EB-2009-0267

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 Kitchener Wilmot 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 Kitchener Wilmot Hydro Inc. ("KWHI" or the "Applicant") for an order approving just and reasonable rates for electricity distribution commencing May 1, 2010.

2. In its Submissions in Chief KWHI has made a number of changes to operating expenses, revenue offsets, PILS, which are summarised at paragraph 53 of the Submissions in Chief. Together these adjustments reduce the revenue deficiency by $581,230 and reduce revenue requirement by $445,013. SEC believes the changes are appropriate.

Rate Base and Capital Expenditures

3. In its Submissions in Chief, KWHI accepted certain changes to its working capital calculations to reflect changes to operating expenses. In addition, KWHI states that its working capital will be adjusted to take into account new energy prices, both RPP and non-RPP. SEC believes both of these adjustments to working capital are appropriate.

4. With respect to capital expenditures, SEC believes that these should be reduced to reflect the change in provincial sales taxes with the move to the harmonized sales tax on July 1, 2010. This issue is discussed in greater detail under OM&A below, however the net result is a reduction in 2010 capital expenditures in the amount of $367,431.

Operating Expenses

5. KWHI's test year forecast of controllable operating expenses is 8.4% greater than 2008 actual. The progression includes a projected increase in 2009 (over 2008) of 3.4% and an additional increase in 2010 of 4.8%.

6. However, as of September 2009, KWHI's expenses were actually $477,260 lower than the equivalent period from the previous year. [Energy Probe IRR#25].

7. SEC submits that KWHI's 2010 OM&A forecast is substantially over-stated. In particular, SEC believes the following adjustments to OM&A should be made:

2010	Adjustments	
Opening Balance		$14,576,026
Less:		
Reductions already acknowledged by KWHI (LEAP expenses, oral hearing costs, and IFRS costs)	$163,976	
Additional Reductions Proposed by SEC:		
a.) Over-time	$401,346	
c.) Bad Debt	$10,000	
d.) PST Reduction	$40825	
Total reduction	$575,392	$575,392
Adjusted OM&A		**$14,000,634**
Adjusted OM&A vs. 2008		4.1%

a.) Over-time

8. OM&A costs increased in 2008 by $401,416 due to increased over-time expenses [Ex. 4, pg. 6, Table 3].

9. In response to an interrogatory by SEC, the company states that over-time expenses in 2008 were higher largely due to a series of major storms that caused major damage to the distribution system [SEC IR #4]. In fact, the company points out that one of the storms in particular was "no ordinary major storm" and that it in fact caused extensive damage and related extensive over-time expenses:

> It is worth noting though, that July 22, 2008 was no ordinary major storm. Although there were no reports of a tornado, the damage was tornado-like (downed power lines, broken and uprooted trees, etc.) for a two kilometre long swath that ran roughly along Stirling Ave. Accompanying this was widespread wind damage over a much larger area. Everyone KW Hydro could put in the field worked around the clock for several days to restore power to the worst hit areas. Cleanup efforts continued on for perhaps another week. This was much, much more severe and widespread than the May 15, 2007 storm and far worse than the tornado that went through Gravenhurst this year.

10. Despite the fact that the extraordinary over-time costs in 2008 clearly resulted from a series of major storms, these costs were maintained at the 2008 level in both the 2009 bridge year OM&A estimate as well as the 2010 test year forecast. With respect to future over-time costs, KWHI states as follows:

> Most of these overtime costs are non-discretionary and outside the control of KW Hydro. The frequency and severity of storms is difficult to predict. Although the number of new service installations will be less than 2006 and 2007, the advance of stimulus monies to municipalities is expected to result in significant pole line and underground cable relocation work in 2009 and 2010 and hence a similar amount of overtime is budgeted for these years

11. In SEC's submission, KWHI's explanation for maintaining over-time at the 2008 level is not plausible. Other than increases in capital expenditures, KWHI has not identified any major new increases to its operations and maintenance work programs.

12. In addition, as stated above, and despite KWHI's 2009 estimated OM&A, the actual OM&A as of September 2009 was substantially less than for the same period in 2008.

13. Therefore, SEC submits that KWHI's forecast that 2010 over-time costs will be identical to 2008- a year of extraordinary over-time caused by unusually heavy storm activity- is not supported and should be removed from the 2010 forecast.

b.) Bad Debt Costs

14. Bad Debt expenses in 2009 are projected to be 26% higher than 2008 [$210,000 vs. $166,753- see Ex. 4, pg. 13]. KWHI states in the evidence [at Ex. 4, pg. 10] that bad debt costs are forecast to increase substantially in 2009 due to the recession but "fall back in 2010 due to the recent changes announced by the Board with the LEAP program." However, KWHI has forecast a further increase in bad debt in 2010, to $220,000, a $10,000 increase over 2009.

15. SEC submits that the effects of the recession have already been built in to the 2009 estimate of a 26% increase in bad debt. SEC believes that a further increase in 2010 is not warranted and has not been supported in the evidence.

c.) Provincial Sales Tax

16. 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.

17. In response to an interrogatory from Energy Probe, KWHI estimated the amount of PST it paid in each of 2006, 2007, 2008 and 2009 (up to September). KWHI also stated that the OM&A portion of the total would equal approximately 10-20%.

18. SEC believes that an adjustment should be made to 2010 OM&A to reflect the fact that KWHI will effectively no longer pay PST after July 1, 2010.

19. SEC believes that a reasonable forecast of the PST costs embedded in 2010 OM&A forecast is to take an average of the years 2006 to 2008, or $816,515, multiplied by 10%, which is the low end of KWHI's estimate for the OM&A portion. That produces a forecast of $81,651 of PST embedded in OM&A for all of 2010. Because the tax change will only be applicable for half the year, we take half that amount, $40,825, as a reduction to 2010 OM&A.

20. The same methodology would produce a reduction in projected 2010 capital expenditures in the amount of $367,431. That is, take the capital portion of the average PST from 2006-2008 (90% of $816,515, or $734,593) and divide by two to reflect the fact that the impact will only be felt for half the year.

<u>Other OM&A</u>

Depreciation Expense

21. SEC agrees with Board Staff's submissions that KWHI should user the half-year rule for recording distribution expenses in respect of 2010 capital additions. That would result in a reduction to depreciation expense, and revenue requirement, of $517,066 [VECC IR#56]

<u>Cost of Capital</u>

<u>a.) Cost of Debt</u>

22. KWHI has requested a cost rate of 7.62% for its long-term debt, which is the Board's deemed long-term debt rate.

23. In support of that rate, KWHI points to the fact that the "Established Rate" of the two Promissory Notes (one issued to the City of Kitchener in the amount of $70,997,576 and one with the Township of Wilmot for $5,964,566) are pegged to the "interest rate…that is equal to the interest rate on debt which the Ontario Energy Board or its successor may permit Kitchener-Wilmot Hydro to pay for rate making purposes in the establishment of distribution rates, and the inte4rest rate as aforesaid shall change from time to time." KWHI has also stated that the Notes are callable on demand.

24. First, the notes are not callable on demand as defined by the Board. The Notes state that the holders may demand repayment upon eighteen months written notice to KWHI. That means they are not callable during the rate year and are therefore not callable on demand for rate making purposes.

25. Second, although the Established Rate under the Notes are technically variable rates, they are pegged to be exactly equal to the Board's deemed long-term debt rate. The Report of the Board, however, states that the deemed rate is a ceiling rate:

> For debt that has a variable rate, the deemed long-term debt rate will be a ceiling on the rate allowed for that debt. This applies whether the debt holder is an affiliate or a third-party
>
> [Report of the Board, pg. 53]

26. The Report then states that applicants still have the onus of demonstrating the prudence of their debt costs:

> A Board panel will determine the debt treatment, including the rate allowed based on the record before it and considering the Board's policy (these Guidelines) and practice. The onus will be on the utility to establish the need for and prudence of its actual and forecasted debt, including the cost of such debt.
>
> [Report of the Board, pg. 54]

27. Earlier in the Report the Board also states that the deemed long-term rate should only be used in exceptional circumstances:

> The Board is of the view that electricity distribution utilities should be motivated to make rational decisions for commercial "arms-length" debt arrangements, even with shareholders or affiliates.
>
> Report of the Board, pp. 53.

28. The terms of the Promissory Note allow KWHI to repay the loans at any time "without notice or bonus".

29. In SEC's submission, a company that was truly acting at arm's length from a commercial lender would not be acting prudently if it were to continue to pay interest at the rate of 7.62% per annum when it was free to obtain lower cost debt from third parties.

30. When asked whether there were any impediments to securing third party financing, KWHI states that its shareholders have no interest in redeeming the Notes, and therefore the company would not be able to provide the type of shareholder guarantee that a commercial lender would likely require.

31. In SEC's submission, however, that should not be a relevant consideration. The fact that these shareholders may not want to provide a guarantee so as to allow the company to obtain lower priced debt in the open market is purely a function of the fact that the current regulated environment the shareholders profit from the higher rate.

32. There is evidence that KWHI could obtain financing at less than 7.62%. Current lending rates from Infrastructure Ontario, for example, range from a low of 2.85% for 5-year terms to a high of 5.36% for 40-year terms.

33. Even if the entire amount of the Promissory Notes could not be repaid, SEC submits that the difference between the amount of the notes ($76,962142) and KWHI's deemed long-term debt for 2010 ($91,343,525), or $14,381,383, could certainly be funded at a rate that is much lower than the Board's current deemed long-term debt rate.

a.) Return on Equity

34. In its Submissions in Chief, KWHI states that it has not yet updated its return on equity calculation in view of the Report of the Board on the Cost of Capital for Ontario's Regulated Utilities as "the other revised parameters that would be used in the calculation of its updated cost of capital (long and short-term debt rates) are not yet known." SEC is therefore unable to make submissions on this issue, as it is not clear whether KWHI is seeking a higher return on equity or not.

35. However, in the event KWHI does seek a higher return on equity in line with the Board's December 2009 Cost of Capital report, SEC would like to point out that the moving from 8.01% to 9.75% return on equity is a revenue requirement increase, when grossed up for taxes, of approximately $1.6 million.

36. Using KWHI's cost allocation formula, the extra revenue will be recovered from rate classes as follows:

Rate Class	% Allocation	Extra $ from class
Residential	55.54%	$888,640
GS<50kW	13.23%	$211,680
GS>50kW	28.29%	**$452,640**
Large Use	1.55%	$24,800
Street Light	1.08%	$17,280
USL	0.31%	$4,960
	100.00%	$1,600,000

37. The table shows the costs to ratepayers of the increased return on equity is significant. The GS>50kW rate class will be particularly affected. This class, with just 1,003 customers, will be asked to absorb an additional half million dollars in distribution expenses. The Large Use class, with just two customers, will be paying an additional $12,400 each. The customers in these rate classes, which represent the economic foundation of KWHI's service area, have been hardest hit by the current economic crises.

38. In the event KWHI seeks, and the Board grants, a higher return on equity, SEC believes that the revenue requirement impact on each customer class, in the manner set out above, should be specified in the Board's order. SEC believes that KWHI ratepayers deserve to know precisely how much more they are being asked to pay as a result of the increased return on equity as well as the reasons for it.

39. In addition, SEC adopts Energy Probe's submission that the return on equity should, at a minimum, be reduced by fifty basis points to remove the flotation costs embedded in the Board's return on equity.

Rate Design

40. Despite the increase in revenue requirement, KWHI is proposing to keep the fixed monthly charges for every rate class frozen at their existing levels. This means that the fixed/variable split for each rate class is falling and, more importantly, the increase in revenue requirement will be recovered entirely through increases to the variable rate.

41. In some rate classes, this produces highly inequitable rate increases within the class. The distribution rate bill impacts in the GS<50kW rate class, break down as follows:

GS<50kW Distribution Bill Impact	
Consumption	**Dx Bill Impact**
800 kWh	5.99%
1,000kWh	7.11%
2,000kWh	11.32%
5,000kWh	17.56%
10,000kWh	21.52%
15,000kWh	23.4%

42. As can be seen from the above table, the impact of the increase in revenue requirement are not spread equitably across the rate class. Lower volume users have a relatively modest increase in their distribution bill whereas higher volume users have an extremely large increase. It appears as though these highly uneven bill impacts are specific to the GS<50kW rate class.

43. KWHI has stated that its fixed charges are already above the minimum level, and that in its view the Report of the Board on Cost Allocation stipulates that in this circumstance it should not increase the fixed service charge.

44. The result, however, is extremely uneven distribution bill impacts within the rate class.

45. SEC submits that a better approach would be to increase the fixed service charges for the GS<50kW rate class proportionate to the increase in revenue requirement in this application, but that during the IRM period the fixed charges remain frozen. That would effect a more gradual reduction in the fixed charge towards the maximum level and avoid the highly uneven distribution rate impacts seen in the bill impact tables.

All of which is respectfully submitted this 28th day of January, 2010.

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