



***PUBLIC INTEREST ADVOCACY CENTRE
LE CENTRE POUR LA DEFENSE DE L'INTERET PUBLIC***

ONE Nicholas Street, Suite 1204, Ottawa, Ontario, Canada K1N 7B7

Tel: (613) 562-4002. Fax: (613) 562-0007. e-mail: piac@piac.ca. <http://www.piac.ca>

Michael Buonaguro
(416) 767-1666

June 29, 2009

VIA MAIL and E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)
EB-2008-0235
London Hydro Inc. – 2009 Electricity Distribution Rate Application**

Please find enclosed the submissions of VECC in the above noted proceeding.

Yours truly,

Michael Buonaguro
Encl.

ONTARIO ENERGY BOARD

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

**AND IN THE MATTER OF an Application by London
Hydro Inc. pursuant to section 78 the *Ontario Energy
Board Act* for an Order or Orders approving just and
reasonable rates for the delivery and distribution of
electricity.**

FINAL SUBMISSIONS

On Behalf of The

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

June 29, 2009

Michael Buonaguro

Public Interest Advocacy Centre

34 King Street East

Suite 1102

Toronto, Ontario

M5C 2X8

Tel: 416-767-1666

E-mail: mbuonaguro@piac.ca

Vulnerable Energy Consumers' Coalition (VECC) Final Argument

1 The Application

1.1 London Hydro Inc. ("London Hydro" or "London") filed its Application for just and reasonable rates to be effective on May 1, 2009. The original Application requested¹ the following relief:

- Approval to charge rates effective May 1, 2009 to recover a revenue requirement of \$64,108,653 which includes a revenue deficiency of \$7,943,577². In the event that the Board is not able to issue a final Rate Order for implementation September 1, 2009, the Board provide for the recovery of incremental revenues for the period of September 1, 2009 to the effective date of the final Rate Order;
- Approval of London Hydro's proposed change in capital structure, decreasing the London Hydro's deemed common equity component from 42.5% to 40.0% and increasing the deemed debt component from 57.5% to 60.0%³, consistent with the Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors dated December 20, 2006 (referred to in this Application as the "Cost of Capital Report");
- Approval to adjust the Retail Transmission Rates – Network and Connection⁴;
- Approval to charge a Smart Meter Rate Rider of \$1.00⁵;
- Approval of the proposed loss factor as set out in Exhibit 4, Page 76, Table 35 (London Hydro notes that the calculation in that table was

¹ Exhibit 1, pages 27-29

² Exhibit 7, page 5

³ Exhibit 6, Table 1, page 2

⁴ Exhibit 9, pages 10-14

⁵ Exhibit 9, page 14

corrected in response to Board Staff IR # 38, but the correction did not affect London Hydro's revenue requirement or the loss factors used in Exhibit 9, as those values were correct. The loss factors in Exhibit 9 page 22 are the same loss factors shown in the table accompanying paragraph 57 of London's Argument in Chief);

- Approval to continue the Specific Service Charges and Transformer Allowance approved in the Board's Decision and Order in the matter of London Hydro's 2008 distribution rates [EB-2007-0844], subject to the change in the manner of applying the transformer allowance for the Large Use customer class⁶; and
- Approval to dispose of the following Deferral and Variance Account Balances using the method of recovery described in Exhibit 5, pages 5/6:
 - 1508 Other Regulatory Assets - Sub-account OEB Cost Assessments
 - 1508 Other Regulatory Assets - Sub-account Pension Contributions
 - 1525 Miscellaneous Deferred Debits
 - 1580 Retail Settlement Variances – Wholesale Market Service Charge.

1.2 London Hydro's Argument in Chief (AIC) makes amendments to the 2009 Distribution Revenue Requirement and deficiency and also proposes a new date of September 1, 2009 as the effective date for new rates.

⁶ Exhibit 9, page 8

Summary of Proposed 2009 Revenue Requirement and Deficiency

Exhibit 1 - Table 4 - Calculation of 2009 Revenue Deficiency
REVISED FOR IR ADJUSTMENTS

	2009 Test at Proposed Rates	Adjustments	Adjusted Application
Revenue			
Revenue deficiency	7,943,577	(268,700)	7,674,877
Distribution Revenue - at existing 2008 rates	52,457,928	68,525	52,526,453
Base revenue requirement	60,401,505	(200,175)	60,201,330
Other Operating Revenue Offsets - net	3,707,148	(13,048)	3,694,100
Total Revenue	64,108,653	(213,223)	63,895,430
Distribution Costs			
Operation, Maintenance and Administration	28,219,400	(17,637)	28,201,763
Depreciation and Amortization	15,919,000		15,919,000
Capital Taxes	472,785	(6)	472,779
Deemed Interest	7,966,783	625,591	8,592,374
Total Costs and Expenses	52,577,969	607,948	53,185,917
Utility Income Before Income Taxes	11,530,685	(821,171)	10,709,514
Tax Adjustments to Accounting Income per 2009 PILs	208,840		208,840
ATT C tax credit adjustment		53,000	53,000
Capital cost allowance adjustments		12,097	12,097
Taxable Income	11,739,524	(756,074)	10,983,450
Income Tax Rate	33.00%	33.00%	33.00%
Income Tax On Taxable Income	3,874,043	(249,504)	3,624,539
Income Tax Credits	58,000	70,000	128,000
Utility Net Income (Loss)	\$ 7,714,642	\$ (501,667)	\$ 7,212,975
Rate Base	\$ 225,126,695	\$ (2,646)	\$ 225,124,049
Equity	40.00%		40.00%
Equity Component Rate Base	\$ 90,050,678		\$ 90,049,620
Allowed return on rate base	8.57%		8.01%
Return - Equity on Rate Base	\$ 7,714,642	\$ (501,667)	\$ 7,212,975

1.3 In its AIC, London Hydro proposed a reduction to its revenue requirement, to \$60,201,330, reflecting largely adjustments to rate base, operating expenses, PILs and Cost of Capital.⁷

1.4 VECC believes that the revised 2009 revenue requirement and associated deficiency is overstated and we also have concerns with cost allocation and rate design. The following sections contain VECC's final submissions regarding

⁷ AIC, pp. 21-22, para. 52

London's Application.

2 Rate Base -Capital Spending and Working Capital Allowance

2.1 London Hydro's proposed rate base for the 2009 Test Year as filed was \$225,126,695⁸. The rate base has been reduced by \$2,646 as a result of minor adjustments to distribution expenses made through the interrogatory process, for a revised 2009 Test Year rate base of \$225,124,049⁹.

Capital Spending

2.2 With respect to its proposed capital spending for the 2009 Test Year, London Hydro submits that its proposed capital spending is fully explained and supported by a comprehensive Asset Management Plan¹⁰.

Distribution Plant and General Plant Projects

2.3 The total estimated 2009 program cost is \$23,728,000. This is comprised of \$11,300,000 for Infrastructure-related projects, \$7,783,000 for City and Developer works, \$1,482,000 for the metering program, and \$3,163,000 for fleet and facility projects¹¹.

2.4 The total estimated net 2008 program cost is \$23,407,000. This is comprised of \$13,100,000 for Infrastructure-related projects, \$5,762,000 for City and Developer works, \$1,402,000 for the metering program, and \$3,143,000 for fleet and facility projects¹².

2.5 VECC has not examined London Hydro's overall 2009 Capital spending in detail, but has taken an overall "CAPEX envelope" approach. Based on this, the overall level of Capital expenditure for infrastructure projects seems reasonable, with the

⁸ Exhibit 2, pages 1-2

⁹ AIC, page 24

¹⁰ Appendix A, Exhibit 2, page 104

¹¹ Exhibit 2, page 57

¹² Exhibit 2, page 81

exception of “softness” in the 2009 City and Developer Works category of capital plans.

- 2.6 In response to Board Staff IR #2, London Hydro explained that the increase for this category of project in 2009 is largely due to project 9E1 – Expansion and Relocation. This project consists of a 27.6 kV line extension to service new industrial development in London’s “Innovation Park”. The 27.6 kV line extensions represent expenditures of \$2.3 million, out of the \$2.8 million budget for the overall project
- 2.7 The timing for this type of project is affected by the economic situation and in VECC’s view, London Hydro has not adequately supported why the proposed level of expenditure is appropriate. VECC had expected that projects under the government economic stimulus package may have been identified. However there is no evidence of this and a more reasonable explanation is that the increase in this category of expenditure from \$5,762,000 in 2008 to \$7,783,000 in 2009 is optimistic and subject to cancellation of capital plans by third parties out of control of the utility. VECC also notes that this projected “expansion” to serve new industrial load is inconsistent with London’s customer forecast¹³ for the GS>50 class where the number of customers for 2008 and 2009 is held constant at the 2007 level.
- 2.8 For these reasons, in the absences of more support for the proposed increase in City and Developer spending, the Board should reduce the approved level of 2009 CAPEX for this component by \$2 million to historic/2008 levels. This will result in a reduction of about \$70,000 in the DRR (before tax).

IT Capital Projects

- 2.9 VECC notes that the 2009 IT Hardware and Software projects largely carry

¹³ Exhibit 3, pages 15-17

forward from 2008 and as such VECC has no specific submissions.

Working Capital Allowance

- 2.10 London Hydro's as filed working capital allowance was forecast to be \$44,216,959 for the 2009 Test Year. With a reduction of \$17,637 in distribution expenses (administrative and general expenses) through the interrogatory process, the working capital allowance has been reduced by \$2,646, to a revised total of \$44,214,313¹⁴.
- 2.11 The revised proposed 2009 working capital allowance has increased by \$3,772,696 or 9.3% over the 2008 Bridge Year as a result of higher OM&A costs. The revised change between the 2006 Board Approved Year and the 2009 Test Year is \$7,010,985 or 18.9%.
- 2.12 VECC notes that the Working Capital Allowance will need adjustment if the Board accepts submissions by VECC and Others that affect 2009 operating costs.
- 2.13 VECC also submits that London Hydro is sufficiently large to require a specific lead/lag study prior to the next rebasing, using similar methodology to the Navigant Study for Hydro One Networks. VECC notes that for those distributors who have undertaken a lead/lag study the resulting working capital allowance can be reduced by several percentage points (from the standard 15%).
- 2.14 Based on London Hydro's proposed return on rate base of 7.02%¹⁵, the working capital allowance increases the annual revenue requirement by over \$3 M (even before any allowance for taxes). This means that each percentage point of the 15% working capital allowance increases the annual revenue requirement by more than \$200,000. VECC submits that this impact is sufficient to warrant the undertaking of a lead/lag study, particularly when the results will impact the rates for the entire IRM period following rebasing.

¹⁴ AIC, page 24

¹⁵ AIC, page 24

3 Operating Revenue - Load Forecast and Revenue Offsets

3.1 In its Application, London Hydro had calculated total operating revenue, net of transformer allowances, of \$64,108,653. This was based on a base revenue requirement of \$60,401,505 and net revenue offsets of \$3,707,148. With adjustments through the interrogatory process, the revised total operating revenue, net of transformer allowances, is \$63,895,430, a reduction of \$213,223. This is based on a base revenue requirement of \$60,201,330 (reduced by \$200,175) and net revenue offsets of \$3,694,100 (reduced by \$13,048).

Load Forecast Methodology

3.2 London's load forecast methodology consists¹⁶ of four steps:

- First, a weather normalized forecast of monthly system purchases is developed based on a multifactor regression analysis that includes weather, economic output and seasonal calendar variables as independent explanatory variables. The regression equation was developed using monthly data for the period 1996-2007¹⁷. The economic forecast used is that provided by the Ontario Ministry of Finance in November 2008¹⁸.
- Second, the forecast is adjusted for losses to produce a weather-normalized billed energy forecast¹⁹. Average weather conditions over the period 1996-2007 are used to determine the weather normalized forecast²⁰.
- Third, the forecast customer count by class is established. In most cases this was done using the geometric mean growth rate over the period 1996-2007²¹. However, for the GS>50 class, the 2007 customer count was held constant for

¹⁶ Exhibit 3, page 10

¹⁷ Exhibit 3, page 10

¹⁸ Exhibit 3, page 12

¹⁹ Exhibit 3, page 14

²⁰ Exhibit 3, page 13

²¹ Exhibit 3, page 16

2008 and 2009.

- Finally, based on customer count forecasts and trends in non-weather normalized per customer use, forecasts of total (non-weather normalized) use are developed for each customer class. These forecasts are then adjusted (based on the relative weather sensitivity of each class) so that the sum of individual customer class forecasts equals the total billed kWh forecast developed in Steps #1 and #2.

3.3 In responding to VECC interrogatory #15, it came to London's attention incorrect percentages had been used in specifying the relative weather sensitivity of the various customer classes. Use of the revised values resulted in a shift in the 2009 kWh attributed to each class but did not alter the forecast of total kWh purchased/billed.

3.4 VECC has issues regarding both Step #1 and Step #4 of London's load forecast methodology. With respect to Step #1, VECC's main issue is that the regression equation for forecasting total purchased kWh does not include number of customers (either in total or by class) as an explanatory variable. VECC notes that London rejected specification of the regression model that included customer count as an explanatory variable on the basis that the variable was not statistically significant and the R^2 value did not improve²². However, as discussed further below, no linkage between the number of customers in the different classes and total sales can lead to anomalous results.

3.5 VECC has a number of concerns regarding the fourth step of London's methodology. This step relies heavily on a customer count forecast that is not tied to the overall purchased/billed kWh load forecast, as discussed above. As a result, changing the forecast customer count for one customer class will impact the total sales forecast for the other (weather sensitive) customer classes. Such impacts do not make sense intuitively.

²² VECC #13 a)

- 3.6 Similarly, as seen in responses to VECC #15 and London's load forecast revision²³, changes in the assumptions regarding the weather sensitivity of one customer class will alter the forecast values for the other weather sensitive classes. Again, such impacts do not make intuitive sense.
- 3.7 In Step #4, VECC also has concerns regarding London's process for determining and adjusting what it deems to be a "non-weather normalized" forecast so that it reconciles with the forecasted weather normalized use²⁴. London's forecast of non-weather normalized use in each customer class is calculated based on i) the projected customer count as discussed above and ii) a projected average use per customer which, in turn, is calculated by escalating the actual 2007 per customer use by the average growth rate in the class' per customer use over the 1996-2007 period²⁵.
- 3.8 The problem with the second part of this approach is that by using the geometric mean the growth rate calculated only really reflects weather conditions in 1996 and 2007 and, therefore, is not reflective of year over year weather changes through out the entire period and does not reflect average weather conditions as London suggests²⁶.
- 3.9 Finally, with respect to Step #4, VECC has concerns regarding the adjustment process London uses to reconcile its non-weather normal forecast by class with its projection of total weather-normalized loads. London's assumes that the Residential and GS<50 classes are 100% weather sensitive²⁷. However, in VECC's view, London has not adequately substantiated that Residential and GS<50 customers' loads are 100% weather sensitive²⁸. Indeed, VECC submits that it is intuitively obvious that they are not²⁹.

²³ London Argument in Chief, pages 10-11

²⁴ Exhibit 3, pages 17-20

²⁵ Exhibit 3/Tab 2/Schedule 1, page 13-14 - for all classes except Street Lights

²⁶ VECC #15 b)

²⁷ Exhibit 3, page 20 and VECC #15 c)

²⁸ VECC #15 c)

²⁹ Both the Residential and GS<50 classes have lighting loads which are not

2009 Load Forecast

3.10 Methodological issues notwithstanding, in order to check the overall reasonableness of London's projections for the weather sensitive customer classes, the following table compares London's projected 2009 per customer use with the historical average use³⁰ and the 2004 weather normal use calculated by Hydro One Networks for the Utility's cost allocation filing.

Comparison of Per Customer Use Values (kWh)

	<u>Average 1999-2008</u>	<u>Average 2004-2008</u>	<u>HON NAC</u>	<u>London's 2009 Forecast</u>	
				<u>As Filed</u>	<u>As Revised</u>
Residential	8,898	8,799	8,872	8,222	8,272
GS<50	34,278	35,085	35,227	33,978	34,186
GS 50-4999	928,994	985,336	980,838	1,037,408	1,035,139
Large Users	65,940,881	71,195,523	73,959,600	68,382,293	66,828,460
Cogen	8,906,633	11,905,407	6,334,579	12,475,191	12,163,164

Sources: 1) Data for 1999-2008 taken from LPMA #14
2) HON NAC - from LPMA #18
3) London's Filed Forecast - Exhibit 3, page 23
4) London's Revised Forecast - VECC #15 d)

3.11 London's proposed 2009 average per customer use values for Residential and GS<50 customers are less than the comparators. In the case of Residential the revised forecast value is 7% less than the recent 5-year average and the HON value. While this is a material difference, at least part of it is likely explained by the conservation programs recently implemented³¹. In the case of GS<50, the variance between the 2009 forecast value and the recent 5-year average is less than 1%.

weather sensitive.

³⁰ Based on the response to VECC #12 b) the average purchases over the 2000-2007 period varied by the weather normal predicted purchases by less than 1%. This suggests that the average use over the period is a reasonable estimate of weather normal use.

³¹ Energy Probe #3 a)

3.12 For the GS 50-4999 class the projected 2009 value is greater than 5-year recent average and the HON weather normalized value by over 5%. For the Large Use class the projected value falls in the range of the comparators and varies from the recent 5-year average by less than 2%. Historically, the average use for cogeneration customers has varied significantly³². VECC notes that the projected 2009 value is reasonably similar to the 2007 actual value which, according to London³³, reflected conditions similar to those for 2009.

3.13 Overall, while there is some question regarding the forecasts for Residential and GS 50-4999, VECC submits that the 2009 forecasted load by customer class should be accepted by the Board for purposes of setting 2009 rates. However, VECC notes that this acceptance of the values for purposes of setting 2009 rates should not be viewed as an acceptance of London's load forecast methodology. In this regard, VECC submits that, similar to the OEB direction given in the Toronto Hydro case³⁴, London should be directed to work with other distributors to develop a more comprehensive and integrated approach to load forecasting.

Miscellaneous Revenues

3.14 Originally London Hydro forecast miscellaneous net revenue offsets of \$3,707,148. As a result of the IR process the revised forecast is \$3,694,100 (reduced by \$13,048). The basis for the adjustments to the revenue offsets is discussed on pages 13/14 of the AIC and revised Exhibit 3 Table 22. VECC has no submissions on the revised forecast.

4 Operating Costs- OM&A and Total Compensation Costs

4.1 In its Application, London Hydro proposed recovery through distribution rates of 2009 Test Year total Operating costs, including amortization and PILs, totaling

³² Exhibit 3, page 17

³³ Exhibit 3, page 22

³⁴ OEB Decision, EB-20070-0680, pages 32-33

\$48,427,228³⁵. Exhibit 4, Table 1, page 2 provides a summary of London Hydro's total operating costs for the 2006 Board Approved, 2006 Actual, 2007 Actual, 2008 Bridge Year and the proposed 2009 Test Year.

- 4.2 The proposed 2009 Test Year value for total distribution expenses before PILs of \$44,138,400 included cost increases of \$1,802,933 or 4.3% over the 2008 Bridge Year³⁶. The variance between the 2007 Actual results and the 2008 Bridge Year is \$2,873,366 or 7.3%. Total variances from the 2006 Board Approved Year and the 2006 Actual results to the 2008 Bridge Year are \$8,655,700 (25.7%) and \$3,734,867 (9.7%) respectively.

OM&A Costs

- 4.3 As shown in Exhibit 4 Table 1, Page 2, the total OM&A costs for the proposed 2009 Test Year are \$28,169,400, an increase of \$1,898,933 or 7.2% over the 2008 Bridge Year.
- 4.4 In its AIC, London Hydro reduced its Total 2009 OM&A by a net \$17,637. This results in an updated total of \$ 28,151,763. London Hydro reduced its provision for regulatory costs associated with this application, due to the elimination of a technical conference and oral hearing being replaced by a second round of interrogatories and fully written process.
- 4.5 VECC notes that intervenors have two main options to address their concerns about the level of and increases in, OM&A costs – either an overall envelope approach or a line by line comparison to historic years. In this case VECC will take an overall envelope approach, with the exception of the increases in total compensation costs that are one of the primary drivers for 2009 OM&A costs.
- 4.6 With regard to the level of and overall increase in OM&A, VECC refers the Board

³⁵ Exhibit 4, Table 1, Page 2, and Exhibit 4, Table 4, Page 4

³⁶ Exhibit 4, page 1

to the response VECC IR#3³⁷. This compares London Hydro to a sample of 4 other utilities offered by London Hydro. Over a period of 5 years London's OM&A per customer has gone from below average to higher than average. More importantly, if the Board approves the requested level of OM&A for 2009 (\$28,169,400) the average OM&A cost per customer will increase by 5.5 % from 2008-2009.

- 4.7 The analysis of OM&A per MWH indicates that London Hydro also has the highest cost per MWH. This result is consistent with the analysis that indicates that London Hydro also has the lowest consumption per customer of the cohort group.
- 4.8 This comparison does not paint a picture of a utility exercising constraint in the current difficult economic times. Rather it shows a utility continuing to spend money without regard to the difficulties facing its customers.
- 4.9 What remedy is appropriate? VECC suggests that the Board should apply an overall constraint of a 3.5% OM&A increase based, in part, on the increase in the unionized staff collective agreement.(see below for discussion of Compensation-related OM&A)

Total Compensation

- 4.10 Total Compensation (Labour and benefits) cost is the most significant component of OM&A expense and in the proposed 2009 Test Year budget is 68.9% of total OM&A expense.
- 4.11 Total Compensation OM&A expense has increased from \$ 18,274,050 in 2008 to \$19,393,700 in 2009 (\$1,119,650) or 6.1% over the 2008 Bridge Year³⁸. The drivers for this are discussed at Exhibit 4, pages 1--11 and summarized in Table 11. London states that base labour cost has increased by \$3,957,002 from the 2006 Board approved Year to the proposed 2009 Test Year. The majority of the

³⁷ Response To VECC IR#3 shows OM&A metrics for London Hydro and 4 comparator utilities

³⁸ Exhibit 4, page 9

cost increase is attributed to:

- 1) Cumulative wage increases;
- 2) Succession planning; and
- 3) Corporate reorganization and industry changes.

This accounts for 86% or \$3,404,400 of the total change in base labour

4.12 VECC submits that many corporations (even including the major banks) but in particular manufacturing industries faced with a no growth situation have imposed hiring constraints. London Hydro can and should be expected to act in a similar fashion by using salary associated with normal turnover/vacancies to bring on new trainees and maintain overall head count at or close to 2008 levels.

4.13 The remedy that VECC recommends that the Board should apply is the same as recommended above - to constrain overall 2009 OM&A to an increase of 3.5% above 2008 levels. VECC computes this to be \$18,913,641- a reduction of \$480,059.

Shared Services Costs

4.14 The table provided in response to VECC IR #5³⁹ shows a breakdown of the services provided to the City of London for each of the years 2006-2008 and the forecast for 2009. The total recovery for each year is prorated to various OEB accounts.

4.15 VECC has four major concerns with the provision of shared services (primarily water services) to the City of London:

- The base service costs are increased at only \$25,000 per year. which is less than 1%, even though London Hydro's OM&A costs are increasing at over 5% a year:

³⁹ Response to VECC IR#5: pages 61-62 Exhibit 4: Response to CCC IR#15

- There is no ARC-compliant Cost Allocation methodology for determining the appropriate allocation of costs to the water service, including return on capital deployed;
- London is undertaking major IT Capital upgrades, but there is no evidence that any of these costs will be allocated to the water services; and
- Movement of Staff providing water services has resulted in stranded occupancy costs of ~\$200,000/yr which must be picked up by London Hydro customers.

4.16 VECC urges the Board to:

- a) require an independent review of the methodology, service level agreement(s) and costing of affiliate services (primarily but not limited to, water services); and also
- b) make an (arbitrary) 5% adjustment to the amount of revenue for the fee for service for 2009. This would result in an additional \$125,000 in cost recovery/revenue in 2009 (\$25,000 increase is already included).

Cost Recoveries

4.17 London Hydro provided a detailed break-out of cost recovery components in the response to Board Staff IR # 32. VECC agrees with Board Staff⁴⁰ that, at least directionally and all other things being equal, the level of Cost Recovery should correspond (increase) with at least the rate of inflation. This would result in an increase of \$220,000 to the Cost Recovery budget estimate for 2009.

PILs and Taxes

⁴⁰ Board Staff Submission Page 11

4.18 VECC relies Board Staff and Mr. Aiken on behalf of LPMA, to examine and exercise due diligence in regard to the methodology and calculations for 2009 PILs.

4.19 With regard to the proposed tax treatment of the new CIS, VECC adopts the submissions of Board Staff regarding the approach that is appropriate under IRM.⁴¹

5 Losses

5.1 London Hydro confirmed⁴² that there was a formula error in the presentation of information in Tables 35 and 36 at Exhibit 4, pages 76 and 77. The error was restricted to the information presented on these two tables and did not affect the calculation of the loss factors as presented in Exhibit 9, page 22 of the Application as filed.

5.2 Exhibit 4, table 35, page 76 indicated a Total Loss Factor of 3.68% which was corrected in response to Board Staff IR # 38 to 4.11%. This corrected amount did not affect the calculation of the revenue requirement or the impact analysis by customer class.

5.3 VECC has no further submissions on this issue.

6 Deferral and Variance Accounts

6.1 In its Application, London Hydro proposed to dispose of the balances in the following four Deferral and Variance Accounts:

- Account 1580 – Retail Settlement Variance Account – Wholesale Market Service Charges

⁴¹ Board Staff Submission Page 14

⁴² Board Staff #38

- Account 1508 – Other Regulatory Assets – Sub-account OEB Cost Assessments
- Account 1508 – Other Regulatory Assets – Sub-account Pension Contributions
- Account 1525 – Miscellaneous Deferred Debits

6.2 The deferral and variance account rate riders have been adjusted to reflect the revised load forecast amounts pursuant to VECC IR #15(d), and the assumption has been made that final rate riders will be based on the projected account balances in the application as at August 31, 2009.

6.3 VECC relies on Board Staff to review the rate rider calculations and has no further submissions on this issue.

7 Cost of Debt

7.1 On February 24, 2009 the Board issued its revised Cost of Capital Parameters for 2009 Cost of Service Rate Applications. The new parameters established an allowed long-term debt rate of 7.62%; a short-term debt rate of 1.33%; and a return on equity of 8.01%.

7.2 London Hydro has long term affiliate debt in the amount of \$70 million. According to London Hydro that debt is callable on demand, and would attract the Board's deemed rate of 7.62%⁴³. London Hydro is requesting a rate of only 6.0% on the \$70 million note.

7.3 However London Hydro is seeking to recover 7.62% on the portion of deemed long term that is classified as Unfunded Debt. London Hydro argues that this is consistent with the Decisions of the Board for other 2009 rebasing applicants that only have affiliate debt that is callable on demand.

7.4 VECC disagrees. In EB-2008-0232 regarding the cost of Capital for Hydro One

⁴³ AIC, page 20

Networks Remotes the Board found the following

“The Board finds 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. Remote’s cost of capital will be adjusted to use its weighted average cost of embedded debt (5.60%) for purposes of determining the cost to be applied to the notional or deemed long-term debt. This is consistent with the treatment given to other LDCs that have undergone rebasing in 2008 and 2009. The table below sets out the Board’s conclusions for Remote’s capital structure and cost of capital.”

- 7.5 In this case, VECC maintains that London Hydro’s true cost of Embedded Debt is the coupon rate for the City of London Promissory Note which is 6.00 %. Furthermore, since the debt is not callable within one year⁴⁴, it is VECC’s view that the Board’s policy of using its deemed debt rate for affiliate debt that is callable on demand does not apply in London Hydro’s case.
- 7.6 VECC also notes that the circumstances associated with the COLLUS and Innisfil Applications are materially different than those for London Hydro. In the case of COLLUS, the existing promissory note with the Town is callable with no notice⁴⁵. In the case of Innisfil, the rate used for the note payable to its affiliate was 3.35%⁴⁶ (i.e., the Board’s deemed rate was not used). In both Decisions the Board determined that the deemed rate should be used for new debt issued to (non-affiliated) third parties, but this is not London’s circumstance.
- 7.7 Board Staff agree that the proposed treatment of unfunded or notional long-term debt, set out in the response to LPMA IR #30, is inconsistent with the Board’s

⁴⁴ Exhibit 6, page 3

⁴⁵ EB-2008-0226, Staff IR# 2.1 a)

⁴⁶ Board Decision, EB-2008-0233, page 23

policy and practice for electricity rate-setting as articulated in the recent Hydro One Remote Communities decision, and should not be approved⁴⁷.

7.8 VECCs position is that the embedded rate for the affiliated debt (6.00%) should apply to the deemed unfunded debt of \$56,060,949.

7.9 Accordingly, VECC requests the Board to adjust London Hydro's 2009 weighted average cost of debt to 6.62% in accordance with VECC IRR #37b):

Table provided in response to supplementary IR VECG 37 b)

- Column "A" is application as filed.
- Column "B" is as proposed by London Hydro.
- Column "C" is column B with affiliated debt rate applied to unfunded long term debt

	COLUMN "A"		COLUMN "B"		COLUMN "C"	
	2009 Test Year		2009 Test Year		2009 Test Year	
	Amount	%	Amount	%	Amount	%
Total rate base	\$ 225,126,696		\$ 225,126,696		\$ 225,126,696	
Long term debt	\$ 126,070,949	56.0%	\$ 126,070,949	56.0%	\$ 126,070,949	56.0%
Short term debt	9,006,068	4.0%	9,006,068	4.0%	9,006,068	4.0%
Common equity	90,050,678	40.0%	90,050,678	40.0%	90,050,678	40.0%
	\$ 225,126,696		\$ 225,126,696		\$ 225,126,696	
Long term debt						
Affiliate	\$ 70,000,000		\$ 70,000,000		\$ 70,000,000	
Unfunded	56,070,949		56,070,949		56,070,949	
	\$ 126,070,949		\$ 126,070,949		\$ 126,070,949	
Interest on Long-term debt		Rate		Rate		Rate
Affiliate debt	\$ 4,200,000	6.00%	\$ 4,200,000	6.00%	\$ 4,200,000	6.00%
Unfunded long term	3,364,257	6.00%	4,272,606	7.62%	3,364,257	6.00%
Interest on short term debt	402,527	4.47%	119,767	1.33%	119,767	1.33%
Return in Equity		Rate		Rate		Rate
Return on common equity	7,717,343	8.57%	7,213,069	8.01%	7,213,069	8.01%
Return on rate base	\$ 15,684,127	6.97%	\$ 15,806,433	7.02%	\$ 14,887,084	6.62%

⁴⁷ Board Staff Submission Page 26

7.10 This adjustment reduces the 2009 DRR by \$909,349 (before tax) compared to London Hydro's revised cost of debt.

8 Cost Allocation

Results of London's Cost Allocation Informational Filing

8.1 6.1 In March 2007 London submitted its Cost Allocation Informational Filing to the Board based on its approved 2006 distribution rates⁴⁸. The revenue to cost ratios are summarized as follows⁴⁹:

- Residential 109.2%
- GS<50 126.8%
- GS 50-4999 76.2%
- Cogeneration 247.1%
- Standby Power 2.3%
- Large Use 80.9%
- Sentinel Lights 14.4%
- Street Lighting 16.9%
- USL 56.9%

8.2 However, for purposes of the 2009 filing Standby Revenues were treated as Miscellaneous Revenues. The results were therefore revised for purposes of the 2009 Rate Application as set out below:

- Residential 108.6%
- GS<50 126.3%
- GS 50-4999 75.9%
- Cogen 247.0%
- Standby Power 84.8%
- Large Use 80.8%
- Sentinel Lights 14.2%
- Street Lighting 16.7%
- USL 56.6%

⁴⁸ Board Staff #43 a)

⁴⁹ Exhibit 8/Tab 1/Schedule 2, Page 3

Use of the Cost Allocation Results in Setting 2009 Rates

- 8.3 London has used⁵⁰ the revenue to cost ratios for each customer class and 2009 revenues at current (2008) rates to determine the 2009 distribution revenue adjustment required for each class in order to achieve a 1% change in the class' revenue to cost ratio. In principle, VECC supports this approach. To the extent that the relative loads and customer counts have changed by customer class⁵¹ as between the Cost Allocation filing and 2006, both the relative revenues and cost responsibilities of the different classes will change. However, as no efforts have been made to realign the revenue to cost ratios in 2007 or 2008, there is no reason to assume that the current revenue to cost ratio for each class (based on current loads and 2008 rates) would be any different than those arising from the original cost allocation informational filing.
- 8.4 However, VECC has a couple of concerns regarding the application of the approach. First, the Revenue to Cost ratios determined by the Cost Allocation Informational filing for each class are based on comparing each class' distribution revenues at approved rates plus an allocation of miscellaneous revenues to the class' share of the total Distribution Service Revenue Requirement. In contrast, London has used the same ratios in conjunction with distribution revenues at approved rates to determine each class' appropriate share of the Base Revenue Requirement which excludes miscellaneous revenues⁵².
- 8.5 Correcting for this difference could result in small shifts in the allocated revenue requirement to each class. In VECC's view, as long as the adjustments in the revenue to cost ratios are designed to move each class' results so as to be within the Board's recommended ranges there is no need to refine the calculation. However, VECC submits that should the decision be made to target revenue to cost ratios closer to 100%, then the calculation would have to be refined.

⁵⁰ Exhibit 8, page 6

⁵¹ VECC #24 a)

⁵² Exhibit 8, page 6

- 8.6 Second, the treatment of the transformer allowance in the current OEB Cost Allocation model⁵³ results in an over allocation of costs to those classes where customers generally do not own their own transformers (e.g. Residential and GS<50). This circumstance arises because the model not only allocates these classes the full cost of the transformers used to serve them but also a share of the discount. In principle the discount is an intra-class issue for those classes where some customers own their transformer and other don't. The Cost Allocation model recognizes that some customers own their transformers and allocates the associated cost to each class based on the proportion of customers/load using distributor owned transformation facilities. However, unless a discount is introduced for those customers that own their transformer (and paid for by the other customers in the same class) those who own their transformer will pay too much and those who don't will not bear full cost responsibility for the transformers they do use.
- 8.7 To properly address this issue, the cost of the transformer ownership allowance should be removed from the Cost Allocation model as should the "revenues" associated with the discount. The "cost" of the transformer allowance discount associated with each class would then be included in the derivation of the variable rate for that class as part of the rate design. VECC notes that this change in the treatment of the transformer allowance was approved for a number of distributors' 2008 rates⁵⁴ and has been consistently adopted by the Board in its 2009 rate decisions.
- 8.8 In response to various interrogatories⁵⁵, London asserts that this revised treatment of the transformer allowance is incorrect. In response to Board Staff #114, London claims the current Cost Allocation results which use the Large User revenues

⁵³ It should be noted that the treatment of the transformer allowance in the Cost Allocation model was not considered by the OEB's Cost Allocation Working Group and was not addressed in the Board's Cost Allocation Review report (RP-2005-0317). Rather, it was incorporated after the fact.

⁵⁴ For example, Horizon Utilities, Hydro Ottawa and Enersource Mississauga.

⁵⁵ Board Staff #114 b)

(prior to any reduction for transformer ownership) and Large User costs (which include no allocation of either utility transformer costs or the transformer ownership) to determine the class' revenue to cost ratio is appropriate. However, the revenues actually received by London from the Large User class are net of the transformer allowance and it is these lower revenues which contribute to covering the costs actually incurred by the utility to service Large Users. The current Cost Allocation does not reflect the real revenues received from the Large Use class to cover the utility's real costs. VECC also notes that the revised treatment of the transformer ownership allowance is consistent with London's proposal not to provide the Large User class with the transformer discount in 2009⁵⁶, as the reported revenues for the class will be net of the allowance.

8.9 In response to VECC #42 a), London has provided a revised version of its Cost Allocation Informational filing that reflects this revised treatment of the transformer ownership allowance. VECC submits that these results more closely represent the appropriate reference point to use. The following table summarizes the resulting revenue to cost ratios.

**London's Current Revenue to Cost Ratios
(With Removal of Transformer Ownership Allowance)**

Residential	110.65%
GS<50	129.17%
GS 50-4999	71.23%
Cogen	239.73%
Standby	79.85%
Large User	61.99%
Sentinel Lights	14.68%
Street Lighting	17.26%
USL	58.25%

Source: VECC #42 a)

⁵⁶ Exhibit 9, page 8

Proposed Revenue to Cost Ratios

8.10 The following Table compares London's proposal for 2009 with the current revenue to cost ratios as calculated by the Cost Allocation update and as corrected for the transformer ownership allowance treatment.

London's Proposed Revenue to Cost Ratios

	<u>London R/C Ratio</u>	<u>VECC #42 a)</u>	<u>2009 Proposal</u>
Residential	108.6%	110.7%	107.0%
GS<50	126.3%	129.2%	120.0%
GS 50-4999	75.9%	71.2%	80.0%
Cogen	247.0%	239.7%	213.5%
Standby	84.8%	79.9%	84.8%
Large User	80.8%	62.0%	85.0%
Sentinel Lights	14.2%	14.7%	42.1%
Street Lighting	16.7%	17.3%	43.4%
USL	56.6%	58.3%	68.3%

Source: London's Current & Proposed - Exhibit 8, page 7

8.11 London's proposal is based on bringing those ratios that currently fall outside of the Board's Guidelines to the upper/lower end of the range over a two year period⁵⁷. VECC agrees with the intent of London's proposed Revenue to Cost ratio adjustments but submits that it should be realigned to reflect the results of VECC #42 a) as the "starting point". In the case of Sentinel Lights, Street Lighting and USL this will result in only minor adjustment to the proposed 2009 Revenue to Cost ratio. Similarly, for the Standby class the ratio will remain virtually unchanged (as originally proposed) but with a value of 80% instead of 84.8%.

8.12 In the case of the Large User and GS>50-4999 classes the adjustments required to the revenue cost ratios for 2009 will be larger than those originally proposed.

⁵⁷ Exhibit 8, page 4

VECC does not anticipate that increasing either ratio half way to the lower end of the Board's range for the associated class will lead to total bill impacts of 10% or more and necessitate consideration of rate impact mitigation. However, if such is the case, the Board should consider limiting the 2009 adjustment accordingly.

8.13 VECC agrees that the ratio for the Standby class should be reduced to the upper end of the Board's guideline over two years and that any "remaining surplus revenues" should be used to reduce the ratios for the Residential and GS<50 classes.

9 Rate Design

9.1 With the exception of the USL class, London is proposing to maintain the current fixed variable split for each customer class⁵⁸. In the case of the Residential class, the current monthly customer charge exceeds the ceiling established by the Board's guidelines⁵⁹. As result, in VECC's view the value should be increased by no more than the cost adjustment arising from the 2009 Rate Application. This means that while the Residential monthly service charge resulting from London's proposal to maintain the fixed variable is consistent with the Board's direction, it is the maximum value for the charge that meets the Board's guidelines.

10 Retail Transmission Rates

10.1 London Hydro is proposing to increase its 2009 Retail Transmission Service rates by the same percentages as the Uniform Transmission rates were adjusted on January 1, 2009⁶⁰. Given the minimal level of monthly variation in the associated deferral accounts since May 1, 2008⁶¹ (when the current RTSR were aligned with the approved Uniform Transmission rates), VECC submits that London's proposal is reasonable.

⁵⁸ Exhibit 9, page 6

⁵⁹ Exhibit 9, page 5

⁶⁰ Exhibit 9, page 13

⁶¹ OEB Staff #40

10.2 VECC notes that Hydro One Networks has recently filed a draft “rate order” for revised uniform transmission rates to be effective July 1, 2009 based on the Board’s EB-2008-0272 Decision. However, the draft is still subject to review and comment prior to being finalized. As result, it is VECC’s view that it would be inappropriate to incorporate these proposed changes into London’s RTSR at this time. However, depending upon the timing of the Board’s Decisions in two proceedings, it may be possible for London to incorporate the approved rates from EB-2008-0272 in its final rate order.

11 Smart Meters

11.1 In accordance with the requirements of section 1.4 of the OEB’s Guideline G-2008-0002, London Hydro’s Application indicates⁶² that:

- It is forecasting to install 81,000 smart meters in the test year 2009
- The estimated cost per installed meter may vary dependent upon currency exchange rates at the time of purchase. Cost may vary between \$150 and \$200.
- Total expenditures for 2009 may also vary in the range of \$12 million to \$16 million;
- London Hydro does not expect to purchase smart meters or advanced metering infrastructure (“AMI”) whose functionality exceeds the minimum functionality adopted in O. Reg. 425/06; and
- London Hydro does not expect to incur costs associated with functions for which the SME has the exclusive authority to carry out pursuant to O. Reg. 393/07, but costs will be incurred associated with integrating the AMI master station, the provincial MDM/R, and London Hydro’s SAP CIS system.

11.2 Estimated annual revenues from the proposed 2009 rate rider of \$1.00 are \$1,700,000 annually and with the existing credit balance in the 1555/1556 smart meter deferral accounts this would provide funding in 2009 of approximately

⁶² Exhibit 9, page 15 and VECC #34

\$2,100,000.

11.3 London indicates that this funding is significantly less than the currently estimated costs that will be incurred during 2009 to install smart meters, but it will provide a source of financing for these investments and the increased rate rider would phase in rate impacts of smart meter rate adjustments to the customer over a multi-year time frame⁶³.

11.4 VECC IR Response # 34 indicated that London Hydro is planning to have 80,000 units installed by end 2009 and the remainder of approximately 55,000 units installed by end of 2010 to meet the Provincial mandate that has been established. Forecast capital spending for 2009 is \$17 million and \$10 million in 2010. Forecast operating costs are \$900,000 in 2009 and \$2.7 million in 2010.

11.5 London is not proposing⁶⁴ to increase the rate adder:

“Forecast expenditures are at this point still just projections. London Hydro would prefer to wait for actual costs to be identified before requesting/supporting or justifying a specific London Hydro rate adder in excess of the \$1.00.”

11.6 VECC disagrees --given \$27 million in CAPEX over 2009/10 and annual operating costs of around \$2.7 million, a huge liability is being deferred and will require a major recovery from residential customers in future.

11.7 VECC notes that Board Staff have also deferred the issue to a future proceeding⁶⁵

“While it would be preferable if London Hydro had better estimates of its 2009 smart meter capital expenditures, this does not impact on the rates proposed in this application. Further, actual expenditures will be subject to review when London Hydro makes application for disposition of the account balances in a subsequent proceeding.”

11.8 VECC submits that the Board should direct London to bring forward a plan to

⁶³ Exhibit 9, page 15

⁶⁴ VECC #34 d)

⁶⁵ Board Staff Submission Page 40

amortize the SM costs over a reasonable period and adjust its 2009 rate adder accordingly.

12 Recovery of Reasonably Incurred Costs

12.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

Respectfully Submitted on the 29th Day of June 2009

Michael Buonaguro

Counsel for VECC