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.

**FINAL SUBMISSIONS**

**OF THE**

**SCHOOL ENERGY COALITION**

1. These are the submissions of the School Energy Coalition ("SEC") in the application by Festival Hydro Inc. ("FHI" or the "Applicant") for an order approving just and reasonable rates for electricity distribution commencing May 1, 2010.

**Operating Expenses**

1. FHI's operating expenses have increased by a total of 6.9% ($260,769) between 2006 actual and 2010. Sixty per cent of that total increase, or $158,458, was due to inflationary labour cost increases.[[1]](#footnote-1) Fuel costs ($122,377 between 2007 and 2010) are the next largest cost driver.
2. SEC believes generally that FHI has done a good job of keeping its OM&A cost increases to a reasonable level.
3. SEC does however has concerns with particular items in FHI's 2010 expense forecast. They are as follows:

a.) Fuel Costs

1. FHI's fuel costs increased by $63,122 in 2008 over 2007 [Exhibit 4, Tab 2, Schedule 3, pg. 1]. FHI states that this is due to very high oil prices in that year. Indeed, crude oil prices spiked in 2008, but have come down considerably since then.
2. FHI has said that its 2010 estimate for fuel costs is derived by applying the same inflationary factor applied to all other non-labour OM&A items- 2.3% [SEC IR#6].
3. In SEC's submission, the inflationary factor applied to fuel costs is unreasonable. It builds on 2008 fuel costs that were the result of anomalous price spike. In fact, 2010 fuel costs are at or below their 2007 level.[[2]](#footnote-2)
4. SEC submits that the extraordinary increase in fuel costs in 2008 should be removed from FHI's 2010 OM&A forecast. That would mean a reduction in 2010 OM&A costs in the amount of $63,122.

b.) Bad Debt Costs

1. For 2010, FHI has forecast bad debt costs of $121,395.58. This is 62% higher than 2008.
2. The 2010 forecast was derived by taking an average of the 2006 to 2009 period [Exhibit 4, Tab 2, Schedule 3, page 12]. The four year average, however, includes two years that appear to be anomalies. In 2006, the total was $152,889, far above the average of the subsequent years. In 2009, the total was $146,037. This was due mainly to the fact that a single large customer went bankrupt in 2009, resulting in a $61,037 bad debt charge.
3. Excluding the $61,037 in 2009, the four-year average would be $106,136. This is still 42% higher than 2008 and 25% higher than 2009 if the $61,037 bankruptcy is excluded. The reason is that 2006 was also an unusually high year, and therefore taking a four year average produces a 2010 forecast that is unusually high.
4. In SEC's submission, the 2010 forecast should be $90,000. This is still 20% greater than 2008 and therefore takes into account the fact that the current economic conditions will likely result in higher bad debt costs. FHI's forecast, however, at 62% higher than 2008, is, in SEC's submission, not reasonable.

c.) Reduction for Impact of Harmonized Sales Tax

1. The provincial government will be replacing the provincial sales tax with a harmonized sales tax as f July 1, 2010. As a result, PST embedded in OM&A will, when replaced by the HST, be subject to an input tax credit.
2. SEC believes that an adjustment should be made to 2010 OM&A to reflect the fact that FHI will effectively no longer pay PST on purchases after July 1, 2010.
3. In response to an interrogatory from Energy Probe, KWHI estimated the amount of PST it paid in September 2009 was $11,500, 25% of which was capitalized. FHI also states that that the month chose is representative of an average month of purchases. [Energy Probe IRR#1].
4. SEC believes therefore that an appropriate reduction to OM&A is $51,750. That is 75% (the OM&A portion) of $11,500, times twelve months, divided by two to reflect the fact that the change will occur half way through the test year.
5. SEC agrees with FHI that this matter impacts all LDC's. However, in the absence of direction from the Board intervenors are left with a risk that if nothing is done in this proceeding then ratepayers may not have an opportunity to have the matter addressed at all.
6. In addition, although the issue is common to all distributors, it is essentially a forecasting issue. It is essentially no different than forecasting operating expenditures which, like PST, are also common to all distributors even though different distributors may use different forecasting methodologies. The question is whether the method used is appropriate for that distributor. Therefore, SEC believe it is possible to address the issue in the context of a rate application.

**Cost of Capital**

1. SEC has two issues with FHI's requested debt costs: a.) it has used the Board's deemed long-term debt rate for its embedded affiliate debt, which is contrary to the Board's December 2009 Cost of Capital Report; and b.) it has used an inflated cost rate cost of the loan it anticipates receiving from Infrastructure Ontario.

*a.) Embedded Affiliate Debt*

1. FHI has two Promissory Notes from its shareholders- one for $13,900,000 issued to the City of Stratford, with an interest rate of 7.5% per annum, and one for $1,700,000 issued to the City of Stratford with an interest rate of 7.25% per annum.
2. Together these Notes represent a total indebtedness of $15,600,000. FHI is asking that the Board's deemed long-term interest rate be used to calculate the cost rate of the loans. [Ex. 5, Tab 1, Schedule 1, pg. 1]
3. The Report of the Board on Cost of Capital, issued December 11, 2009, however, states that the deemed interest rate will act "as a ceiling" on the cost rate of the debt. In SEC's submission, that means that if the actual interest rate payable under the Note is lower, then that rate should be used. If the interest rate is higher than the deemed rate, then the deemed rate is used.
4. For debt that is callable on demand, the rate used as the ceiling is the current deemed interest rate. For debt that is not callable on demand, the ceiling rate is the deemed long-term rate at the time of issuance.
5. The City of Stratford are callable on demand. Therefore, the ceiling rate, in SEC's submission, is the current deemed long-term debt rate.
6. SEC submits, therefore, that FHI's debt should be recalculated to use the actual debt rates for the two Promissory Notes issued to the City of Stratford, namely 7.25% and 7.5% respectively.

*b.) Infrastructure Ontario Loan*

1. FHI has included in its capital structure, under long-term debt, the projected cost of a loan to be obtained from Infrastructure Ontario. Although the only evidence in respect of the loan is that the cost rate is 5.04%, FHI has chosen to use a cost rate of 6% in its application. The purpose of using 6%, according to FHI, is to allow "for some interest rate volatility between now and when the loan is drawn upon in 2010" [Exhibit 5, Tab 1, Schedule 1, pg. 2].
2. Interest rates can go up or down from the forecast level. FHI confirmed in an interrogatory response [SEC IR#1(a)] that it has not provide an allowance for a decrease in interest rates between the time of the application and the time the loan is taken out.
3. In fact, interest rates have declined since the original quote was obtained. The 5.04% cost rate was obtained in June 2009. The interest rate on Infrastructure Ontario website as of January 27, 2010 is 4.42%.[[3]](#footnote-3)
4. FHI also confirmed in an interrogatory response that it does not have any other information about the Infrastructure Ontario loan other than that posted on Infrastructure Ontario's website.
5. SEC believes the cost rate included for the Infrastructure Loan in the pre-filed evidence, 6%, is unreasonable and not supported by even the forecast available at the time the application was filed. Even that forecast, however, has now been supplanted by more up to date information that shows a lower cost rate. SEC believes the most up to date forecast, 4.42%, should be used.
6. SEC submits that the combination of the above results in long-term debt reduction of $76,506.20, calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Amount of Debt** | **Cost Rate (%)** | **Cost ($)** |
| **I. Actual Cost of Debt** |  |  |  |
| City of Stratford I-November 1, 2000 | $13,900,000.00 | 7.50% | $1,042,500.00 |
| City of Stratford II-November 7, 2002 | $1,700,000.00 | 7.25% | $123,250.00 |
| Infrastructure Ontario- 2010 | $2,500,000.00 | 4.42% | $110,500.00 |
| **Total Funded Debt** | **$18,100,000.00** |  | **$1,276,250.00** |
| Weighted Average Cost of Debt |  |  | **7.05%** |
|  |  |  |  |
| **II. Applied on a Rate-Regulated Basis** |  |  |  |
| Deemed Long-Term Debt | $22,166,845.00 |  |  |
| Weighted Average Cost of Debt | 7.05% |  |  |
| Deemed Cost of Debt | $1,563,007.51 |  |  |
|  |  |  |  |
| **III. Calculating Reduction in Long-Term Debt Cost from As-Filed** |  |  |  |
| Deemed Cost of Debt using actual | $1,563,007.51 |  |  |
| Deemed Long-term interest: **As-Filed** | 1,639,513.71 |  |  |
| **Difference** | **-$76,506.20** |  |  |

**Other Distribution Revenue**

1. In the pre-filed evidence, FHI forecasts Other Distribution Revenue at $659,450. This is approximately equal to the 2009 level but lower than any other year between 2006 and 2008. SEC has concerns about two of the sub-categories of revenue within the Other Distribution Revenue category.

i.) Late Payment Charges

1. The 2010 forecast for Late payment set out in the pre-filed evidence is $128,414. This is just 2.2% higher than 2008.
2. The forecast for Bad debt charges in the OM&A section of the evidence, however, shows a large increase in 2010. Bad debt costs are forecast to be $121,395 in 2010, up 62% over 2008.
3. In SEC's submission, the factors that lead to an increase in bad debt costs would logically also lead to an increase in late payment charges.

ii.) Other Distribution Revenue

1. Other Distribution Revenue and Other Income and Expenses are also down in 2010 (forecast $323,376). In fact, the 2010 projection is lower than any other year in the 2006 to 2010 period. FHI cited a number of reasons for this, including the fact that scrap metal prices declined in the last quarter of 2008 and the interest rate it receives on bank balance also declined.
2. In response to an interrogatory, FHI provided updated forecast for both Other Distribution Revenue and Other Income and Expenses. Together the revised forecast for the two items now totals $383,641 [see VECC IR (supplemental) #23]. This is $60,265 higher than the original forecast.
3. FHI states in the response that it is not equitable to choose one item for updating [VECC IR (supplemental) #23].
4. However, SEC submits that it is appropriate to use the revised forecast. The revised forecast is still only 1.5% higher than 2009 versus a 3.7% decrease in the original forecast. It appears therefore that the original forecast was based on assumptions, in particular with respect to scrap metal prices, that were anomalous. The revised forecast is likely more accurate, as demonstrated by the fact that it is more consistent with previous years.

**Cost allocation**

1. The proposed revenue to cost ratio for Streetlighting in 2010 is 50.7%, up from 28.9%. Other LDC cost of service applicants have similarly proposed that Streetlighting be moved part way to the minimum level in 2010, but have also planned on moving to 70% in 2011. FHI has not in its application indicated any intention of doing so. However, in response to an interrogatory, FHI said that it would consider, in its 2011, 2012 and 2013 3rd Generation IRM filings, seeking permission to adjust each of the classes (Streetlighting, Sentinel and USL) below the minimum level to bring them within the target ranges by 2013 [SEC IR#10].
2. In SEC's submission, there is no reason to wait until 2013. The standard practice is to move half way to the minimum level in each year. That is in itself a rate mitigation measure- it is an alternative to doing so all in a single year. Therefore, SEC submits that FHI be directed to move the three aforementioned rate classes to the minimum level by 2011.

All of which is respectfully submitted this 27th day of January, 2010.

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1. See Exhibit 4, Tab 2, Schedule 3, pg. 1, columns 2007 to 2010. [↑](#footnote-ref-1)
2. See U.S. Department of Energy website tracking retail gasoline prices from 1990 to 2010: <http://tonto.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MG_RT_US&f=W> [↑](#footnote-ref-2)
3. See <http://www.infrastructureontario.ca/en/loan/rates/sectors/local_distribution_rates.asp>. FHI states in evidence that the cost rate is based on a 15-year loan with blended principal and interest payments [Ex. 5, Tab 1, Schedule 1, pg. 1]. The cost rate is therefore found in the 15 year row under the column "Amortizer", which is the rate applied when borrower pay "pay equal amounts of blended principal and interest every six months." See definitions page at http://www.infrastructureontario.ca/en/loan/faq.asp. [↑](#footnote-ref-3)