

**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 London
Hydro Inc. for an Order or Orders approving or fixing
just and reasonable rates and other charges for the
distribution of electricity commencing May 1, 2009.**

**Final Submissions
of the
School Energy Coalition**

1. These are the Final Submissions of the School Energy Coalition ("SEC") in the application by London Hydro Inc. ("LHI") for an order approving just and reasonable rates for the distribution of electricity commencing May 1, 2009.

OM&A

2. LHI's OM&A expenses will increase by 33% between 2006 Board Approved and 2009 test year: from \$21.5 million in 2006 Board approved to \$28.2 million in 2009¹

3. In order to check whether this increase is growth-related, SEC relies on OM&A per customer as a proxy to determine how much of the increase in OM&A is due to expansion of the distribution system. However, as is shown below, LHI's OM&A per customer has increased significantly since 2006:

¹ Exhibit 4, p. 2. Figures exclude Insurance, Bad Debt and Advertising.

<u>LHI OM&A Per Customer</u>					
	20006 B.A.	2006	2007	2008	2009
OM&A	\$21,494,271	\$23,415,921	\$25,164,406	\$26,270,467	\$28,169,400
# Customers ²	n/a	139,326	141,683	143,771	145,887
OM&A per Customer		\$168.07	\$177.61	\$182.72	\$193.09
Yr/Yr Increase			5.68%	2.88%	5.67%
Cumulative % Increase					
2006 to 2009					14.89%

4. SEC notes the Board's concerns, expressed in recent rate decision involving West Coast Huron Hydro³, that comparing OM&A per customer among utilities may not be very useful because "they can be significantly affected by such factors as customer mix and type of service area, which can vary substantially, especially for smaller distributors." However, SEC submits that changes in OM&A per customer within a utility provides a useful barometer of the extent to which growth in spending is caused by expansion of the system as opposed to other inflationary factors. In other words, to what extent are ratepayers paying more, or much more, for the same service?

5. In SEC's submission, the increases in OM&A in the test year significantly increase the cost to ratepayers- as evidenced by the increased cost per customer- and have not been fully justified.

6. SEC believes significant reductions to LHI's OM&A costs are warranted, as set out below:

Labour and Benefits- OM&A Costs

² Excluding connections. Source: Ex. 3, p. 9. For example, for 2006 total =174,120 less 32,249 Streetlight connections, less 765 Sentinel light, and less 1,780 Unmetered Load= 139,326.

³ EB-2008-0248, Decision and Order dated June 17, 2009, p. 13.

7. Labour costs are the largest component of OM&A and, not surprisingly, represent the largest driver of the overall OM&A increase. In fact, over half of the increase in OM&A in 2009 over 2007 is due to labour and benefits increases [Ex. 4, p. 9, Table 7].

8. Historically, the major driver of increases to labour and benefits costs were annual labour cost increases. LHI shows, for example, that 59.4% of the increase to base labour costs from 2006 Board Approved to 2009 are due to cumulative wage increases [Ex. 4, p. 15, Table 11].

9. Another important factor driving up labour costs are increases in staff. However, LHI has stated that most of the increase in staff complement between 2007 and 2009 will not be charged to OM&A.

10. Between 2004 and 2009, total FTE's will increase from 261.2 to 278.9 [Appendix SEC 7]- an increase of 17.7 FTE's. Of those 17.7 FTE's, 10 are related to LHI's plan to hire new apprentices as part of its succession planning efforts. LHI has said that apprentices have been deployed to capital programs and therefore the cost associated with them, \$539,200, is not included in OM&A [SEC IR#9(c)].

11. In addition, 3.5 FTE's will be added in 2009 "to assist in customer inquiries expected to increase with the roll out of the new smart metering program." The costs for these FTE's is included in the smart meter deferral account and therefore are also not included in OM&A [SEC IR #10(b)].

12. That leaves a remaining 4.2 FTE's that will have an incremental OM&A cost associated with them.

13. If that is the case, then there is a large increase in OM&A labour costs that is unexplained.

14. The following table shows what the 2009 Labour and Benefit OM&A would look like if it were increased only by the rate of inflation from 2004 (2006 Board approved) onward:

	Labour and Benefits OM&A	Inflation Rate
2004	\$15,660,468	
2005	\$16,130,282	3%
2006	\$16,614,191	3%
2007	\$17,112,616	3%
2008	\$17,625,995	3%
2009 (1)	\$18,198,840	3.25%
2009 As-Filed (2)	\$19,393,700	
Difference between As-Filed and Inflation Adjusted Amount for 2009- (2) -(1)	\$1,194,860	
Incremental FTE Charged to OM&A:	4.2	
OM&A Cost per FTE:	\$284,491	

15. As is seen from the above table, if Labour and benefits costs increased only by the LHI's inflationary rate of 3% from 2004 to 2008 and 3.25% in 2009, the total Labour and Benefits costs in 2009 would be \$18.198 million. This leaves a gap of \$1,194,860 between the inflation-adjusted 2009 amount and the 2009 forecast level.

16. Since we know that 13.5 of the 17.7 additional FTE's are not charged to labour, this means that the \$1,194,860 gap is attributable to just 4.2 FTE's. Since about 75% of labour costs

are charged to OM&A, that means that the 4.2 FTE's have total costs (capital and labour) of \$1,593,147- or about \$379,320 per FTE.⁴

17. SEC believes a reduction in OM&A is warranted as LHI has failed to demonstrate that its 2009 OM&A labour cost forecast is justified.

Corporate Training and Employee Expenses

18. The increases in labour and benefits costs identified above are over and above the increases in corporate and training expenses. These expenses are separately identified in the evidence and increase significantly in 2009- from \$640,157 in 2008 to \$932,900, a 45% increase.

[LPMA IR#33]

19. Notably, the 2008 actual figure was well below the forecast figure of \$813,900. [LPMA IR#33] There does not appear to be any explanation for the under-spending in 2008.

20. Since the 2009 estimate was likely based on the 2008 forecast, SEC suggests that the budget for Corporate Training and Employee Expenses should be reduced.

Insurance

21. LHI has estimated insurance costs for 2009 in the amount of \$501,000. In response to an interrogatory from LPMA, LHI indicates that the actual 2009 costs will be \$444,897. LHI did not indicate in the response or in its Argument in Chief whether it is amending its OM&A costs to reflect the reduction of \$56,103. In SEC's submission, LHI's OM&A should be reduced to reflect the updated information.

⁴ The amount of total labour costs charged to OM&A has decreased from 77.7% in 2006 to 75% in 2009 [SEC IR#8]. Therefore, changes in capitalization rates cannot explain any of the increase in OM&A Labour and benefits costs.

Cost Recoveries: Water-Billing Services

22. While LHI's OM&A costs for the test year are over-stated, SEC believes that its cost recoveries, particularly the costs recovered from the City of London for water billing services, are significantly under-stated. These revenues were \$3.5 million in 2006 Board Approved, but declined to \$3.0 million in 2006 actual and have only increased to \$3.05 million in the 2009 test year [Board Staff IR#32(a)].

23. First, SEC does not understand how the revenue for water billing services provided to the City of London was derived. LHI's estimated 2009 revenue from water billing services is \$3,050,000 [Board Staff IR #32]

24. However, the pre-filed evidence states that the cost per bill is \$2.50, or \$30 per year per customer [Ex. 4, p. 67]. Using the total forecasted 2009 customer count provided at Exhibit 3, p. 7, 145,886⁵, that should yield 2009 revenue of \$4,376,580 (145,886 times 30). Even if only Residential customers are included, the revenue should be \$3,958,080 (131,936 Residential customers times \$30). In either case, the 2009 revenues are under-forecasted.

25. It appears from Appendix SEC 21a [in particular, p. 19 of 103] that the number of water accounts may be less than the number of electricity customers. That may partially explain the apparent under-counting of water billing revenues. However, that attachment does not provide the number of water accounts for 2009 so it is not possible to reconcile the figures. SEC invites LHI to clarify this issue in its Reply submissions.

26. In addition, SEC believes the water-billing services may be under-charged. LHI's evidence states that water-billing services are provided to the City of London "on a full cost

⁵ Equals sum of: 131,936 Residential, 12,349 GS<50kW, 1,595 GS>50kW, 3 Large User, and 3 Co-Generation).

recovery basis" [Ex. 4, p. 67]. However, the 'Water Meter Management Study' conducted for the City of London recommends that pricing be done on a marginal cost basis [Appendix SEC 21a-Water Billing Consultants Study, p. 12 of 103].

27. In response to an interrogatory by SEC, LHI indicates that the costs charged to the City of London for water billing services were reduced in 2005 after a Consultant's report found the rates being charged were too high:

The rates for water billing services have not been re-examined since 2005. In the Consultant's report's summary of Key Findings, the external consultant concluded that based upon a detailed costing analysis, and based upon comparative market values for this service, the 2004 rates to the City of London for water billing services should be approximately \$2.1 million as compared to London Hydro's contract rate of \$3.5 million. Due to this significant costing variance between the consultant's report and London Hydro's contract rate, the rate was adjusted to \$3.0 million for 2005, 2006 and 2007, \$3.025 million in 2008 and \$3.050 million in 2009. The contract will be renegotiated when it expires on June 30, 2009, at which time inflationary and other factors will be considered.

[SEC IR#21(b)]

28. SEC has reviewed the Consultant's report, which was provided in response to SEC IR #21(b). SEC believes that the bulk of the reductions proposed by the Consultant were inappropriate for rate setting purposes. For example⁶:



⁶ Because the report was filed in confidence, the specific references to the Report have been redacted from SEC's submissions.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

29. In SEC's submission, several of these proposed reductions are inappropriate. In particular, the reductions related to the decision to bill monthly vs. bi-monthly appear to be an attempt to allocate costs to the city on a marginal cost basis, which in SEC's s submission is contrary to Board policy. Section 2.3.4.2 of the Board's Affiliate Relationships Code for Electricity Distributor and Transmitters, for example, states that, where a reasonably competitive market does not exist for a service...the utility shall charge no less than its fully-allocated cost to provide that service."

30. Although there may be a "reasonably competitive market" for water billing services, as stated below LHI has not provided evidence of a market price, and has indicated that its price is

cost-based. Therefore, in SEC's submission, the "cost" that is used should be the fully allocated cost.

31. In addition, in its response to SEC IR #21(b), LHI indicates that the rates for water-billing services have not been re-examined since 2005, but that the fee will be renegotiated in June 2009 "at which time inflationary and other factors will be considered." In SEC's submission, it is very likely that the re-negotiation will result in new rates for the second half of 2009 that are higher than those currently included in the application.

Summary- Water Billing Services

32. Based on the above, SEC submits that the reduction in water billing services costs to the City of London in 2005- from \$3.5 million to \$3 million- was inappropriate for rate setting purposes. SEC submits that the amount of revenues included in rates for water billing services for 2009 should be based on the 2005 amount- \$3.5 million- increased by inflation of 3% per year consistent with other OM&A costs. This results in a 2009 offset of \$3.94 million- or approximately \$890,000 greater than stated in the application.

Cost of Capital

Cost of Debt

33. In its application, LHI listed all of its long term debt, both affiliate debt in the amount of \$70,000,000 as well as its notional debt, together, and applied a cost of debt of 6%. [see Ex. 6, p.

4]. There was no discussion in the pre-filed evidence of any intention to ask that the Board's long-term debt rate be applied to LHI's notional debt.

34. In response to an interrogatory from LPMA, however, LHI indicated, apparently for the first time in this proceeding, that it "would expect the Board will allow the deemed rate of 7.62% to apply to this portion of London Hydro's long-term debt." [LPMA IR#30(b)] Several intervenors, as well as Board Staff, questioned LHI's about this statement in supplementary interrogatories [see SEC IR #26, VECC IR# 37, Board Staff IR#109]. LHI referred these questions to their response to Board Staff IR#109.

35. Most of the questions referred to the Board's decision in Hydro One Remote Communities, in which the Board found as follows:

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.

EB-2008-0232, Decision dated April 30, 2009 [emphasis added].

36. When asked why it was maintaining its position in view of the above decision, LHI made essentially two arguments; responded that, because its shareholder, the City of London, is prohibited from funding more of LHI's debt, the unfunded debt may only be funded through

external third party sources. Furthermore, because "the Board has determined that the current market rate for long-term debt is 7.62% it would appear reasonable to London Hydro that the rate assigned to the unfunded amount should be 7.62% since this should be reflective of the rate London Hydro may need to pay in the current market conditions in order to secure third party long term debt." [Board Staff IR #109(b)].

37. With respect, LHI's response is unconvincing. In the first place, the Board's decision in Hydro One Remotes is unequivocal that it is the "cost of [the] embedded debt which should be applied to any additional notional (or deemed) debt that is required to balance the capital structure."

38. Secondly, LHI essentially argues that an exception should be made in the case where the affiliate would not be able to advance additional debt in the event the utility decided to convert its notional debt to actual debt. In SEC's submission, whether or not the affiliate can advance additional funds is an irrelevant consideration. The Board's policy is that where a utility shareholder chooses to capitalize the utility with more equity than is allowed under the Board's deemed capital structure, which results in "notional" debt, the cost rate that is applied to the excess equity- or notional debt- is the embedded average cost rate of its real debt. In other words, the notional debt is part of the historic capital of the utility and is treated accordingly. There is no reason, as LHI suggests, to treat it as if it were incremental debt, which would attract current market rates.

39. LHI had the option, if it chose to, to go to the market and issue new debt to replace its unfunded long-term debt. It would then have come to the Board with evidence of a market rate for its debt. The Board has not stated that its deemed long-term debt rate is a proxy for a market

debt rate. It is a cost rate that is meant to apply to utility debt in certain prescribed situations. LHI has tendered no evidence of third party debt rates that would apply to its debt and should not be allowed to use the deemed debt rate for that purpose.

40. With respect to LHI's affiliate debt, LHI has stated that it would ordinarily attract a deemed debt rate, but it is seeking the posted rate for this debt of 6%. As Board Staff point out in their Argument, this debt has a fixed term- it is only "callable" by the holder with more than a year's notice. In SEC's submission, this note is embedded debt and the cost rate included in rates should be 6%.

41. LHI has stated that the impact of applying the deemed debt rate (as opposed to the average cost of its embedded debt) to its unfunded debt is an increase in the revenue requirement of \$908,349 [LPMA IR#49(c)]. SEC submits that LHI's revenue requirement should be reduced by that amount to remove the impact of applying the deemed debt rate on LHI's unfunded debt.

Rate Design

42. LHI's proposed fixed charges for the GS<50kW and GS>50kW rate classes are well above the 'Upper Bound' as defined in the Board's Report Application of Cost Allocation for Electricity Distributors [EB-2007-0667, p. 12]:

Rate	'Upper Bound'	LHI Proposal for 2009
GS<50kW	\$14.18	\$34.46
GS>50kW	\$50.17	\$285.60

Exhibit 9, p. 5.

43. In SEC's submission, a fixed charge that bears no relation to the actual fixed costs of servicing a particular rate class creates intra-class subsidies and places an unfair burden on smaller volume users within a class.

44. LHI's rationale for not reducing the fixed charges is that the Board's Cost Allocation Report did not require utilities to reduce fixed charges that are above the maximum [Ex. 9, p. 4]. Even so, SEC believes that where evidence exists, as it does here, of significant intra-class subsidies, the result is rates that are not just and reasonable and the utility has an obligation to make a correction to the rates to effect a more equitable allocation of costs.

45. Even though the fixed charges were already well above the ceiling amount, LHI has not only not in this proceeding proposed to reduce them, but has instead proposed to increase them so that the existing fixed/variable split can be maintained.

46. In SEC's submission, there is no magic in maintaining the existing fixed/variable split, particularly when the split results in fixed charges that are clearly too high.

47. At a minimum, therefore, SEC believes the fixed charges for the GS<50kW and GS>kW should be frozen at their existing level.

Costs

48. SEC participated responsibly in this proceeding and respectfully requests that it be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted this 29th day of June, 2009.

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