EB-2008-0230

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 Greater Sudbury Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2009.

ARGUMENT-IN-CHIEF OF GREATER SUDBURY HYDRO INC.

DELIVERED AUGUST 31, 2009

A. INTRODUCTION

1. Greater Sudbury Hydro Inc. ("Sudbury Hydro", or "Greater Sudbury") owns and operates electricity distribution systems serving the majority of electricity customers in the City of Greater Sudbury (referred to as the "City", or "Sudbury") and the Municipality of West Nipissing (referred to as "West Nipissing"). The current Sudbury Hydro is the result of an amalgamation of the former Sudbury Hydro and West Nipissing Energy Services Ltd. ("WNES").

2. On December 22, 2008 Sudbury Hydro submitted an Application to the Ontario Energy Board (the "OEB") seeking an order approving just and reasonable distribution rates and other charges for electricity distribution to be effective May 1, 2009.

3. Sudbury Hydro's Application, before the OEB for approval, will provide the revenue requirement necessary to sustain its capital, operating and maintenance programs in a manner that continues to provide safe and reliable distribution of electricity in Sudbury and West Nipissing.

4. Sudbury Hydro filed comprehensive, detailed and thorough pre-filed evidence. The Application was followed in March and May of this year by responses to approximately 170 interrogatories from OEB staff and intervenors, delivered in two rounds. Sudbury Hydro also participated in a transcribed Technical Conference and a Settlement Conference, although no settlement was reached. In addition, Sudbury Hydro has responded to 31 Undertakings that arose from a two day oral hearing on a limited number of issues, conducted on July 23 and 24, 2009.

5. Throughout the Application process, Sudbury Hydro has been conscious of and focused on minimizing impacts to its customers. Sudbury Hydro is proposing to design rates based on the partial reallocation of customer class distribution revenue and the partial harmonization of distribution rates (2009 is the first year of a two year process) of Sudbury Hydro with those of the former WNES, and its proposed rates will result in minimal total bill impacts of 6.08% (Sudbury) and 2.72% (West Nipissing) for the typical Residential customer (1,000 kWh/mo.); 4.03% (Sudbury) and 4.71% (West Nipissing) for the typical General Service <50 kW customer (2,000 kWh/mo.); and 0.77% (Sudbury) and 9.07% (West Nipissing) for the typical General Service >50 kW customer (100 kW in Sudbury, and 80 kW in West Nipissing).[1]

6. Sudbury Hydro submits that its proposed revenue requirement has been determined appropriately; that its proposed capital and OM&A programs for the 2009 Test Year are reasonable and supported by the evidence in this proceeding; and that the resulting distribution rates are fair and reasonable. Sudbury Hydro submits that in approving this Application, the OEB will have met its objective, set out in section 1 of the *Ontario Energy Board Act, 1998*, as amended, "to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service."

B. RELIEF SOUGHT

The relief sought by Sudbury Hydro will result in just and reasonable rates effective May 1, 2009.

7. Sudbury Hydro filed an Application for just and reasonable rates to be effective on May 1, 2009, and subject to changes in the OEB-approved Return on Equity ("ROE"), PILs rates and Retail Transmission Rates, Sudbury Hydro requested that the OEB approve the following items in this Application (see Exhibit 1, Tab 1, Schedule 5):

   a) Approval to charge rates effective May 1, 2009 to recover a revenue deficiency of $2,645,783 as set out in Exhibit 7, Tab 1, Schedule 1 (Sudbury Hydro's proposed 2009 base revenue requirement is $28,818,357). The schedule of proposed rates is set out in Exhibit 1 Tab 1 Schedule 2 Appendix A and Exhibit 9 Tab 1 Schedule 6. In the event that the OEB was unable to provide a Decision and

[1] Source: January 9, 2009 revisions to Exhibit 1, Tab 2, Schedule 1, Tables 1.2.1-2 and 1-2

Order in this Application for implementation by Sudbury Hydro as of May 1, 2009, Sudbury Hydro requested that the OEB issue an interim Order approving the proposed distribution rates and other charges, effective May 1, 2009, which may be subject to adjustment based on its final Decision and Order;

b) Approval to recover the costs of a new customer information system which Sudbury Hydro was forced to implement based on circumstances beyond its control (see Exhibit 2, Tab 3, Schedule 1, Appendix C, section 1 – Executive Summary);

c) Approval to establish a deferral account to accumulate the interest carrying charges associated with the (required) enhanced capital program, and the smart meter program until such assets are incorporated into Sudbury Hydro's rate base;

d) Approval to harmonize the distribution rates of the former WNES with Sudbury Hydro rates over a two year period;

e) Approval of an enhanced capital program required to expedite the catch up of an identified infrastructure deficit while deferring the finance carrying charges for subsequent disposition (pursuant to Exhibit 2, Tab 1, Schedule 1, Appendices A and B);

f) Approval of Sudbury Hydro's smart meter program on the basis of the utility specific charge while undertaking to defer the interim finance carrying charges for subsequent disposition (pursuant to Exhibit 2, Tab 3, Schedule 2);

g) Approval to transfer the regulatory assets of the former WNES to the amalgamated utility's account 1590;

h) Approval of the default rates for services provided by Sudbury Hydro and accounted for as revenue offsets;

i) Approval of Sudbury Hydro's proposed retail transmission rates;

j) Approval of Sudbury Hydro's loss factor; and

k) Approval of Sudbury Hydro's proposed Conservation and Demand Management ("CDM")-related Lost Revenue Adjustment Mechanism ("LRAM") and Shared Savings Mechanism ("SSM") adjustments through appropriate riders to be added to Sudbury Hydro's proposed electricity distribution rates over a two-year period.

8. Sudbury Hydro notes that it intends to complete capital projects with a value of $10,549,192 in 2009, and its OM&A expenditures are expected to be as set out in the Application, notwithstanding that Sudbury Hydro has not had its rate order approved as of May 1st. Sudbury Hydro filed the Application on December 22, 2008, for rates effective May 1st, 2009. As Sudbury Hydro's current rates were declared interim as of May 1, 2008, there will be a difference between the revenue collected under the existing rates and the revenue that would have been collected if the new rates were implemented May 1, 2009. Sudbury Hydro requests that the Board find that the new rates shall be set so as to recover the annualized revenue requirement over the remaining period of the 2009 rate year. For example, if Sudbury Hydro will be able to implement the new rates on November 1, 2009, the new rates should reflect the fact that there will be only 6 months to April 30, 2010. Sudbury Hydro acknowledges that for the 2010 rate year, adjustments will have to be made to adjust the rates so that the revenue requirement will then be recovered over 12 months.

C. SUMMARY OF EVIDENCE AND ISSUES

9. The Board appended its Issues List to Procedural Order No. 5. The Issues List identified the following main categories of issues:

1. Administration (Exhibit 1)
2. Rate Base (Exhibit 2)
3. Revenue Requirement (Exhibit 3)
4. Cost of Service (Exhibit 4)
5. Deferral and Variance Accounts (Exhibit 5)
6. Cost of Capital/Debt (Exhibit 6)
7. Cost Allocation and Rate Design (Exhibit 8)
8. Rate Design (Exhibit 9)
9. Other Issues

10. The submissions that follow have been organized according to these categories, and contain discussions of each of the issues. Sudbury Hydro expects that it will be making further comments on many of these issues in its reply submissions.

1. ADMINISTRATION (EXHIBIT 1)

Issue 1.1 – Sudbury Hydro has responded appropriately to all relevant Board directions and settlement agreements from previous proceedings.

11. Sudbury Hydro's last major distribution rate application was its 2006 EDR application. There were no directions to Sudbury Hydro from the OEB in that proceeding or in subsequent Sudbury Hydro proceedings that were required to be addressed in this Application. There are no settlement agreements applicable to Sudbury Hydro.

Issue 1.2 – Sudbury Hydro has complied with the Board's Filing Guidelines.

12. The Application was prepared in accordance with the OEB's Filing Requirements for Transmission and Distribution Applications, and more particularly with Chapter 2 - *Filing requirements for electricity transmission and distribution companies' cost of service rate applications, based on a forward test year* – as those requirements read at the time of filing the Application.

13. Sudbury Hydro has therefore complied with the OEB's Filing Guidelines in the preparation of this Application.

2. RATE BASE (EXHIBIT 2)

Issue 2.1 – The amounts proposed for Rate Base are appropriate.

14. Sudbury Hydro's Application sought approval of a 2009 Test Year Rate Base of $77,533,209 calculated on average net assets plus a working capital allowance of 15% of the sum of the cost of power and controllable expenses. The net fixed assets include those distribution assets that are associated with activities that enable the conveyance of electricity for distribution purposes, and the rate base calculation excludes any non-distribution assets. Sudbury Hydro submits that the rate base has been sufficiently supported throughout the Application and reflects its requirements to ensure a safe, reliable and sustainable distribution system.

Issue 2.2 – The amounts proposed for 2009 Capital Expenditures are appropriate.

15. In its Application, Sudbury Hydro proposed a net total (after contributions) of $10,868,524 in capital expenditures for 2009 (see Exhibit 2, Tab 3, Schedule 1, Page 1). In its responses to Undertakings J1.3 and J1.5, Sudbury Hydro provided information on the value of capital projects ($10,549,192) that would be completed by the end of 2009. Sudbury Hydro acknowledges that this represents a sizeable increase over historical capital spending, but submits that it is of critical importance that capital expenditures, particularly on plant renewal, be increased to ensure continued system reliability and address historical underinvestment in the distribution system. Sudbury Hydro notes that the 2010 and 2011 capital budgets, included at Exhibit 2, Tab 1, Schedule 1, Appendix I, contemplate further increases in plant renewal expenditures.

16. Sudbury Hydro's proposed capital budget has been supported in at least four ways in the Application:

- Sudbury Hydro has provided a copy of its October 27, 2008 Capital Asset Management Report (also referred to as the Capital Asset Management Plan, or "CAMP") at Exhibit 2, Tab 1, Schedule 1, Appendix A to the Application. In the CAMP, Sudbury Hydro explains the need to "ramp up" its capital investments, and in particular, its plant renewal investments. A significant factor in the need to increase capital expenditures has been "years of inadequate investment"[2] resulting in backlogs of capital projects. As Sudbury Hydro notes at section 2.3 of the CAMP, "The Board must consider a significant rate adjustment at this time if the distribution electrical system is to have the reinvestment necessary to sustain it in the long term."[3]

- Sudbury Hydro has provided an August 2008 Asset Condition Report on its municipal substations, prepared by a third party (Costello Associates).[4] That report, which provided extensive analysis of the Applicant's 43 substations in the Sudbury (36) and West Nipissing (7) service areas concluded (at page 6):

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[2] CAMP, page 10
[3] *Ibid.*
[4] See Exhibit 2, Tab 1, Schedule 1, Appendix A [Appendix III]

> "The age and condition of the Greater Sudbury Hydro substation assets are at the point of becoming a significant concern. A substation replacement/rehabilitation program is required in the very near future, if not immediately. A short term plan for work required should be created as part of the 2009 capital budget process, with the creation of a longer-term plan to be developed soon afterwards.
>
> Greater emphasis on substation maintenance is warranted, based on the condition of the stations. Current resource levels do not support the amount of maintenance work required, let alone the major substation replacement/rehabilitation work under consideration."

- Sudbury Hydro has provided a copy of an independent third party review of the CAMP, prepared by METSCO Inc. (the "METSCO Review"), at Exhibit 2, Tab 1, Schedule 1, Appendix B to the Application. The METSCO Review found[5] that

> "For the past many years, Greater Sudbury Hydro has not kept up the capital investments into asset renewal at the required level to optimally manage the risk of in-service asset failures. This has resulted in a disproportionately high percentage of the assets reaching beyond their mean life expectancy. In our opinion, Greater Sudbury Hydro will need to ramp up the capital investments into asset renewal and replacement to a level of approximately $11 million annually, for the next 10 years or so, to clear the backlog of assets that are currently in service well past the optimal level of service life.
>
> We have independently reviewed the asset renewal projects proposed by Greater Sudbury Hydro for implementation during the next three years and implementation of each of these projects is timely and in the best interest of rate payers."

- Finally, Sudbury Hydro has provided support in the Application for all capital projects exceeding its variance analysis threshold of $606,207 and numerous significant projects that do not exceed that threshold. The overview of the capital budget by project is located at Exhibit 2, Tab 3, Schedule 1 of the Application. This overview includes a detailed analysis of the requirements for, and procurement process in respect of, Sudbury Hydro's replacement CIS and ERP systems. The replacement of the CIS system is of particular importance as Sudbury Hydro's current system is no longer supported by its vendor. The discussion of issues related to these systems begins at page 38 of Exhibit 2, Tab 3, Schedule 1. In its response to Board Staff Interrogatory 31(b), Sudbury Hydro has explained why it would not be advisable to postpone its CIS, ERP and SCADA projects scheduled for the 2009 Test Year.

17. Sudbury Hydro submits that the capital expenditures proposed for the 2009 Test Year are fully supported in the Application, and are appropriate. Without the proposed

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[5] METSCO Review, page 3

increases in capital investments, Sudbury Hydro is at risk of declines in reliability and service quality, to the detriment of its customers.

Issue 2.3 – The Working Capital Allowance has been determined appropriately.

18. Sudbury Hydro's working capital allowance is forecast to be $13,410,886 for 2009 (see Exhibit 2, Tab 4, Schedule 2) and is based on the "15% of specific O&M accounts formula approach" referred to at page 15 of the Board's Filing Requirements for Transmission and Distribution Applications as they read at the time of preparation and filing of the Application. Sudbury Hydro notes that this approach, now referred to as the "15% allowance approach", remains a permitted mechanism in the May 29, 2009 revised version of Chapter 2 of the Filing Requirements (at p.8) that will apply to subsequent years' forward test year cost of service rate applications.

19. As required by the Filing Requirements, Sudbury Hydro has provided calculations by account for each of the years required, at Exhibit 2, Tab 4, Schedule 2 of the Application.

20. Sudbury Hydro submits that it has determined its working capital allowance appropriately.

Issue 2.4 – The asset condition information adequately addresses the condition of the distribution system assets and supports the planning and budgeting for OMA and Capital expenditures for 2009.

21. As discussed above in the context of Issue 2.2, Sudbury Hydro has provided extensive evidence on the condition of its system through the CAMP and the material that accompanied it (which included the "Distribution System Planning 2001-2005 Rolling Plan" [Appendix II to the CAMP] and the August 2008 Costello Associates Asset Condition Report [Appendix III to the CAMP]), and the METSCO Review.

22. Sudbury Hydro submits that this information, together with Sudbury Hydro's responses to applicable interrogatories and clarification questions during the Technical Conference and testimony during the oral hearing, adequately addresses the condition of the distribution system assets and supports the planning and budgeting for OM&A and Capital expenditures for 2009. Although it will be discussed later in this submission, Sudbury Hydro also submits that this material supports the establishment of a deferral account to accumulate the carrying charges associated with the (required) enhanced

capital program, and the smart meter program until such assets are incorporated into Sudbury Hydro's rate base.

Issue 2.5 – Sudbury Hydro's overhead Capitalization Policy is appropriate.

23. Sudbury Hydro's Capitalization Policy has been provided at Exhibit 2, Tab 3, Schedule 4, Appendix A of the Application. As stated at page 1 of that Schedule, Sudbury Hydro's Capitalization Policy is based on Generally Accepted Accounting Principles ("GAAP"), in particular CICA Handbook Section 3060 – Capital Assets, as well as guidelines set out by the OEB, where applicable. It can be seen at page 3 of the policy that Sudbury Hydro places a high priority on compliance of the policy with the OEB's Accounting Procedures Handbook and the CICA Handbook, and compliance with the policy by Sudbury Hydro staff.

24. The Capitalization Policy explains (at page 3) Sudbury Hydro's approach to capitalization of overhead costs. Specifically, the Capitalization Policy provides:

> "Overhead costs must be directly attributable to construction activity at the utility. This will be interpreted to mean that the overhead costs to be charged to capital are those that would not exist if Greater Sudbury Utilities did not construct its own capital assets. Eligible costs may appear fixed in the short term but would be eliminated over time (in 3 to 5 years) if GSUi did not have a capital program. Overhead costs that are capitalized include such costs as salaries and benefits of construction and engineering personnel not directly chargeable to project costs and the cost of administrative and support services that are required as a result of construction activity."

25. Sudbury Hydro's management use their best estimates to determine the appropriate cost allocation rates to distribute directly attributable costs to its three major activities of Maintenance, Capital and Work for Others. In certain cases (such as direct labour, and vehicle and equipment rates), hourly rates are applied to each category of activity based on timesheet reporting. In other cases such as those related to administrative costs, where timesheet reporting is not used, estimates are used.

26. Sudbury Hydro submits that this approach to capitalization of overhead is reasonable and consistent with GAAP and OEB policies, and that its policy is appropriate.

3. REVENUE REQUIREMENT (EXHIBIT 3)

Issue 3.1 – The calculation of the proposed revenue requirement for 2009 is appropriate.

27. The revenue requirement reflects Sudbury Hydro's OM&A costs; return on Rate Base; amortization; and PILs for the 2009 Test Year. Sudbury Hydro submits that its revenue requirement was properly calculated in accordance with the OEB's Filing Requirements.

Issue 3.2 – The proposed amount for 2009 Other Revenues, including Corporate and Shared Services is appropriate, and the methodology used to cost and price these services is appropriate.

28. Sudbury Hydro anticipates receiving other distribution revenues in the amount of $1,647,880 in the 2009 Test Year. This reflects a reduction of $50,000 from the amount shown in the Application as a result of removing RSVA carrying charge revenue (see Sudbury Hydro's response to Undertaking J2.16). Material variances (that is, variances above the threshold of $141,783) have been addressed on an account-by-account basis in Exhibit 3, Tab 3, Schedule 2 of the Application.

29. Sudbury Hydro anticipates a net reduction of $107,488 in other revenues from 2008 to the 2009 Test Year. Sudbury Hydro is anticipating a reduction of $287,293 in interest income.

30. Sudbury Hydro submits that its anticipated Other Revenues have been calculated in accordance with the OEB's Filing Requirements, and that the calculation is appropriate.

Issue 3.3 – The proposed Specific Service Charges for 2009 are appropriate.

31. As noted at Exhibit 1, Tab 1, Schedule 1, page 3 of the Application, Sudbury Hydro is not proposing any changes to the Specific Service Charges previously approved by the OEB, although Sudbury Hydro is proposing to harmonize West Nipissing's service charges to those of Sudbury. Sudbury Hydro submits that these previously-approved service charges remain appropriate, and should be approved.

Issue 3.4 – Sudbury Hydro's Economic and Business Planning Assumptions for 2009 are appropriate.

32. The multifactor regression model used in developing Sudbury Hydro's load forecast incorporates, among other factors, economic data. At Exhibit 3, Tab 2, Schedule 1, page 5 of the Application, Sudbury Hydro states "Economic growth – which encompasses population trends in the Greater Sudbury Hydro service area as well as general economic conditions is captured in the model using an index of economic output, Ontario Real Gross Domestic Product ("GDP") and population statistics."

33. Sudbury Hydro acknowledges that there has been a general economic downturn in Ontario and the world in recent months. In Board Staff Interrogatory No. 1(a), Staff asked whether, given the general economic situation in Ontario, Sudbury Hydro had "assessed the situation and identified any specific issues that may have a material impact on its load and revenue forecasts and bad debt expense forecast". Sudbury Hydro responded that it had considered the communities' economic circumstances relative to the world's economic situation. While there have recently been dramatic layoffs in the mining sector, Sudbury Hydro believes that with the diversification efforts that the community has been implementing over the past decade, the general feeling is that Sudbury "is excellently positioned to ride out the current situation." Sudbury Hydro noted that the load is expected to remain flat, and that the areas it serves tend to be more established and are better positioned to ride out difficult economic circumstances.

34. Sudbury Hydro advised in response to Board Staff Interrogatory 1(b) that it would not be adjusting its load forecast in light of the current economic downturn, as extensive quantitative and qualitative analysis were incorporated into its initial submission. Sudbury Hydro is concerned, that its allowance for bad debts may have been understated relative to the higher anticipated risk associated with account non-collection due to the adverse economic circumstances, but as it confirmed in its response to Board Staff Supplementary Interrogatory No. 6 that it is not proposing any change to its bad debt expense of $165,000.

Issue 3.5 – Sudbury Hydro's load forecast and methodology, including the weather normalization methodology and the impact of CDM initiatives, are appropriate.

35. Sudbury Hydro has provided extensive evidence regarding its load forecast and methodology, at Exhibit 3, Tab 2 of the Application. As noted at Exhibit 3, Tab 2, Schedule 1, page 1 of the Application, Greater Sudbury Hydro reviewed the various processes used by the 2008 cost of service applicants and is proposing to adopt a weather normalization forecasting method similar to the one used by Toronto Hydro-Electric System Limited in its 2008 rate application (EB-2007-0680).

36. This approach has been approved by the OEB in numerous 2009 cost of service applications including those of London Hydro Inc. (EB-2008-0235); Innisfil Hydro Distribution Systems Ltd. (EB-2008-0233); Lakeland Power Distribution Ltd. (EB-2008-0234); Niagara-on-the-Lake Hydro Inc. (EB-2008-0237); and Thunder Bay Hydro Electricity Distribution Inc. (EB-2008-0245). Sudbury Hydro understands that to a certain degree the process of developing a load forecast for cost of service rate application is an evolving science for electric distributors in the province. Sudbury Hydro expects to include additional improvements to the load forecasting methodology in future cost of service rate applications by taking into consideration data provided by smart meters and how others are conducting load forecasts in future cost of service rate applications. However, based on the OEB's approval of this methodology in a number of 2009 applications, Sudbury Hydro submits the load forecasting methodology is reasonable at this time for the purposes of setting distribution rates in this Application.

Issue 3.6 – Sudbury Hydro's Revenue Deficiency calculation for the 2009 Test Year is appropriate. (Exhibit 7)

37. Sudbury Hydro provided its Revenue Deficiency calculation at Exhibit 7, Tab 1, Schedule 1 of the Application. As shown in that Schedule, the net revenue deficiency was calculated as $1,772,674, or $2,645,783 when grossed up for PILs. The calculation considers the revenue that would be recovered at 2008 OEB-approved rates and compares it to the 2009 Test Year revenue requirement. Changes to Sudbury Hydro's revenue requirement in the course of this proceeding will change the value of the revenue deficiency.

38. Sudbury Hydro submits that the calculation has been performed in accordance with the OEB's Filing Requirements and in a manner consistent with other applications, and that the calculation is appropriate.

4. COST OF SERVICE (EXHIBIT 4)

Issue 4.1 – The overall levels of the 2009 Operation, Maintenance and Administration budgets are appropriate.

39. Sudbury Hydro has provided extensive evidence – in the Application; in its responses to interrogatories; in its responses to questions during the Technical Conference; and in oral evidence – with respect to its proposed OM&A expenditures for the 2009 Test Year. At Exhibit 4, Tab 2, Schedule 2 of the Application, Sudbury Hydro has provided its OM&A Cost Table, which illustrates Sudbury Hydro's OM&A costs from 2006 Board Approved (which was based on 2004 data) through the 2009 Test Year.

40. In the five years since 2004, Sudbury Hydro's OM&A expenses (before PILs) have risen from $14,824,349 to $17,471,675 – a total increase of $2,647,326 or approximately 17.9%, or an average annual increase of 3.6%. Sudbury Hydro submits that this is a reasonable increase, particularly when one considers the important staff additions planned for 2009.[6] Sudbury Hydro also notes that of the $2,647,326, the sum of $1,279,679 is attributable to additional amortization, which is driven by fixed assets and additions thereto.

41. Sudbury Hydro submits that the proposed 2009 Test Year OM&A expenses are both appropriate and necessary in order to ensure the safe, reliable distribution of electricity at the lowest cost to Sudbury Hydro's customers.

Issue 4.2 – The proposed Purchased Services and Shared Services are appropriate.

42. As noted at Exhibit 4, Tab 1, Schedule 1 of the Application, all staff with the exception of the two employees that comprise Sudbury Hydro's conservation and demand department are employees of Greater Sudbury Hydro Plus Inc. ("GSHPI"), an affiliate of

[6] See Exhibit 4, Tab 2, Schedule 3, page 3 for Sudbury Hydro's discussion of its requirements with respect to new Apprentice Powerline Technicians, a new System Operator and a new Substation Electrician, and the benefits that these new employees will bring to the utility and its customers.

Sudbury Hydro. At page 1 of that Schedule, Sudbury Hydro explains that "GSHPi and GSHi in effect operate as one entity focusing on and supporting the distribution utility activities….Transfer pricing is a non issue as all labour and goods and services are procured on an actual cost basis and are not marked up with a profit component. A fixed annual amount of $42,000 is charged by [GSHPI] to [Sudbury Hydro] to recover the corporation's statutory costs such as, annual audit, legal filings and taxation filings."

43. The relationship between Sudbury Hydro and GSHPI is not uncommon among Ontario's electricity distributors. The services that Sudbury Hydro purchases and shares are similar to those purchased and shared by other distributors with a "services model" for their corporate structure. Sudbury Hydro's departmental and corporate OM&A activities are described in detail in Exhibit 4, Tab 2, Schedule 1 of the Application, and the Service Level Agreement (referred to as the Operations and Maintenance Services Agreement) between Sudbury Hydro and GSHPI has been provided at Exhibit 4, Tab 2, Schedule 4, Appendix A.

44. The purchased and shared services represent those services necessary to operate and maintain Sudbury Hydro's distribution system and deliver electricity reliably and economically to Sudbury Hydro's customers, and Sudbury Hydro submits that the services are reasonable. The advantage of purchasing and sharing services is that it provides opportunities to maintain lower costs to customers as only the services necessary for Sudbury Hydro's activities are being paid for by Sudbury Hydro.

Issue 4.3 – The methodologies used to allocate Corporate and Shared Services, and the Affiliate Service Agreements, are appropriate.

45. The methodologies used to allocate corporate and shared services are Addressed at Exhibit 4, Tab 2, Schedule 4 of the Application.

46. Sudbury Hydro submits that these methodologies are appropriate. Sudbury Hydro understands, however, that certain parties may have concerns about Sudbury Hydro's approach to the allocation of certain shared services such as billing activities for

electricity and water services. Sudbury Hydro has explained the allocation of billing services in its interrogatory responses. [7]

47. At Exhibit 4, Tab 2, Schedule 4, page 2 of the Application, Sudbury Hydro advised "that it is undertaking a review of transfer pricing methodologies and intra-company cost allocations once additional requested information and interpretations from the regulator are received." In its response to Board Staff Interrogatory No. 25, Sudbury Hydro confirmed that it would be undertaking a transfer pricing study. During the hearing[8] In response to Undertaking J2.6, Sudbury Hydro filed draft terms of reference for a transfer pricing study and (in confidence) two proposals from consultants for the completion of studies for Sudbury Hydro. Sudbury Hydro once again confirms its commitment to conduct such a study, and the OEB should be confident that the study will be performed.

48. As the OEB and parties to this Application are aware, in April 2006, Sudbury Hydro's counsel wrote to the OEB's Chief Compliance Officer to set out Sudbury Hydro's position with respect to certain activities of Sudbury Hydro and its affiliates – more particularly, Sudbury Hydro believed (and continues to believe) that the outsourcing of certain utility activities is beneficial to electricity consumers as it allows "personnel involved in providing those services to be used in the most efficient manner without prejudicing electricity customers."[9] By letter dated July 13, 2006, the Chief Compliance Officer expressed his disagreement with the Sudbury Hydro position.[10] Counsel to Sudbury Hydro wrote to the Chief Compliance Officer on August 1, 2006,[11] requesting a meeting. More particularly, Sudbury Hydro's counsel wrote:

> "Before deciding exactly what to do and how to do it with respect to its affiliates, our client would appreciate an opportunity to meet with you to discuss with you its preliminary plan and work through some of the details. This would help us all avoid a false start."

49. The Chief Compliance Officer did meet with Sudbury Hydro. However, as Mr. Reeves, the former President of Sudbury Hydro, testified[12], shortly after this exchange, the Electricity Distributors Association (the "EDA") commenced a proceeding to amend the

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[7] See Sudbury Hydro's response to VECC Supplementary Interrogatory No. 34
[8] See Tr. Vol. 1, page 114 lines 14 to 21; page 120, line 19 to page 21, line 6; page 159, line 128; and page 160, line 18
[9] See Sudbury Hydro's response to Undertaking J1.15.
[10] See Appendix 16 to Sudbury Hydro's responses to the interrogatories of the School Energy Coalition.
[11] See Sudbury Hydro's response to Undertaking J2.9.
[12] For example, see Tr. Vol.1, page 170 and Tr. Vol.2, page 122

licences of electricity distributors and the Affiliate Relationships Code. The proceeding was initiated because several distributors, including Sudbury Hydro, had been involved in disagreements with the Chief Compliance Officer over the appropriate interpretation of the ARC and the activities permitted thereunder.

50. Exhibit K2.2 is a package of material filed at the hearing in this Application that illustrates the progression from the EDA application through to the commencement in 2007 of a review of the ARC by the OEB and its culmination a year later in the issuance of a significant set of amendments to the ARC to address transfer pricing, including the outsourcing of utility services. Even after the issuance of the amendments in May 2008, Sudbury Hydro attempted through its counsel in July 2008, before the amendments came into force, to discuss certain matters with the Chief Compliance Officer, but, no meeting took place.[13] The *Green Energy and Green Economy Act, 2009* contemplates expanded activities for distributors, and this may also have an impact, as yet undetermined, on the ARC. As Mr. Reeves testified,[14] Sudbury Hydro was looking for some clear direction or interpretation with respect to the ARC before proceeding to make structural changes to the utility.

51. The hearing panel has requested[15] comments from the parties in argument on two items:

(a) the scope of the transfer pricing study (which includes corporate cost allocation), a reasonable time frame for its preparation, and what should be done when the results of the transfer pricing study are available. The panel indicated that it was considering the possibility of a very limited scope hearing, written or otherwise, dealing specifically with the outcome of the study and perhaps readjusting rates and the cost base going forward, once the results are available; and

(b) The appropriate allocation of the new CIS system.

52. Sudbury Hydro expects that various parties will have comments on these questions, and Sudbury Hydro therefore expects to make further submissions on them in its reply

[13] See Sudbury Hydro's response to Supplementary Board Staff Interrogatory 8
[14] For example, see Tr. Vol. 2, page 126
[15] Transcript Vol.2, at pages 191-194.

submission. However, Sudbury Hydro has the following comments on these questions at this time.

53. With respect to item (a) above, as noted previously, the draft terms of reference and two confidential proposals for the study were filed in response to Undertaking J2.6. As can be seen from the terms of reference and the proposals, this is not a simple or inexpensive project, and the consequences of such a project can be significant and involve major structural changes to the utility's corporate structure and that of its corporate family – structures that have been in place for the better part of a decade. While it is reasonable to anticipate that the study itself might be completed within one year, if the outcome of the study is that restructuring of the utility and its corporate family is required, it is reasonable to anticipate that it could take another year to implement the resulting restructuring. Sudbury Hydro notes that it would also anticipate consulting with Board staff prior to making any structural changes.

54. With respect to the question of what the OEB should do once the results of the study are available, Sudbury Hydro submits that the results and their implementation should not be considered separately. Upon receiving the results, if the outcome of the study is that changes to pricing and/or structure are required, Sudbury Hydro will have to determine its next steps. Any implementation of structural changes will require coordination with other members of the corporate family and Sudbury Hydro's shareholders.

55. Sudbury Hydro submits that the appropriate time to consider the results of the study is next rebasing. That is currently expected to be the subject of an application in 2012 for 2013 implementation. Sudbury Hydro respectfully submits that the concept of a limited scope hearing is not appropriate in these circumstances. Sudbury Hydro offers the following comments in this regard (as mentioned previously, Sudbury Hydro anticipates making further comments in its reply submission:

(i) This allows adequate time for the completion of the study and the implementation of any conclusions and recommendations that may flow from the study.

(ii) As the OEB and parties are aware, based on its corporate structure Sudbury Hydro obtains all of its services from GSHPI. The pricing of services obtained by Sudbury Hydro necessarily relates to Sudbury Hydro's overall cost of operating and maintaining its system and providing distribution service. This would amount to a review of Sudbury Hydro's revenue requirement, which is a fundamental element of the rebasing process, and any limited scope proceeding would, in this case, effectively amount to a rebasing of Sudbury Hydro. Sudbury Hydro submits that the appropriate time to deal with these issues is when it next rebases.

(iii) Moreover, Sudbury Hydro submits that dealing with transfer pricing in the context of its 2012 application for rebasing in 2013 is appropriate in that the anticipated timing of completion and implementation of the study coordinates with the timing of preparation and filing of the next rebasing application. More particularly, as the OEB is aware, electricity distributors' cost of service applications are extensive and take a significant amount of time to prepare and complete. Sudbury Hydro would expect that many of the distributors that will be rebasing in 2011 have either already started the preparation of their applications that must be filed in August 2010, or will be doing so shortly. This means that the preparation of a 2012 application for 2013 rebasing will likely begin in the late summer or fall of 2011. At that point, Sudbury Hydro can reasonably expect to have completed and implemented the study, and to address it in the rebasing application. Sudbury Hydro suggests that it would not be appropriate to insert another proceeding that essentially amounts to another rebasing application into this timeline.

56. With respect to item (b) above, Sudbury Hydro submits that it would not be appropriate to allocate costs of the new CIS system to parties other than Sudbury Hydro. As explained during the hearing[16], the new CIS system was required due to changes in circumstances relating to electricity, and not water. In response to Undertaking J2.7, Sudbury Hydro calculated an alternative allocation for the CIS system's capital costs between it and the City based on the methodology in the OEB's Tillsonburg Decision. However, consistent with its response to the Undertaking, Sudbury Hydro does not support this approach, nor does it propose to amend the Application to reflect this approach. As noted in the response, "If a change in the business of billing

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[16] See Tr. Vol.2, page 81, line 4 to page 82, line 6

water/wastewater should occur in the future that would require a subsequent change or upgrade to the billing system we would not expect that the electricity rate payer should be responsible for such costs." Accordingly, Sudbury Hydro submits that its treatment of the new CIS system in the Application is appropriate.

Issue 4.4 – The 2009 Human Resources related costs (wages, salaries, benefits, incentive payments, labour productivity and pension costs) including employee levels, are appropriate.

57. Sudbury Hydro submits that these costs have been supported in the Application (see Exhibit 4, Tab 2, Schedule 6), and are appropriate.

58. As noted above in the context of Issue 4.1, the additional staff positions required by Sudbury Hydro are also supported in the Application. Sudbury Hydro also notes that in the November 4, 2008 Costello Associates Report which was included in the Application as Exhibit 3, Tab 2, Schedule 1, Appendix A, Sudbury Hydro's consultant confirms that current staffing levels are inadequate to support the existing stations infrastructure (see page 1 of that Appendix).

Issue 4.5 – Sudbury Hydro's depreciation expense is appropriate.

59. Sudbury Hydro describes its approach to depreciation, amortization and depletion at Exhibit 4, Tab 2, Schedule 7 of the Application. At page 1 of that Schedule, Sudbury Hydro advises that:

> "Pursuant to the APH, electric utilities that were subject to reporting using the Accounting for Municipal Electric Utilities in Ontario manual as prescribed by the former Ontario Hydro will be expected to use these rates until a change can be supported by an objective study and the change has been authorized by the Board. Greater Sudbury Hydro Inc. confirms that it has complied with the APH with respect to the amortization of capital assets."

60. At page 2 of that Schedule, Sudbury Hydro states:

> "In the Final Report of the Board on the 2006 EDRH, dated May 11, 1 2005, the OEB considered that the use of the average of the opening and closing balances for calculating amortization offered the most reliable figure without imposing an unreasonable burden on the distributor. In addition, the OEB noted (at page 23) that the "object is to arrive at a data set that is more representative of a typical year in the life of the distributor".
>
> Greater Sudbury Hydro Inc. submits that its methodology for calculating amortization meets this objective."

61. Finally, at page 21 of the OEB's Accounting Procedures Handbook, the OEB states:

> "Consistent with the CICA Handbook, this APHandbook does not provide prescriptive guidance in terms of the amortization methods to be used, the asset categories, the estimated useful lives or amortization rates. Instead, it is expected that in the absence of an objective study to support changes to the current methods, lives or rates, utilities will continue to use methods, lives or rates consistent with past practice. Note that the Board may review the selected amortization methods, estimated useful lives and amortization rates, as it considers necessary."

62. Sudbury Hydro submits that its depreciation expense and the calculation of that expense are appropriate.

Issue 4.6 – the amounts proposed for 2009 capital and property taxes are appropriate.

63. Sudbury Hydro submits that its 2009 property taxes and capital taxes have been calculated appropriately. Property taxes were budgeted based on previous years' payments, and capital taxes were calculated in accordance with all applicable requirements.

Issue 4.7 – the amounts proposed for 2009 Payments in Lieu of Taxes, including the methodology, are appropriate.

64. Sudbury Hydro submits that it has calculated PILs in accordance with all applicable OEB requirements. Detailed PILs calculations have been provided in the Application, beginning at Exhibit 4, Tab 3, Schedule 1 of the Application.

5. DEFERRAL AND VARIANCE ACCOUNTS (EXHIBIT 5)

Issue 5.1 – Sudbury Hydro's proposal for the amounts, disposition and continuance of its existing Deferral and Variance Accounts (Regulatory Assets) is appropriate.

65. Sudbury Hydro does not propose to dispose of any of its existing Deferral and Variance Account ("DVA") balances. For the OEB's reference, those balances can be found at Exhibit 1, Tab 3, Schedule 2, Appendix B, page 1 of the Application – the 2009 Sudbury Hydro *pro forma* balance sheet. Sudbury Hydro is aware that on July 31, 2009, the OEB issued its Report on its Electricity Distributors' Deferral and Variance Account Review Initiative. Sudbury Hydro will be considering that Report in the context of its upcoming 2010 3rd Generation IRM rate application.

66. As noted previously, among the items of relief requested in this Application is the OEB's approval to transfer the regulatory assets of the former WNES to the amalgamated utility's account 1590. The basis for that request is set out at Exhibit 5, Tab 1, Schedule 1 of the Application. While the DVA balances for the pre-amalgamation Sudbury Hydro that were approved as part of the 2006 EDR process were transferred from their accounts of origin to Account 1590, this had not been done for WNES, as WNES did not file a 2006 EDR application or the related "Phase II" application for recovery of Regulatory Assets. As a result, the WNES balances remain in their original accounts, and interim recoveries of Regulatory Assets continued under rates approved for 2002 through 2005.

67. Sudbury Hydro's request in this Application with respect to the WNES DVAs would, if approved, effectively complete the Phase II Regulatory Asset process in respect of the WNES balances. More particularly, as discussed in Schedule 1, Sudbury Hydro has written off transition costs in excess of the "minimum review" balance (in WNES's case, this means a reduction from transition costs of $78.36 per customer to $60.00 per customer) effective December 31, 2006, resulting in a proposed transition cost balance of $184,140, and Sudbury Hydro would move the December 31, 2004 Regulatory Asset balances into Account 1590 in accordance with the OEB's requirements. That results in a transfer of $544,459 to account 1590. The calculations of the balances to be transferred are set out in the table following Schedule 1. As at December 31, 2007, interim recovery of these balances, including carrying charges, totaled $503,020, and the funds have been reflected in Account 1590 in Sudbury Hydro's quarterly and annual filings with the OEB.

68. Sudbury Hydro submits that this approach is reasonable and appropriate, in that it allows for consistent treatment of the WNES-related DVA balances with those related to the rest of Sudbury Hydro. As with the rest of the Sudbury Hydro DVA balances, Sudbury Hydro does not wish to clear the balances of its DVA accounts at this time, but intends to seek approval for their disposition at a later date.

Issue 5.2 – Sudbury Hydro's proposal to create a new Deferral Account for the enhanced capital program carrying charges is appropriate.

69. Sudbury Hydro has requested the OEB's approval of a deferral account to accumulate the carrying charges associated with Sudbury Hydro's (required) enhanced capital program, and its smart meter program, until such assets are incorporated into its rate base.

70. As explained in the Application and in Sudbury Hydro's testimony during the oral hearing[17], and as discussed above in the context of Exhibit 2 – Rate Base, Sudbury Hydro requires significant amounts of increased capital expenditures on plant renewal in the coming years in order to reverse many years of historical underinvestment in the system. As noted previously, the proposed enhanced capital program is supported in several ways in the Application.

71. As can be seen from the proposed distribution rates and impact analysis, the enhanced capital program can be implemented without unreasonable impacts on Sudbury Hydro's customers. However, funding for this significant increase in capital expenditures (related to both plant renewal and smart meters) will place a burden on the utility. As noted in Exhibit 1, Tab 2, Schedule 2, Page 1, "The capital budget forecast is prepared over a 5-year period and is influenced, among other factors, by GSHi's capacity to finance capital projects and the OEB approval to establish a deferral account for the financing costs for the period until the capital asset is incorporated in the Utility's rate base."

72. Sudbury Hydro submits that its proposal will allow it to obtain a degree of financial certainty in making the enhanced expenditures necessary to ensure that it remains able to provide safe, reliable distribution service to its customers.

6. COST OF CAPITAL/DEBT (EXHIBIT 6)

Issue 6.1 – The proposed Capital Structure and Rate of Return on Equity for Sudbury Hydro's distribution business is appropriate.

73. Sudbury Hydro's current capital structure for rate making purposes is 53.3% debt and 46.7% equity, with a return on equity of 9%. These parameters are consistent with the

[17] See for example, Tr. Vol.1, page 82, line 18 to page 84, line 8

capital structure and return specified in the OEB's Decision in EB-2007-0899, dated April 16th, 2008.

74. In this Application, Sudbury Hydro is requesting OEB approval of a shift in its capital structure to 56.67% debt (4% of which is short term debt), 43.33% equity. The proposed change in Sudbury Hydro's capital structure is consistent with the requirements of the *Report of the Board on Cost of Capital and 2nd Generation IRM* (the "Cost of Capital Report"), whereby distributors are required to move to a debt to equity ratio of 60%/40% over time. The proposed adjustment represents the second of three steps in Sudbury Hydro's transition to the 60%/40% ratio from its original ratio of 50%/50%, and Sudbury Hydro submits that its request is appropriate and in compliance with the OEB's requirements.

75. The Application was based on the OEB's 2008 cost of capital parameters, which included a return on equity of 8.57%. In its Application,[18] Sudbury Hydro acknowledged that the OEB will be finalizing the return on equity for 2009 rates based on January 2009 market interest rate information. The 2009 parameters now provide for a return on equity of 8.01%, and Sudbury Hydro confirms that it will adjust its proposed distribution rates to reflect this revised parameter in the draft rate order that will be prepared following the OEB's Decision on this Application.

Issue 6.2 – Sudbury Hydro's proposed costs and mix for its short and long-term debt for the 2009 Test Year are appropriate.

76. The Application was based on the short term debt rate of 4.47% as established in the OEB's 2008 cost of capital parameters. As with the rate of return on equity, Sudbury Hydro acknowledges that the OEB's 2009 cost of capital parameters will apply to its short term debt. Those parameters now provide for a return of 1.33%, and Sudbury Hydro confirms that it will adjust its proposed distribution rates to reflect this revised parameter in the draft rate order that will be prepared following the OEB's Decision on this Application.

77. With respect to long term debt, Sudbury Hydro has one debt instrument – a promissory note payable to its parent, Greater Sudbury Utilities Inc. ("GSUI") in the amount of

[18] See Exhibit 6, Tab 1, Schedule 2, page 1.

$48,645,458 (referred to as the "Promissory Note"). A copy of the Promissory Note was provided in response to Board Staff Interrogatory 42(a).[19] For rate making purposes, the Promissory Note has been subject to a rate of 7.25% since Sudbury Hydro's initial unbundled distribution rates were established in 2001, in accordance with the deemed debt rate contained in the OEB's initial (2000) Electricity Distribution Rate Handbook for distributors with rate bases the size of Sudbury Hydro's.

78. During the hearing,[20] Sudbury Hydro indicated that it considered the Promissory Note to be embedded debt at 7.25%, as it had been approved by the OEB in all previous Sudbury Hydro rate applications. For embedded debt, the OEB's Cost of Capital Report provides[21] that "the rate approved in prior Board decisions shall be maintained for the life of each active instrument, unless a new rate is negotiated, in which case it will be treated as new debt." Sudbury Hydro maintains that the Promissory Note should be considered embedded debt, and therefore subject to the 7.25% rate for 2009 and in subsequent rebasing proceedings. Sudbury Hydro's witness panel confirmed that it is seeking a rate of 7.25% on the Promissory Note.

79. The OEB's Cost of Capital Report also provides[22] 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. When setting distribution rates at rebasing these debt rates will be adjusted regardless of whether the applicant makes a request for the change." The Promissory Note contains a clause that provides that GSUI may demand repayment of all or part of the outstanding principal with interest at the established rate upon six months written notice to Sudbury Hydro.

80. Sudbury Hydro has given further consideration to the matter of the rate applicable to the Promissory Note, and wishes to address the following concern with the OEB: If Sudbury Hydro's approach – that is, that the Promissory Note represents embedded debt that bears interest at 7.25% – is accepted, then the 7.25% interest rate will remain in place for the life of the instrument. If, however, the OEB determines that the Promissory Note represents affiliate debt that is callable on demand, then it would be subject to the OEB's

[19] See Appendix 42(a) to Sudbury Hydro's responses to Board Staff Interrogatories.
[20] See Tr. Vol.2, page 156, lines 2-5
[21] At page 13
[22] At page 14

deemed debt rate, which will presumably change with each rebasing application. That rate is currently 7.62% for 2009 rebasing applications, but will in all likelihood be a different value in four years when Sudbury Hydro is next before the OEB with a cost of service application. In Sudbury Hydro's submission, it would not be reasonable for the OEB to determine both that the Promissory Note is callable affiliate debt *and* that the rate should be limited to 7.25%. If the OEB were to make such determinations, then in subsequent rebasing applications, Sudbury Hydro would expect to face arguments that if the deemed rate is lower than 7.25%, then the lower rate should apply, but that if the deemed rate is higher than 7.25%, then Sudbury Hydro's rate in respect of the Promissory Note should be limited to 7.25%.

81. Sudbury Hydro submits that this would clearly not be a fair and reasonable outcome, nor would it be consistent with the Cost of Capital Report. In summary, Sudbury Hydro submits that, consistent with the OEB's policy, the Promissory Note represents embedded debt at a rate of 7.25% for the life of the instrument. In the alternative, if the OEB determines that the Promissory Note represents callable affiliate debt that would be subject to the deemed debt rate in accordance with the Cost of Capital Report, then the appropriate debt rate for rate making purposes in this Application is 7.62%.

7. COST ALLOCATION AND RATE DESIGN (EXHIBIT 8)

Issue 7.1 – Sudbury Hydro's cost allocation is appropriate.

82. At Exhibit 8, Tab 1, Schedule 2 of the Application, Sudbury Hydro presented both its revenue to cost ratios as filed in its initial (March 2007) cost allocation informational filing and an updated version that corrected errors in the earlier filing with respect to amortization costs and the valuation of metering assets. At Exhibit 9, Tab 1, Schedule 1, page 11 of the Application, Sudbury Hydro advised that the transformer allowance would remain at $0.60/kW, but that "The amount of transformer allowance expected to be provided to those General Service 50 to 999 kW customers that own their transformers has been included in the volumetric charge for this class. In its response to Technical Conference Undertaking No.4, Sudbury Hydro submitted a revised calculation that removed the transformer allowance from all rate classes except for the GS>50 kW class. This calculation resulted in a nominal shift in the revenue to cost ratios for all classes.

Sudbury Hydro will address this in its draft Rate Order following the OEB's Decision on this Application.

83. Sudbury Hydro submits that it has applied the OEB's Filing Requirements and has accurately calculated the revenues and costs attributable to its rate classes, and the calculation of its cost allocation is appropriate.

Issue 7.2 – Sudbury Hydro's proposed revenue to cost ratios are appropriate.

84. As noted above, at Exhibit 8, Tab 1, Schedule 2 of the Application, Sudbury Hydro presented both its revenue to cost ratios as filed in its initial (March 2007) cost allocation informational filing and an updated version that corrected errors in the earlier filing with respect to amortization costs and the valuation of metering assets. Sudbury Hydro has proposed[23] to re-align its revenue to cost ratios as follows:

> "…by adjusting the allocations of revenue among rate classes in order to reduce some of the cross-subsidization that is occurring. The re-alignment will move those classes, which are under contributing, to approximately 50% between their current ratio and target ratio. Specifically, the streetlighting and sentinel lighting rate classes. The proposed rate of 41.11% for streetlighting is approximately midway between the existing rate of 6.51% and the low end rate of 70% as proposed by the OEB. The proposed rate of 54.01% for sentinel lighting is more than halfway between the existing rate of 18.24% and the low end rate of 70% as proposed by the OEB.
>
> Additional revenue from under contributing classes will be distributed to those classes that are over contributing with the highest share being applied to the GS < 50 and GS > 50 classes as these have the highest level of over contribution."

85. Sudbury Hydro submitted in its Application that the proposed reallocation of distribution revenue is fair and reasonable because customer class revenues will more closely reflect the actual costs of providing distribution service to that class; and partial reallocation provides time for further refinement of the cost allocation model and movement between classes.

86. Also as noted above, in its response to Technical Conference Undertaking No.4, Sudbury Hydro submitted a revised calculation that removed the transformer allowance from all rate classes except for the GS>50 kW class. Although the resulting changes to the revenue to cost ratios were very small, Sudbury Hydro proposes to use the revenue to cost ratios set out in that undertaking response as the starting point for its reallocation

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[23] See Exhibit 8, Tab 1, Schedule 2, page 3 of the Application

of distribution revenue. Sudbury Hydro will make this adjustment in the draft Rate Order to be prepared following the OEB's Decision.

87. Sudbury Hydro maintains that its proposed approach to adjustments to revenue to cost ratios, subject to the adjustments to the calculations in Sudbury Hydro's response to Technical Conference Undertaking No.4, remains appropriate. It is consistent with the OEB's requirements, in that the ratios for all under-contributing rate classes are moved, at a minimum, to halfway between their current levels and the low end of the OEB's ranges, with additional revenue from under contributing classes being distributed to those classes that are over contributing, and this approach has consistently been accepted by the OEB.

8. RATE DESIGN (EXHIBIT 9)

Issue 8.1 – Sudbury Hydro's customer charges and the fixed-variable splits for each class are appropriate.

88. With respect to Sudbury Hydro's fixed-variable splits, Sudbury Hydro has explained its approach to fixed-variable splits at Exhibit 9, Tab 1, Schedule 3, page 7 of the Application. Sudbury Hydro summarized the OEB's approach to the fixed rate component, which has been accepted by the OEB in numerous cost of service applications, as follows:

> "In its November 28, [2007] Report on Application of Cost Allocation 1 for Electricity Distributors, the OEB addressed a number of "Other Rate Matters", including the treatment of the fixed rate component (the Monthly Service Charge, or "MSC") of the bill. At page 12 of the Report, the OEB determined that the floor amount for the MSC should be the avoided costs, as that term is defined in the September 29, 2006 report of the OEB entitled "Cost Allocation: Board Directions on Cost Allocation Methodology for Electricity Distributors". Greater Sudbury Hydro's MSCs exceed that floor amount. With respect to the upper bound for the MSC, the OEB considered it to be inappropriate to make changes to the MSC ceiling at this time, given the number of issues that remain to be examined within the scope of the OEB's Rate Review proceeding (EB-2008-0031). The OEB indicated that for the time being, it does not expect distributors to make changes to the MSC that result in a charge that is greater than the ceiling as defined in the Methodology for the MSC; and that distributors that are currently above that value are not required to make changes to their current MSC to bring it to or below that level at this time."

89. Sudbury Hydro's approach to fixed-variable splits in this Application is generally consistent with this approach. Sudbury Hydro's intent had been to make no changes to the current fixed and variable portions of its rates, but has made certain minor adjustments to fixed and variable proportions in the case of its West Nipissing

customers, as part of its efforts to mitigate the rate impacts on the West Nipissing customers over the two year harmonization period. As Sudbury Hydro explained in the Application, fixed charges for West Nipissing customers are midway between existing rates and proposed fixed rates assuming full rate harmonization. In situations where the fixed charge was nil (the case for sentinel lights), a phased in increase was applied.

90. Generally, however, changes in Monthly Service Charges are due to changes in the total base revenue requirement attributable to each customer class.

91. Sudbury Hydro submits that its approach to the fixed-variable splits, including the modifications with respect to West Nipissing customers, are consistent with accepted OEB practice and are appropriate.

Issue 8.2 – Sudbury Hydro's proposed rates, including the rate harmonization plan for West Nipissing customers, are appropriate.

92. Sudbury Hydro's proposed rates will enable it to recover the revenues it has determined are necessary to operate and maintain its distribution system (including a significant and necessary increase in plant renewal, subject to the requested deferral account to permit the recovery of carrying charges on the enhanced capital investments at a time to be determined), recover its PILs expense, and earn returns on capital and debt at the OEB's permitted rates.

93. As noted at Exhibit 1, Tab 1, Schedule 2, page 3 of the Application, the proposed rates have been prepared in accordance with the Filing Requirements and reflect traditional rate making and cost of service principles, and impacts are reasonable and appropriate.

94. The two year rate harmonization plan for West Nipissing customers allows for the phasing in of higher rates to those customers, and the resulting rates for those customers are also reasonable.

Issue 8.3 – Sudbury Hydro's customer bill impacts are appropriate.

95. As discussed previously, Sudbury Hydro has been conscious of and focused on minimizing impacts to customers throughout the Application process. Sudbury Hydro's proposed rates will result in minimal total bill impacts of 6.08% (Sudbury) and 2.72%

(West Nipissing) for the typical Residential customer (1,000 kWh/mo.); 4.03% (Sudbury) and 4.71% (West Nipissing) for the typical General Service <50 kW customer (2,000 kWh/mo.); and 0.77% (Sudbury) and 9.07% (West Nipissing) for the typical General Service >50 kW customer (100 kW in Sudbury, and 80 kW in West Nipissing). Impacts for various consumption profiles are set out at Exhibit 9, Tab 1, Schedule 9, Appendix A of the Application.

96. Sudbury Hydro maintains, as it submitted at Exhibit 9, Tab 1, Schedule 2 of the Application, that the bill impacts of its proposed 2009 electricity distribution rates are not so significant as to warrant any mitigation measures. While the Street Light and Sentinel Light classes have total bill impacts over 10%, this is due to cost allocation-related adjustments, and Sudbury Hydro submits that these adjustments are appropriate notwithstanding the resulting bill impacts for members of those classes.

Issue 8.4 – Sudbury Hydro's proposed rate impact mitigation plan is reasonable.

97. As noted above, Sudbury Hydro is not proposing any mitigation measures in the Application, with the exception that Sudbury Hydro proposes that the harmonization of WNES and Sudbury rates should take place over a two year period. As mentioned above in the context of Issue 8.2, the harmonization plan, which allows for the phasing in of increased rates to West Nipissing customers, is reasonable and appropriate.

Issue 8.5 – The proposed Retail Transmission Service Rates and LV Rates are appropriate.

98. With respect to Retail Transmission Service Rates ("RTSRs"), Sudbury Hydro has calculated its RTSRs to take into account the uniform transmission rates approved by the OEB in its Uniform Transmission Rate Order in File No. EB-2008-0759, as those rates were available prior to the filing of the Application. Sudbury Hydro's methodology for determining its proposed RTSRs is set out at Exhibit 9, Tab 1, Schedule 3. As discussed in that Schedule, the proposed RTSRs incorporate IESO Network Service Charges, the IESO Line Connection Charges, the IESO Transformation Connection Service Charges, and the Hydro One RSTR charges. The RTSRs passed on from Hydro One Networks for embedded distribution have been estimated with rate increases similar to those in the Uniform Transmission Rate order referred to above. Sudbury

Hydro submits that the RTSRs as proposed will require updating to reflect the 2009 rate orders recently approved by the OEB, and Sudbury Hydro will do so in the draft Rate Order that will follow the Decision in this proceeding.

99. With respect to LV charges, Sudbury Hydro has described its approach to the calculation and allocation of LV charges at Exhibit 9, Tab 1, Schedule 1, page 12 of the Application. More particularly, Sudbury Hydro has allocated LV costs of $224,166 have to each rate class based on the proportion of retail transmission connection revenue collected from each class. Sudbury Hydro submits that this approach is consistent with the OEB's approach in its 2006 EDR model, and that this is appropriate. Sudbury Hydro notes that there will be a change in its LV charge calculation. In its Application, Sudbury Hydro reported LV costs of $160,000 and a LV revenue requirement of $224,000. The $224,000 amount was incorrectly calculated , and will be reduced to $160,000 to match the costs in the draft Rate Order.

100. On a related matter, Sudbury Hydro notes that its Rural Rate Assistance charge will increase from $0.001/kWh as shown in the Application, to 0.0013/kWh. Sudbury Hydro intends to address this adjustment in its draft Rate Order.

Issue 8.6 – The proposed Loss Factors are appropriate. (Exhibit 4)

101. As discussed at Exhibit 4, Tab 2, Schedule 8 of the Application, Sudbury Hydro has calculated the total loss factor to be applied to customers' consumption based on the average wholesale and retail kWh for the years 2002 to June 2008.

102. Sudbury Hydro has calculated its total loss factor to be 4.71%. Pursuant to the Filing Requirements, as the Total Loss Factor is less than 5%, Sudbury Hydro is not required to provide a further explanation of, or justification for, its loss adjustment factor. Sudbury Hydro submits that its loss factor calculations, and the resulting loss factors, are appropriate.

Issue 8.7 – Are the proposed Regulatory Asset (Deferral and Variance Account) rate riders appropriate? (Exhibit 5)

103. Sudbury Hydro is not proposing any Regulatory Asset (Deferral and Variance Account) rate riders.

Issue 8.8 – The Smart Meter rate adder change is appropriate. (Exhibit 2)

104. Sudbury Hydro currently collects a smart meter rate adder of $0.27 per metered customer. At Exhibit 9, Tab 1, Schedule 1, page 16 of the Application, Sudbury Hydro proposed a utility-specific rate adder of $2.17 for 2009, calculated using the OEB's Smart Meter Rate Addendum Model. According to the results of the model, this adder would increase to $2.60 for 2010, and decline to $2.01 in 2011.

105. In Board Staff Interrogatory No. 44(b), Staff noted that "it is common practice for the calculated 2009 Revenue Requirement for Smart Meters to be reduced by the amount of smart meter rate adder revenue forecast to be collected up to April 30, 2009." Staff requested that Sudbury Hydro provide a revised 2009 Smart Meter revenue requirement. In response, Sudbury Hydro advised that anticipated revenues would be $445,753, with $85,000 in costs, and a resulting net revenue of $360,753. Sudbury Hydro advised that if the costs were removed in the first year, the 2009 adder would decline from $2.17 to $1.49, with the 2010 adder remaining at $2.60 and the 2011 adder remaining at $2.01. Sudbury Hydro proposed to smooth the rate adder over three years, allocating one-third of the net revenue to each of 2009, 2010 and 2011. The resulting adders would be $1.94 for 2009, $2.37 for 2010 and $1.79 for 2011. Sudbury Hydro confirmed this proposed approach in its response to Supplementary Board Staff Interrogatory No. 16.

106. Sudbury Hydro agrees that it is appropriate to reduce the smart meter revenue requirement to account for forecasted smart meter rate adder revenues. Sudbury Hydro also submits that it is appropriate to smooth the adders for the 2009-2011 period in order to avoid significant fluctuations in the adder over this period.

9. OTHER ISSUES

Issue 9.1 – the LRAM and SSM proposal is appropriate. (Exhibit 9)

107. Sudbury Hydro's LRAM/SSM proposal, and its methodology for establishing the proposed LRAM/SSM riders, are set out at Exhibit 9, Tab 1, Schedule 10 of the Application. Sudbury Hydro seeks a total combined LRAM/SSM amount of $220,524, calculated to December 31, 2007. This is comprised of $61,092 in lost revenue resulting

from savings achieved through Sudbury Hydro's third tranche CDM plan for the years 2005-2007; and $159,432 in SSM recoveries. Sudbury Hydro's third tranche CDM plan was approved by the OEB in file no. RP-2004-0203/EB-2004-0471.

108. At page 6 of Schedule 10, in Table 1, Sudbury Hydro sets out its proposed LRAM and SSM-related rate riders. Sudbury Hydro has provided tables setting out its detailed LRAM and SSM-related calculations in the remainder of Schedule 10. GSHI proposes to recover the total combined LRAM/SSM amount of $220,524 through a class-specific volumetric rate rider over a two year period that would be in effect commencing in the 2009 rate year.

109. Sudbury Hydro submits that its LRAM and SSM-related calculations have been performed in accordance with the OEB's requirements, including those set out in the *Guidelines for Electricity Distributor Conservation and Demand Management* (EB-2008-0037) issued on March 28, 2008 (the "Guidelines"). The Guidelines provide the basis and methodology required to file an application for LRAM and SSM recovery. Sudbury Hydro used the Guidelines in calculating the quantities and dollar amounts that comprise its claim. In addition, GSHI has followed the Board's Decision and Order in the EB-2007-0096 proceeding in which the Board approved Toronto Hydro-Electric System Limited's LRAM/SSM recovery application (the "THESL Decision"). LRAM amounts to be recovered were adjusted for free riders as defined in the Guidelines, with percentage reductions based on the THESL Decision. Table 7 of Schedule 10 illustrates the free rider impact on the quantities for each program for the years 2005 to 2007. In accordance with the Guidelines, Sudbury Hydro's SSM claim is based on 5% of the net benefits before tax as calculated using the Total Resource Cost Test.

110. Sudbury Hydro submits that it has complied with the Guidelines and the THESL Decision in preparing its LRAM/SSM claim, and that the claim, and the corresponding LRAM/SSM rate riders, are appropriate.

Issue 9.2 – Service quality in relation to the OEB specified performance indicators is acceptable.

111. Sudbury Hydro provided its 2007 service quality results for 2007 at Exhibit 1, Tab 2, Schedule 1, Appendix A of the Application. As is clear from that material, Sudbury

Hydro's performance was better than the OEB's standards, and its service quality in relation to the OEB's performance indicators is therefore acceptable. However, Sudbury Hydro is constantly working to improve the quality of service that it provides to its customers. Sudbury Hydro anticipates that measures such as the implementation of its new CIS and ERP systems will assist it in providing even higher levels of customer service.

D. CONCLUSION

112. Sudbury Hydro submits that it has complied with the OEB's Filing Requirements and all other applicable requirements in preparing this Application, whereby Sudbury Hydro will recover the revenues necessary to operate and maintain its distribution system; significantly increase its capital expenditures related to plant renewal as discussed in the Application (subject to the request for a deferral account to track the carrying costs related to the enhanced capital programs); earn permitted returns on capital; harmonize the rates of its West Nipissing customers with those of its Sudbury customers; and recover LRAM and SSM adjustments, all with minimal customer impacts.

113. Sudbury Hydro respectfully requests that the OEB approve its Application subject to the adjustments referred to herein.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 31st DAY OF AUGUST, 2009.

Original Signed by James C. Sidlofsky
James C. Sidlofsky
Counsel to Greater Sudbury Hydro Inc.

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