

**Ontario Energy
Board**

**Commission de l'énergie
de l'Ontario**



EB-2007-0761

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

BEFORE: Gordon Kaiser
Vice Chair and Presiding Member

Cynthia Chaplin
Member

DECISION

Background

Lakefront Utilities Inc. (“Lakefront”) filed an application dated October 31, 2007 with the Ontario Energy Board (the “Board”) under section 78 of the *Ontario Energy Board Act, 1998*; S.O. c.15, Sched. B) (the “Act”), for an order or orders approving or fixing just and reasonable rates and other charges for the distribution of electricity as of May 1, 2008.

Lakefront is a municipally owned distribution company owned by Town of Cobourg Holdings Inc. Lakefront was incorporated under the *Ontario Business Corporations Act* on April 12, 2000 and began doing business as Lakefront Utilities Inc. on May 1, 2000. Lakefront serves approximately 8,000 residential

customers, and 3,500 general service customers as well as street lighting and sentinel lights in the Town of Cobourg and the Village of Colborne.

Lakefront 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. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year, by electricity distributors.

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

The application proceeded as a written hearing with School Energy Coalition (“Schools”) and the Vulnerable Energy Consumers Coalition (“VECC”) intervening. Lakefront replied to staff and intervenors’ interrogatories; Board staff and the intervenors filed written submissions; and Lakefront filed a reply submission.

The application requested distribution rates and other charges to collect a \$5,077,851 revenue requirement. This revenue requirement was to collect an allowed return of 7.28% on a \$15,557,507 rate base as well as other cost changes. Lakefront claimed that the current rates and charges would result in a revenue deficiency of \$1,011,962. The impact of this request on a residential customer consuming 750 kWh per month is a 5% increase on the total bill, and for a general service customer consuming 3,000 kWh per month is a 5.3% increase on the total bill.

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

THE ISSUES

The following issues were raised in the submissions filed by Board staff, Schools and VECC:

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

LOAD FORECAST

Lakefront developed its forecast of customer numbers using the trend growth based on data from 2003 to 2006. For the weather sensitive loads, Lakefront used the 2004 normalized average use per customer (“NAC”) provided to it by Hydro One. VECC expressed concern with reliance on the 2004 weather normalized customer use data, but concluded no better alternative was available. Lakefront submitted that it was reasonable to use the Hydro One 2004 weather normalized data for average use per customer.

Board staff submitted that there was no rationale given for the kW demand forecast for the customer classes which use this charge determinant. Lakefront replied that the kW demand forecast values are determined by calculating an “average load ratio” and applying it to the appropriate kWh value. For 2006, weather actual kW is divided by weather actual kWh to set the average load ratio. This ratio is then applied to weather normalized kWh to determine the weather normalized kW. For 2007 and 2008 the same method is used, but the average load ratio is determined by taking the average of the ratio over 2002 to 2006. The GS 3,000–4,999 kW class is based on the average load ratio for 2006 only.

The customer number growth averages 1.3% per year from 2006 to 2008, compared with historical growth of 1.5% during 2003-2006. Lakefront submitted that there was not sufficient data to allow for the use of time series techniques to estimate customer numbers. Lakefront submitted that its use of a simple trend growth is likely not much different from what would result from a more

sophisticated technique given the limited variation in load growth by customer class.

Schools submitted that although Lakefront explained that the decrease in customer numbers for the GS 50-2,999 kW class is due to customer rate reclassifications, the load forecasts for other classes do not increase to reflect this shift. Schools noted that the decrease in the GS 50-2,999 kW class from 2006 to 2008 is 13,854,000 kWh but the increase in the GS<50 kW class for the same period is only 1,057,000 kWh.

In its reply, Lakefront explained that the load forecasts are driven by the average customer use figures, and because customer numbers are declining in the GS 50-2,999 kW class, total load is forecast to decline even though total customer numbers are forecast to increase marginally.

Lakefront reported in its reply submission that Kraft Canada, its largest customer (which is in the GS 3,000-4,999kW class), will be closing its operations in October 2008, and noted that load has declined by 10% over the last two months. Lakefront forecast the reduction for 2008 load to be 15,561,809 kWh and 29,581 kW. Lakefront proposed to adjust the application to reflect this reduced load, as it is unlikely that a customer of this size would be replaced prior to the next rebasing. Lakefront claimed that if the adjustment were not made, it would lose \$179,000 in projected revenue, for a 15% reduction in net income (after the impact of PILs).

Board Findings

The Board accepts the use of the Hydro One data for 2004 average weather normalized customer usage for purposes of determining the 2008 load forecast. The Board also accepts Lakefront's method for deriving the kW demand forecast from the kWh levels and the customer number forecast.

The Board notes Lakefront's explanation that the decrease in customer numbers in the GS 50-2,999kW class is the result of changes in customer count and the reassessment of customer class based on consumption. However, it appears that, to the extent customers have shifted from one class to another, the use of average loads has distorted the impact of these shifts on the load forecast. In other words, if a customer shifts from the GS 50-2,999 kW class to the GS<50kW

class, the former class load is reduced by more than the latter class load is increased. It is likely that in fact the actual load change has been much smaller than the difference between the class average loads. As a result, the Board finds that the load decrease for 2008 has been overstated. However, there is insufficient evidence to determine an accurate adjustment to correct for this distortion. We do not know the extent to which the decrease in the customer count in the GS 50-2,999kW class is due to customer attrition and how much is due to customer reclassification.

On the other hand, Lakefront is seeking a downward adjustment to the GS 3,000-4,999 kW class) to reflect Kraft's announcement that it will close its plant in 2008. On the basis of a 10% decline in January, Lakefront has estimated a total reduction for the year of 15,561,809 kW. This projection assumes a 10% reduction in load per month, with the load reduced to 0 in October. Lakefront has provided no substantiation for this load pattern, and this evidence was untested as it was provided through reply submissions. As a result, while the Board accepts the evidence that Kraft will close in 2008, only limited weight may be placed on the load adjustment proposed by Lakefront.

In conclusion, the Board will make no adjustment to the 2008 load forecast. Based on the limited evidence on the record, the two situations have largely offsetting impacts. The appropriate load increase to reflect the shift of customers from the GS 50-2,999 kW class to the GS<50 kW class is likely of the same magnitude as the appropriate decrease in the GS 3,000-4,999 kW class for the closure of Kraft. The Board cannot determine with any precision what the net effect of these two adjustments would be. We have therefore concluded that the most appropriate approach is to leave the forecast unchanged.

OPERATING, MAINTENANCE AND ADMINISTRATIVE EXPENSES

Controllable OM&A

The following table is derived from Board staff's submission and sets out historical and forecast amounts for the following expense categories: operations, maintenance, billing and collection, community relations, and administrative and general expenses. Together, these categories comprise the "controllable" OM&A

expenses. This table does not include spending related to CDM. That issue is addressed separately later in this decision.

Controllable OM&A

	2006 Board Approved	2006 Actual	2007 Forecast	2008 Forecast
Operations	523,452	481,734	568,635	620,871
Maintenance	104,971	88,033	114,011	324,385
Billing & Collecting	223,962	420,421	441,986	453,844
Community Relations (excl. CDM)	8,918	17,130	19,767	19,767
Administrative & General (excl. LV)	698,073	801,751	786,480	988,498
TOTAL	1,559,376	1,809,069	1,930,879	2,407,365

These expenses are forecast to increase by 33% in 2008 from the actual level in 2006. According to Board staff's analysis, most of the increase is attributable to compensation (including staff additions); smart meters; supplies, services and expenses; and regulatory costs. Smart meter expense is dealt with separately later in this Decision.

Of the total increase in controllable OM&A between 2006 actual and 2008 forecast of \$598,296, the increase in supplies, service and expenses is \$116,256. Board staff submitted that the evidence contained limited explanation of this increase. Schools echoed this submission. VECC submitted that without a satisfactory explanation from Lakefront, the increase in supplies, services and expenses should be limited to 3%.

Lakefront replied that the increase of \$116,256 since 2006 for supplies, services and expenses, was related to 3% inflation from 2007 to 2008, abnormally high transformer repairs in 2007 which are budgeted again for 2008 with inflation, and

forecasts for billing and collection and administration and general expenses based on an extrapolation of 2007 actuals until the time of filing. Lakefront also replied that compensation and benefits are forecast to increase by \$148,635 between 2006 actual and 2008 and include the addition of a Financial Clerk.

Shared services costs are a significant component of Lakefront's operating expenses. Board staff reported the level for 2006 as being \$1.3 million, out of total expenses of \$3.0 million. These costs are related to billing and collecting, and general administration expense. Staff submitted that Lakefront had failed to provide adequate information regarding the costs associated with these shared services, which it understands Lakefront Utility Services Inc. ("LUSI") provides to Lakefront, particularly with respect to cost allocators.

LUSI, Lakefront and Cobourg Networks are each subsidiaries of Town of Cobourg Holdings Inc. Lakefront responded that LUSI is a non-profit service company and all charges to Lakefront are based on actual costs and only on cost recovery; LUSI also provides services to Cobourg Networks Inc. Lakefront explained that employee costs are allocated based on the time spent performing each company's activities; Lakefront also set out the allocations for specific positions. Operating and maintenance costs are shared 50/50 when not attributed to a specific company.

With respect to regulatory expense, Lakefront forecast an increase of \$100,000 in 2008 over the estimated 2007 level of \$49,198, and attributed the increase to the preparation of the 2008 COS application. Lakefront, through an interrogatory response, suggested that the revenue requirement should include \$75,000 in additional expenses to recognize "a partial amortization of this application's costs as well as future regulatory expenses."

VECC agreed that a portion of the regulatory expense forecast should be amortized over future years, and that the 2008 expense should be reduced by \$65,000 accordingly since \$100,000 is the increase in expenditure over 2007 related to the 2008 application. Schools noted that prior overspending of \$12,349 in this area should not be carried over into 2008 and that there was an apparent discrepancy in legal fees. Schools concluded that these expenses should be reduced and then amortized over three years.

Lakefront proposed in its reply submission to amortize the regulatory costs of \$100,000 over three years, for total regulatory expense in 2008 of \$56,714 (2007 expense without costs related to the 2008 application) and \$33,333 (one third of the \$100,000 expense for the 2008 application).

The intervenors made additional specific recommendations for adjustments:

- Schools submitted that the increase of \$45,586 in bad debt should be disallowed because a large company bankruptcy does not justify a permanent step increase in this cost.
- VECC submitted that the \$16,650 for a new cost allocation study should be removed as the updating of the cost allocation study should take place at the time of the next rebasing.
- Both intervenors submitted that smart meter expense should be removed from the revenue requirement.

Board Findings

The Board will adopt the proposal to reduce OM&A by \$66,667 to reflect the amortization of the incremental regulatory expenses associated with the 2008 application over a three-year period.

The Board will also remove the expenses associated with Lakefront's smart meter proposal. The Board will deduct the amount of \$220,278 (contained in answer to VECC interrogatory 6(d)) for this adjustment. This issue is addressed in greater detail later in this Decision.

The Board will make a further downward adjustment to OM&A of \$25,000 related to bad debt expense. The Board finds that Lakefront has not substantiated its forecast of a continuing high level of bad debt expense. The Board will not make the specific adjustments for the cost allocation study which has been proposed by VECC.

As a result of these adjustments, which reduce the 2008 controllable OM&A from \$2,407,365 to \$2,095,420, the increase in controllable OM&A from 2006 actual to 2008 forecast is 16%. While this is still a substantial increase, the Board finds that the evidence, particularly in relation to staff increases, supports a conclusion that the increase is appropriate.

Amortization

Schools and VECC submitted that it appears that Lakefront has not used the half year rule for determining depreciation related to 2008 capital expenditures.

Lakefront replied that the Accounting Procedures Handbook does not provide prescriptive guidance in terms of amortization methods to be used, but rather it states that it is expected that utilities will continue to use methods consistent with past practice. Lakefront's practice has been to not use the half-year rule for financial presentation, but only with respect to income tax filing as required by the *Income Tax Act*.

Board Findings

The Board directs Lakefront to re-calculate its amortization expense to reflect the half year rule. This approach is consistent with the Board's practice for determining rate base.

Incremental CDM Funding

In EB-2007-0550/EB-2007-0106 Lakefront applied for approval of \$550,000 in incremental CDM spending. In its April 12, 2007 decision, the Board allowed Lakefront to collect \$38,761 through 2007 rates, noting that this represented the "capital-related expenses" for the full request of \$550,000. The Board also established a separate sub-account in Account 1508 to track the expenditures in this program and noted that the Board had still to decide whether it would authorize the full requested program amount of \$550,000. In its August 13, 2007 decision, the Board approved CDM spending of \$119,169 on the Distribution System Optimization and Line Loss program.

In its current application, Lakefront has forecast CDM O&M expenditures of \$119,169 for 2007 and \$80,408 for 2008.

VECC submitted that the calculation of the \$80,408 for 2008 expenditures is totally erroneous. The amount is described as the difference between the \$119,169 approved by the Board in its August 13, 2007 decision and the \$38,761 that the Board previously authorized for inclusion in 2007 rates. VECC noted that the former figure is an approved level of capital spending (versus the applied for level of \$550,000) whereas the latter is related to the annual capital related expenses associated with the originally requested CDM level of \$550,000. In VECC's view, capital expenditures of \$119,169 would relate to an annual

expense level of \$8,398 (assuming the same relationship as between a capital expenditure level of \$550,000 and an expense level of \$38,761).

VECC submitted that \$80,408 should be removed from Lakefront's revenue requirement. VECC also submitted that although the Board directed Lakefront to track CDM expenditures in account 1508, no additions are shown for 2007. VECC submitted that the difference between the \$32,825 collected and the \$8,398 ultimately authorized by the Board should be recorded as revenue in this account so that this over-collection can be returned to customers.

Board staff noted that the Board's decision of April 12, 2007 indicated that incremental funding for capital projects would be approved using a cost of service methodology; in other words, these capital projects would be included in rate base and not expensed.

Lakefront replied that the \$38,761 approved by the Board in the April 2007 decision was the annual capital-related expenses for the \$550,000 investment originally proposed. Lakefront interpreted the Board's decision to be that \$119,169 was to be recovered from rates as the decision made no mention of \$8,398 or a time period for recovery. Lakefront reiterated that \$80,408 should be included in its 2008 revenue requirement and that if the Board accepts VECC's position that only \$8,398 be included in the revenue requirement, then Lakefront withdraws its request for the inclusion of any amounts in 2008 revenue requirement as the cost to administer that amount of funding would be uneconomical.

Board Findings

In its August 13, 2007 decision in EB-2007-0106, the Board approved CDM spending of \$119,169 on the Distribution System Optimization and Line Loss program, but this approval related to capital expenditures, and therefore these amounts are properly included in rate base, where they will earn the allowed rate of return and be expensed through depreciation, and not expensed immediately through OM&A.

In its current application, Lakefront has treated the Board approved amount as an annual OM&A amount, which would be recovered on a recurring basis.

The Board finds that Lakefront has misinterpreted the Board's August 13, 2007 decision. The Board did not approve the direct recovery of \$119,169 through the revenue requirement as claimed by Lakefront; the Board approved amounts for capital spending to be included in rate base and the consequent revenue requirement amounts. The Board notes that the project is in fact included in rate base and therefore the appropriate amounts will be recovered through rates.

The Board will adjust OM&A to remove the amount of \$80,408.

In addition, rates were initially set to recover \$38,761 as the annual expense associated with the originally proposed \$550,000 CDM plan. VECC has extrapolated an annual expense level of \$8,398 for the \$119,169 in CDM spending which was ultimately approved. The Board accepts this as an appropriate amount to be recovered. As a result, an over-collection has taken place. The original decision contemplated this as a potential outcome and directed that a sub-account be used in Account 1508 to track this item. The Board directs Lakefront to record the over-collection arising from this difference between the originally approved \$38,761 and the appropriate level of \$8,398 in the sub-account for return to customers at a future date.

PAYMENTS IN LIEU OF TAXES (“PILs”)

Board staff noted that Lakefront’s calculation of PILs did not reflect the change in the federal tax rate. Staff also submitted that Lakefront made a number of errors in its calculation of the tax provisions. Lakefront included revised calculations for 2007 in its reply and included the small business deduction. The result is a combined rate of 33.8% rather than the 38.708% included for 2007 in its original application.

For the test year, Lakefront used a combined tax rate of 36.519%. This rate is higher than the maximum combined income tax rate of 33.5%, which is applicable to 2008. Lakefront stated in its reply that it “expects PILs to be re-calculated after all adjustments and final figures are determined.”

Board Findings

The Board finds that Lakefront should incorporate all known income and capital tax changes into its PILs calculations for 2008. This approach incorporates the most current tax levels which are substantially enacted.

In calculating the PILs provision, the Board directs Lakefront to reflect in its Draft Rate Order the new maximum federal income tax rate (reduced to 19.5%, yielding a combined maximum 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.

CAPITAL EXPENDITURES AND RATE BASE

Capital Budget

Capital Expenditures in 2008, excluding smart meters, are forecast to be substantially lower than the level in 2006 or 2007. Expenditures for 2006 actual and 2007 forecast were \$1.6 million and \$1.5 million respectively. The forecast for 2008 is approximately \$900,000. However, expenditures during the period 2002 through 2005 ranged from a low of \$499,000 to a high of \$763,000. Board staff submitted that the pattern supports Lakefront's position that there was a need for "catch-up" on infrastructure investment following the period of low capital expenditures. Staff noted that Lakefront's reliability performance has improved since 2004.

VECC did not express concern with Lakefront's proposed spending, except smart meters, which is addressed separately in this Decision.

Board Findings

The Board accepts Lakefront's proposed capital budget, excluding smart meters, for purposes of setting rates.

Smart Meters

Lakefront has included its smart meter capital expenditures forecast for 2008 in rate base, rather than tracking the revenue requirement impacts in the smart meter deferral account. Lakefront proposed to replace the meters of all its 9,088 customers through one deployment in 2008. The capital expenditures total \$2.038 million, of which \$1.956 million is for meters and about \$82,000 is for costs related to repairs and installation, consulting and legal expenses. This represents over 69% of Lakefront's 2008 capital program. The associated OM&A budget is \$220,278 and includes cost for the advanced metering regional collector, control computer, and infrastructure.

Lakefront explained its proposal as follows: Approximately half of our customers' meter seals are expired or on the verge of expiration. We have advised Measurement Canada and sought a reprieve. However, we believe it is imprudent and unfair to our customers to replace expired seal meters with kWh meters only to change them out within a short period. The cost, of approximately \$300,000 will be a stranded cost that our rate payers would have to bear unnecessarily. (Board staff IR #6)

Lakefront is not one of the 13 distributors authorized by regulation to undertake smart meter activities. Lakefront confirmed that it had not undertaken any smart meter activity in 2007 other than a meter study. Lakefront did participate with the Cornerstone Hydro Electric Concept Group in a technology selection process. This group has requested authorization from the Minister of Energy to move forward with procurement; a response from the Assistant Deputy Minister states that after completion of the RFP and the Minister's approval, a recommendation will be made to Cabinet to amend the relevant regulation to include the consortium members.

Schools agreed with Lakefront that it would not be prudent to replace expired meters with regular meters when they will likely need to be replaced with smart meters. Schools noted, however, that it is unclear whether Lakefront will get approval and do the planned installations in 2008. Schools proposed that smart meter expenses be tracked through a deferral account and recovered through a rate adder rather than through the revenue requirement. VECC made similar submissions, but noted that there were discrepancies in the level of capital spending and OM&A expenses related to this activity. VECC was of the view that if Lakefront's derived adder of \$2.51/meter/month is adopted, Lakefront should provide supporting schedules as part of the draft rate order. VECC submitted that the rate adder should be discounted to recognize the uncertainty of Lakefront receiving authorization to proceed in 2008.

Lakefront replied that while it is not an "authorized" distributor, it is one of the 11 "un-named" distributors who filed a specific smart meter plan in 2006. Lakefront submitted that the Board is allowed under section 53.18 of the *Electricity Act* to authorize discretionary metering by way of an order.

Lakefront submitted that if the Board denies the inclusion of the capital in rate base and the revenue requirement, then it should set an appropriate rate adder and continue the use of the smart meter deferral accounts. Alternatively, if the spending were denied, then Lakefront would spend about \$500,000 to replace expired meters with conventional meters, and would advance 2009 capital projects in the amount of \$325,000, for total capital spending in 2008 of \$1.738 million.

Board Findings

The Government has established a phased approach to the implementation of smart meters across the province. The Board notes the letter from the Ministry of Energy which indicates that the Government is aware that Lakefront and others are seeking authorization and that it intends to consider those proposals in due course. The Board finds that unless there are exceptional circumstances, the Board will not order the deployment of smart meters for distributors that have not received government authorization through regulation.

The Board concludes that Lakefront does not represent an exceptional circumstance. Lakefront's evidence is that "approximately half of our customer's meter seals are expired or on the verge of expiration." The Board notes, however, that an expired seal does not necessarily require replacement of the meter. Rather, the meters will be subject to further testing. In any event, at least half of Lakefront's meter seals have not yet expired, and therefore there is no requirement for these to be replaced.

The Board concludes that the forecast smart meter costs should be removed from OM&A and rate base. Lakefront is directed to make the appropriate adjustments to the revenue requirement (reductions in depreciation and rate base) and provide the details of these adjustments as part of its Draft Rate Order. Further, the Board will not allow an increase in the revenue requirement for purposes of a revised capital budget which includes the replacement of regular meters with new regular meters. The Board finds that the evidence as to the cost and magnitude of such a project is insufficient to support a revised 2008 capital budget.

The Board finds that it is appropriate to set a revised smart meter rate adder for Lakefront. The new rate adder will be \$1.00/meter/month. This rate adder takes

account of the funds already collected, the cost estimates provided by Lakefront, and the Ministry's recent letter indicating that Lakefront (and others) may have authorization in advance of the next rates proceeding. This higher rate adder will allow Lakefront to collect additional funds and will reduce the need for a further application to the Board as and when authorization to proceed is received. This new higher rate adder should not be viewed as approval for final recovery of the costs in question; that determination will need to take place in a future proceeding.

Reliability Performance

The System Average Interruption Duration Index ("SAIDI") and System Average Interruption Frequency Index ("SAIFI") are measures of reliability performance.

Lakefront provided its annual reliability numbers for the years since 2002, and included a target for 2008 based on the average for 2005 through 2007. Board staff submitted that Lakefront had not provided any specific plan as to how it would achieve its targets and expressed concern as to whether the improved performance could be maintained given the reduction in capital expenditures in 2007 and 2008.

Lakefront replied that the poor performance in 2003 was due to the August blackout and in 2004 due to lighting storms, as a result of which Lakefront has improved its tree trimming practices. Lakefront submitted that it plans to invest in the distribution system to improve its reliability indices.

Board Findings

The Board concludes that no further action is required in this area at this time.

Assessment of Asset Condition and Asset Management Plan

Board staff submitted that there was little evidence of a methodical asset management plan. Schools agreed that an asset management plan is necessary to address reliability and asset condition problems.

Lakefront responded that it does address asset management in a methodical way and pointed to its long term plan to convert from 4 kV to 27.6 kV, and explained how given the small size of the system this work is done based on upgrading sections which most need it first.

Board Findings

The Board believes that asset condition assessments and asset management plans are an important component of capital expenditure proposals, particularly when significant capital expenditures are contemplated. However, Lakefront has demonstrated that its capital expenditures, particular in the area of voltage conversion, are the result of a plan developed in response to its ongoing assessment of asset conditions on its system. The Board concludes that this approach is suitable given the circumstances of Lakefront's system. Therefore the Board will not require a more formal asset condition assessment or asset management plan at this time.

Working Capital

Lakefront developed its forecast working capital requirement based on the April 2007 Navigant forecast of the cost of power. VECC submitted that the cost of power component of the calculation should be reduced to \$54/MWh, the most recent Navigant forecast. Lakefront replied that the forecast was based on the best available information at the time and that there was no need for a recalculation.

In deriving its forecast of working capital, Lakefront used the currently established retail transmission costs. VECC submitted that the Retail Network Transmission costs should be reduced by 20% and Retail Connection Transmission costs should be reduced by 10%, to reflect the anticipated change in Hydro One's retail rates. Lakefront replied that Hydro One's proposed charges were not yet approved by the Board.

Board Findings

The Board concludes that the most accurate data should be used in the calculation of working capital. For this reason, Lakefront is directed to recalculate working capital to reflect the lower retail transmission rates. (This adjustment is further described below in the section Retail Transmission Rates.)

The Board also directs Lakefront to update the cost of power to reflect the most recent data contained in the April 2008 RPP report, the all in supply cost of \$0.0545/kWh.

COST OF CAPITAL

The Board's guidelines for the cost of capital are set out in its *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation of Ontario's Electricity Distributors* (the "Board Report"), dated December 20, 2006.

Lakefront's proposed capital structure is 53.33% debt (49.33% long-term debt and 4.0% short-term debt) and 46.67% equity.

Lakefront forecast a cost of long-term debt of 7.161% based on the 7.25% included in its promissory note held by the Town of Cobourg and a rate of 6.25% forecast for new third-party debt in 2008. Board staff noted that in the Board Report it was stated "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." Board staff submitted that the deemed long-term debt rate, as determined in accordance with the Board Report, should be the rate applied to all of Lakefront's long-term debt. Schools and VECC took the same position.

Lakefront confirmed that it expects the costs of short-term debt and the return on equity to be updated in accordance with the Board Report. Lakefront also acknowledged in its reply that 6.1% was the appropriate rate for its long term debt.

Board Findings

The Board finds that Lakefront's proposals for the capital structure are in accordance with the Board's Report and are appropriate. The return on equity and cost of short-term debt will be set in accordance with the Board report as set out in the table below. With respect to the cost of long-term debt, the deemed rate of 6.1% will be used.

The table below sets out the Board's updated costs for the various components of the capital structure. Lakefront's weighted average cost of capital is 7.19%.

Lakefront Utilities
Board-approved 2008 Capital Structure and Cost of Capital

Capital Component	% of Total Capital Structure	Cost rate (%)
Long-Term Debt	49.3	6.10
Short-Term Debt	4.0	4.47
Equity	46.7	8.57
Total	100.00	7.19

COST ALLOCATION AND RATE DESIGN

Revenue to Cost Ratio

The following table presents the revenue to cost ratios in Lakefront's Informational Filing (column 1) which included incorrect load data. Lakefront submitted a set of ratios based on corrected load data, but the study as resubmitted had an imbalance of total cost and revenue. The imbalance arises because miscellaneous revenues have been excluded but the cost of providing the various services is still included. VECC adjusted the ratios to correct for this imbalance and these figures (taken from VECC's submission) are contained in column 2. For reference, column 3 shows the range for each class consistent with the Board's cost allocation policy.

Revenue to Cost Ratios			
Col. 1	Col 2	Col. 3	
Informational	Adjusted Ratios	Range	
Filing	(VECC	(Board Report	
Run 2	submission ¶ 8.3)	EB-2007-0317)	
Customer Class			
Residential	114.0	94.9	85 – 115
GS < 50 kW	141.4	124.4	80 – 120
GS 50 - 2999 kW	148.3	146.8	80 – 180
GS 3000 - 4999 kW	24.9	35.1	80 – 180
Street Lights	12.9	9.3	70 – 120
Sentinel Lights	29.3	39.4	70 – 120
Unmetered	96.5	103.9	80 -- 120
Scattered Load			

Lakefront submitted another set of ratios, based on using the number of customers in each class rather than number of connections to allocate certain costs to the classes. The effect is to reduce costs allocated to street lighting significantly because there are only two customers in the class, and in this way the model yields a higher revenue-to-cost ratio for that class along with lower ratios for all other classes. Board staff submitted that if the number of connections is not used, then weighted customer counts would be a possible alternative, but not the simple number of customers. In any event, Board staff noted that using the number of customers was not in accordance with Board policy, as set out in the Board's *Directions on Cost Allocation Methodology for Electricity Distributors EB-2005-0317*, November 28, 2007.

Lakefront replied that the number of connections is an inappropriate yardstick because various numbers of street lights are connected at a single connection point. Lakefront maintained that the number of customers should be used as there is insufficient information available regarding the number of connections, and that the allocation using the number of customers was the appropriate basis for analysis.

Schools noted the level of over contribution, particularly of the GS<50kW and GS>50kW rate classes, and submitted that this should be addressed immediately. Schools submitted that the rules of affiliate pricing should be applied to street lighting, and that the rates should be set at 100% of costs. Schools cited the recent Enersource settlement and proposed that a similar approach be adopted, namely that all the ratios be moved to within a 91.5% to 111% range.

VECC submitted that revenue requirement should be moved from the GS<50 kW and GS 50-2,999 kW classes to the GS 3,000-4,999 kW, Street Lights and Sentinel Lights classes, and priority for rebalancing rates should be given to the GS<50 kW class.

Board Findings

The Board finds that the revenue to cost ratios provided in VECC's submission provide an appropriate starting point, because they are based on the corrected load data provided by Lakefront, they are consistent with the Board's methodology, and the total cost and total revenue are in balance. The Board does not agree with Lakefront that the number of customers should be used in the model; the Board has clearly stated that number of connections, or weighted customer numbers, are the appropriate alternatives. As Lakefront has decided not to adopt a weighted customer number approach, using number of connections is the best alternative.

The result is that Street Lights and Sentinel Lights classes are under-contributing significantly. The target minimum ratio for both these classes is 70% and the Board therefore finds that the current levels of 9.3% and 39.4%, respectively, are inappropriate. The Board has concluded that an immediate move to the target ranges would result in unacceptable impacts for customers in these classes and some mitigation is warranted.

The Board directs Lakefront to increase the rate for Street Lights so that the ratio is 25%. This increase is approximately one quarter of the way to the target minimum of 70%. The Board further directs Lakefront to adjust this rate annually so that the revenue to cost ratio increases in 15% increments each year during the IRM period (in other words, to 40% in 2009, 55% in 2010, and 70% in 2011). Similarly, the Board directs Lakefront to increase the rate for Sentinel Lights so

that the ratio is 55% in 2008, and to further adjust the rate so the ratio is 70% in 2009.

To the extent that additional revenue is forecast to be collected from the Street Lights and Sentinel Lights classes, the rates of the GS<50kW and GS 50-2,999kW classes shall be adjusted downward to yield the total revenue requirement.

Given the announced closure of Kraft in 2008, the Board will not direct any change in the ratio for the GS 3000-4999kW class at this time.

Line Losses

Lakefront has proposed a Distribution Loss Factor (“DLF”) of 1.0494, which is based on the average for the last three years. Board staff noted that the observed DLF has increased over the period since 2002.

Schools questioned whether the factor should be set lower, given the evidence that Lakefront’s voltage conversion project is expected to reduce losses in 2009 and 2010. VECC submitted that in light of the expected improvement in Lakefront’s losses, due to the voltage conversion program, the Distribution Loss Factor should remain unchanged at 1.0471 for 2008 (rather than increasing to 1.0494).

Lakefront replied that it needs the Distribution Loss Factor set to 1.0494 to reduce the amount for losses accumulating in the Power Variance account. Lakefront also submitted that losses will decline over time as a result of the system voltage conversion investments which have been undertaken and which are planned for the next ten years.

Board Findings

The Board accepts Lakefront’s proposed Distribution Loss Factor of 1.0494 and adopts the proposed Total Loss Factor of 1.0541.

Low Voltage Charges

Lakefront is an embedded distributor, served by host distributor Hydro One. Lakefront forecast LV charges of \$346,196 for 2008, equivalent to \$28,850 per

month. The average monthly cost for the period August through September 2007 was \$31,400.

Board staff noted that Hydro One's application includes lower LV charges to embedded distributors, but also new charges. Lakefront responded that based on Hydro One's proposed charges, the projected expenses will be \$360,000, which is comparable to Lakefront's proposed forecast of LV charges of \$346,196. Lakefront noted that any difference will be captured in the RSVA account.

Board staff also submitted that these costs should be allocated on the basis of revenue collected from each class under the Retail Transmission Service Rate – Connection. This method was used in the 2006 EDR process. Staff noted that it was unclear whether the proportions used are based on new RTS revenues. Lakefront replied that the allocation of LV charges was based on the total retail transmission revenue for 2008, which was calculated using forecasted loads for 2008 at existing 2007 rates by customer class. Lakefront presented the resulting ratios in its reply.

Board Findings

The Board accepts Lakefront's proposal with respect to LV Charges. The evidence suggests that if Hydro One's charges are accepted as proposed, Lakefront's forecast will not be materially inconsistent with the new charges.

Retail Transmission Service Rates

Lakefront proposed that its current retail transmission service rates not be changed. Board staff noted that Hydro One has proposed reductions in the rates to be paid by embedded distributors such as Lakefront. VECC agreed with Board staff's submissions.

Board Findings

The Board finds that Lakefront shall adjust its retail transmission rates to incorporate the changes to the wholesale transmission rates. The Network Retail Transmission Service Rate will be reduced by 18% from the currently approved rate charged to each class, and the Connection Retail Service Rate will be reduced by 5% from the currently approved rate charged to each class.

Rate Design – Fixed Charges

Board staff noted that Lakefront's monthly service charges are generally above the ceiling reference point, and that they are proposed to be increased, although by a lower percentage than the volumetric charge.

VECC submitted that the fixed charge should be determined with the smart meter adder excluded and the variable charge determined with the LV adder removed.

VECC submitted that the proposed charge of \$11.44 is 139% above the Minimum System Fixed charge of \$8.24, whereas the ceiling is considered to be at 120% above the Minimum System Fixed charge.

Board Findings

The Board finds that the monthly fixed charges should remain unchanged at the 2007 level net of the smart meter adder. This is consistent with the Board's policy as set out in its Report (*Application of Cost Allocation for Electricity Distributors*, November 28, 2007) in which the Board stated that distributors should not make changes which result in a charge which is greater than the ceiling, but that distributors which are currently above the ceiling are not required to bring the charges to the ceiling or below. The Board finds that it would be inappropriate to further increase these charges given the high level at which they are currently.

DEFERRAL AND VARIANCE ACCOUNTS

The following table show the account balances Lakefront is seeking to recover.

Lakefront
Deferral and Variance Account Balances

Account	Balance *
1508 Other Regulatory Assets,	\$129,296
1518 RCVA – Retail,	\$20,731
1548 RCVA – STR,	\$24,557
1550 LV Variance,	\$91,718
1580 RSVA – Wholesale Market Service Charge,	(\$359,475)
1582 RSVA – One Time Wholesale Market Service,	\$17,302
1584 RSVA – Retail Transmission Network Charges,	(\$136,899)
1586 RSVA – Retail Transmission Connection Charges,	(\$164,589)
1588 RSVA – Power,	\$1,168,228
1590 Recovery of Regulatory Asset Balances,	\$598,999
Total	\$1,389,869

* Positive figures represent balances proposed to be collected from customers. Negative figures represent balances proposed to be returned to customers.

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

Lakefront is requesting disposition of Account 1588 (RSVA – Power) along with the other RSVA and RCVA accounts, although there is already a separate process examining these accounts. Lakefront submitted that the size of the balance has a significant impact on a utility the size of Lakefront.

Board Findings

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

Account 1590 – Regulatory Assets

Lakefront made two proposals in respect of this account: to recover the April 30, 2008 forecast balance, and to add \$296,000 to the account to correct for an alleged error in 2006 rates.

With respect to the first proposal, Board staff noted that the Board, in its Phase 2 decision for the Review and Recovery of Regulatory Assets, determined that the approved balances should be recovered to the period ending April 30, 2008 and that any residual balance should be disposed of at the end of the period. Board staff pointed out that the final balance cannot be determined in advance of April 30, 2008, when the rate rider ends. Schools also submitted that this account should not be disposed of before the balance is finalized and verified.

With respect to the second proposal, Lakefront claimed that there was an error in its 2006 EDR due to the inclusion of \$296,000 (interest accrued on account 1570 Transition Costs) as a revenue requirement offset. Lakefront is now requesting to recover this amount and has proposed that account 1590 be continued and that the account should be restated to include the under-recovered amount and incorporated into a single set of regulatory asset rate riders for an additional two-year period.

Schools submitted that Lakefront is requesting a reconsideration of the 2006 rates and that it should be dealt with by way of motion to review the 2006 EDR application and Decision. Further, Schools submitted the proposal is inappropriate because 2006 rates have already been superseded by 2007 rates, and 2008 rates will soon be in place. VECC made similar submissions. VECC submitted that if the request was not rejected outright, then it should be the subject of a separate and formal review and vary application by Lakefront.

Lakefront replied that it was not an error on Lakefront's part, but rather the \$296,000 revenue offset was caused by the 2006 EDR model. The result is that Lakefront has been unable to recover \$296,000 and has lost a further \$296,000 because the discrepancy was carried over to 2007. Lakefront submitted that it was not in a position to discover this discrepancy until it prepared its 2008 application.

Board Findings

The Board finds that it is inappropriate to recover a forecast deferral account balance in this instance. The Board's decision in the regulatory asset proceeding is clear: the account and rate riders are to run until April 30, 2008 and the residual balance is to be disposed of at a later time.

With respect to the claimed \$296,000 error, the Board notes that Lakefront is responsible for the data in its applications. If the application of the 2006 EDR model resulted in the inappropriate treatment of an account, or part of an account, it was Lakefront's responsibility to identify this and bring it to the Board's attention. The 2006 EDR Handbook included the option for a distributor to make adjustments for this situation, namely the re-classification of amounts between accounts to ensure the proper determination of the revenue requirement. Many distributors applied for and received approval to make similar adjustments, and Lakefront undertook certain other account adjustments of a similar nature. The Board concludes that this error was the responsibility of Lakefront.

The intervenors are correct that what Lakefront now seeks is a review and variance of a prior Board order, an order which has already been superseded by a subsequent rate order. While that could have been the subject of a separate motion to the Board, the Board will deal with the request as part of this application.

Lakefront seeks recovery of revenue lost in a prior period due to this error. Lakefront asserted that it could not have detected the error until it was preparing its 2008 application. There is no evidence to support this assertion and it contradicts the Board's experience in which a number of distributors sought to make similar adjustments as part of their 2006 rate applications and Lakefront itself made other adjustments.

Had the error been reported sooner it might have been appropriate to review Lakefront's 2006 rates. Those rates have already been superseded by 2007 rates, which in turn are soon to be superseded by 2008 rates. An adjustment now for this error would result in significant retroactivity. Such a retroactive adjustment might be appropriate if there were evidence that Lakefront was not responsible for this error; however, that is not the case, as already set out above.

The Board concludes that it will not allow for the retroactive correction of this error. The Board notes this error has been removed from the current application and therefore has been corrected on a going forward basis.

Accounts 1508 and 1550

The Board finds that the balances in these accounts will be disposed, subject to any adjustments arising elsewhere in this Decision. The Board notes that Lakefront's proposal to dispose of their deferral and variance accounts was based on a two year recovery period. As a result of Board's findings, the total deferral and variance account balances approved for disposition will be reduced from \$1,389,869 to approximately \$220,000 (subject to any further adjustments required to reflect the Board's finding regarding the Horizon Plastic Metering error set out below). Therefore, the Board believes that a one year recovery period is appropriate.

Horizon Plastic Metering Error

In 2007, Lakefront refunded its customer Horizon Plastics for a metering error discovered in May 2007, covering the period 2004 to mid-2007. The refund of \$1,428,792 included interest as stipulated in the Retail Settlement Code ("RSC"). This interest rate is higher than that allowed for deferral and variance accounts. The difference (of \$16,970) was included in the December 31, 2006 balance of account 1588. Board staff questioned whether ratepayers should bear this interest cost differential for a utility error.

The refund also impacted Lakefront's line loss factor, RSVA balances and account 1550 LV for the period 2004 to 2006. Lakefront proposed to make a future application to recover the cost impacts of this error related to 2007, but has adjusted the 2006 EDR approved balances of deferral and variance accounts to correct for this error in the 2004 period. Board staff questioned whether this was appropriate.

VECC expressed concern with respect to the request to revisit decisions made almost two years ago. VECC also opposed the requested recovery of the interest differential arising from the refund. VECC submitted that the RSC establishes that it is the distributor, not ratepayers, which is liable for paying interest as a result of a distributor mistake. VECC submitted that if Lakefront advanced further grounds for recovery, then it might seek the right of reply.

Lakefront replied that it is seeking to recover the December 31, 2006 balances of the affected RSVA accounts adjusted to correct for the consequences of the metering error. The total adjustment is \$927,352. Lakefront submitted that it is not seeking an adjustment to the 2004 balances, because the adjustments did not arise until the problem was identified and Lakefront reimbursed the customer.

Lakefront submitted that the correction of billing errors in relation to a pass-through cost is not retroactive ratemaking. The fundamental rationale of the variance accounts is to keep customers and utilities whole. Failure to make the adjustments would result in a windfall for customers.

Board findings

The Board notes that the intention of the RSVA accounts is to keep the distributor and its customers whole in respect of commodity and associated commodity costs. Therefore, the Board finds that it is appropriate to adjust the RSVA and Account 1550 balances to reflect the correction of this metering error. However, the adjustment should not be made to the 2006 balances; rather the adjustments should be made to the 2007 balances to reflect the timing of the refund which was made. This revised 2007 balance will be dealt with in a subsequent application for disposition.

The Board finds that the incremental interest expense is not recoverable from ratepayers; this cost is appropriately borne by the distributor, not its customers.

Lakefront is directed to revise its 2006 balances to reflect these findings and to provide the details as part of its Draft Rate Order.

Requests for new Accounts

Lakefront proposed to establish three new accounts:

- Late Payment Class Action Suit
- Meter Data Management Repository Account
- Future Capital Projects

Lakefront subsequently withdrew its requests for the first two accounts in its reply submission.

Board staff submitted that requests for new accounts should be considered in light of the four regulatory principles: materiality, prudence, causation, and management's ability to control. Board staff noted that within the electricity sector, deferral and variance accounts are generally established on a generic basis – not a utility specific basis.

Lakefront requested an account to record the annual cost of service for new assets (including depreciation and return, but not PILs). Board staff noted that this request may be premature as the mechanism for 3rd Generation IRM has not yet been determined. Schools made similar submissions. VECC also concluded that it is premature to approve new accounts at this time and that such accounts should be established on a generic basis as and when it is determined that they are required.

Lakefront responded that it would not use the future capital projects deferral account if this issue were dealt with in 3rd Generation IRM.

Board Findings

The Board finds that it is not appropriate to establish an account for future capital projects. The issue of capital expenditures is currently being explored within the 3rd Generation IRM process; it would be premature and inappropriate to establish a deferral account in advance of the completion of that process.

IMPLEMENTATION

The Board has made findings in this Decision which change the revenue deficiency and change the deferral and variance account balances for disposition, and therefore the proposed 2008 distribution rates. These are to be reflected in a Draft Rate Order prepared by Lakefront. This Draft Rate Order is to be developed assuming an effective date of May 1, 2008, but the Board will not implement new rates on May 1, 2008.

The Board issued an Interim Rates Order on April 22, 2008 which allows for an effective date as early as May 1, 2008. However, as Lakefront was late in filing its application, the Board has determined that an effective date as of the date of the final Rate Order is appropriate in the circumstances of the case. The current, interim rates are in effect until the Board approves the final Rate Order.

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

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

The Board therefore directs that:

1. Lakefront shall file with the Board, and shall also forward to VECC and Schools, a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The Draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.
2. VECC and Schools shall file any comments on the Draft Rate Order with the Board and forward to Lakefront within 20 days of the date of this Decision.
3. VECC and Schools shall file with the Board and forward to Lakefront their respective cost claims within 26 days from the date of this Decision.
4. Lakefront shall file with the Board and forward to VECC and Schools responses to any comments on its Draft Rate Order within 26 days of the date of this Decision.

5. Lakefront shall file with the Board and forward VECC and Schools any objections to the claimed costs within 40 days from the date of this Decision.
6. VECC and Schools shall file with the Board and forward to Lakefront any responses to any objections for cost claims within 47 days of the date of this Decision.
7. Lakefront shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, May 9, 2008

Original signed by

Gordon Kaiser
Vice Chair and Presiding Member

Original signed by

Cynthia Chaplin
Member