



**EB-2013-0116**

**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 Cambridge and  
North Dumfries Hydro Inc. for an order approving just and  
reasonable rates and other charges for electricity distribution  
to be effective May 1, 2014.

**BEFORE:** Christine Long  
Presiding Member

Cathy Spoel  
Member

**DECISION AND ORDER**  
**August 14, 2014**

Cambridge and North Dumfries Hydro Inc. (“CND”) filed a complete cost of service application with the Ontario Energy Board (the “Board”) on October 28, 2013 under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that CND charges for electricity distribution, to be effective May 1, 2014.

Energy Probe Research Foundation (“Energy Probe”), the Vulnerable Energy Consumers Coalition (“VECC”) and School Energy Coalition (“SEC”) were intervenors in the proceeding.

CND, Energy Probe, VECC and SEC reached a settlement of some of the issues in dispute. A Settlement Proposal was filed with the Board on April 2, 2014, and an oral

hearing on the unsettled issues was held on April 29 and 30. The Board approved and adopted the Settlement Proposal at the oral hearing. A copy is attached.

The unsettled issues on which the Board heard evidence are grouped into broad areas:

- OM&A (Issues 1.1, 1.2, 2.1, 3.1, 4.1, 4.2, 4.3, 5.1, 6.1, 6.2, 7.1, 7.4, 7.7 and 8.6);
- Long Term Debt and Interest Income (Issues 7.5 and 7.6);
- Design of the GS 50 – 999 kW Rate (Issue 8.3); and
- Removal Costs (Issues 7.1, 7.2, 9.1 and 9.2).

### ***RRFE issues***

This application is one of the first under the Renewed Regulatory Framework for Electricity (the “RRFE”) to be considered by the Board. The parties were unable to reach complete settlement on any of the specific issues on the issues list that relate to the RRFE – foundation, performance measures, customer focus, operational effectiveness, public policy responsiveness and financial performance.

The submissions on these issues were largely grouped into the OM&A “issue” as the focus was on the cost to implement the various initiatives proposed by CNL rather than the extent to which the initiatives met the objectives of the RRFE.

The Board recognizes that this application was one of the first to be considered under the new RRFE framework. Accordingly, the approach by which to consider these issues would have been new to the applicant and the intervenors. It became apparent at the oral hearing that the intervenors may have had difficulty agreeing to the settlement of an issue, where they agreed with the means by which the applicant arrived at a decision, but they disagreed with the decision reached. It would have been very helpful to the Board if parties were able to differentiate between the process followed and the result achieved.

**OM&A**

CND is proposing a forecast OM&A excluding property taxes of \$14,877,658.<sup>1</sup> This amount represents a 48% increase from 2010 Board approved, a 55% increase over 2010 actuals and an 8% increase over 2013 actuals.

CND explained that part of the increase is caused by the addition of regulatory responsibilities that the utility must now undertake. Simply put, CND is now required to do more than it was required to do in 2010. Added responsibilities require additional staff and resources. CND acknowledged that these additional responsibilities have had an impact on most Ontario LDCs.

CND also identified three major drivers for the OM&A increase specific to their utility. These include:

1. An increase in information technology (“IT”) spending;
2. An increase in personnel to allow for better control room coverage; and
3. An increase in personnel for succession planning purposes.

CND undertook a risk assessment of the utility in 2012 (the “Corporate Risk Assessment”) and identified the need for IT improvements. CND provided evidence related to large scale IT upgrades which it has deemed necessary for the efficient running of the utility.<sup>2</sup>

CND’s evidence set out that it did not have enough control room operators to allow for proper coverage. CND hopes to transition to 24/7 coverage in the next few years. To achieve this, CND needs to start hiring and training additional staff now.

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<sup>1</sup> Reply p, 8 Table 1

<sup>2</sup> Exhibit 4 Tab 1 Schedule 1 p. 6

Finally, CND noted that it has instituted a multi-year training program that will ensure that apprentices will be prepared to assume specialized technical positions upon the retirement of current employees.

An increase in staffing is one of the major drivers of the OM&A increase. CND has hired for 15 new positions from 2010 to mid-2013. Its intention was to hire for an additional seven positions by the end of 2013. An additional 5 new positions are to be added in 2014. CND advised that increased staffing is required in order to respond to additional responsibilities mandated by the Board and by legislation and regulations, and to address issues identified in the Corporate Risk Assessment.

Intervenors take the position that CND is expanding its workforce at too fast a pace with a corresponding increase in OM&A which is unacceptable. Intervenors argued that in many cases, CND is hiring new employees to operate a number of new initiatives, the success of which will be unknown until after the test year.

Energy Probe pointed out that the number of employees increased by 13.2 FTEs from 2006 through 2013 and that CND is now proposing to increase the level of FTEs by 15.9 in 2014 relative to 2010.<sup>3</sup> SEC was concerned about the pacing of spending, and in particular, the disconnect between spending and the benefits that would flow in future years. SEC submitted that front end increases with no accrued benefits would result in the future benefits flowing to the shareholder until the next rebasing, at which time the savings would be incorporated into base rates.<sup>4</sup>

VECC pointed out that while CND plans to hire, it is having difficulties hiring as planned.<sup>5</sup>

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<sup>3</sup> Energy Probe Final Argument p.10

<sup>4</sup> SEC Final Argument p. 7

<sup>5</sup> VECC Final Argument p. 3

Intervenors and Board Staff argued for a reduction in OM&A for the 2014 test year. The amount of reduction ranged from \$680,000 to \$ 1.5 million dollars.

### **Board Findings**

The Board has reduced OM&A expense for the test year to \$14,970,736. This amount is inclusive of 2014 Removal Costs. The Board approved amount represents a total reduction from the proposed OM&A of \$623,371. The reduction reflects a decrease in 2014 Removal Costs of \$243,565 which is discussed later in the Decision. The remaining reduction of \$379,806 is explained below.

Actual OM&A in 2010 was \$9,580,557. 2013 actual OM&A was \$13,807,478.<sup>6</sup> The proposed 2014 OM&A is an 8% increase over 2013 actuals. The Board finds that this level of increase at the beginning of a 4 year IRM period, when CNL has stated that there will be future savings, is too high. The Board recognizes that an increase which is over and above inflation is required to account for growth, to fund projects and programs and to account for an appropriate increase in staff. Therefore the Board has applied a 5% increase to 2013 actuals of OM&A spending and approved test year Removal Costs.

The Board has decided on a reduction to proposed OM&A for three reasons ; 1) the increase in staffing levels which seems aggressive in the circumstances 2) a delay in implementing new hiring which will mean a reduced OM&A expense and 3) the recognition that the programs undertaken should result in some efficiencies over the test period.

A large component of the increase of OM&A is related to additional hiring of employees. In 2010, CNL had 89 staff.<sup>7</sup> It anticipates having 117 in 2014.<sup>8</sup> This represents an

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<sup>6</sup> Reply Table 1 p. 8

<sup>7</sup> Exhibit 4 Tab 4 Schedule 2 Table 4-20

<sup>8</sup> Ibid

increase of 28 people in four years. This is a sizeable increase for a utility with approximately 52,000 customers, experiencing a customer growth rate under 7% over the same period.<sup>9</sup> The purpose of these hires is to address succession planning, to provide better control room coverage and to implement new initiatives that the utility has identified. Some of these additional hires are necessary. Some are discretionary.

CND's intention to add additional FTEs may in fact be outpacing its ability to hire qualified candidates. CND has stated in evidence that some of its anticipated hires would not be completed until late in 2014. As a result, the Board is of the view that there should be a corresponding decrease in the revenue amount to reflect wages and benefits foregone as a result of a delay in hiring. The Board has made a reduction to OM&A using as a guide that the average employee (benefits included) costs the utility approximately \$80,000.<sup>10</sup>

The Board has also used the above number in reducing the OM&A amount to account for some staff additions, the utility of which may be better realized later in the test period.

The Board is also of the view that while CND is undertaking initiatives that are worthwhile it will take some time before benefits are realized from all these projects. CND has commenced certain initiatives intended to improve productivity. These initiatives are in their early days. Potential savings have not been reflected in the application because they are as yet unknown. New technology is another area in which CND has invested resources and personnel hours. Again, the results of these initiatives have yet to be realized. SEC argued that these potential savings would benefit the shareholder throughout the IRM period, but the application as filed did not provide for any benefit to the ratepayer. The Board agrees that some benefit to the ratepayer must be attributed to the efficiencies that should be gained as a result of these initiatives.

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<sup>9</sup> Day 1 Tr. p.83 lines 15 – 21

<sup>10</sup> Day 1 Tr. p.8 lines 9 – 19

CND management has provided a thorough and well thought out plan. CND's witness panel was comprised of senior management who were knowledgeable and provided a comprehensive presentation of the various projects and programs the utility is undertaking. Many of the new programs were started after the completion of a Corporate Risk Assessment. The evidence put forward by CND explains CND's position that they are planning for future needs as they relate to key positions. However, a comprehensive list of new projects cannot be undertaken regardless of the impact on rates. The pace at which changes are implemented must reflect a balance between the desired outcomes for the operation of the utility and the increased rates that result.

### ***Long Term Debt and Interest Income***

Long Term Debt and Interest Income are related to the same issue; whether CND's long term debt structure is appropriate. To the extent CND uses its cash balances to finance capital expenditures; the interest earned on these cash balances is reduced.

The following table sets out the capital structure proposed by CND:<sup>11</sup>

	(%)	(\$)	(%)	(\$)
<b>Debt</b>				
1 Long Term Debt	56.0%	73,765,320	4.96%	3,655,571
2 Short Term Debt	4.0%	5,268,951	2.11%	111,175
3 <b>Total Debt</b>	<b>60.0%</b>	<b>79,034,271</b>	<b>4.77%</b>	<b>3,766,746</b>
<b>Equity</b>				
4 Common Equity	40.0%	52,689,514	9.36%	4,931,739
5 Preferred Shares	0.0%	0	0.00%	0
6 <b>Total Equity</b>	<b>40.0%</b>	<b>52,689,514</b>	<b>9.36%</b>	<b>4,931,739</b>
7 <b>Total</b>	<b>100.0%</b>	<b>131,723,785</b>	<b>6.60%</b>	<b>8,698,484</b>

<sup>11</sup> Settlement Proposal; Revenue Requirement Work Form.

CND is proposing a weighted average cost of long term debt of 4.96%, which is based on a \$35 million promissory note payable to Sun Life at 4.962%, and a demand promissory note of \$3,019,708 payable to the Township of North Dumfries, an affiliate of CND at 4.88%, the Board's deemed rate for affiliate long term debt.

CND is not forecasting any additional third party long term debt in 2014. Instead, CND proposes to finance its capital expenditures from operations and its large cash reserves of approximately \$10 million. CND's evidence was that it would eventually secure additional long term debt but wanted to wait until its needs were large enough to access preferential debt markets.

At present CND is earning approximately 1.3% interest on its cash reserves. This interest income will be reduced if these cash reserves are used to finance long term debt.

Board Staff took no issue with CND's proposal. In their view, CND's proposed treatment is consistent with the Board's policy on cost of capital.

Energy Probe, VECC and SEC all objected to CND's proposal on the basis that CND's actual long term debt is significantly lower than the Board's deemed long term debt for rate making purposes.

Energy Probe argued that CND should be required to refinance by taking out additional long term debt.<sup>12</sup> Energy Probe argued that CND's approach to financing results in an inappropriate outcome as it ignores the benefits of locking in long term rates at historically low levels "at a time when these rates are expected to rise in the future".<sup>13</sup> The Board's policy on cost of capital requires a party who wishes to depart from it to support that departure with evidence. There was no evidence filed in this hearing that

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<sup>12</sup> Energy Probe Final Submission p. 19

<sup>13</sup> Energy Probe Argument p. 21



rates are expected to rise in the future. As pointed out in the Board's Report on the Cost of Capital for Ontario's Regulated Utilities, evidence is required for any deviation from Board Policy.<sup>14</sup> As a result, the Board places no weight on Energy Probe's submission on this issue.

SEC argued that the "just and reasonable result" would be to assume the rate of deemed debt applied for by CND, but at a lower interest rate, based on an assumption that the incremental debt is borrowed at prevailing interest rates, not at higher past interest rates.<sup>15</sup> This proposal is also a departure from the Board's policy and requires evidence to support it. There was none filed.

### **Board Findings**

The purpose of the Board's policy on cost of capital as articulated in its Decision and Order in EB-2009-0259 is to use a consistent approach, so as to avoid rearguing policy matters on cost of capital in each case.<sup>16</sup> CND's proposal in this application is entirely consistent with the Board's policy. CND used deemed, not actual, debt to equity ratios, and the interest costs are calculated in accordance with the Board's current allowed rates; the actual rates for third party debt, and the deemed rate for affiliate debt. The Board's policy was the result of a generic process involving a broad range of stakeholders. While it does not require slavish adherence by Board panels, if a party, applicant or intervenor, wishes to urge a panel to depart from the policy, convincing evidence is required. This panel has considered the evidence and arguments made by the applicant and the intervenors and finds that CND's proposal with respect to cost of capital is entirely consistent with the Board's policy and finds no reason on the basis of the evidence/arguments put forward to depart from it.

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<sup>14</sup> *EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009, p. 13

<sup>15</sup> SEC Final Submission p.9

<sup>16</sup> *EB -2009-0259 Decision and Order Burlington Hydro Inc.* March 1, 2010

The interest income earned by CND is directly related to its cash reserves. Clearly CND should take reasonable steps to earn the most interest income possible, but there is no requirement in the Board's policy that CND maximize its cash reserves for the purpose of earning interest income.

### ***Design of the GS 50 – 999 kW Rate***

CND proposes to maintain the existing ratio between the fixed and variable components of the rate charged to this customer class at 19:81. This results in an increase in the fixed monthly charge from \$109.35 to \$126.44. The current rate already exceeds the "ceiling" of \$96.99 established in CND's cost allocation study.<sup>17</sup>

The basis for the proposal for this rate class is that as part of the settlement proposal, the ratio between fixed and variable was to remain the same.<sup>18</sup> CND notes in its reply argument that the same issue of exceeding the ceiling also applies to the GS1000-4999 kW rate class and the Large Use rate class, but that no parties have objected. This may be because they are not represented at the hearing or because they have been consulted by CND and have no objection.

While the split between fixed and variable monthly charges should be revenue neutral for CND, it may have an impact on individual customers, especially those making efforts to reduce their consumption. SEC advanced that many of its member schools belong to the GS50-999 kW rate class. SEC has objected to the proposed change.

The Board's policy as set out in the *Report of the Board, Application of Cost Allocation for Electricity Distributors, EB-2007-0667* is that fixed charges are not allowed to move further from the ceiling if they are already above it.

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<sup>17</sup> Cost Allocation Model Worksheet O1

<sup>18</sup> Reply Argument p. 33

“In the interim, the Board does not expect distributors to make changes to the MSC that result in a charge that is greater than the ceiling as defined in the Methodology for the MSC. Distributors that are currently above this value are not required to make changes to their current MSC to bring it to or below this level at this time.”<sup>19</sup>

Board staff pointed out that the fixed charge is moving further away from the ceiling. Energy Probe stated that there is no reason to mover further away. These positions were supported by SEC.

### **Board Findings**

The Board has determined that it is appropriate for the fixed charge for this customer class to remain at \$109.35.

The fixed monthly charge proposed for other rate classes will remain as outlined in the Settlement Proposal. The Board notes that there was no evidence or argument on this issue except for CNL’s reply argument which supported that the other rate classes remain the same.

### **Removal Costs**

Removal Costs refer to the costs incurred to remove existing assets which have been replaced by new assets.

Prior to 2012, CNL had added these costs to the capital cost of the new asset. In 2012, CNL changed its approach and started to charge these costs as expenses.

In keeping with the transition to IFRS, CNL recorded the differences between the two approaches for 2012 and 2013 in Account 1576. The differences amounted to \$333,253 in 2012 and \$639,000 in 2013.<sup>20</sup>

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<sup>20</sup> Exhibit 4 Tab 2 Schedule 1 Table 4-9

There are 2 distinct aspects to this issue. First, was the use of Account 1576 appropriate for the 2012 and 2013 differences? Second, how should removal costs be accounted for in 2014?<sup>21</sup>

### **Use of Account 1576**

Use of Account 1576 is described in the OEB's FAQ's dated July 2012 as follows:

*“Distributors will use Account 1576 to record the financial differences arising as a result of changes to accounting depreciation or capitalization policies permitted by the Board under Canadian GAAP in 2012 or as mandated by the Board in 2013.”*

CND used Account 1576 to record various costs arising from a change in its capitalization policy, which represents costs that are no longer eligible to be recognized as capital.

These costs included the removal costs referred to above.

Board Staff argued that Account 1576 should not have been used to record the difference in treatment of removal costs. Board Staff put forward two main arguments in support of their position: that the change in treatment of removal costs cannot be properly characterized as a change in capitalization policy, and that even if it could, this type of cost is ineligible for inclusion in Account 1576.

According to the Board's Accounting Procedures Handbook (“APH”), under CGAAP, removal costs are to be charged as an offset to accumulated depreciation of the asset class to which the assets being removed belong. They were never to be charged to the capital cost of the new asset. However, at the time the net impact on rate base was the

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<sup>21</sup> Board Staff Submission p. 7

same, so the fact that CND charged them to the capital cost of the new asset had no net impact.

However, it is not evident that every time an asset is removed from service it is being replaced by a new asset, so there may well be occasions when it is inappropriate to have charged it to the cost of the new asset. Even in the case where the removal of an old asset is directly related to the bringing into service of a new one, there may well be significant time lags between the two events. As pointed out by CND in its evidence, the old asset is not taken out of service and removed until the new one has been brought into service.<sup>22</sup> The Board agrees with Board Staff that these costs were never intended to be capitalized as part of the cost of a new asset. While no harm was done at the time by this anomaly by CND, the Board finds that it should not be carried forward through the transition period to IFRS.

While the change in treatment of the costs by CND was a change in its approach, the Board finds that this change cannot be properly characterized as a change in capitalization policy related to the transition to IFRS. The use of variance accounts such as Account 1576 must be strictly related to the purpose for which they are intended – in this case related to changes in capitalization policy where certain costs could be capitalized as part of the cost of a new asset under CGAAP and cannot under IFRS. Since these removal costs should not have been capitalized in the first place based on the Board's APH, the Board finds that the use of Account 1576 is not permitted.

### **Board Findings**

The Board notes that CND's evidence is that it can restate its Property Plant and Equipment for the 2012 and 2013 years to allocate these costs as an offset to accumulated depreciation. The Board finds that this is the appropriate approach because it is in accordance with the Board's APH based on CGAAP.

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<sup>22</sup> Tr. Day 1 p. 44 lines 17 – 22

Having found that these costs were inappropriately recorded to Account 1576, the question of how broad its scope is need not be decided in this case. However, the Board does not agree with Board Staff's position that it is restricted to overhead costs. In the Board's various documents relating to this account, overhead costs are cited as an example of the type of costs that were charged to the capital cost of an asset under CGAAP that would not be under IFRS. Nowhere do these documents state that these are the only costs eligible for such treatment.

### **2014 Removal Costs**

There does not appear to the Board to be any reason not to allow the removal costs in 2014 and for the rest of the IRM period to be treated as an expense. This is what will be required in any event once the transition to IFRS occurs in 2015. Allowing the collection of these costs in 2014 reduces the amounts that need to be tracked and recorded in variance accounts for disposition in future years. This approach also has the benefit of consistency through the IRM period.

### **Board Findings**

The Board does note that the quantum of removal costs varies significantly from year to year. Therefore, the Board finds that the amount to be included in the revenue requirement for 2014 will be the average of the forecast removal costs for the years 2014-2018. This will reduce the amount from \$716,449 requested by CND to \$472,884.

### **Effective Date and Implementation Date**

There were no objections to CND's request for a May 1, 2014 Effective Date. The Board recognizes that this is one of the first cost of service applications under the Board's RRFE, which resulted in additional time being taken by the parties and the Board to complete this proceeding. CND was diligent in completing procedural steps throughout this proceeding. For the above-stated reasons, the Board finds the Effective Date to be May 1, 2014.

CND is permitted to calculate class specific rate riders to recover the deferred incremental revenue requirement for the period May 1, 2014 to July 31, 2014. CND is directed to file a draft Rate Order that reflects the Board's determinations in this Decision.

### **Implementation**

The Board has made findings in this Decision which change the 2014 revenue requirement and therefore change the distribution rates from those proposed by CND. In filing its draft Rate Order, the Board directs CND to file detailed supporting material, including all relevant calculations showing the impact of the implementation of this Decision on its proposed revenue requirements, the allocation of the approved revenue requirement to the classes and the determination of final rates and all approved rate riders, including bill impacts. Supporting documentation shall include, but not be limited to, the filing of a completed version of the Revenue Requirement Work Form Excel spreadsheet, which can be found on the Board's website.

### **THE BOARD ORDERS THAT:**

1. CND's new distribution rates shall be effective May 1, 2014.
2. CND shall file with the Board, and shall also forward to intervenors, a draft Rate Order that includes revised models in Microsoft Excel format and a proposed Tariff of Rates and Charges reflecting the Board's findings no later than 14 days from date of issuance of this Final Decision and Order.
3. Board staff and intervenors shall file any comments on the draft Rate Order including the revised models and proposed rates with the Board and forward to CND within 7 days of the date of filing of the draft Rate Order.
4. CND shall file with the Board and forward to intervenors responses to any comments on its draft Rate Order including the revised models and proposed

rates within 4 days of the date of receipt of Board staff and/or intervenors' comments.

All filings to the Board must quote the file number, **EB-2013-0116**, be made through the Board's web portal at <https://www.pes.ontarioenergyboard.ca/eservice/>, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at <http://www.ontarioenergyboard.ca/OEB/Industry>. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

**DATED** at Toronto, August 14, 2014

**ONTARIO ENERGY BOARD**

***ORIGINAL SIGNED BY***

Kirsten Walli  
Board Secretary