery.

OTHER MATTERS

This section deals with issues that do not directly fit within the areas used by the Board to discuss the specific issues or are considered to be cutting across sections.

Service Reliability Indices

Board staff noted that the Board requires distribution companies to maintain service reliability within their three year historical performance. Board staff noted that the Company's performance in 2004 was poor compared to 2003 or 2005 and if continuous maintenance has been an ongoing practice for OPUCN, it is not clear why OPUCN has been unable to improve on its past reliability performance. Board staff further noted that it is not clear from the evidence that OPUCN has acted upon the Kinectrics report to develop a well-defined and comprehensive asset management plan to proactively address its poor reliability performance and effectively manage its facilities.

In reply, the Company corrected an error in its reliability indices it had previously reported and it noted that the higher outage time duration for 2006 was due to a lengthy outage caused by a substation breaker failure. The Company listed the programs that have been undertaken as a result of the Kinectrics study and noted that 70% of the Company's capital budget for 2008 relates to programs that would enhance the reliability of its distribution system.

Board Findings

The Board notes the Company's evidence regarding service reliability indices, which is reproduced in Table 5 below.

> SAIDI is the ratio of total customer hours interruption divided by total number of customers served.
>
> SAIFI is the ratio of total customer interruptions divided by total number of customers served.
>
> CAIDI is the ratio of total customer Hours of Interruption divided by total customer interruptions.

Table 5: Reliabilty Indices			
	SAIDI	SAIFI	CAIDI
2002	1.707	1.422	1.201
2003	1.505	1.221	1.233
2004	1.337	0.993	1.346
2005	1.122	1.142	0.982
2006	2.268	1.289	1.760
2007	1.782	1.158	1.539
Three-year average, 2005-2007	1.724	1.196	1.427
OPUCN Target	Less than 65 min	Less than 1	Less than 65 min

The Board finds that Board staff's concerns have merit. In all three categories of reliability, the Company's performance indicates a problematic trend generally and the achieved indices are substantially below the Company's own targets, particularly so in the case of SAIDI and CAIDI. The Board notes the Company's evidence that 70% of the proposed capital expenditures are related to programs that would enhance future reliability. As service reliability is most important to customers, the Board expects the Company to be vigilant about its service reliability performance going forward and to ensure that the capital expenditures authorized by the Board do result in substantial improvements in that regard.

Line Losses

Line losses are the difference between the Company's recorded energy purchases and recorded retail sales. The Board allows a loss factor to be included in rates. Differences between the losses reflected in rates and the actual losses are recorded in a variance account. The Company's proposed total loss factor (TLF") for 2008 is 1.0487. The underlying distribution loss factor ("DLF") for 2008 is 1.0440 and it is based on a three year average of the actual DLF for 2004 to 2006.

The actual DLF increased from 1.0402 in 2005 to 1.0474 in 2006. OPUCN stated that the increase was largely driven by theft in growhouses. Board staff and VECC expressed concern with the increase in actual losses in 2006.

In reply, OPUCN set out the following action it plans to take to decrease distribution losses:

- Perform a system optimization study in order to configure the distribution system in its most efficient state;
- Continue its practice to purchase transformers with optimum loss factors;
- Continue its program of working with local law enforcement agencies to identify and investigate theft of energy occurrences; and
- Upon implementation of smart metering, utilize a transformer metering device to compare transformer energy delivered with the summation of metering data for each service supplied, in order to identify theft of energy occurrences.

Board Findings

While the Board does not consider the reported loss factors to be that excessive compared with certain other electricity distributors and accepts the proposed loss factors, the Board is concerned with the increase in distribution losses in 2006 over 2005. The Board is encouraged by the Company's plan of action and expects the Company to be vigilant with respect to its losses, particularly those caused by theft.

IMPLEMENTATION MATTERS

Cost of Capital Update

In mid-2006, the Board initiated a consultative process to examine the cost of capital applicable to the Ontario electricity distribution sector. This process was conducted in conjunction with the development of the 2nd Generation Incentive Regulation plan. The product of these consultations was the Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors (the "Board Report"), issued December 20, 2006. The Board Report considered the extensive consultation record and established, in part, guidelines for setting and updating the cost of capital parameters for distribution rate-setting from 2007 onwards, including the return on common equity ("ROE"), the deemed short-term debt rate, and, as appropriate, the deemed long-term debt rate.

The Board Report established that the approved ROE to be used for rate-setting purposes should be calculated by application of the formula in Appendix B of the Board Report. In setting the ROE for the establishment of 2008 rates, the Board has used the Consensus Forecasts and published Bank of Canada data for January 2008, in accordance with the Board's guidelines. In fixing new rates and charges for the Company the Board has applied the policies described in the Board Report. Based on

the final 2007 data published by Consensus Forecasts and the Bank of Canada, the Board has established the ROE to be 8.57%.

The Board Report also established that the short-term debt rate should be updated using the methodology in section 2.2.2 of the Board Report. The Board has set the short-term debt rate at 4.47% using data from Consensus Forecasts and the Bank of Canada for January 2008.

Draft Rate Order

The Board has made numerous findings throughout this Decision. These are to be appropriately reflected in a Draft Rate Order incorporating an effective date of May 1, 2008 for the new rates and charges.

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

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

1. The Company shall file with the Board, and shall also forward to intervenors, a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision.

2. Intervenors may file with the Board and forward to the Company responses to the Company's Draft Rate Order within 20 days of the date of this Decision.

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

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

4. Intervenors eligible for cost awards shall file with the Board and forward to the Company their respective cost claims within 26 days from the date of this Decision.

5. The Company may file with the Board and forward to intervenors eligible for cost awards any objections to the claimed costs within 40 days from the date of this Decision.

6. Intervenors, whose cost claims have been objected to, may file with the Board and forward to the Company any responses to any objections for cost claims within 47 days of the date of this Decision.

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

DATED at Toronto, March 19, 2008.

Original signed by

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Paul Vlahos

Original signed by

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Bill Rupert