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1 **REVENUE DEFICIENCY**

2 **OVERVIEW**

3 LUI has provided detailed calculations supporting its 2012 Revenue Deficiency. LUI has used
4 MIFRS (Modified International Financial Reporting Standards) in order to calculate the 2012
5 Revenue Deficiency for 2012. LUI's Revenue Deficiency when grossed up for PILS is
6 \$ 743,941 . This is calculated as the difference between the 2012 Test Year Revenue
7 Requirement of \$ 4,752,741 and the Forecast 2012 Test Year Revenues Requirement at LUI's
8 2011 approved distribution rates of \$ 4,008,801 . Table 6-0 below provides the revenue
9 deficiency calculations for the 2012 Test Year at Existing 2011 OEB approved rates and the 2012
10 Test Year Revenue Requirement.

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12 **REVENUE REQUIREMENT**

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14 LUI's Revenue Requirement consists of the following:

- 15 • Administrative & General, Billing & Collecting Expense
- 16 • Operation & Maintenance Expense
- 17 • Depreciation Expense
- 18 • Property Taxes
- 19 • PILS'
- 20 • Deemed Interest & Return on Equity

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22 LUI's revenue requirement is primarily received through electricity distribution rates and offset
23 by revenue from OEB-approved specific service charges, late payment charges, interest, and
24 other operating income.

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Table 6-1 Calculation of Revenue Deficiency

**Lakefront Utilities Inc.
Revenue Deficiency Determination**

Description	2011 Bridge	2012 Test Existing Rates	2012 Test - Required Revenue
Revenue			
Revenue Deficiency			743,940.79
Distribution Revenue	4,019,092	4,008,801	4,008,801
Other Operating Revenue (Net)	298,240	378,462	378,462
Total Revenue	4,317,332	4,387,263	5,131,204
Costs and Expenses			
Administrative & General, Billing & Collecting	1,563,298	1,796,132	1,796,132
Operation & Maintenance	885,828	1,271,182	1,271,182
Depreciation & Amortization	1,124,562	816,209	816,209
Property Taxes	48,099	49,542	49,542
Capital Taxes	0	0	0
Deemed Interest	521,621	491,348	491,348
Total Costs and Expenses	4,143,408	4,424,412	4,424,412
Less OCT Included Above	0	0	0
Total Costs and Expenses Net of OCT	4,143,408	4,424,412	4,424,412
Utility Income Before Income Taxes	173,924	(37,150)	706,791
Income Taxes:			
Corporate Income Taxes	32,287	(80,113)	35,198
Total Income Taxes	32,287	(80,113)	35,198
Utility Net Income	141,637	42,963	671,593
Capital Tax Expense Calculation:			
Total Rate Base	15,728,172	17,525,919	17,525,919
Exemption	15,000,000	15,000,000	15,000,000
Deemed Taxable Capital	728,172	2,525,919	2,525,919
Ontario Capital Tax	0	0	0
Income Tax Expense Calculation:			
Accounting Income	173,924	(37,150)	706,791
Tax Adjustments to Accounting Income	(59,632)	(479,707)	(479,707)
Taxable Income	114,292	(516,857)	227,084
Income Tax Expense	32,287	(80,113)	35,198
Tax Rate Reflecting Tax Credits	28.25%	15.50%	15.50%
Actual Return on Rate Base:			
Rate Base	15,728,172	17,525,919	17,525,919
Interest Expense	521,621	491,348	491,348
Net Income	141,637	42,963	671,593
Total Actual Return on Rate Base	663,257	534,311	1,162,941
Actual Return on Rate Base	4.22%	3.05%	6.64%
Required Return on Rate Base:			
Rate Base	15,728,172	17,525,919	17,525,919
Return Rates:			
Return on Debt (Weighted)	5.53%	4.67%	4.67%
Return on Equity	9.58%	9.85%	9.85%
Deemed Interest Expense	521,621	491,348	491,348
Return On Equity	602,704	671,593	671,593
Total Return	1,124,324	1,162,941	1,162,941
Expected Return on Rate Base	7.15%	6.64%	6.64%
Revenue Deficiency After Tax	461,067	628,630	(0)
Revenue Deficiency Before Tax	642,602	743,941	(0)

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1 **COST DRIVERS ON REVENUE DEFICIENCY**

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3 LUI notes there are several factors that contribute to the gross revenue deficiency of

4 \$ 743,941 for the 2012 Test Year. The following discussion highlights some significant
5 items that contribute to this deficiency.

6 The revenue deficiency is primarily the result of increasing OM&A expenses (as previously
7 mentioned in the Cost Driver Table 4.14 in Exhibit 4). The cost drivers with the most significant
8 impacts are Third Party Services, Non-Union Wage Adjustments, Meter Maintenance,
9 Consulting Regulatory Fees, Capital Maintenance, Collections, and Software Maintenance. A
10 brief synopsis of the effect these cost drivers have on LUI's OM&A is shown below.

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12 Increases in OM&A expenses are primarily due to:

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✓ Increases in direct and indirect labour costs

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- Economic wage increases have increased salaries and wages paid each year. Effective Feb 1st of each year, economic increases negotiated through collective agreements were 3% for four years effective 2010 to 2013 respectively.

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- LUI is requiring the hiring of new staff of 5.75 Full Time Equivalent positions between 2008 and 2012. Of these positions, there will be a net addition of 3.25 unionized staff, 1.75 Non-unionized staff, and 0.75 Management staff (non-union). LUI requires this new complement of staff to properly recover from attrition of its workforce, and also to efficiently execute industry initiatives. A detailed discussion can be found in Exhibit 4 following Table 4.36 "2008-2012 Employee Complement Compensation".

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- Cost associated with hiring third party services to complete activities including audit, legal, maintenance services, collection services, and disposal services. The hiring of third party services is cost effective as these services

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1 are not required on a full time basis, and expenses can be removed from
2 daily operating costs.

3 ✓ Inflation has increased from 2.4% in 2008 to 3% in 2011 Bridge and 2012 Test Year.
4 All utilities will be confronted with increased operational costs due to the rising
5 inflation costs to services.

6 ✓ Increases have occurred due to planned maintenance programs for proactive
7 measures against the aging of LUI's capital infrastructure as well as initiatives
8 undertaken as an industry i.e. Smart Meter, Conservation Demand Management,
9 IFRS Compliance and Asset Management Plan etc.

10 ✓ Maintenance programs are not only used as a method of preserving useful life of
11 equipment and buildings, but it is required to continue operations and promote a
12 safe environment. Assets must be kept within safety code, and in working order to
13 operate daily and this is proving to be an increasing expense yearly.

14 ✓ Increasing Regulatory Expenses
15 ○ LUI's regulatory expenses have been steadily increasing year to year
16 (discussed in Exhibit 4) and it further expects to incur approximately
17 \$103,000 in additional expenses due to the 2012 rate application.

18 ✓ Increasing Collection Expenses
19 ○ Collections accounts have been an increasing driver due to the economic
20 environment and recession in 2008. A large increase is seen as customer late
21 payments become more frequent and there is decreased job security. LUI's
22 service area has experienced a shift in employment as a result of economic
23 downfalls.

24 ✓ Increasing Software Maintenance Expenses
25 ○ Software has traditionally been a cost driver that exceeds the inflation rate
26 as technology rapidly adapts to be more user friendly and service the
27 industry in the best method possible. LUI expects this cost to continue
28 increasing as the electricity industry works through Smart Metering
29 technology and must maintain adequate and appropriate Service Level

1 Agreements. To adapt with the new technologies, other software will
2 require updates for compatibility purposes.

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5 Additions to capital assets in all years exceeded depreciation levels resulting in an
6 increased rate base on which the rate of return is calculated. In particular, in 2011, LUI
7 initiated the construction of an expansion to the OWC in 2011/2012. As mentioned in
8 Exhibit 2 LUI requires additional office space due to its increased initiatives and
9 operations.

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