March 13, 2009

BY EMAIL & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2008-0247
Welland Hydro-Electric System Corp. – 2009 Rates Rebasing Application
Argument of Energy Probe

Pursuant to Procedural Order No. 3, issued by the Board on January 23, 2009, please find two hard copies of the Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2008-0247 proceeding. An electronic version of this communication will be forwarded in PDF format.

Should you have any questions, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc:
Wayne Armstrong, Welland Hydro-Electric System Corp. (By email)
James C. Sidlofsky, Borden Ladner Gervais LLP (By email)
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EB-2008-0247

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 **Welland Hydro-Electric System Corp.** for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2009.

ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")

ARGUMENT

March 13, 2009

WELLAND HYDRO-ELECTRIC SYSTEM CORP.
2009 RATES

EB-2008-0247

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

INTRODUCTION

This is the Argument of the Energy Probe Research Foundation ("Energy Probe") related to the setting of 2009 rates for Welland Hydro-Electric System Corp. ("Welland") effective May 1, 2009.

This Argument has been structured to reflect the major components of the Welland evidence. Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of Welland. However, in order to minimize intervenor time and costs, a comprehensive impact analysis has not been undertaken. If the Board accepts any or all of the Energy Probe submissions, it is assumed that the direct and indirect impacts will be determined by Welland and reviewed by intervenors and Board Staff through the associated draft rate order. An example of a comprehensive impact analysis would include the direct impact on rate base of a reduction in $10,000 in OM&A expenses and a $25,000 reduction in capital expenditures. Depreciation expense would also be directly impacted by the capital expenditure change. The indirect impacts would include the change in total cost of capital and taxes (due to CCA, interest and OM&A expense changes) and the change in the working capital allowance.

Welland is forecasting a significant deficiency. As shown in Exhibit A attached to its January 20, 2009 Supplemental Filing, the gross revenue deficiency is $1,768,861 on forecasted revenues of $7,377,004. The deficiency represents an increase in total revenues of 24%. This deficiency reflects a number of significant changes to the original evidence filed related to the volume forecast, OM&A expenditures and capital expenditures.

ADJUSTMENTS TO THE COST OF SERVICE APPLICATION

On January 20, 2009 Welland made a supplemental filing primarily to reflect the loss of two large customers and the steps that Welland intended to take to help mitigate the impact on rates of this lost revenue. Energy Probe refers to this as the "Supplemental Filing" throughout this argument. On February 3, 2009, Welland filed a number of revised exhibits to reflect the January 20, 2009 supplemental filing. When referring to these schedules, Energy Probe identifies them as Revised.

RATE BASE

a) Working Capital

Energy Probe accepts the approach taken by Welland to calculate the working capital allowance component of rate base, with the adjustments noted below. However, Energy Probe continues to believe that the 15% methodology may be overstating the required allowance for working capital and recommends that the Board direct Welland to prepare a working cash (lead lag) study for its next rebasing application.

i) Cost of Power

Energy Probe submits that the cost of power component of the working capital allowance should be updated to reflect the most recent cost of power forecast presented to the Board. It should also be updated to reflect the forecast of network and connection transmission services provided by Hydro One Networks.

As shown in Exhibit 2, Tab 4, Schedule 1, the allowance for working capital associated with the cost of power (including transmission costs) represents nearly $5,576,078 of a revised rate base forecast of $27,186,822 (Supplemental Filing, Exhibit F) This represents more than 20% of the forecasted rate base for the distributor. Given the magnitude of the influence of the cost of power on rate base and the resulting revenue requirement Energy Probe submits that the Board should direct Welland to update the calculation based on the most recent information available to the Board at the time of its Decision.

The cost of power assumptions used in the calculation of the working capital allowance are shown in the Exhibit D attached to the response to Energy Probe Interrogatory # 10. Energy Probe submits that these figures should be updated to reflect the most recent information available at the time of the Board's Decision. In particular, Welland has forecast the cost of power to be $0.0593 per kWh, based on an actual cost of $0.05594 in 2007, increased by 3% in each of 2008 and 2009. Energy Probe submits that the rates to be used should be based on the most recent Regulated Price Plan Price Report available to the Board.

ii) Cost of Power Methodology

Energy Probe does not support the methodology used by Welland to calculate the commodity component of the cost of power. Welland has used a single rate of $0.0593 per kWh regardless of whether the customer is an RPP or non-RPP customer.

Energy Probe submits that the estimation of the kWh's that are associated with the Tier 1 and Tier 2 volumes for RPP consumers and the kWh's associated with non-RPP consumers and the application of the appropriate prices to these different sets of volumes to calculate the cost of power component of the working capital allowance is appropriate. This is especially important for a utility like Welland where one large customer accounts for more 11% of the kWh forecast to be purchased (Exhibit 3, tab 2, Schedule 2, Revised Feb. 3, 2009). Moreover, the GS > 50 kW accounts for a further 37% of the total kWh volumes. The majority of these customers would not be RPP customers. Further, beginning May of 2009, the MUSH sector will no longer be eligible for the RPP. This means that approximately 50% or more of the volumes consumed by customers of Welland will be non-RPP volumes. Given the potential difference between RPP and non-RPP prices, this could have a significant impact on the cost of power component of the working capital allowance component of rate base, which as noted earlier, is a significant component of the overall rate base of the company.

iii) Changes to Controllable Expenses

Energy Probe submits that if the Board makes any adjustments to the controllable OM&A expenses in its Decision, these changes should be reflected in the calculation of the working capital component of rate base.

b) Capital Expenditures

Welland's original capital expenditure forecast for 2009 was $2,558,000 (Exhibit 2, Tab 2, Schedule 1, Table 9). This amount has been reduced by $280,000 to $2,278,000 as shown in Exhibit F of the supplemental filing. This reduction reflects a reduction in the cost for the Crowland TS Wholesale Metering Point (Board Staff Interrogatory # 3a) by fifty percent.

With the Crowland reduction, capital expenditures forecast for 2009 are in line with actual expenditures of $2,002,021 in 2006, $2,293,025 in 2007 and the projection of $2,223,970 in 2008 (Exhibit 2, Tab 2, Schedule 1, Tables 6 – 8).

Energy accepts the capital expenditure forecast as proposed by Welland, with the reduction for the Crowland station noted above, as being reasonable.

OM&A EXPENSES

In the original evidence Welland proposed a total OM&A forecast of $5,113,936 which was an increase of 8.2% from the forecast for 2008 (Exhibit 4, Tab 1, Schedule 1, Table 1, excluding amortization). The forecasted increase in 2008 was 4.8% over the 2007 level of OM&A expenses, an increase of $216,521. OM&A expenses in 2007 increased by more than 28% over the actual 2006 level of expenditures.

a) Supplemental Filing

As part of its Supplemental Filing, Welland has made a number of reductions in the forecast of OM&A expenses to help mitigate the impact of lost revenues associated primarily with the forecast loss of two large user customers. The reductions in OM&A expenses are shown in Exhibit E of the Supplemental Filing and total $193,849. The rationale for these reductions is provided in the Supplemental Filing and in the response to Board Staff Interrogatory # 3a. The reductions are related to a reduction in the costs associated with retiree benefits based on an updated actuarial report $43,000, the use of the average cost for the three year tree trimming cycle ($34,000), the spreading of the costs of testing field transformers for PCB contamination from three to five years ($30,000), a reduction in overtime expenses to reflect actual amounts incurred in 2006 to 2008 ($20,000), and the deferral of an additional apprentice lineperson to a later day ($66,849).

Energy Probe agrees with and accepts the reductions as proposed by Welland.

b) 2009 Rate Rebasing Costs

Welland is forecasting a total cost associated with the 2009 rate rebasing application of $90,000 (Energy Probe Interrogatory # 23b). Welland has included one-third of this amount, or $30,000 in the 2009 revenue requirement.

As part of the interrogatory response, Welland indicated that the consulting costs, which were forecast to total $30,000 for the rate rebasing application were now estimated to be $60,000. However, as shown in the response to Energy Probe Interrogatory # 38b, Welland has not included the incremental $10,000 ($30,000 increase amortized over 3 years as proposed by Welland) in the revenue deficiency estimate in the Supplemental Filing.

Energy Probe submits that three adjustments should be made to the costs associated with the 2009 rates rebasing.

i) Consulting Costs

Welland has indicated that its total consulting costs associated with the 2009 rates rebasing application is now forecast to total $60,000 (Energy Probe Interrogatory # 38b). This cost includes both legal and consulting costs. Of this total, $10,000 has been identified as being related to a technical conference and an oral component of the process (Energy Probe Interrogatory # 39c).

Energy Probe submits that since there was neither a technical conference nor an oral component to this proceeding, the forecast consulting cost should be reduced from $60,000 to $50,000.

ii) Regulatory Expenses

Welland has included a total of $60,000 for intervenor and Board costs associated with the 2009 rates application. Given the limited number of intervenors and the fact that there will be no technical conference or oral hearing associated with this application, Energy Probe submits that a reduction in this forecast to $45,000 is warranted.

iii) Amortization Period

Welland proposed to amortize the costs associated with the 2009 rates application over three years. Energy Probe submits that the cost of this application should be recovered over a four year period since base rates determined in this case will be used for the current rebasing year and the following three years under IRM.

Energy Probe submits that based on a total forecast cost of $95,000 ($50,000 consulting and $45,000 regulatory) a four year amortization period results in the amount to be included in the revenue requirement of $23,750. This is a reduction of $6,250 from the $30,000 included by Welland in the original evidence.

c) 2008 Level of Expenses

Welland is proposing an increase in overall OM&A costs in 2009 of $193,255 or 4.1% over the 2008 forecasted levels. These figures can be determined from Exhibit 4, Tab 2, Schedule 2, Revised Feb. 3, 2009.

However, as shown in the response to Energy Probe Interrogatory # 18, the year-to-date September, 2008 OM&A expense is $3,355,468, which is nearly $40,000 or 1.2% below the expenditures for the same period in 2007. As noted earlier, Welland is forecasting an increase in the 2008 OM&A expenses of more than $215,000 or 4.8% in the costs for 2008 as compared to 2007. Assuming that the expenses incurred over the last three months of 2008 were similar to those incurred in 2007, the 2008 OM&A expenses would be approximately $250,000 lower than forecast. If the 2008 expenses came in at 2% higher than the 2007 expense, the 2008 figure would be $4,600,517 ($4,510,311 x 1.02). At this level, the 2008 OM&A cost would be approximately $126,000 lower than the forecast for 2008.

Energy Probe submits that with a generous increase of 2% in OM&A costs in 2008 as compared to 2007, the 2009 OM&A forecast should be reduced by $126,000 to reflect a significantly lower base for the increases proposed in 2009. The 2% increase in 2008 is generous given that nine months through the year, expenses are tracking more than 1% below the levels in 2007.

d) Overall Increase in OM&A Costs

Energy Probe submits that the reductions to OM&A as proposed by Welland in the "Adjustments" table, supplemented by the additional reductions related to lower 2008 costs and a lower rates rebasing cost are appropriate.

Welland's original OM&A forecast for 2009 was $5,113,936 (Exhibit 4, Tab 1, Schedule 1, Table 1). Welland Hydro has reduced this amount by $193,849 as part of their supplemental filing. Energy Probe has submitted that there should be additional

reductions of $126,000 to reflect lower 2008 costs than forecast and $6,250 to reflect lower rate rebasing costs. In aggregate, this would reduce the 2009 OM&A expense to $4,787,837. Based on the adjusted 2008 OM&A expense of $4,600,517 estimated above, this represents an increase of 4.1%. Given the low rate of inflation expected as the economy slows in 2009, Energy Probe submits that an increase in controllable costs of 4.1% is more than reasonable.

Energy Probe notes that Welland has a number of areas where they could reduce OM&A expenses in 2009 in order to keep their costs within the figure proposed above. For example, as shown in the exhibits attached to the response to Board Staff Interrogatory, Welland is forecast increases in base wages for executive/management of 3.2% in 2009 following increases of 8% in 2007 and 3.1% in 2008. A reduction in this increase by one percentage point reduces costs by more than $10,000. Similarly, Welland is forecasting an increase in unionized base wages of 4.3% in 2009. A reduction in this increase by two percentage points reduces costs by more than $28,000. Deferring of the addition of the CDM analyst would reduce costs by more than $80,000 (Exhibit 4, Tab 2, Schedule 3, page 10). These three reductions total $118,000, close to the $126,000 reduction related to lower 2008 expenditures.

Energy Probe submits that in times when revenues are being severely impacted by the loss of large customers and the resulting impact on the local economy of the lost jobs, the reductions and deferrals are more than justified.

DEPRECIATION & AMORTIZATION

Energy Probe has reviewed the calculation of the depreciation & amortization expenses shown in Exhibit 2, Tab 2, Schedule 1, Table 9, as well as the rates used, which are shown in Exhibit 4, Tab 2, Schedule 7.

Energy Probe accepts the forecasts for depreciation & amortization as being accurate based on the forecasts for gross assets and capital expenditures in 2009.

Energy Probe also accepts the reduction of $4,667 in depreciation as shown in Exhibit E of the Supplemental Filing that reflects the reduction in capital expenditures of $280,000 as proposed in the Supplemental Filing evidence to be appropriate.

If the Board makes any further changes to the capital expenditure forecast for 2009, then Energy Probe submits that these changes should be reflected in the calculation of the depreciation expense calculated for the 2009 test year.

TAXES

Energy Probe submits that Welland should calculate its income and capital taxes using the most recent information available, including tax rates that are expected to be applicable to 2009. This would include any changes that have resulted from the recent federal budget. It would also include any other changes as the result of the provincial budget that are known to the Board and other parties when the Decision is issued. Further the appropriate tax rates should be applied. For example, there are different provincial tax rates when the taxable income is below $1.5 million than when it is above this level. With a return on equity of 8.01%, Welland may be very close to the $1.5 million level.

a) Capital Tax

Energy Probe agrees with the calculation used by Welland to forecast the capital tax in 2009 (Exhibit 4, Tab 3, Schedule 1). Energy Probe accepts the tax rate of 0.225% used by Welland in this calculation for 2009 as well as the $15 million exemption used in the calculation.

Based on the Supplemental Filing (Exhibit A), the capital tax forecast has decreased from $27,730 (Exhibit 4, Tab 3, Schedule 1) to $27, 420, a reduction of $310. This amount corresponds to the reduction in rate base associated with the reduction in 2009 capital expenditures of $280,000.

Energy Probe submits that any rate base changes that result from any further changes in capital expenditures and/or OM&A costs and cost of power changes (that impact on the working capital allowance) as determined by the Board should also be reflected in the calculation of the capital tax since these changes will have an impact on the rate base calculation.

b) Income Tax

i) Tax Rates

Welland used a total tax rate of 33.00% in the calculation of income taxes in 2009 (Exhibit 4, Tab 3, Schedule 1, Table 13). This rate included a federal tax rate of 19.00% and a provincial tax rate of 14.00%. Energy Probe agrees with the federal and provincial tax rates based on regulatory taxable income that is in excess of $1.5 million.

If the level of regulatory taxable income falls below $1.5 million, then the provincial tax rates should be 5.50% applied to first $500,000 in taxable income, 14.00% applied to taxable income in excess of $500,000 and 4.25% for taxable income between $500,000 and $1.5 million.

ii) Apprenticeship Tax Credit

Welland does not appear to have made any reductions to its income tax payable related to the apprenticeship tax credit. As shown in Welland's 2007 tax filing (Exhibit 4, Tab 1, Schedule 1, Appendix A, it had apprenticeship tax credits associated with apprentice linepersons hired in 2007.

As indicated in the evidence at Exhibit 4, Tab 2, Schedule 6, page 2, Welland hired 2 apprentice linespersons in 2007 and included the costs associated with two more positions – one in 2008 and one in 2009. Energy Probe understands that the apprenticeship tax credit is available for up to three years. This would mean that all four of the positions should be available to generate these tax credits in 2009. Energy Probe

does note that as part of its Supplemental Filing Welland is now proposing to defer one of the additional apprentice lineperson to a later date. However, this still leaves three positions for which a tax credit should be claimed.

Energy Probe submits that the Board should direct Welland to provide the calculation associated with the apprenticeship tax credits and that these tax credits should be utilized to reduce the income tax payable and reduce the revenue requirement accordingly.

iii) Impact of the Federal Budget

The January 27, 2009 federal budget introduced a number of changes that may have an impact on the regulatory taxable income in 2009. In particular, there is a change that increases the CCA deduction for computers and system software in Class 50 acquired after January 27, 2009 and before February, 2011 from 55% to 100%. It also eliminates the half-year rule. In other words, businesses can fully deduct the cost of these computers and systems software in 2009.

Based on the response to Board Staff Supplemental Interrogatory # 12, Welland appears to accept the increase in the CCA deduction for computers in Class 50. As shown in Exhibit 4, Tab 3, Schedule 3, Table 15, Welland has forecast the addition of $28,500 to this Class in 2009 (Welland has identified this Class as Class 45.1). This results in a deduction to taxable income of $7,837 ($77,310 x ½ x 55%). The allowable deduction is now the full $28,500, or a reduction in taxable income of $20,663.

Energy Probe also agrees with the reduction in the CCA related to the reduction in the capital expenditures in 2009. As shown in the response to Board Staff Supplemental Interrogatory # 12, the net impact of this reduction in capital spending and the impact of the federal budget change is a net increase in the CCA of $9,462.

iv) Update to Regulatory Taxable Income

Energy Probe submits that if the regulatory taxable income is changed as a result of the Board's Decision and/or adjustments that Welland has proposed to make, then the income tax calculation should also be updated to reflect the revised level of regulatory taxable income.

LOSS ADJUSTMENT FACTOR

Welland has calculated the distribution loss factor to be 1.0485 with a corresponding total loss factor of 1.0532 (Exhibit 4, Tab 2, Schedule 8). This calculation has used the actual loses for 2005 through 2007. The total loss factor of 1.0532 is a reduction from the current factor of 1.0599 (Exhibit 9, Tab 1, Schedule 5, page 3) and the distribution loss factor is a reduction from 1.0552 (Exhibit 4, Tab 2, Schedule 8, page 3). Energy Probe accepts the loss adjustment factors as calculated by Welland.

REVENUES

a) Forecast Methodology

i) A Simplistic Methodology

Welland uses a simplistic approach to forecasting volumes. In particular, the forecast for the average use per customer for the residential, GS < 50 kW and GS > 50 kW classes is based entirely on historical figures with no analysis done as to what changes have been and should be reflected in usage figures going forward.

In the original evidence, Welland used the 2004 normalized average use per customer that was calculated by Hydro One (Exhibit 3, Tab 2, Schedule 2, pages 2 – 3). The average use figures used for the GS < 50 kW and GS > 50 kW classes are based on the 2007 actual usage figures, adjusted for customer movement between these classes.

As part of the Supplemental Filing, Welland changed the methodology that it proposes to use for the calculation of the residential average use forecast from the 2004 normalized

figure to using an average of the 2002 through 2007 figures that are not weather normalized (Supplemental Filing).

Energy Probe has a number of concerns with the approach used to forecast the average use. Suggestions for future forecast methodologies are presented in section (ii) below.

The major concerns that Energy Probe has with the current methodology are as follows:

- The residential average use forecast for 2009 is based on the average of actual kWh/customers for the 2002 through 2007 period. This average is based on actual consumption, not normalized average consumption as it should be.
- The GS < 50 kW and GS > 50 kW average use figures are based on 2007 actual usage (adjusted for customer movement) and not normalized average use.
- The reduction in the forecasted residential average use is the result of a continued emphasis on conservation and demand, but no analysis to support the reduction has been included in the evidence.

ii) Future Forecasts

Energy Probe recommends that the Board direct Welland to develop a forecasting methodology that generates a forecast of billed energy on a bottom up basis by rate class. In other words, a forecast is developed for each rate class and these forecasts add up to the overall forecast. Welland has used this approach in the current application; however the methodology does not involve a comprehensive analysis of the factors that have driven changes in average use.

The forecast for each rate class would be based on a forecast for the number of customers in each rate class and a forecast of normalized average use for each rate class. The latter would be based on an econometric estimation of average use based on a number of explanatory variables that could differ by rate class. The equation could be based on annual data or on monthly data. The monthly data approach allows the modeling of the different impacts that the weather can have on a month to month basis. For example, one

heating degree day is likely to have a different impact on use in January than it would in May. The forecast of customers could be driven by economic activity and/or local developments.

Such a process would enable Welland to distinguish between the drivers of volumes and average use by rate class. The current methodology includes little forward looking analysis of the underlying drivers that impact on the average use per customer. These drivers are likely to be different by rate class. The load forecast relies almost entirely on historical data with little, if any, analysis of what is driving changes in average use. Energy Probe submits that a forward looking test year should include an analysis of what has changed average use in the past and what will drive future changes.

b) Adjustments to the Forecast

Energy Probe submits that a number of adjustments should be made to the forecast as filed. The adjustments are listed below.

i) Change in Number of Customers

Welland has revised the customer forecast in the Supplemental filing by increasing the number of GS < 50 kW customers in 2009 by 22, reducing the number of GS > 50 kW customers by 8 and reducing the number of Large User customers by 2 (Exhibit 3, Tab 2, Schedule 2, Revised Feb. 3, 2009). No changes to the other rate classes have been proposed. Based on the information provided by Welland, including the response to Energy Probe Interrogatory # 13, Energy Probe submits that the updated forecast for the number of customers is appropriate and should be accepted by the Board.

ii) Loss of Two Large Use Customers

As part of the Supplemental Filing, Welland is forecasting the loss of two of the three current Large Use customers. One of these customers is closing, while the other is downsizing and switching to the GS > 50 kW class. The net reduction in distribution revenue has been calculated to be $258,189, as shown in the response to Energy Probe Interrogatory # 12.

Welland has not included any Large Use revenue in its forecast for either of these two customers in 2009. However, as indicated in the response to Energy Probe Interrogatory # 34, there is some uncertainty with these dates. The customer that has announced it will be closing has indicated that it intends to wind down the majority of its operations by the end of April, 2009, just prior to the beginning of the 2009 rate year. Similarly, the large customer that is downsizing is expected to switch to the lower cost GS > 50 kW class on May 1, 2009, again the beginning of the 2009 rate year.

Energy Probe submits that the Board should establish a variance account for revenues from these two customers. Welland is forecasting $0 in Large Use revenues from these customers. As a result, Welland has no risk associated with these customers because there is no revenue included in the forecast. The changes that affect the revenues from these customers are both forecast to be at the end of April/beginning of May. As these changes are at the beginning of the rate year, the risk associated with these customers has been entirely shifted to ratepayers. Each of these customers contributes more than $120,000 a year in distribution revenues. Even a delay of just one month in the closing/shifting of these accounts could generate more than $10,000 from each of these customers. Ratepayers would be at risk because they are being asked to make up for the loss of all revenues from these customers as large use customers in 2009 and if any revenue is generated by these customers, the benefits would go entirely to the company.

Energy Probe submits that in a unique situation like this ratepayers should be protected at the same level as is the utility. Welland is being held harmless from the loss in revenues. If any revenues are generated, they should go into a variance account for a later refund to customers who are bearing the entire burden of the lost revenues.

iii) Residential Average Use

Energy Probe submits that the Board should disallow the reduction in the residential average use proposed by Welland in its Supplemental Filing. Welland proposes to reduce the residential average use forecast for 2009 from 8,427 kWh to 8,383 kWh. This

reduction in average use reduces residential volumes by approximately 871,000 kWh. At the proposed distribution volumetric rate of $0.0139/kWh shown in Exhibit 9, Tab 1, Schedule 6, this represents a reduction in revenue of more than $12,000.

Energy Probe submits that the reduction should be denied for a number of reasons. First, the forecast of 8,383 kWh per residential customer is based on actual consumption, not normalized average consumption as is the 8,427 kWh figure used in the original evidence. Energy Probe submits that forecast volumes should be based on a normalized forecast. Welland has a component of its return on equity to reflect forecast risk, including the risk associated with weather. The Welland approach reduces this risk with no corresponding reduction in return.

Second, Welland states that the lower residential use figure reflects the impact of the economic recession and the increased focus on conservation and demand (Energy Probe Interrogatory # 35b). However, Welland has presented no evidence to provide any quantification of the impact of conservation and demand measures. Moreover, it is not clear if the reduction from conservation and demand measures offsets the increased use of electricity from the increased use of electrical appliances such as microwaves and computers that have an increasing penetration rate for households. As for the impact of the recession on average residential use, Welland has presented no evidence of such a link. The loss of jobs will usually result in individuals trying to cut costs such as electricity consumption. However, unemployed people are often home longer hours, resulting in increased electricity consumption.

In summary, Energy Probe submits that Welland has failed to provide the justification required to move away from the normalized actual forecast it originally used in its forecast. Basing the average use forecast on only 2004 data is not ideal, but it is the best alternative currently available.

c) Other Distribution Revenue

Welland is forecasting a decrease in other distribution revenue from $589,546 in 2008 to $458,361 in 2009, for a total decrease of $71,708. These figures are provided in Exhibit 3, Tab 1, Schedule 2, Revised Feb. 3, 2009.

i) Interest and Dividend Income

As shown in Exhibit D of the Supplemental Filing, Welland is proposing to reduce the interest income from $205,950 in 2008 to $74,855 in 2009. This reduction is partially related to a reduction in the average bank account balance, but it is primarily the result of a reduction in interest rates. Energy Probe accepts this reduction as reasonable given the current level of interest rates.

However, as also shown in Exhibit D of the Supplemental Filing, Welland has included a reduction in interest income of $13,140 related to regulatory accounts. This amount is also shown on Exhibit 3, Tab 3, Schedule 1, Revised Feb. 3, 2009 as interest on variance accounts. Energy Probe submits that this reduction to interest income should be disallowed for determining the distribution revenue requirement.

Energy Probe submits that the interest income or expense associated with deferral and variance accounts should not be included in the calculation of these revenue offsets. This is because this interest income or cost will be cleared to customers at the time that the associated deferral and variance accounts are cleared to customers.

If Welland includes this interest cost in 2009, they are effectively double counting the impact. Welland will recover these interest costs when it clears the balances in the associated accounts, including interest. At the same time, Welland has decreased the level of other distribution revenues which are used to offset the revenue requirement that needs to be recovered through distribution rates. Ratepayers would be, therefore, effectively paying this interest cost twice. Energy Probe respectfully submits that the Board should direct Welland to remove the interest expense that is currently included in the interest and dividend income forecast in 2009.

ii) Gain on Disposition of Utility and Other Property

Welland has not forecast any proceeds associated with the sale or scrap value of utility assets in either 2008 or 2009, despite recording income in both of 2006 and 2007 (Exhibit 3, Tab 3, Schedule 1). However, as shown in the response to Energy Probe Interrogatory # 16e and Exhibit H attached to it, the actual year-to-date September 2008 gain was nearly $20,000 related to sale of scrap transformers and the sale of transformers.

Energy Probe submits that give the three consecutive years of 2006 through 2008 in which there has been a net gain on the disposition of utility assets, a forecast for 2009 of $0 is not reasonable. Energy Probe submits that a reasonable forecast for 2009 would be to take the average of the 2006, 2007 and YTD September, 2008 figures. This average equals just over $11,000.

iii) Scrap Metal Sales

Welland has forecast the proceeds from scrap metal sales in 2009 of $12,000, the same level as that forecast for 2008 (Exhibit 3, Tab 3, Schedule 1). The actual levels of scrap metal sales in 2006 and 2007 were $20,669 and $27,919, respectively.

Further, as shown in response to Energy Probe Interrogatory # 16i, year-to-date September, 2008 scrap metal sales had already topped the $16,500 level, and were running approximately 30% ahead of the sales for the same period in 2007, when the actual annual sales were nearly $28,000.

Based on the actual scrap metal sales recorded in 2006 and 2007 and a conservative estimate of $17,400 for 2008, Energy Probe submits that a reasonable forecast for 2009 is the average of the three figures, or $22,000. This represents a $10,000 increase in scrap metal sales in 2009 from that forecast by Welland.

iv) Miscellaneous Non-Operating Revenue

Miscellaneous non-operating revenue has grown substantially since 2006 when it was only $3,674 (Exhibit 3, Tab 3, Schedule 1). In 2007 it totaled $11,119. Welland has forecast a level of $7,020 in both 2008 and 2009. However, as shown in the response to Energy Probe Interrogatory # 16j, the year-to-date September, 2008 figure is already more than $16,500, or more than double the 2008 forecast. The year-to-date 2008 figure is also almost double the amount recorded in 2007 for the same period

Energy Probe submits that a reasonable forecast for 2009 based on the growth in this account since 2006 would be to increase the level from $7,020 by $13,000 to $20,020. This is a conservative forecast for 2009 given that the year-to-date figure for 2008 would imply a doubling of the 2007 revenue to more than $22,000 in 2008.

v) Other Accounts

Energy Probe has reviewed the other accounts included in Exhibit 3, Tab 3, Schedule 1 and with the exception of those noted above, believes that in aggregate the forecasts for 2008 and subsequently for 2009 are reasonable.

vi) Summary

The following table summarizes the changes to Other Distribution Revenue based on the submissions above. The changes total an increase in Other Distribution Revenue of $47,140. These changes will partially offset the reduction in interest income due to declining interest rates.

Source	As Filed	Proposed	Difference
Interest – Var. Accts	(13,140)	0	13,140
Gain on Disposition	0	11,000	11,000
Scrap Metal Sales	12,000	22,000	10,000
Misc. Non-Oper. Rev.	7,020	20,020	13,000
Total			47,140

DEFERRAL AND VARIANCE ACCOUNTS

Welland originally applied for the disposition of accounts 1508, 1525 and 1574. The total amount requested for disposition was a recovery from ratepayers of $416,929 (Exhibit 5, Tab 1, Schedule 2). As part of its Supplement Filing (page 4 and Exhibits M & N), Welland is now proposing to include accounts 1580, 1582, 1584, 1586 and 1588 (excluding Global Adjustment). Addition of these accounts would result in a credit to customers of $721,566 (Exhibit N). Welland proposes to refund this balance over 2 years.

i) Accounts to be Cleared

Energy Probe submits that the amounts to be cleared to ratepayers should include all of the accounts as provided by Welland in their Supplemental Filing. This will result in a substantial credit to ratepayers, as compared to the debit to ratepayers as originally proposed.

Energy Probe submits that the Board should allow disposition of the accounts as now requested by Welland even though it has not been the practice to dispose of the RSVA and RCVA accounts through the rate rebasing applications. Without the credits that are in these accounts, the disposition of deferral and variance account balances would add to the burden of customers from the significant increase in the distribution revenue requirement. The addition of the credits available in these other accounts not only completely offsets the debits in the original accounts that were proposed to be cleared, but they also provide an additional credit to customers to help mitigate the impact of the significant increase in the revenue requirement.

The only exception to this clearance is the adjustment in 2008 in account 1588. Energy Probe agrees with the submission of Board Staff on this adjustment. It should be removed from the current disposition and dealt with in a future proceeding.

ii) Interest Rate

As shown in the response to Energy Probe Interrogatory # 32a, Welland used an interest rate of 4.08% for the third and fourth quarters of 2008 and the January through April, 2009 period. It appears that these same interest rates have been used to generate the figures provided in the continuity schedule filed as Exhibit M in the Supplemental Filing.

Energy Probe submits that the interest rates used in the calculation of the interest balances on the accounts should be updated to reflect the prescribed interest rates of 3.35% for the third and fourth quarters of 2008 and 2.45% for the first quarter of 2009 (and for the month of April, 2009). This reduces the amount to be refunded to customers from $721,566 to $714,929 (Energy Probe Interrogatory # 42a).

iii) Allocation to Customer Classes

Welland proposes to dispose of the regulatory asset rate riders on the basis of historical 2007 distribution revenues and kWh. This would be consistent with past practice as indicated in the response to Energy Probe Interrogatory # 42d).

However, as also indicated in the response to Energy Probe Interrogatory # 42d, Welland did see some merit in the Energy Probe suggestion that 2009 customers/volumes should be used as the allocation factors, reflecting the significant change within the Large Use class.

Energy Probe submits that there would be inequities in the assignment of the balances in the various accounts whether the 2007 or 2009 allocators were used. This is especially true for the large use customer class. Note that there is only one customer forecast to be in this class in 2009. As shown in Exhibit N to the Supplemental Filing, the large use class would receive a rebate of nearly $185,000 based on using the 2007 allocation. Exhibit K attached to the response to Energy Probe Interrogatory # 42e shows that using the 2009 allocation factors, this amount would drop to under $125,000. Therefore this has an impact of more than $60,000 on one customer. This difference also has impacts

on the other rate classes, with the other classes getting a larger rebate if the 2009 allocation factors were to be used.

Energy Probe submits that under the situation in which Welland is losing 2 of its 3 large use customers, the use of the 2007 allocation factors would assign too much of the rebate to the remaining large use customer. Similarly, using the 2009 allocation factors would assign an amount that may be too low. Energy Probe submits that the fairest way to deal with this issue would be to use the historical 2007 allocation factors adjusted for the removal of the two large use customers that are excluded from the 2009 forecast. Removal of the 2007 distribution revenues and kWh's from the actual 2007 figures will effectively redistribute the account balances among all of the remaining classes while still allocating a portion to the remaining large use customer. Energy Probe believes this to be a fair and equitable approach to a unique circumstance.

iv) Recovery Period

If the Board requires Welland to recover the debits from ratepayers as originally proposed by Welland, then Energy Probe submits that the recovery period should be extended to four years. This is the period until the next rebasing application. This would moderate somewhat the rate impact of the increase in the distribution revenue requirement for customers. Welland was agreeable to this suggestion (Energy Probe Interrogatory # 42b).

If the Board allows Welland to rebate the credits to ratepayers as requested in the Supplemental Filing, then Energy Probe believes that the proposed credit should be split over two years as proposed by Welland. This would provide a significant amount of rate mitigation over these two years to partially offset the increase in the distribution revenue requirement.

COST OF CAPITAL

a) Capital Structure

Welland is requesting a deemed equity component of 43.3%, short term debt of 4.00% and long term debt of 52.7% (Exhibit 6, Tab 1, Schedule 1). Energy Probe accepts this capital structure as it is in compliance with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006.

b) Return on Equity

Welland has requested a return on equity of 8.57% for the 2009 test year, but indicates that the Board would update the ROE based on January, 2009 market interest rate information (Exhibit 6, Tab 1, Schedule 1) in accordance with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006. Energy Probe notes that the Board has updated the cost of capital parameters in its letter dated February 24, 2009. The return on equity has been calculated to be 8.01%. Energy Probe submits that Welland should use the 8.01% figure for its revenue requirement calculation.

c) Short Term Debt Rate

Welland has requested a short term debt rate of 4.47% in the test year (Exhibit 6 Tab 1, Schedule 1), but notes that his rate would finalized by the OEB in accordance with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006. Energy Probe notes that the Board has updated the cost of capital parameters in its letter dated February 24, 2009. The short term debt rate has been calculated to be 1.33%. Energy Probe submits that Welland should use the 1.33% figure for its revenue requirement calculation.

d) Long Term Debt Rate

Welland has a long term loan from its shareholder, the City of Welland in the amount of approximately $13.5 million (Energy Probe Interrogatory # 20, Exhibit G). The interest rate on this loan is 6.25% and was set October, 2005 with an effective date of May 1, 2006.

Welland's original evidence on the requested rate was quite clear. As shown in Exhibit 6, Tab 1, Schedule 1, Welland stated that it was requesting a return on long term debt for the 2009 test year of 6.25% which is the rate currently paid on the existing long term loan. The evidence goes on to quote the Cost of Capital Report:

> "that for embedded debt the rate approved in prior Board decisions shall be maintained for the life of each active instrument, unless a new rate is negotiated, in which case it will bed treated as new debt".

However, as shown in the response to Board Staff Supplemental Interrogatory # 2d, Welland is now apparently requesting that the long term debt rate be changed to the Board determined deemed long term debt rate. This rate, based on the Board's Cost of Capital Parameter Updates of February 24, 2009 is 7.62%.

Energy Probe submits that the Welland request to use the Board deemed long term debt rate should be denied.

The Board's Cost of Capital Report stated (at page 13) that"

> "The Board has determined that for embedded debt the rate approved in prior Board decisions shall be maintained for the life of each active instrument, unless a new rate is negotiated, in which case it will be treated as new debt".

Energy Probe submits that this affiliate debt was approved in a prior Board decision and should be treated as embedded debt. As shown in the response to Energy Probe Interrogatory # 20b, Welland confirms that the 6.25% was approved by the OEB during the 2006 EDR rate setting process in EB-2005-0428. Clearly the current loan at a rate of 6.25% is embedded debt.

Energy Probe further notes that Welland could replace its affiliate debt with a loan from Infrastructure Ontario. As shown on their website as of March 10, 2009, the interest rate charged on a 25 year loan was 5.67%. Lower rates are also available for shorter term loans down to 3.19% for a 5 year term. Energy Probe submits that if the current long term debt held by the company is not considered to be embedded debt, then it would not be reasonable for Welland to continue to utilize a loan from an affiliate at a deemed interest rate that is higher than an actual rate available from a third party. If the Board determines that the debt is not embedded debt, then Energy Probe submits that the 25 year rate available from Infrastructure Ontario when the Board's Decision is made should be applied to the long term debt.

COST ALLOCATION & RATE DESIGN

a) Re-Allocation

The Supplemental Filing provides the amended allocation of costs and revenues (Exhibit G) and proposed revenue to cost ratios (Exhibit K) after revisions to the 2007 cost allocation filing to reflect the loss of two of the three large use customers.

Energy Probe submits that it would have been preferable to update the 2007 cost allocation filing to reflect forecasted figures for 2009 given the significant changes that the loss of two large customers could have on the allocation and recovery of costs. However, Energy Probe agrees with Welland that preparing a revised cost allocation study is time consuming. As a result Energy Probe agrees with Welland that it should update its cost allocation study when it files its next cost of service application to reflect the circumstances that exist at that point in time.

Welland has adjusted the 2007 cost allocation filing in Exhibit G of the Supplemental Filing to reflect the loss of distribution revenue for the two large user accounts as well as the corresponding costs allocated to this class of customers based on the revenue to cost ratio of 100.73% from the 2007 filing. The Supplemental Filing (page 3) explains how these lost revenues and adjusted costs are allocated to the other rate classes. The result of

the re-allocation by rate class is shown in Exhibit G. Energy Probe accepts the re-allocation as proposed by Welland as acceptable, in the absence of a new cost allocation study.

b) Revenue to Cost Ratios

As shown in the Supplemental Filing (pages 3 – 4, and Exhibit K) Welland proposes to make significant changes to the revenue to cost ratios for a number of rate classes. Each of the changes proposed is discussed below.

i) Street Lighting

Welland proposes to increase the street light class ratio by 50% of the required movement to the bottom of the Board approved range for this class (i.e. 70%) in 2009. Welland indicates that this increases the revenue to cost ratio from 12.17% to 40.35%. In 2010 this class would be moved the remainder of the distance to the bottom of the Board approved range.

Energy Probe agrees with the approach proposed by Welland. However, Energy Probe notes that moving half way to 70% from 12.17% would mean the ratio should be set at 41.09%, not 40.35% for 2009. Further, Welland shows the 2010 ratio to be 71.06%, as opposed to the 70% which is the bottom of the Board range for this class. Energy Probe submits that the ratio should be set at 41.09% in 2009 and at 70.0% in 2010.

ii) Sentinel Lights

Welland proposes to increase the ratio from 18.71% to 52.97% in 2009 and to 90.45% in 2010. This is based on a proposal to increase the ratio in 2009 by 50% of the increase necessary to attain a targeted ratio of 90%.

Energy Probe does not agree with this goal. The goal should be to increase the revenue to cost ratio by 50% of the increase necessary to bring the ratio to the bottom of the Board approved range in 2009, with the ratio moving to the target ratio of 70% in 2010. This would be the same approach as that proposed by Welland for the street lighting

class. Energy Probe does not see any rationale for increasing the sentinel light class to a higher target than that for the street lighting class when they both have the same Board approved range.

Energy Probe submits that a revenue to cost of 44.36% in 2009 and 70% in 2010 should be targeted for the sentinel light class.

iii) General Service Classes

The GS < 50 kW class has a revenue to cost ratio of 75.23% while the corresponding ratio for the GS > 50 kW class is 65.24%. Welland proposes to increase these ratios to 85% in 2009 and maintain them at this level in 2010.

Energy Probe agrees with this approach, even though the 85% targeted by Welland is above the 80% minimum in the range approved by the Board for these rate classes. These are second and third largest rate classes in terms of distribution revenue. In order for the residential rate class ratio to decline, these two general service classes need to contribute more revenue than would be generated at a revenue to cost ratio of 80%.

iv) Unmetered Scattered Load

Welland proposes to reduce the ratio for this class of customers from 114.93% to 100.15% in both 2009 and 2010.

Energy Probe submits that there is no need to change the current ratio as it already is within the Board approved range of 80% to 120%.

v) Large Users

Welland proposes to reduce the revenue to cost ratio for the large user customer class from the current 100.73% to 95.56% in 2009 and to 85.00% in 2010. Welland justifies the decrease in 2009 as being related to the transformer credit which is not increasing and the 2010 reduction as bring this class in line with the general service class ratios proposed.

Energy Probe opposes these reductions to this class of customers. Not only is the current ratio within the Board approved range for this class of customers, it is nearly at unity, at 100.73%. It is counterintuitive to reduce the ratio in 2009 or 2010 and move it further away from 100%. Further, it would not be just and reasonable, in the view of Energy Probe, to reduce the ratio for one class of customer that is already well within the Board approved range, when another class (residential) remains above the Board approved maximum for their range.

vi) Residential

The current revenue to cost ratio for the residential class is 127.28%, well above the maximum of 115% for the Board approved range. Welland proposes to use the residential class as the residual class, effectively reducing the ratio to 115.61% in 2009 and to 112.90% in 2010 based on the changes in revenues generated by the proposed ratio changes in all the other rate classes.

Energy Probe accepts the approach since the residential class is the only class that has a ratio in excess of the maximum. The additional revenue that would be generated in each of 2009 if the revenue to cost ratios as proposed by Energy Probe in the other rate classes (i.e. higher ratios for unmetered scattered load, street lights and larger users, partially offset by a lower ratio for sentinel lights) would allow for a further reduction in the ratio for the residential class, although it would still likely be in excess of 115%. In 2010, it would bring the residential ratio down a little further than that resulting from the Welland proposals.

COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Recognizing the size of Welland, Energy Probe has attempted to minimize its time on this application, while at the same time ensuring a thorough review.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

March 13, 2009

Randy Aiken

Consultant to Energy Probe