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May 27, 2009

BY EMAIL & 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-2008-0246
Tillsonburg Hydro Inc. – 2009 Rates Rebasing Application
Argument of Energy Probe

Pursuant to the Interim Rate Order and Procedural Order No. 3, issued by the Board on April 23, 2009, Energy Probe Research Foundation (Energy Probe) encloses two hard copies of its Argument in respect of Tillsonburg Hydro Inc. for the Board's consideration. An electronic version of this communication will be filed in PDF format.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc: Steve Lund, Tillsonburg Hydro Inc. (By email)
Bryan Drinkwater, Tillsonburg Hydro Inc. (By email)
Randy Aiken, Aiken & Associates (By email)
Intervenors of Record (By email)

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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
Tillsonburg Hydro Inc. 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

May 27, 2009

**TILLSONBURG HYDRO INC.
2009 RATES**

EB-2008-0246

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 Tillsonburg Hydro Inc. (“THI”) effective May 1, 2009.

This Argument has been structured to reflect the major components of the THI evidence. Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of THI. 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 THI 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.

THI is forecasting a significant deficiency. As shown in Attachment B.2 to the updated evidence filed on April 14, 2009 (“April filing”), the gross revenue deficiency is \$817,590 on forecasted total net revenues (assuming no rate changes) of \$2,528,427. This figure is shown in Appendix C.2 to the THI Argument in Chief dated May 15, 2009. The deficiency represents an increase in total revenues of more than 32%. This deficiency reflects a number of significant changes to the original evidence filed on August 22, 2008 and to the December 2008 update. In fact, as shown in Attachment B.1 to the April filing, the deficiency grew from \$746,792 in August, 2008 to \$794,497 in December, 2008 and to the current estimate of \$817,590 in April, 2009.

ADJUSTMENTS TO THE COST OF SERVICE APPLICATION

THI has made a number of changes to the original evidence filed in August, 2008 in both December, 2008 and again in April, 2009. The changes made reflect the loss of large customers of THI, corrections to the evidence, and updated information.

For the purposes of this argument, Energy Probe has based its submissions on the figures provided in the appendices to the THI Argument-in-Chief dated May 15, 2009.

RATE BASE

a) Working Capital

Energy Probe accepts the approach taken by THI 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 THI to prepare a working cash (lead lag) study for its next rebasing application.

i) Cost of Power

Energy Probe submits that THI has updated the cost of power component of the working capital allowance appropriately to reflect the changes in the demand forecast. The updated cost of power expenses included in the working capital allowance calculation is shown in Appendix C.3 attached to the Argument-in-Chief. As shown in this appendix, the power supply expenses account for approximately \$2.15 million of rate base, or about 25% of total rate base.

It is unclear, however, if THI has updated the power supply expenses to reflect the more recent Navigant RPP costs, transmission and LV charges. 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 THI to update the calculation based on the most recent information available to the Board at the time of its Decision.

ii) Cost of Power Methodology

Energy Probe does not support the methodology used by THI to calculate the commodity component of the cost of power. THI has used a single rate 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 THI where the working capital allowance associated with power supply expenses represents 25% of total rate base.

It is Energy Probe's understanding that beginning May of 2009, the MUSH sector will no longer be eligible for the RPP. This means that the vast majority of the volumes consumed by customers of THI 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.

Energy Probe respectfully submits that the Board should direct THI to provide this breakdown of cost of power expenses as part of their next rebasing application.

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

Energy accepts the capital expenditure forecast as proposed by THI of \$677,602 for the 2009 test year (Exhibit 2, Tab 1, Schedule 2, Attachment A1, December, 2008). This

level of capital expenditures is in line with recent expenditures of approximately \$720,000 in 2006, \$803,000 in 2007 and \$694,000 in 2008.

OM&A EXPENSES

THI's OM&A expenses are projected to grow significantly in 2009 relative to increases in the past few years. As shown in Exhibit 4, Tab 2, Schedule 1, Attachment E, OM&A expenses went from \$1,621,346 (excluding other taxes) in 2006 to \$1,620,270 in 2007 and to \$1,626,967 in 2008. The increase through 2008 as compared to 2006 was only \$5,600 or approximately 3.5%. The OM&A forecast for 2009, as shown in Attachment B.2 of the April filing, is now \$2,135,524. This is an increase of more than \$508,000 from the 2008 level and represents an increase of 31.3%.

a) Overall Increase in OM&A Costs

Energy Probe submits that the proposed increase in OM&A costs is unreasonable at the best of times. In the current economic situation, with THI losing a number of large customers, there is even more onus on THI to control its spending.

Energy Probe submits that some of the increase in 2009 costs may be the result of little if any increase in costs in 2007 and 2008 from the actual 2006 level of expenditures, this alone cannot justify the increase in OM&A costs of more than 30% proposed for 2009.

Energy Probe submits that a reasonable increase in 2009 OM&A costs as compared to the level recorded in 2006 of \$1,621,341 would be increase this level of expenditures by a maximum of 5% in each of 2007, 2008 and 2009 to arrive at a reasonable level of expenditures for 2009. The 5% annual increase is significantly above the level of inflation. This approach would yield an OM&A forecast for 2009 of \$1,876,900, approximately \$260,000 lower than forecast by THI.

The major components of the increase proposed by THI are shown in their Argument-in-Chief at page 6 of 23. The key drivers of the increase are \$189,000 due to labour cost changes, \$71,000 due to the amortization of the costs of the new CIS, \$31,500 due to THI

assuming responsibility for paper and postage costs, \$47,400 due to change in capitalized fleet costs, \$86,200 due to changes in capitalized labour costs, and \$64,800 due to the 4 year amortization of rate rebasing costs.

Energy Probe makes a number of submissions on these costs below.

b) Labour Cost Changes

As shown in the response to School Energy Coalition interrogatory # 13 (Exhibit 10, Tab 4, Schedule 13), the labour cost increase in 2009 as compared to 2008 is \$189,000 and this is made up of \$60,000 for an apprentice linesman, \$102,000 for a new operations regulatory affairs manager and \$27,000 for a cost of living adjustment.

Energy Probe submits that additional costs associated with apprentice linesman is appropriate but that the other two causes of the increase need to be examined.

Energy Probe submits that THI has not provided sufficient evidence to support the inclusion of a new operations regulatory affairs manager position. The justification provided is that there is a need for this position due to the increasing regulatory burden and the complexity of regulation. Energy Probe submits that since the 2009 rate rebasing has taken place, there will be a decrease in the regulatory burden associated with rate applications for the next three years. The only duties identified for this position are “document compliance with regulatory instruments, conducting special studies” (Exhibit 10, Tab 3, Schedule 26 c). Energy Probe submits that THI has the onus to justify the need for a position that accounts for \$102,000 of the increase in OM&A costs, especially when it already is paying for 73% of an FTE for a Finance Regulatory Affairs Manager. Energy Probe submits that THI has failed to justify the need for this position.

Even if the Board determines that the position is required, THI has not reduced the costs associated with the current Finance Regulatory Affairs Manager position. Energy Probe submits that a reduction of one-half of the \$102,000, or \$51,000 should be made to reflect the overlap in duties of the new and existing positions.

With respect to the cost of living adjustment increase of \$27,000, this estimate was based on consumer price index increase of 2.0% (Exhibit 10, Tab 3, Schedule 26 d). Energy Probe submits that in light of the current economic conditions, this CPI increase should be lowered to 1% which is still at the high end of current forecasts for 2009. The most recent data from Statistics Canada which is for the month of April 2009 indicates that the inflation rate over the same period in 2008 had fallen to 0.4%. A reduction in the CPI forecast to 1.0% would reduce the increase by \$13,500.

c) Board of Directors

THI increased the number of members of the Board of Directors from 7 to 9 in 2007. This increase was made to achieve compliance with the requirements of the Board's Affiliate Relationships Code (Exhibit 10, Tab 4, Schedule 13). THI clarified that it was section 2.1.3 of the Affiliate Relationship Code to which it was referring (Exhibit 10, tab 3, Schedule 37a). This section requires at least 1/3 of the members be independent from any affiliate.

However, as shown in the response to part (b) of Exhibit 10, Tab 3, Schedule 37, the composition of the Board of Directors prior to the increase in membership was 4 affiliated members and 3 independent members. THI was already in compliance with this requirement. THI now claims that the increase from 7 to 9 members was so that sufficient resources and expertise were on hand to deal with the work of the board (Exhibit 10, Tab 3, Schedule 37 a).

Energy Probe submits that it is not reasonable for a utility the size of THI to have such a large Board of Directors. In the EB-2007-0928 Decision and Order dated October 27, 2008 for Erie Thames Powerlines Corporation, the Board dealt with a similar issue. Erie Thames had increased the number of members of the Board of Directors from 7 to 11 to meet the criteria of 1/3 of the members being independent. In their Decision, the Board concluded that a utility the size of Erie Thames (14,000 customers) did not require such a large Board and denied the additional costs for the larger board (pages 10 to 11).

Energy Probe submits that this is a similar situation. THI has less than one-half of the number of customers of Erie Thames, yet THI increased the number of members on its Board from 7 to 9. Energy Probe submits that this increase has not been justified and the costs associated with the additional 2 directors should be removed from the cost of service. Based on the response that the 2009 Board of Director costs is \$83,000 (Exhibit 10, Tab 3, Schedule 37 c), Energy Probe submits that a reduction of \$18,400 ($\$83,000 \times 2/9$) be made to the revenue requirement.

d) Rate Rebasing Costs

THI has updated its total rate rebasing costs to \$255,000, as shown in the response to Board Staff at Exhibit 10, Tab 1, Schedule 47. However, the total costs shown in that schedule actually add up to \$253,000. THI has amortized the cost over 4 years, resulting in an amount of \$63,750 being included in the revenue requirement.

Energy Probe agrees with the amortization over 4 years, but takes issue with two of the figures used by THI in arriving at the total cost of \$253,000. First, the \$25,000 provision for OEB costs appears too high to Energy Probe, given that there will not be an oral component to the application. Energy Probe submits that the Board should substitute its estimated costs associated with this application in place of the \$25,000. Given that this application has been relatively straight forward, Energy Probe estimates that there should be a reduction in OEB costs of about \$10,000.

Second, Energy Probe submits that the \$12,000 claimed as a management fee should be removed from the costs. This management fee is calculated as 5% of the total of the third party costs for consulting costs, OEB costs and intervenor costs (Exhibit 10, Tab 3, Schedule 39). Energy Probe submits that it is inappropriate for THI to add a mark up to third party costs. The explanation provided for this inclusion is provided at Exhibit 10, Tab 1, Schedule 46a. Based on this explanation, it would appear that the \$12,000 in management fees associated with the rate case application are being used to cover a portion of the costs of the Accounts Payable clerk. Energy Probe submits this is an

absurd amount to charge for dealing with a small number of accounts payable. There is no justification for this. Further, as shown in the response to an Energy Probe interrogatory, THI indicates that it already pays for 15% of the costs associated with Accounts Payable clerk (Exhibit 10, Tab 3, Schedule 2).

In aggregate the reduction in rebasing costs proposed by Energy Probe total \$22,000. This would reduce the associated costs from \$253,000 to \$231,000. Amortized over 4 years this results in an amount of \$57,750 included in the 2009 revenue requirement. This is a reduction of \$6,000 from that claimed by THI.

e) CIS Costs

In the original filing, THI claimed costs in 2009 of \$117,000 in OM&A costs associated with the new CIS. This was subsequently corrected to \$101,600 due to some errors in the original calculation (Exhibit 10, Tab 4, Schedule 12g). Based on the Argument-in-Chief, this amount has now been reduced to \$71,000 (page 7 of 23).

It is Energy Probe's understanding that this amount has been calculated based on the total cost of the CIS system of \$308,175 amortized over 4 years, for a cost of \$77,000. Added to this cost is the THI share of the ongoing support costs of \$34,400, which is 71.7% of the total supports costs for the new CIS of \$48,000. Offsetting these costs is a reduction of \$40,400 that was the 2008 costs associated with the former CIS system. The amortization over a four year period is change from the original application that proposed to recover these costs over three years. The net cost totals \$71,000 as indicated in the Argument-in-Chief.

As shown in the response to Exhibit 10, Tab 3, Schedule 27, the ongoing support costs of \$48,000 includes the 5% management fee. As well, the capital costs which are proposed to be amortized over 4 years include the 5% management fee. Energy Probe submits that because these are external costs, no management fee, or markup, should be applied. This would reduce the capital cost from \$308,175 to \$293,500 and the total ongoing support

costs from \$48,000 to \$45,700. The THI portion of these costs would be 71.7% of this, or \$32,800.

Based on these changes alone, the \$71,000 proposed for recovery from customers would decline to \$65,775 ($293,500 / 4 + 32,800 - 40,400$). However, Energy Probe submits that there should be another adjustment made to this calculation.

As indicated in the response to Exhibit 10, Tab 3, Schedule 36, 100% of the capital costs of the new CIS has been allocated to THI despite the fact that it will also be used for water and sewer billing. The rationale for allocation all of the CIS costs to THI is that the legacy system vendor decided not to maintain the system with current developments in the electricity market but was willing to continue to support the water and sewer CIS needs (Exhibit 10, Tab 4, Schedule 12e).

However, the response found in Exhibit 10, Tab 3, Schedule 36 states that “the benefit to the Town of Tillsonburg is that it will be able to avoid the costs of owning and operating two CIS and of printing and mailing two separate bills – one for electricity and the other for water/sewer”. Energy Probe submits that these savings to the Town of Tillsonburg should be reflected in an allocation of the new CIS capital costs to the town. It would not be reasonable for electricity ratepayers to bear the full burden of the new CIS system when there will be benefits accruing to the town.

In addition, it has been decided that THI will be responsible for 71.7% of the ongoing support costs. This allocation is apparently based on the fact that the same number of bills is issued for electricity as for water/sewer, while reflecting the additional complexity in calculation the electricity bill (Exhibit 10, Tab 4, Schedule 12e).

Energy Probe submits that it would be reasonable to allocate the same 71.7% share of the capital costs to THI as are allocated to them for the ongoing support costs. Applying this share would reduce the capital costs of the new CIS from \$293,500 (excluding the management fee) to approximately \$210,500. In turn this would decrease the amount

included in the 2009 revenue requirement to \$45,025 ($210,500 / 4 + 32,800 - 40,400$), for a total reduction of \$25,975 from the \$71,000 included by THI.

The Board may also want to consider amortizing the capital costs over a five year period to match the expected life of computer hardware. This change would further reduce the 2009 revenue requirement by \$10,525 based on the allocated capital cost of \$210,500.

f) Management Fee

Energy Probe has serious concerns about the application of the 5% management fee on third party costs. As illustrated above in the rate rebasing costs, the Town of Tillsonburg imposes a 5% management fee on consultant costs, intervenor costs and OEB costs associated with the rate rebasing application.

Exhibit 4, Tab 1, Schedule 2, page 3 indicates that this management fee is applied to all directly incurred costs of the period. Examples provided include direct labour costs, period costs of facilities such as property taxes, natural gas, and insurance. The Town burdens each charge to THI with a 5% management fee.

Energy Probe objects to the mark up being applied to flow through costs from third party supplies, such as property taxes, natural gas costs, insurance costs, contracted vegetation management costs, intervenor costs, OEB costs, consulting costs, audit costs, legal costs, and so on.

There is no rationale for the Town of Tillsonburg to mark up these costs by 5% or any percentage. These mark ups only add to the cost of THI without providing any benefits. Any costs from third parties (or those related to property taxes) that are directly attributable to THI should not be increased by the 5% mark up by the Town. As noted earlier in this submission, THI is already allocated a portion of the FTE associated with the accounts payable clerk. As shown in Exhibit 10, Tab 3, Schedule 2, THI is also allocated portions of FTE's related to a chief administrative officer, a director of finance, a director of corporate services, a manager of customer service, a finance regulatory

affairs manager, a senior accountant, a records management clerk and a deputy treasurer. These allocations cover the costs associated with work done on behalf of THI. Adding a mark up on pass through costs such as property tax, insurance and so on is not based any type of cost causality and should be eliminated.

Energy Probe does not have the information to determine what the impact of the elimination of the management fee on the pass through of these third party costs is, but submits that the Board should direct THI to provide the relevant figure included in the 2009 OM&A forecast.

g) Capitalized Costs

As indicated in their Argument-In-Chief, THI has forecast that OM&A costs will be \$47,400 higher due to changes in capitalized fleet costs and \$86,200 higher due to changes in capitalized labour costs. These changes in capitalized costs total \$133,600. No rationale has been provided for this increase in costs in 2009. Indeed, as shown in Exhibit 2, Tab 1, Schedule 2, Attachment A1, the total capital expenditures for 2008 and 2009 are virtually identical, at \$694,168 and \$677,602, respectively. The composition of the capital expenditures on an account by account basis is also very similar. There is certainly no indication of why there would be an increase in OM&A due to changes in capitalized costs of more than \$130,000.

It appears that the only evidence related to capitalization included in the application and interrogatory responses is a short statement in Exhibit 2, Tab 1, Schedule 1, page 6 that indicates that THI uses historic cost accounting and records asset acquisition costs and appropriately capitalized costs (e.g. labour, materials, burdens). There is no indication of any change in the capitalization policies that would reflect the significant change in OM&A costs first identified in the Argument-in-Chief.

In light of the lack of evidence on this issue, Energy Probe submits that the Board should shift \$100,000 out of OM&A costs and into capital expenditures.

h) Summary

The following table summarizes the specific submissions of Energy Probe with respect to the reductions in OM&A proposed in this submission.

Finance Regulatory Affairs Manager	\$102,000
Cost of Living Adjustment reduced to 1%	\$13,500
Board of Directors reduced to original 7	\$18,400
Rate Rebasing Costs	\$6,000
CIS Costs	\$25,975
Removal of Management Fee on Pass Through	?
Capitalized Costs	<u>\$100,000</u>
Total	\$265,875 +

The total shown in the above table of \$265,875 + approximates the \$260,000 overall reduction in OM&A costs calculated by Energy Probe on an envelop approach based on 5% increases in each of 2007, 2008 and 2009 applied to the 2006 actual costs at the beginning of this section.

DEPRECIATION & AMORTIZATION

Energy Probe has reviewed the calculation of the depreciation & amortization expenses shown in Exhibit 2, Tab 2, Schedule 4, Attachment A, page 4.

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

If the Board makes any 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 THI 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 is 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. Similarly, there are different federal tax rates when the taxable income is less than \$500,000.

a) Capital Tax

THI is not claiming any expense related to the capital tax (Exhibit 10, Tab 3, Schedule 24b) as their rate base is less than the available exemption of \$15 million. Energy Probe submits that this is correct and should be accepted by the Board.

b) Income Tax

i) Tax Rates

THI originally used a total tax rate of 17.00% in the calculation of income taxes in 2009 (Exhibit 4, Tab 1, Schedule 2, Attachment D). This rate included a federal tax rate of 11.50% and a provincial tax rate of 5.50% (Exhibit 10, Tab 3, Schedule 24a). Energy Probe submits that the appropriate tax rates to be used for THI, with taxable income of less than \$500,000 is 11.00% for federal taxes and 5.50% for provincial taxes. THI has indicated that they agree that these are the appropriate tax rates that should be used (Exhibit 10, Tab 3, Schedule 24 c & d). Further, THI undertook to update its models to reflect the reduction in the federal tax rate to 11.00%.

As part of the April filing, THI indicated that it had corrected the federal tax rate from 11.50% to 11.00% (Exhibit 1, page 8 of 14). Energy Probe submits that this correction is appropriate.

ii) Apprenticeship Tax Credit

THI does not appear to have made any reductions to its income tax payable related to the apprenticeship tax credit. There are no tax credits shown in Exhibit 4, Tab 1, Schedule 2, Attachments C or D (December, 2008).

As indicated in the response to Energy Probe interrogatories (Exhibit 10, Tab 3, Schedule 2), THI will have two apprentice linesmen in 2009. Based on the response found in Exhibit 10, Tab 3, Schedule 1, both of these positions have been filled.

Energy Probe understands that the apprenticeship tax credit is available for these positions. As part of the recent provincial budget, the Apprenticeship Training Tax Credit for small businesses (i.e. corporates with taxable income under \$500,000 such as THI), has been increased from 30% of the salaries and wages paid for apprentices to a maximum of credit of \$5,000 per apprentice to 45% of the salaries and wages paid to a maximum credit of \$10,000 per apprentice.

Energy Probe submits that the Board should direct THI 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. Based on 2 apprentice linesmen, a tax reduction of \$20,000 could be available. This is nearly one-third of the projected PILS expense as shown in Attachment B.2 to the April filing.

iii) Update to Regulatory Taxable Income

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

LOSS ADJUSTMENT FACTOR

In its April filing THI indicated that correctly computed loss factors have been applied. THI describes this correct in Exhibit 10, Tab 2, Schedule 28. This correction appears to have increased the loss factors for primary and secondary metered customers from 2.84% and 3.88% respectively (Exhibit 4, Tab 2, Schedule 10) to 3.20% and 4.20% respectively (April Filing, Exhibit 1, Attachment A).

Energy Probe submits that it believes that the corrected figures are appropriately calculated.

REVENUES

a) Forecast Methodology

Energy Probe has concerns with the methodology used by THI to forecast the volumes for each rate class. THI uses one econometric equation to forecast the calculated weather sensitive load which is defined as monthly kWh purchases less monthly kWh from GS 500-4999 kW class, lighting and USL (Exhibit 3, Tab 2, Schedule 1, Attachment). Data for a five year period (2003 through 2007) was used to estimate this single equation that effectively represents residential, GS < 50 kW and GS 50 – 499 kW customers. This figure is then divided into volume forecasts for these three rate classes based on the class share for 2007.

Energy Probe's main concern with this approach is that it implies that each of the three weather sensitive rate classes (residential, GS < 50 kW and GS 50 – 499 kW) is equally impacted by changes in degree days (heating and cooling) and economic variables. THI agreed with this comment (Exhibit 10, Tab 3, Schedule 18). Energy Probe submits that this is most likely not the case. Economic circumstances will affect the customers in these rate classes in different ways and with different magnitudes. Similarly, heating and cooling degrees are not likely to have the same impact on residential customers as they would on general service customers.

An additional concern is that the historical data used to estimate the lone econometric equation includes not only the volumes consumed by the residential, GS < 50 kW and GS 50 – 499 kW classes, but also the system losses associated with the system (Exhibit 10, Tab 2, Schedule 3). In other words, the equation is forced to model not only consumption related to the three specific classes, but also the losses associated with all rate classes.

Energy Probe submits that in future rate rebasing applications THI should bring forward forecasts for each of the weather sensitive accounts on the basis of separate equations that will allow the estimated coefficients on degree days and economic variables to differ from one another, providing a more accurate reflection of their impacts on volumes.

b) Adjustments to the Forecast

Energy Probe submits that a number of adjustments should be made to the forecast as filed and updated. The adjustments are listed below. These adjustments are primarily based on the use of actual 2008 data now being available.

Further it is not clear to Energy Probe what the final version of the forecast volumes proposed by THI is. There are different energy and demand figures provided in the response to a Board Staff interrogatory (Exhibit 10, Tab 1, Schedule 37) as compared to a response to a VECC interrogatory (Exhibit 10, Tab 2, Schedule 28).

i) GS 500 – 4999 kW

As noted in the footnote on page 12 of the Elenchus load forecast (Exhibit 3, Tab 2, Schedule 1, Attachment), the kW forecast for this class was based on the 2006 kW/kWh ratio multiplied by the forecast kWh for 2009 in the class. The 2006 ratio was used rather than the most recent information for 2007 to correct for the large customer that operated for only a portion of 2007. This ratio is actually used for both of the new general service classes that THI proposes to replace the GS 500 – 4999 kW class with (GS 500 – 1,499 & GS > 1,500).

Energy Probe submits that THI should update the forecast for kW for 2009 for this class to reflect the most recent information now available. As shown in the response to Exhibit 10, Tab 3, Schedule 18, part r, information is now available for 2008. Applying the 2008 ratio of 0.00237 (235,194 / 99,077,531) to the current forecast of 70,217,128 kWh (Exhibit 10, Tab 2, Schedule 28) for these rate classes would increase the kW billing determinants from 141,313 kW to 166,684 kW, for an increase of more than 25,000 kW.

The corresponding revenue impact of this change would be significant and reduce the overall revenue deficiency.

ii) Street Lighting & USL (including Sentinel Lighting)

As indicated in the Elenchus report, the forecast for street lighting and USL (including sentinel lighting) was held constant at the most recent actual levels, which was 2007 when the forecast was prepared.

Energy Probe submits that this methodology should be maintained, but the forecast should be updated to reflect the most recent actual data available. This information is for 2008 actual figures shown in Exhibit 10, Tab 3, Schedule 18, part r. As shown in this response, the street lighting kWh are 4.3% above the 2007 level with the corresponding kW figure up 1.3%. USL volumes for 2008 are 0.8% below the 2007 level, but sentinel light kWh's are up nearly 10%.

c) Other Distribution Revenue

As shown in Attachment B.2 to the April filing, THI has reduced the revenue offset from a level of \$128,433 in both the August and December filings to \$106,433. This is a reduction of \$22,000. As explained in Exhibit 1 of the April filing (at page 9 of 14) this reduction reflects a reduction in interest income that has resulted from lower interest rates in 2009. Energy Probe accepts this reduction as reasonable.

However, Energy Probe submits that THI has failed to correct the original forecast level of \$128,443 to reflect the omission of some miscellaneous revenues. The original forecast figure of \$128,433 for other regulated revenues (revenue offsets) is shown in Exhibit 3, Tab 1, Schedule 2 (December, 2008). This was a component of the total revenue forecast of \$2,530,918 shown in the same schedule. This figure is also shown in Exhibit 3, Tab 1, Schedule 1, Table 2 (December, 2008). Included in this total was an amount of \$69,766 for other operating revenues. When asked in an Energy Probe interrogatory why this amount was so much lower than the \$94,000 forecast for 2008, THI responded that the table reflected the correct amounts of miscellaneous service

revenues for 2008, but that these revenues for 2009 had been understated because the revenues recovered through the application of a number of specific service charges had not been included (Exhibit 10, Tab 3, Schedule 15, part b). That response indicated that the correct figure for 2009 was \$94,066, or \$24,300 more than the forecast of \$69,766.

THI undertook to correct its application for this omission of \$24,300 (Exhibit 10, Tab 3, Schedule 15, part b). However, it does not appear to Energy Probe that this increase in revenue was reflected in the April filing or in the attachments to the Argument-in-Chief. Energy Probe submits that this omitted revenue should be included in the forecast to help reduce the overall revenue deficiency.

DEFERRAL AND VARIANCE ACCOUNTS

i) Accounts to be Cleared

THI is proposing to recover a balance of \$157,402 from customers through rate riders associated with balances in accounts 1508, 1525 and 2425 (Exhibit 5, Tab 2, Schedule 2, Attachment H). This balance may change slightly due to changes in interest rates applied to the balances as requested in a number of interrogatories.

As shown in Exhibit 5, Tab 1, Schedule 2, Attachment A, page 5, the balance in all of the accounts shown at the end of April, 2009 is actually a credit to customers of \$968,378. This is because the amount proposed to be recovered from customers of \$157,402 is more than offset by the balances in the RSVA accounts (1580, 1582, 1584, 1586 and 1588). In aggregate these accounts are a credit to customers of more than \$1 million.

Energy Probe submits that the Board ought to consider whether it is appropriate to recover the amounts from ratepayers while not refunding any of the significant balances in the accounts that will be rebated to these ratepayers at some point in the future. This is an especially important question given the magnitude of the increase in the requested revenue requirement.

Energy Probe submits that while it has not been the practice of the Board to dispose of the RSVA accounts through the rate rebasing applications, it should consider doing so in the current case. Without any of the credits that are in these accounts, the disposition of deferral and variance account balances will add to the burden of customers from the significant increase in the distribution revenue requirement. The addition of at least some of the credits available in these other accounts not only completely offsets the debits in the original accounts that are 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.

ii) Interest Rate

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 as set by the Board.

iii) Allocation to Customer Classes

THI has indicated that it has allocated the account balances to the specific customer classes consistent with the Board's Decision in the Regulatory Assets Phase 2 Decision (Exhibit 5, Tab 1, Schedule 3). Based on this, Energy Probe accepts the allocation of the balances as proposed by THI.

iv) Recovery Period

THI is proposing to recover the balances in the deferral and variance account balances over a two year period rather than only in 2009. This is being proposed because of the significant increase in the revenue requirement and adjustments to current revenue to cost ratios that may have significant rate impacts on some classes of customers. Spreading the recovery of the deferral and variance account balances over two years helps to mitigate the impact of the increases (Exhibit 9, Tab 1, Schedule 4). Energy Probe submits that the Board may want to extend the recovery period for a further year to three to provide even more rate mitigation.

COST OF CAPITAL

a) Capital Structure

THI is requesting a deemed equity component of 43.33%, short term debt of 4.00% and long term debt of 52.67% (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

THI has updated its requested return on equity to 8.01% for the 2009 test year (Argument-in-Chief, page 8 of 23, and Exhibit 1, page 9 of 14 of the April filing) 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 submits that this update to 8.01% is appropriate.

c) Short Term Debt Rate

As with the return on equity above, THI has indicated that it has changed its short term debt rate to reflect the Board's most recent cost. This rate is 1.33%. This is accordance with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario Electricity Distributors* dated December 20, 2006.

d) Long Term Debt Rate

THI has utilized the Board's deemed cost of long term debt for rate making purposes. This rate was originally 6.1% (Exhibit 6, Tab 1, Schedule 1, page 3). This rate has been updated to 7.62%, reflecting the updates to the cost of capital parameters issued by the Board for use for the 2009 rate rebasing applications (Argument-in-Chief, page 8 of 23).

Based on a rate base of \$8,713,761 (Attachment B.1 to April filing) and a long term debt ratio of 52.67%, the increase in the interest rate from 6.1% to 7.62% would increase the revenue requirement by approximately \$70,000. As a result, this is a significant component of the overall revenue shortfall, representing 8.5% of the claimed deficiency.

Energy Probe submits that the Board should reject the THI claim for its deemed long term debt at the 7.62% deemed cost of long term debt.

THI is 100% equity financed (Exhibit 6, Tab 1, Schedule 1, page 1, line 23). As a result, THI has no debt, either third party or affiliate. As a result, all of THI's long term debt is notional or deemed long term debt.

The Board's Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors dated December 20, 2006 explicitly provides when the deemed long term debt rate is to be used. In particular, the Report states at page 13 that:

"For new affiliated debt, the Board has determined that the allowed rate will be the lower of the contracted rate and the deemed long-term debt rate."

Further, the Report states at page 14 that:

"For all variable-rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate."

These are the only circumstances in which the deemed long term debt rate is to be used in calculating the long term debt cost of capital. In other words, the Board's deemed long term debt rate is only to be used for new affiliated debt (and only if the contracted rate is higher than the deemed long term debt rate) and for all variable rate debt and for affiliate debt that is callable on demand.

Energy Probe submits that none of these circumstances exist for the THI long term debt. This debt is not affiliate debt. It is not affiliate debt that is callable on demand. This debt does not have a variable rate. There is no actual debt. THI refers to this debt as "hypothetical long term debt" (Exhibit 6, Tab 1, Schedule 1, page 3, line 9).

As noted earlier, all of THI's long term debt is notional or deemed long term debt. Energy Probe submits that this deemed long term debt should not have the deemed long term debt rate applied to it. The Board agrees with this. In the EB-2008-0232 Decision and Order dated April 30, 2009 for Hydro One Remote Communities Inc. the Board responded to evidence that applied the deemed long term debt rate to the deemed long term debt. The Board stated at page 12 of the Decision and Order that:

"The Board find that it is not appropriate to apply the Board's deemed long-term debt rate to the notional or deemed long-term debt. The two are quite separate concepts. The deemed long-term debt rate is intended to apply in the absence of an appropriate market determined cost of debt, such as affiliate and variable rate debt situations. For companies with embedded debt, it is the cost of this embedded debt which should be applied to any additional notional (or deemed) debt that is required to balance the capital structure."

It is clear, in the view of Energy Probe, that the deemed long term debt rate should not be applied to the notional or deemed long term debt, as claimed by THI. Unlike the Hydro One Remotes situation, however, there is no average rate associated with the embedded cost of debt to apply to the notional or deemed long term debt.

The question then becomes what long term rate should be applied to this deemed long term debt. The Board could simply maintain the existing 6.10% rate that was approved by the Board in the past. However, as noted in the Board Report on the Cost of Capital, this approach is to be applied for embedded debt where the rate approved in prior Board decisions would be maintained for the life of each instrument, unless a new rate is negotiated, in which case it would be treated as new debt. Again, however, Energy Probe submits that there is no embedded debt, since there is no actual debt at all.

Energy Probe submits that the Board should set the long term debt rate for this deemed long term debt based on a proxy for what the embedded cost of debt for a distributor the size of THI could expect to pay had they obtained third party debt in the past. The Board has determined that the cost of long term debt for a number of other small distributors in

their 2009 rates proceedings. For example, the long term cost of debt for Niagara-on-the-Lake was determined to be 6.04% (EB-2008-0237), while that for Lakeland was found to be 5.16% (EB-2008-0234). Energy Probe also notes that as of May 22, 2009, the rate for a 40 year loan from Infrastructure Ontario to an electricity distributor is 5.76%.

In light of the above information, Energy Probe submits that the Board should retain the 6.10% used by THI in its original evidence, not because it is the embedded cost of debt, but because it is a reasonable proxy for the cost of that debt, had there been embedded debt.

COST ALLOCATION & RATE DESIGN

a) Revenue to Cost Ratios

It is not entirely clear what the revenue to cost ratios are to start with or what the ratios would be based on the THI proposals.

The original filing, for example, showed a revenue to cost ratio for the street lighting class in excess of 340%. As a result of a correction, this ratio has fallen to approximately 45% (Exhibit 10, Tab 3, Schedule 40, Attachment 1). It is believed that the revenue to cost ratios provided in this response for all rate classes are the effective starting points for the allocation of costs, including the appropriate treatment of transformation allowance revenues and costs as requested in Exhibit 10, Tab 2, Schedule 10. The proposed revenue to cost ratios appear to be shown in Appendix C.5 of the Argument-in-Chief. These two sets of figures are provided in the following table.

Customer Class	Ex. 10, Tab 3, Sch. 40	Argument-in-Chief	OEB Range
Residential	139.17	123.74	85 to 115
GS < 50	121.59	110.57	80 to 120
GS > 50 - 500	60.64	58.68	80 to 180
Street Lighting	45.81	317.37	70 to 120
USL	76.20	74.91	80 to 120
GS > 500 - 1,500	42.24	53.75	80 to 180
GS > 1,500	9.97	34.67	80 to 180

THI proposes to transition from its existing revenue to cost ratios to the OEB revenue to cost ranges over a two year period (Exhibit 9, Tab 1, Schedule 1). Energy Probe accepts that this two year phase in is required since most of the revenue to cost ratios are currently significantly outside of the OEB range.

Energy Probe has a number of concerns with the proposals as summarized in the above table. First, the street lighting ratio as proposed by THI appears to continue to use the incorrect data, giving rise to a proposed ratio of more than 300%. Second, the ratio for the USL class appears to decline (from 76.20 to 74.91) as proposed, rather than move towards the bottom of the range. Similarly, the GS > 50 – 500 kW class has a declining revenue to cost ratio. Finally, the ratio for the GS < 50 kW class is shown to be declining well before the upper end of the OEB range, while the residential ratio remains significantly above the upper end of the OEB range for this class.

Given the uncertainty surrounding the ratios shown in the above table, Energy Probe makes the following generic submissions with respect to the revenue to cost ratios. First, no revenue to cost ratios should be further away from the upper or lower bounds of the OEB range than they currently are.

As noted above, Energy Probe accepts the need for a two year phase in to get all the classes to the upper or lower limits of the OEB range. In 2009 Energy Probe submits that GS < 50 kW ratio should be moved to 120% and kept at that level in 2010. The USL class should be moved to 80% and kept at that level in 2010. The street lighting class should be moved 50% of the way required to get it to 70% in 2009 with the remaining movement to 70% accomplished in 2010. The residential rate class should be lowered from the existing ratio to 123.74% as proposed in the Argument-in-Chief in 2009. The remaining three general service class ratios should be increased by the amounts necessary to ensure the net changes to all of the ratios is neutral to the distributor. Energy Probe makes no submissions as whether the general service classes (other than GS < 50) should be adjusted proportionately or by some other manner.

In 2010, the residential class ratio would be reduced to 115%, with the revenue needed to achieve this based on further increases in the three large general service classes.

b) Rate Class Changes

Energy Probe notes that THI proposes to partition the General Service 500 – 4,999 kW class into two classes – General Service 500 - 1,499 kW and General Service > 1,500 kW. THI is also proposing to merge the Sentinel Lighting class with the Unmetered Scattered Load customer class. Energy Probe does not oppose these changes, but notes that Board is currently reviewing customer classes in a generic proceeding. It may, therefore, be premature for THI to make the changes it is proposing, not knowing if there may be additional changes in the near future.

COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Recognizing the size of THI, 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

May 27, 2009

Randy Aiken

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