

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by Midland Power Utility Corporation pursuant to the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for the delivery and distribution of electricity.

FINAL ARGUMENT ON BEHALF OF THE SCHOOL ENERGY COALITION

February 25, 2009

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1 GENERAL COMMENTS

1.1 Introduction

- 1.1.1 On August 18, 2008 Midland Power Utility Corporation filed an application for new distribution rates commencing May 1, 2009. The application identifies a deficiency of \$897,322, and seeks approval for rates to recover a base revenue requirement of \$3,582,722. It also seeks significant adjustments to revenue to cost ratios. Although there have been a number of changes as the evidence unfolded, the end result is still an average rate increase of about 30%, and increases in distribution bills for some customers, including schools, approaching 100%.
- 1.1.2 This is the Final Argument in this matter on behalf of the School Energy Coalition.
- 1.1.3 In preparing this Final Argument, we have benefited from a review of the Staff Submission dated February 6, 2009. That was most helpful, and the fact that we had it before finalizing our own submissions has simplified this argument.

1.2 Summary

- 1.2.1 The large increases in distribution rates for schools in this Application result from three causes, each of which we deal with in detail in these submissions:
- (a) **Revenue Requirement.** The Applicant proposes a substantial increase in revenue requirement, totalling more than 33%. We have proposed adjustments to rate base, OM&A, and other items that together, we believe, would reduce the deficiency in half, to \$450,000 or less.
 - (b) **Fixed/Variable Split.** The Applicant has proposed a substantial increase in the fixed charge for the GS>50KW class, which disproportionately increases distribution bills for schools. However, it is compliant with Board policy, and we believe it should be approved.
 - (c) **Revenue to Cost Ratios.** The Applicant has proposed changes to revenue to cost ratios in a manner not compliant with Board policy, in particular a substantial increase in GS>50KW, which is already within the appropriate range. We have proposed that the revenue to cost ratios for this distributor be changed in a manner exactly compliant with the relevant Board policy.

2 LOAD FORECASTING AND METHODOLOGY

2.1 Methodology

No submissions.

2.2 Total Loss Factor

- 2.2.1 It is submitted that the Applicant's proposed total loss factor of 1.0651, and the components of that calculation, should be accepted as filed.

3 RATE BASE AND CAPITAL SPENDING

3.1 Capital Spending Plan

- 3.1.1 The Applicant has proposed a capital spending program for the Test Year that is 8% higher than the Bridge Year, and 89% higher than the Historical Year. The primary driver of this capital program is an "aggressive" plan to replace all six of the Applicant's substations over a six year period, 2007 through 2012. The plan is based on an independent review of the six substations by an engineering firm familiar with the Applicant's system.
- 3.1.2 It is submitted that the proposed capital budget is substantially higher than is necessary, and is not consistent with either the prudent operation of the distribution system, or the independent engineering report on the substations.
- 3.1.3 ***The Substation Replacement Program*** A review of the independent engineering report [Ex.2/3/1, Attachment] shows that the engineers reached the following conclusions [we cannot reference page numbers, as the pages of the study do not appear to be numbered on our version]:
- (a) The Fourth Street Substation is in the worst condition, is "obsolete", and should be replaced on a priority basis.
 - (b) The Brandon Substation is also of concern, for reliability and safety reasons, and needs extensive work done to it.

(c) The Scott, Queen, Dorion and Montreal Substations are suitable for continued service, but in each case there are repairs or upgrades recommended.

- 3.1.4 Notwithstanding the recommendations of the engineers, the Applicant says it proceeded first with the replacement of the Scott Street Substation in 2007 although it does not appear that it needed to be replaced. In fact, in the detailed evidence it is clear that it was an upgrade and major repair, not a replacement, but choosing it first was still clearly not indicated. Then, in 2008 the Applicant has proceeded with the Brandon Substation, which the engineers advised “poses a reliability and personnel safety concern”. The engineers did not propose that it be replaced entirely, but they did recommend extensive replacement and upgrading of equipment, which is what was actually done. It is not until 2009 that the Applicant proposes to replace the Fourth Street Substation, in respect of which the independent engineers said “We recommend replacing the complete substation from the 44KV incoming feeder to the 5KV feeder cables.” This is the only substation with a “replacement” recommendation, and the Applicant acknowledges that it has to be moved to a new location as well.
- 3.1.5 Given the nature of the engineering report, it is inexplicable why the Applicant would start the program with a substation that was not in as bad shape and didn’t need as substantial work done on it (as evidenced by the much lower cost), and leave the only one that really needed to be replaced until the Test Year, two years later. We have looked for a rationale for this ordering in the evidence, and have not been able to find one.
- 3.1.6 Further, it appears clear that while some work needs to be done on Queen, Montreal and Dorion, that work is of a much smaller magnitude than the work required for Brandon and Fourth.
- 3.1.7 If, as implied in the engineering report, the Applicant had started with Fourth in 2007, then moved to Brandon in 2008, we would probably recommend that the Applicant delay the remaining four, doing the work in 2010, 2012, 2014 and 2016, a more reasonable (ie. less aggressive) program for substation renewal. This would also reduce the pressure on the Applicant to seek an incremental capital module during the IRM period.
- 3.1.8 However, as the Fourth Street Substation has not yet been done, and the engineering report is clear as to the immediate need for that project, it would in our view be inappropriate to propose delaying that project. This component of the capital expenditures budget for the Test Year is, we believe, well supported by the evidence.
- 3.1.9 **Other Test Year Capital Expenditures** We have reviewed the remaining capital budget, which is \$1,512,040. We note that the 2008 forecast, excluding the substation replacement program, was \$1,234,453, so the 2009 budget is 22.5% higher than 2008. Further, we note that the 2007 actuals, excluding the substation replacement program,

were \$760,100, so the 2008 forecast is 62.4% higher than 2007. In total, the Applicant proposes to increase its capital spending, excluding the substations program, by \$751,940, or 98.9%, over the amount it felt was appropriate to spend in 2007. This, in our submission, is not a reasonable capital spending level.

- 3.1.10** In the normal course, we would expect capital spending to increase annually at a rate of inflation plus customer growth, although obviously it is sometimes lumpier than that. We would also expect that a utility embarking on a major capital program would look for ways to find room for that program by cutting back its normal capital budget. This is the standard process of prioritization that goes on routinely in most businesses.
- 3.1.11** Against that background, we find it disingenuous for the Applicant to say, as they have in response to Staff IR #15, that the sole project they can delay is the only one (the SCADA project) for which the delay, because of the tax shield, is likely to increase rather than decrease the Test Year revenue requirement. All of the rest are essential. We note that, in the EB-2005-0001 Enbridge rate case, the Board made a point of reminding that utility of the need to prioritize, despite Enbridge's protests in that case that all of the projects planned were critical to maintain the reliability and safety of the system, or for similar reasons. In that case, the Board gave the utility a reasonable budget, and left them with the flexibility to set priorities within that budget. To the best of our knowledge, Enbridge continues to operate its distribution system safely and reliably.
- 3.1.12** In this case, it is submitted that the capital spending budget, other than that related to the Fourth Street Substation, should be reduced to \$838,000, which includes 5% increases for each of 2008 and 2009. This would make the total capital spending budget for the Test Year \$2,072,800, still an increase of 42.8% over 2007.

3.2 Rate Base

- 3.2.1 Fixed Assets.** The capital spending in the Test Year, and other items closing to rate base in that year, result in an increase in rate base in 2009 of \$3.3 million over 2007, or about 37%. If our submissions above on capital spending are accepted by the Board, that increase would be reduced to about \$3.0 million, or 33%. This is still very substantial.
- 3.2.2** As we have noted earlier, it would appear to us that proceeding with the upgrade of the Scott Street Substation in 2007 was not prudent use of scarce capital dollars, particularly where the Applicant had evidence that contraindicated that course of action. On the other hand, a finding of imprudence in this situation would be unusually harsh, and the Board has quite rightly been loathe to do that except in cases of clear mismanagement and waste. These expenditures do not appear to be wasted. The ratepayers will see a benefit from them. They are just early.

- 3.2.3 In our view, the correct way to do this would be to allow a calculation of rate base assuming the prudent scenario, ie. Fourth Street in 2007, Brandon in 2008, and Scott in 2009 (or not at all). However, not only would that be a very complicated calculation (consider the OM&A impacts that might arise), but it would appear to us to have only a small impact on Test Year rate base. Further, it would be a novel approach, and we would not ask this Board panel to do it without a thorough airing of the possible implications, not just for this utility, but in other cases.
- 3.2.4 Therefore, we have no choice but to recommend that the Board accept the revised rate base of \$12.0 million (adjusted by the reduced capital spending, above), subject to our comments below on working capital.
- 3.2.5 **Working Capital.** We have no submissions on the calculation of the working capital allowance in this case.
- 3.2.6 We remain very concerned that this and other LDCs are using a 15% working capital calculation in the face of evidence from other utilities (Toronto, Hydro One, Horizon) that the 15% level significantly overstates the actual working capital requirements of a distributor. However, we have made this submission in a number of rate cases, and the Board panels have consistently taken the view that, in the absence of more reliable information on working capital requirements, the Board's 15% guideline figure should be used. It now appears to be no longer feasible to argue for a lesser amount, since that would make the working capital of this utility inconsistent with the levels approved for many others.
- 3.2.7 The only solution, it would appear to us, is for the Board to have before it more reliable information on working capital requirements. We therefore ask that the Board order the Applicant to undertake a lead-lag study and file it with their next rebasing application.
- 3.2.8 We note that we have made a similar recommendation in our submissions in EB-2008-0226 (COLLUS), and the distributor has responded in their Reply Submissions commenting on the cost of such a study. They have proposed, as an alternative, that there be a generic study done, perhaps under the auspices of the Board. We believe that is a reasonable response, and we would support a generic approach to this issue. In this case, we would urge the Board to order MPUC to carry out a lead-lag study and file it with their next rebasing application, unless prior to that time the Board carries out or orders a more generic lead-lag study to set working capital requirements for utilities including this Applicant.

4 OPERATING EXPENSES

4.1 2009 OM&A Budget

- 4.1.1 **Benchmarking.** We note that the PEG Benchmarking Study lists Midland at an OM&A per customer of \$263 in 2007, the last year for which there is data available. The average for the cohort for 2007 is also \$263, so there would appear to us to be no immediate concern with the historical base. While the figure of \$263 per customer is substantially greater than many other LDCs in the province, using the PEG methodology it is neither an above average nor a below average performer relative to its cohort.
- 4.1.2 The proposed OM&A in this application would, by our calculations, increase OM&A per customer for Midland to \$304 in 2009, an increase of 15.6% since 2007. We have not been able to identify a solid justification for such an increase in the Application.
- 4.1.3 While we understand the many weaknesses of the benchmarking data, it is an analysis that has been thoroughly reviewed by the Board and publicly debated at length. In our submission, it is useful in this case to provide perspective on what a reasonable level of OM&A for the Test year might be. In this case, it would appear to us that 3% increases in the OM&A per customer in each of 2008 and 2009 would be reasonable, producing a result of \$279 per customer. That would result in an overall increase of 8.6% in the OM&A budget to \$1,918,700.
- 4.1.4 It is submitted that \$1,918,700 is a reasonable OM&A budget for the Applicant for the Test Year. This would reduce the revenue requirement for the Test Year by \$174,400. We note that, together with other changes proposed in these Submissions, this would result in a deficiency for the Test Year of about \$450,000, and thus an average rate increase of about 16%, still quite substantial.

4.2 Depreciation Expense

- 4.2.1 We believe that the reduction in the capital spending proposed in these Submissions would reduce amortization of fixed assets by about \$40,000 which should be reflected in the final calculation of revenue requirement.

4.3 Capital and Property Taxes

No submissions.

5 COST OF CAPITAL INCLUDING PILS

5.1 Long Term Debt

- 5.1.1 We believe the long term debt rate proposed by the Applicant is appropriate.
- 5.1.2 It is appropriate, however, to comment specifically on the terms of the promissory note with the Town of Midland. The Town has stipulated terms that are favourable to the LDC and its ratepayers, but still give the Town a rate of return comparable to its investment alternatives. In our view, this is a commendable approach, and in that context worthy of note.

5.2 Short Term Debt

- 5.2.1 As the Board has now published its revised cost of capital calculations, the revenue requirement should be recalculated using the 1.33% short term debt rate.

5.3 Return on Equity

- 5.3.1 As the Board has now published its revised cost of capital calculations, the revenue requirement, and the PILs amount, should be recalculated using the 8.01% return on equity.

5.4 Payments in Lieu of Taxes

- 5.4.1 We agree with the submission of Board Staff that, subject to our comments below, the correct tax rate for Midland for the Test Year is 16.5%.
- 5.4.2 There are two categories of tax changes that, in our view, should also be incorporated into the final PILs calculation:
- (a) The federal budget of January 27, 2009 included a number of changes to corporate tax calculations, including additional accelerated capital cost allowance applicable to 2009. To the extent that those changes have not been reflected in the PILs calculation, it is submitted that they should be.
 - (b) The government of Ontario plans to release its 2009 budget on March 26, 2009, which we expect will be before rates are put in place for this Applicant. It is widely expected that the Ontario budget will also include corporate tax reductions. If that is the case, it is submitted those reductions, if applicable to 2009, should be included in the final PILs calculation for the Applicant.

6 REVENUE REQUIREMENT

6.1 Revenue Requirement Calculation

No submissions.

6.2 Other Revenues

No submissions.

7 REGULATORY ASSETS

7.1 Disposition of Existing Deferral and Variance Accounts

- 7.1.1 Given the size of the distribution rate increases being proposed for some customers, including schools, we believe it is appropriate for the Board to order clearance of the RSVA accounts in the Test Year. This would reduce and smooth the impact of those rate increases.

7.2 New Deferral and Variance Accounts

- 7.2.1 It is our understanding that the Applicant is not seeking the establishment of any new deferral or variance accounts or sub-accounts in the Test Year.

8 COST ALLOCATION AND RATE DESIGN

8.1 Cost Allocation

- 8.1.1 **Transformer Allowance** We agree with VECC that the Board's cost allocation model does not deal with the transformer allowance correctly. However, as we have noted in other cases, we do not agree with the alternative methodology they propose.
- 8.1.2 Under the VECC methodology, the cost of the transformer allowance is excluded from costs and from revenues in calculating revenue to cost ratios. This is an improvement over the Board's cost allocation, but it has the weakness that it will tend to exaggerate the extent to which the revenue to cost ratios of affected classes vary from 100%.
- 8.1.3 In our view, the better approach is to start with the presumption that the LDC delivers transformed power. For most customers, the LDC owns transformers to do that. For a few customers, the customers own the transformers, and the LDC pays them for the use of those transformers through the transformer allowance. It can be looked at as "rent" of the customer-owned equipment. Thus, it should be treated as a cost of transforming power for the class in which those customers are situated, and should be collected from the customers of that class. The result is similar to the VECC method, but the revenue to cost ratios will be calculated more accurately.

8.2 Revenue to Cost Ratios

- 8.2.1 **General Position.** The School Energy Coalition believes that LDCs should be moving to revenue to cost ratios of 100%. Although there are undoubtedly weaknesses in the current cost allocation information, it is the best available information, and in our view the Board should use that information to require utilities to move towards 100% for each class.
- 8.2.2 However, SEC has been unsuccessful in making that argument. In most LDCs, the general service classes that include schools have been well above 100%, and are thus overcontributing relative to other classes. Streetlighting, on the other hand, is almost always a small fraction of the 100% norm. We have on numerous occasions sought to alleviate the overcontribution of schools by increasing classes such as streetlighting, and in every case the Board has been unwilling to move further than the edge of the range.
- 8.2.3 Midland is one of those cases in which the general service classes that include schools are undercontributing rather than overcontributing, in this case the GS>50KW class. In our view, consistent with the many other decisions of the Board, the policy should be followed and uncontributing classes should be moved, stepwise, towards the bottom

of the range. Those that are in the range should not be altered unless it is required to move other classes to the edge of their range. If the Board's practice is not followed in this case, the perverse situation would be created in which the general service classes do not get rate relief in the franchise areas in which they are overcontributing, but they are forced to give up immediately the benefit of inter-class subsidies in franchise areas in which they are undercontributing. This would not be fair.

- 8.2.4 Calculation of Revenue to Cost Ratios.** There are a number of ways of calculating the revenue to cost ratios, and we expect that the submissions of other parties may include still more suggestions. For the purposes of these submissions, we have relied on the revenue to cost ratios set out in Table 5 of the Board Staff Submissions, at page 12.
- 8.2.5 Adjustments to Revenue to Cost Ratios** For this Applicant, and based on the revenue to cost ratios set forth in the Board Staff Submissions, only GS<50, at 97.96%, GS>50, at 83.67%, and USL, at 117.38%, are currently inside the ranges, and subject to our comments below, they should not be moved any further towards unity at this time.
- 8.2.6** In the case of the Residential class, which is at 118.18%, the Board's policy requires that be brought toward the edge of the range (115%) in two steps. This would require Residential to move to 116.59% in 2009, and 115% in 2010. We believe that policy should be implemented in this case. On the revenue requirement as filed, and before any reductions, this would require that the revenue collected from the Residential class be reduced by \$24,371 in 2009 relative to the \$1,811,424 figure that would be collected at the current revenue to cost ratio [VECC IR #6(d)].
- 8.2.7** In the case of the Streetlighting, at 23.46%, and Sentinel Lighting, at 28.21%, classes, they should be moved up to the bottom of the range (70%) in two steps. That would mean that they would be 46.73% and 49.11% respectively in 2009, and 70% each in 2010. On the revenue requirement as filed, and before any reductions, this would increase the revenue collected from these classes by \$71,430 and \$4,114 respectively, a total of \$75,544. In our view, this should be allocated pro rata (based on existing revenue share) between Residential and USL to bring their revenue to cost ratios down further, by our estimate to 113.5% and 114.0% respectively for 2009.
- 8.2.8** In 2010, a similar increase in the lighting classes would allow the revenue to cost ratios of Residential and USL to be brought closer to unity while remaining 100% in compliance with the Board's policy in this regard. On current numbers, we estimate that Residential USL would each end up at about 108% in 2010.
- 8.2.9** We note that the main beneficiary of following the Board's policy exactly is the GS>50KW class, which includes most of the schools. In our submission, this is the correct result. The distributor in this case proposed to allocate a substantial additional amount of revenue responsibility to this class, contrary to the Board's policy, which would have resulted in a doubling of the distribution bills for many schools and small

businesses in the GS>50KW class and with load at the lower end of the class range. The main beneficiary of this would have been the Residential and USL classes, and yet there was no rationale given other than that the distributor thinks these change are fair. With respect, the Board has a policy on how to establish just and reasonable rates in these circumstances, and if the distributor wants to displace that policy, in our submission it is obligated to show a compelling reason why the policy should not be followed in this case. No such reason is set out in the evidence.

8.2.10 We note that where ratepayers have sought similar variations from the Board's policy on revenue to cost ratios, the Board has consistently rejected those submissions. It would be wrong in law, and inappropriate regulatory policy, it is submitted, for the Board to accept such submissions from a distributor when the same submissions from ratepayers are normally not accepted.

8.2.11 It is therefore submitted that the revenue to cost ratios that should be used to set rates for the Test Year should be (subject to recalculation in light of changes to the revenue requirement):

- (a) Residential – 113.5%;
- (b) GS<50KW – 97.96%;
- (c) GS>50KW – 83.67%;
- (d) Street Lighting – 46.73%;
- (e) Sentinel Lighting – 49.11%; and
- (f) USL – 114.0%.

8.3 Fixed/Variable Splits

8.3.1 The Applicant has proposed to bring the fixed charge for GS>50KW up to the bottom end of the range, which causes a substantial increase in distribution bills to the smaller customers in that class, including schools. However, consistent with our past positions on this principle, we believe that this adjustment is appropriate, and should be approved.

8.4 Retail Transmission Service Rates

No submissions.

9 OTHER MATTERS

9.1 Costs

- 9.1.1** The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

All of which is respectfully submitted.



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