Festival Hydro Inc.

P.O. Box 397, Stratford, Ontario   N5A 6T5

187 Erie Street, Stratford
Telephone: 519-271-4700
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www.festivalhydro.com

November 23, 2009

BY COURIER

Wayne McNally
Ontario Education Services Corporation
439 University Avenue, 18th Floor
TORONTO, ON M5G 1Y8

Re: ED Number EB-2009-0263
Festival Hydro Inc. Response to School Energy Coalition (SEC) Interrogatories
2010 Electricity Distribution Rates, Licence No. ED-2002-0513

Dear Mr. McNally:

On August 28, 2009, Festival Hydro Inc., referred to herein as the Applicant, filed its application for 2010 electricity distribution rates and, subsequently, on November 6, 2009, SEC submitted its interrogatories to the Applicant as per the Board's Procedural Order #1 dated October 16, 2009. The Applicant now submits its responses to those interrogatories.

A copy of this package has been electronically filed through the Ontario Energy Board's RESS system and emailed to the Board Secretary. The original has been couriered to the Board's offices.

Should you require any further information or clarification of any of the above, kindly contact the writer.

Respectfully submitted,

Originally Signed by

W.G. Zehr   President

Cc All Intervenors

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November 23, 2009

BY COURIER

Shibley Righton LLP
250 University Ave, Suite 700
TORONTO, ON M5H 3E5
Attention: John De Vellis

Re: ED Number EB-2009-0263
Festival Hydro Inc. Response to School Energy Coalition (SEC) Interrogatories
2010 Electricity Distribution Rates, Licence No. ED-2002-0513

Dear Mr. De Vellis:

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EB-2009-0263

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

AND IN THE MATTER OF a review of an application filed by Festival Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution commencing May 1, 2010.

INTERROGATORIES
OF THE
SCHOOL ENERGY COALITION

Cost of Capital

1. **Exhibit 5**, cost of debt: the evidence states that the loan from Infrastructure Ontario has a projected cost rate of 5.04% but that FHI has used a cost rate of 6% in the application, in order to allow "for some interest rate volatility between now and when the loan is drawn upon in 2010."

(a) Interest rate volatility can be both positive and negative. What allowance has FHI made for a decrease in interest rates between now and May 2010?

Response:

FHI has not provided an allowance for a decrease in interest rates between now and May 2010.

(b) The evidence also states that the loan was approved by Infrastructure Ontario in June 2007. What is the current status of the loan? Is the interest rate subject to change?

Response:

It is anticipated that the loan will be received fully in 2010 when the capital outlay for the smart meters will be made. The interest rate is subject to change up until the date the loan is received.

FHI is still finalizing the details of the smart metering project timing, however it is certain that the complete roll out will occur in 2010. Additional details regarding the timing of the payment by FHI for the smart meters will be provided to the OEB by FHI as they become available.

(c) Does FHI have any other information, other than that posted on the Infrastructure Ontario website, as to the projected cost rate for this loan?

Response:

FHI does not have any other information other than that posted on the Infrastructure Ontario website as to the projected cost rate for this loan.

Rate Base and Capital Expenditures

2. Ex. 2, Tab 2, Schedule 3: Capitalized Asset Transfers

(a) With respect to the Capitalized Asset Transfers in 2004, 2005, 2006, 2007, 2008 2009 and 2010, the evidence states that they represent the transfer of assets provided by the customer which were assumed by FHI upon the completion of the economic evaluation. Please:

(i) Provide explain whether FHI paid for the assets and if so, how much;

(ii) If FHI did not pay for the assets, then FHI should have recorded an offsetting capital contribution to reflect the fact that they were paid for by another party. Please explain whether that is the case and if not, why not.

Response:

An economic evaluation is completed for each subdivision to determine if an amount has to be paid for the assets. The amounts paid from 2004 to 2010 are as follows:

Year	**Amount**
2004	**$Nil**
2005	**$70,820**
2006	**$89,321**
2007	**$151,726**
2008	**$60,326**
To Sep 30/09	**$Nil**

The portion FHI does not pay for is set up as offsetting capital contribution and is amortized at the same depreciation rate as is used for the corresponding assets.

3. Exhibit 2, Tab 2, Schedule 3, pg. 25: With respect to the Spare parts inventory reclassification ($648,253 increase in gross fixed assets in 2008); please explain how these assets were treated, for rate base purposes, prior to the reclassification.

Response:

Prior to the reclassification and the introduction of CICA handbook section 3031 these major spare parts were treated as an inventory item and therefore not included in the rate base.

4. Exhibit 2, Tab 2, Schedule 3, pg. 25: With respect to the Asset Disposal Reclassification ($968,310 increase in gross fixed assets in 2008), please provide a copy of the auditors' report that led to the reclassification.

Response:

An excerpt from our audit report from KPMG is as follows:

Accumulated depreciation – Account 2105

- **As a result of a discussion with KPMG, management changed from setting up the costs associated with removing assets in a contra accumulated depreciation account to setting them up as part of the cost basis of the asset.**
- **KPMG discussed the issue with management and the conversation was centered around the fact that no depreciation is ever taken on the costs within the 2105 account. As a result, this asset would continually increase in value and would never decrease resulting in an overstated net book value associated with property plant and equipment and also an artificially increased rate base.**

Actions Taken by Management

- **Management determined the costs within the 2105 account and determined the actual depreciation expense which should have been recorded if this amount had been depreciated each year.**
- **Management determined that they had not depreciated assets by $94,613 during the prior years as the costs were in a non-depreciable account.**
- **Management determined that as the costs were transferred in 2008, the only depreciation expense to be taken is the 2008 portion. Management determined that the remaining $94,613 will be depreciation on a prospective basis.**

Effect on the Audit

- **KPMG examined the documentation associated with the adjustment.**
- **KPMG examined the analysis over the depreciation expense prior to the adjustment.**
- **As the depreciation expense has not been taken in prior years, the net book value of the assets identified is overstated and the accounting treatment is not appropriate. As such, KPMG has taken the $94,613 adjustment to the uncorrected misstatement schedule.**

5. Exhibit 2, Tab 3, Schedule 3: Stratford MS#1 Conversion

(a) This project is being completed over five years. Please provide the total cost of this project.

Response:

The estimated total cost of the Stratford MS#1 conversion is $1,249,271.

(b) Please provide any cost-benefit or net present value analysis or any other reports prepared in support of this project.

Response:

There are no cost-benefit or net present value calculations performed for these types of projects. There are no reports that were prepared to support this project. As outlined in the Asset Management Plan (Exhibit 2, Tab 3, Schedule 2, Appendix A, pages 14 to 16), substations are assessed as the station and the associated distribution assets (ie the area supplied by the station) approach end of life. In this case, it was obvious over 10 years ago that the location and physical condition of MS#1 was such that the station could not be sustained in the long term. To replace the station would require a complete new one to be constructed in a new location near the downtown core of Stratford. There were no vacant lots of suitable size or zoning that would permit a station to be constructed. Since there is 27.6 kV readily available in the area, and there is only a marginal cost increase to replace 4 kV distribution with 27.6 kV, the obvious conclusion was to start a project to convert the area to 27.6 kV as the distribution assets approached end of life, and when the conversion was complete, to remove the station from service.

OM&A

6. Ex. 4: please provide the percentage of labour that was capitalized from 2006 to 2010.

Response:

2006	2007	2008	2009	2010
15%	27%	29%	29%	29%

7. Ex. 4, Tab 2, Schedule 3, p. 1: there appears to have been a spike in fuel costs in 2008. Please explain the reasons for the increase. Also, the 2010 forecasts appears to be higher than 2008. Please explain how the 2010 forecast was determined and why it remains higher than 2008.

Response:

The fuel cost driver peaked in 2008 as a result of very high oil prices in that year. The 2010 forecast is based on an average increase of 2.3% from the 2009 estimate for most OM&A expenses except for labour costs which are budgeted to increase 3% in-line with the union contract. As clarification for the fuel cost driver documentation in our application, it is anticipated that fuel costs will become less of a driver of the overall budgeted increase in

2009 and 2010 than in 2008 but are still anticipated to increase slightly year over year due to inflationary causes.

8. Ex. 4, Tab 2, Schedule 3, p. 17: please explain how the $100,000 forecast for IFRS transition costs was determined. Please provide all assumptions made.

Response:

The $25,000 over four years was requested for one time administration costs as well as on-going compliance costs. Section 8.2 of the July 28, 2009 Board Report on the Transition to IFRS along with the recently released frequently asked questions document highlights that a deferral account will be set up to record the incremental one-time conversion costs to IFRS. FHI anticipates using this deferral account mechanism to record such costs, however feels that there will be significant on-going compliance costs related to IFRS reporting that should be considered and so applied for such costs in this application. In addition to the specific issues being faced by the Rate Regulated Industry in the conversion to IFRS, we are aware of significant changes to many of the IFRS standards to be implemented in the upcoming years as noted in the table below (the information is per IASB plans at October 30, 2009)

2011	2012	2013	Unknown Implementation Date
Consolidation	Derecognition	Financial statement presentation	Earnings per share
Discontinued operations	Financial Instruments	Financial instruments with characteristics of equity	Extractive activities
Joint Ventures	Fair value measurement	Insurance contracts	Common control transactions
Non-financial liabilities	Income taxes	Leases	Government grants
Related Party Disclosures	Rate Regulated Activities	Post-employment benefits	Intangible assets
		Revenue recognition	
		Emissions trading schemes	

It is anticipated that many of these standard changes will impact FHI and that we will incur significant incremental consulting costs to ensure the proper implementations of the changes in each standard.

Due to the fact that the original application was filed under the assumption that $100,000 would include both one-time conversion costs as well as ongoing compliance costs, and one time conversion costs will now be included in a deferral account, FHI feels it is prudent to decrease the on-going compliance costs included in this application to $56,000 in total or $14,000 each year for four years. The change will be incorporated into the model at the rate order stage.

9. Ex. 4, Tab 2, Schedule 4: Charges to Affiliates

(a) Please provide a more detailed explanation of Table 3 on p. 3. It appears that the first row is the revenue derived from Water and Sewer Billing Revenue from the City of Stratford? Is this correct?

Response: This is correct.

(b) The next row represents the cost of providing the water and sewer billing. However, what is not clear is whether these costs- $357,869 in 2010- are billed to the City of Stratford in addition to the $420,485? Please explain.

Response:

The costs incurred in 4380 are not billed to the City of Stratford, but are the costs of doing the billing for the City by FHI. The net of account 4375 and 4380 is the actual return to FHI on performing the water and sewer billing services for the City of Stratford.

Cost Allocation

10. Exhibit 7: the proposed revenue to cost ratio for Streetlighting in 2010 is 50.7%, up from 28.9%. Other LDC cost of service applications have proposed a similar movement for Streetlights, but with a plan to move to 70% in 2011. Please explain whether FHI has a similar intention and if not, why not.

Response:

The Board's Filing Instructions for the 2010 3rd Generation Incentive Regulation Mechanism (IRM3) dated August 24, 2009 under Section SD1.2 allows for the adjustment if so ordered by the Board. If not ordered by the Board, Festival Hydro will consider requesting the Board to allow Festival Hydro, as part of the 2011, 2012 and 2013 3rd generation IRM filings, to adjust each of the three classes (Streetlights, sentinel lights and USL) below their ranges to bring the revenue to cost ratios within the target ranges by the 2013 rate year. The offsets will be to the classes which are on the higher side of their ranges.