

**OVERHEAD CAPITALIZATION RATE**

This evidence will discuss the methodology used to allocate Common Corporate Functions and Services (CCF&S) and Asset Management costs to Capital Projects.

Hydro One capitalizes costs that are directly attributable to capital projects and also capitalizes overheads supporting capital projects. The Overhead Capitalization Rate is a calculated percentage representing the amount of overhead costs that are required to support capital projects in a given year.

In 2005, the company commissioned a study by RJ Rudden Associates to recommend a method to derive its overhead capitalization rate for CCF&S and Asset Management costs. In RP-2005-0020/EB-2005-0378, the Ontario Energy Board (OEB) accepted the study's methodology, recommendations and the allocation of costs for the test year from the study. The 2008 overhead capitalization rate is calculated consistent with the methodology accepted in the Rudden study.

Capitalized overheads for the Distribution business for the historical years and bridge year are shown in Table 1:

**Table 1**  
**Overhead Capitalized**  
**Historical Years (2004-2006) & Bridge Year (2007)**

	<u>Historic</u>			<u>Bridge</u>
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Total capitalized overheads (\$M)	45.0	46.2	59.8	46.6
Capitalized overhead rate (%)	17.0	16.0	17.0	10.5

1 The Rudden overhead capitalization rate methodology, submitted in RP-2005-0020/EB-  
2 2005-0378, recommended a true-up (referred to as an E-Factor) in determining the  
3 overhead capitalization rate. The E-Factor represents the true-up between the amount of  
4 overhead costs actually capitalized for a prior year and the amount that would have been  
5 capitalized for that year using actual data instead of the estimates used in calculating the  
6 overhead capitalization rate. The study recommended the inclusion of an E-Factor in the  
7 calculation of the overhead capitalization rate for subsequent years. The actual data for  
8 2006 would result in an E-Factor adjustment to be included in the overhead capitalization  
9 rate calculation for 2008. The E-Factor adjustment for the true-up of 2006 capitalized  
10 overheads was calculated to be (\$14.4M). This amount is included as an adjustment to  
11 the derivation of the 2008 overhead capitalization rate.

12  
13 Table 2 summarizes the overhead capitalization rates as determined by the Rudden  
14 methodology and the resultant allocation of costs.

15  
16 **Table 2**  
17 **Overhead Capitalized**  
18 **2008 Test Year**  
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<b>Overhead Cost Category</b>	<b>Capitalization Rate</b>	<b>Amount Capitalized (\$M)</b>
Corporate Functions and Services	7.9%	43.1
Asset Management and Operators	1.3%	7.2
Sub-Total	9.2%	50.3
E-Factor Adjustment (for 2006)	(2.7%)	(14.4)
Total (Including E-Factor)	6.5%	35.9

20 Note: For planning and actual charging purposes, the overhead capitalization rate is rounded to the nearest whole percentage point.

21  
22 In 2007, the Rudden overhead capitalization rate methodology true-up principle  
23 continues to be adhered to, however it is being implemented in a more efficient manner.  
24 Beginning in 2007, Hydro One Networks is adjusting the overhead capitalization rate

1 several times within the year as required to reflect actual changes in capital expenditures  
2 spending. This will improve the timeliness of the potential E-Factor true-up and result in  
3 a better alignment of overhead costs with the capital projects that they support. It is also  
4 proposed that the year-end E-Factor true-up, going forward, will be included in the  
5 calculation of the overhead capitalization rate for the subsequent year.

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