January 28, 2010

BY EMAIL & COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2009-0267
Kitchener-Wilmot Hydro Inc. – 2010 Cost of Service Application
Energy Probe Argument

Pursuant to Procedural Order No. 3, issued by the Board on December 10, 2009, please find two hard copies of the Final Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2009-0267 proceeding for the consideration of the Board. An electronic version of this communication will be forwarded in PDF format.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc: Jerry Van Ooteghem, Kitchener-Wilmot Hydro Inc. (By email)
Randy Aiken, Aiken & Associates (By email)
Intervenors of Record (By email)

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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 Kitchener-Wilmot Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2010.

ENERGY PROBE RESEARCH FOUNDATION ("ENERGY PROBE")

ARGUMENT

January 28, 2010

KITCHENER-WILMOT HYDRO INC.
2010 RATES

EB-2009-0267

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A - INTRODUCTION

This is the Argument of the Energy Probe Research Foundation ("Energy Probe") related to the setting of 2010 rates for Kitchener-Wilmot Hydro Inc. ("KW Hydro") effective May 1, 2010.

This Argument has been structured to reflect the major components of the KW Hydro evidence. Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of KW Hydro. However, in order to minimize intervenor time and costs, a comprehensive impact analysis has not been undertaken. If the Board accepts any or all of the Energy Probe submissions, it is assumed that the direct and indirect impacts will be determined by KW Hydro and reviewed by intervenors and Board Staff through the associated draft rate order. An example of a comprehensive impact analysis would include the direct impact on rate base of a reduction in $10,000 in OM&A expenses and a $25,000 reduction in capital expenditures. Depreciation expense would also be directly impacted by the capital expenditure change. The indirect impacts would include the change in total cost of capital and taxes (due to CCA and interest expense changes) and the change in the working capital allowance.

KW Hydro is forecasting a significant deficiency. As shown in the Revenue Sufficiency/Deficiency sheet in Table 3 of Exhibit 1, the gross revenue deficiency is $6,157,264 on forecasted total net revenues (assuming no rate changes) of $34,473,918. The deficiency represents an increase in total revenues of nearly 18%.

Adjustments to the Cost of Service Application

Based on the responses to first and second round interrogatories, KW Hydro has made a number of proposed adjustments to the cost of service application. A summary of these changes made to the application was provided by KW Hydro in response to VECC Interrogatories #32 (g) and #58. These changes, in summary, include a reduction in OM&A costs associated with the removal of LEAP related costs, a reduction in rate rebasing costs and the transfer of IFRS transitions costs to a deferral account; increases to other distribution revenues associated with street lighting services, specific service charges and late payment charges; and changes to the PILS calculations related to the capital tax, income tax rates and tax credits. KW Hydro has provided a revised gross revenue deficiency based on these changes in Table 7 of its Submission-in-Chief dated January 12, 2010. The revised gross deficiency is $5,576,034, a reduction of more than $580,000 from that filed.

Energy Probe accepts these changes as appropriate, except where noted in the submissions that follow.

B - RATE BASE

a) Capital Expenditures

i) Reduction in 2009 Capital Expenditures

As shown in Table 1 of Exhibit 2, KW Hydro had forecast capital expenditures in the 2009 bridge year of $19,714,100. After taking into account the contributed capital and the change in work-in-progress, the change to rate base in the 2009 bridge year was forecast to be $11,228,273 (Exhibit 2, Table 7 & Table 15).

The response to Energy Probe Interrogatory #3 indicates that KW Hydro updates and revises its capital budgets and that it was currently in the process of updating the budgets for both 2009 and 2010 and that this process should be completed by the end of November, 2009.

In the response to Energy Probe #38, provided as part of the December 22, 2009 responses to second round interrogatories, KW Hydro provided revised Tables 1, 7 & 15 that show a significant decline in both capital expenditures and the change in rate base for the 2009 bridge year. In particular, the revised 2009 capital expenditures are shown as $15,984,800, a decrease of $3.7 million or 19% from the original forecast. The primary driver identified by KW Hydro in the response for this decline is the failure, during test, of two large power transformers that will delay the remaining payments for these units until 2010.

After taking into account the contributed capital and the change in work-in-progress, the change to rate base in the 2009 bridge year is now forecast to be $10,403,836 (Energy Probe Interrogatory #38, Tables 7 & 15 Revised). This is a reduction in the 2009 addition to rate base of more than $800,000. A comparison of Table 15 in Exhibit 2 and the Revised Table 15 provided in the response to the Energy Probe interrogatory shows a reduction in the net book value at the end of 2009 of nearly $1.1 million, reflecting both the reduction in capital additions and the impact on the accumulated depreciation related to the change in capital contributions.

Energy Probe submits that the contention put forward by KW Hydro in the response to the Energy Probe Interrogatory that the revised numbers are their internally updated budgets and do not reflect adjustments that would be made through a rate rebasing process is incorrect. The evidence provided indicates that there has been a substantial reduction in the expected increase to rate base in the bridge year that has a material impact on the 2010 rate base and revenue requirement. It is not clear why internally updated budgets should not be considered relevant for a cost of service application. On the contrary, Energy Probe submits that it is a more recent forecast and reflects the current expectations of the distributor. The Board should take this information into account when determining the level of rate base.

ii) Level of 2010 Capital Expenditures

As shown in Table 1 of Exhibit 2, KW Hydro had forecast capital expenditures in the 2010 test year of $22,457,100. After taking into account the contributed capital and the change in work-in-progress, the change to rate base in the 2010 test year was forecast to be $27,256,312 (Exhibit 2, Table 8 & Table 16).

In the response to Energy Probe #38 noted above, KW Hydro provided revised Tables 1, 8 & 16 that show the revised capital expenditures and the change in rate base for the 2010 test year. In particular, the revised 2010 capital expenditures are shown as $23,864,600, an increase of $1.4 million or 6.3% from the original forecast. The primary driver for this increase is the delay associated with the two large transformers noted above in 2009 to 2010.

After taking into account the contributed capital and the change in work-in-progress, the change to rate base in the 2010 test year is now forecast to be $26,558,949 (Energy Probe Interrogatory #38, Tables 8 & 16 Revised). This is a reduction in the 2010 addition to rate base of nearly $700,000. A comparison of Table 16 in Exhibit 2 and the Revised Table 16 provided in the response to the Energy Probe interrogatory shows a reduction in the net book value at the end of 2010 of nearly $2.0 million reflecting both the reduction in capital additions and the impact on the accumulated depreciation related to the change in capital contributions and the impact from the 2009 changes.

Energy Probe submits that the Board should approve the rate base for the 2010 test year based on the most recent updated budgets provided by KW Hydro that reflect their current forecasts of capital additions.

iii) Elimination of the Provincial Sales Tax

As noted below in Section F – Taxes, part c) HST Harmonization, Energy Probe submits that a reduction of $340,000 related to the elimination of the provincial sales tax effective July 1, 2010 is an appropriate reduction that should be made to the 2010 capital additions forecast.

b) Working Capital

i) Cost of Power Methodology

Energy Probe does not support the methodology used by KW Hydro to calculate the commodity component of the cost of power. As shown in the response to Energy Probe Interrogatory #5, KW Hydro has used the weighted average RPP price for non-RPP volumes, along with the RPP prices for the first and second tier RPP consumption.

Energy Probe supports the latter approach that applies the appropriate RPP price to the volumes in the two tiers for RPP consumption. However, Energy Probe does not support application of the RPP price to non-RPP customers and volumes.

Energy Probe submits that an estimation of the kWh's that are associated with RPP consumers and the kWh's associated with non-RPP consumers and the application of the appropriate prices to these different sets of volumes to calculate the cost of power component of the working capital allowance is appropriate. This is especially important for a utility like KW Hydro where the working capital allowance associated with the power supply expense (excluding transmission and wholesale costs included in the cost of power) represents nearly 11% of the total rate base (Tables 10 & 21 of Exhibit 2). It is imperative to estimate as accurately as possible the impact on rate base of the commodity cost of power.

Energy Probe Interrogatory #40 requested that the KW Hydro update the cost of power component of the working capital allowance to reflect the October 15, 2009 RPP Report and to provide the calculation if the RPP and non-RPP volumes were used. It is clear that the use of RPP and non-RPP volumes has a significant impact on the cost of power. Based on the methodology used by KW Hydro, the commodity cost of power is $117,865,885 (Energy Probe Interrogatory #40 (b)) if the RPP price is applied to the non-RPP consumption, while with the application of the forecasted non-RPP price for non-RPP volumes, the cost of power declines to $114,478,726 (Energy Probe Interrogatory #40 (d)). This is a reduction of 2.9% or nearly $3.4 million, which translates into a reduction in rate base of more than $508,000.

Further, as noted in the response to Energy Probe Interrogatory # 40 (a) KW Hydro did not include the movement of any further customers/volumes to non-RPP status related to the November 2009 eligibility change. However, they did indicate that approximately 2.5% of total sales would be a proxy for this change. KW Hydro has reflected this increase in the non-RPP volumes shown in the remainder of the calculations provided in the interrogatory response. Energy Probe submits that this adjustment is appropriate.

Energy Probe submits that the use of separate prices for RPP and non-RPP volumes provides a more accurate estimate of the commodity cost of power. Given the significant impact on rate base, it is submitted that the Board should direct the distributor to reflect this methodology in its working capital allowance calculation. Energy Probe notes that KW Hydro has indicated its support for the methodology proposed by Energy Probe for the calculation of the commodity costs (Energy Probe Interrogatory #40 (d), after the table).

ii) Cost of Power Update

Consistent with Board Decisions related to 2009 cost of service rebasing applications (for example, EB-2008-0247 Decision and Order dated July 7, 2009 for Welland Hydro-Electric System Corp., page 19), Energy Probe submits that the cost of power should be updated to reflect the most recent cost of power forecast presented to the Board by Navigant and to reflect the latest Board approved transmission charges at the time of the Board's Decision in this proceeding. KW Hydro has updated the cost of power to reflect the most recent Navigant report in the responses provided to Energy Probe Interrogatory #40 and should be accepted by the Board.

Energy Probe also submits that the other cost of power costs should be updated to reflect the current rates at the time of the Board Decision.

iii) Changes to Controllable Expenses

Energy Probe submits that if the Board makes any adjustments to the controllable OM&A expenses in its Decision, these changes should be reflected in the calculation of the working capital component of rate base.

iv) Requirement for a Lead/Lag Study

Energy Probe submits that the Board should direct KW Hydro to undertake a lead/lag study in time for its next rates rebasing cost of service application. As shown in Table 10 of Exhibit 2, the 2010 test year working capital allowance is $23.3 million and represents more than 14% of the total rate base. This means that a one percentage point change in the 15% factor currently used to estimate rate base is equivalent to more than $1.6 million in rate base and represents nearly 1.0% of total rate base.

If the Board is concerned with the potential costs associated with a full lead/lag study, then Energy Probe submits that a lead/lag study should be undertaken for the cost of power component of the working capital calculation. As shown in Table 21 of Exhibit 2, the cost of power (including commodity costs, transmission costs, rural rate assistance and wholesale market service costs) accounts for approximately 90% of the total working capital allowance. A review of these expenses should be undertaken because of their significant impact on rates.

C - REVENUES

a) Forecast Methodology

Energy Probe has reviewed the comments of Board Staff provided in their Submission dated January 22, 2010. Energy Probe agrees with these comments in general and agrees that despite the shortcomings of the approach used by KW Hydro there is no viable alternative on the record in this proceeding.

b) Adjustments to the Forecast

Energy Probe submits that there are two adjustments that should be made to the forecast. The first is related to the normalized average residential consumption and the second is related to the kW/kWh ratios used for the GS > 50 kW, Large User and Streetlighting rate classes.

i) Normalized Average Residential Consumption

Based on its forecast methodology, KW Hydro has calculated that the normalized average residential consumption was 8,445 kWh (Exhibit 3, Table 13). KW Hydro then reduces this level by 1.0% in 2009 and a further 0.5% in 2010 to arrive at a 2010 average use forecast of 8,319 kWh (Exhibit 3, Table 17). This figure is then multiplied by the forecast number of residential customers to arrive at the residential kWh consumption forecast.

KW Hydro is justifying its forecasted decrease in 2009 and 2010 based on the impact of CDM programs. As an example they provide Table 14 in Exhibit 3 that shows an average annual consumption decline in 2007 of 3.48% due to CDM and OPA programs. However, their own evidence in Table 13 shows that the normalized actual residential consumption fell by only 0.76%, or 64 kWh, in 2007. In other words, if the CDM and OPA program reductions which totaled 229 kWh per customer are accurate, then there was an offsetting increase of 164 kWh per customer.

Energy Probe submits that KW Hydro has not provided any evidence to support its reductions of 1.0% in 2009 and 0.5% in 2010. The evidence provided in Table 13, however, does provide the historical change in residential normalized average consumption between 2004 and 2008. Average use has declined from 8,655 kWh to 8,445 kWh over this period. This decline is an average compound decline of 0.6% per year.

Energy Probe submits that this decline should be applied to the 2008 figure of 8,445 kWh for 2008 to yield a forecast 2010 average use of 8,344 kWh. The difference between this figure and the figure used by KW Hydro for 2010 (8,319), when multiplied by the number of residential customers (78,139) would add nearly 2,000,000 kWh to the residential kWh forecast.

Based on the evidence in this proceeding, Energy Probe submits that this change is appropriate.

ii) kW/kWh Ratios

Table 18 of Exhibit 3 shows the 2000 through 2008 kW/kWh ratios for the GS > 50 kW, Large User and Streetlighting rate classes. KW Hydro has used the average ratio over this period to convert the kW demand forecast for each of theses classes to a kWh forecast, which is needed to calculate the cost of power component of the working capital allowance.

Energy Probe submits that the Board should direct KW Hydro to use the same type of trend analysis for the kW/kWh ratios as the distributor has used for average use for the residential and GS < 50 kW classes. As can be seen in the data in Table 18, there is a clear trend to higher kW/kWh ratios for the GS > 50 kW and Large User classes, while there is a decline for the Streetlighting class. In particular, the compound annual growth rates for the ratio for these three classes are 3.5%, 2.8% and (1.1%), respectively.

Based on applying these growth rates to the 2008 actual kW/kWh ratios, there is an overall decline in the kWh consumption forecast of more 110,000,000 kWh (Energy Probe Interrogatory #14 (c)). This reduction in the kWh forecast does not impact on distribution revenues from these customers since they are billed on kW. The reduction does, however, have the impact of reducing the working capital allowance through a reduced cost of power. This has the impact of reducing the revenue requirement. KW Hydro has estimated this reduction to be more than $86,000, as shown in the response to the Energy Probe interrogatory.

c) Other Distribution Revenue

In its original filing, KW Hydro had a 2010 forecast for total other distribution revenue of $1,740,295 (Exhibit 3, Table 31). This amount was reduced by $15,000 to reflect the retention of one-half of the capital gain associated with the disposition of utility property (VECC Interrogatory #32 (a)).

As part of its Submission-in-Chief, KW Hydro has updated the other distribution revenue to $1,861,512 (Table 5), an increase of $136,217. This increase reflects an increase of $11,113 for Specific Service Charges (Energy Probe Interrogatory #18), an increase of $14,820 for late payment charges (Energy Probe Interrogatory #44), and an increase of $110,284 for revenues from street lighting capital and maintenance service revenues (Board Staff Interrogatory #9 (e) & Energy Probe Interrogatory #51 (a)).

Energy Probe accepts these adjustments to the Other Distribution Revenue as proposed by KW Hydro as being appropriate.

D - OM&A EXPENSES

Energy Probe has reviewed the change in OM&A costs on the basis of both an overall or envelope approach (part (a) below) as well as specific adjustments of individual expenses (part (b) below) arrived at through a more comprehensive review of the OM&A expenses.

a) Overall Increase in OM&A Costs

KW Hydro is forecasting total OM&A costs, excluding depreciation, PILS and interest costs of $14,190,476 for the 2010 test year (Exhibit 4, Table 1). This is an increase of 6.4% in 2010 from the level of $13,331,700 forecast for the 2009 bridge year, which in turn is an increase of 5.6% from the actual level of expenses recorded in 2008. It should be noted for clarity that both of the 2009 and 2010 figures include $90,000 related to charitable donations that are not included in the revenue requirement.

As shown in Table 7 of the Submission-in-Chief dated January 12, 2010, total OM&A costs forecast for the 2010 test year have been reduced by $163,976 to $13,936,500 (excluding charitable donations). This represents an increase of 5.2% over the forecasted level of OM&A expenditures in 2009 (also adjusted for the removal of $90,000 in charitable donations). The adjustments accepted by KW Hydro relate to LEAP funding ($46,976), rate rebasing costs ($74,000), IFRS related costs ($43,000). Energy Probe accepts these reductions, subject to any comments below.

In response to Energy Probe Interrogatory #38 (b) KW Hydro provided an updated operating budget as of the end of November, 2009. The OM&A information provided in this update indicates OM&A expenditures for 2009 that are significantly below those forecast by KW Hydro for the 2009 bridge year.

The updated OM&A forecast for the 2009 bridge year is $12,866,500 as compared to the original bridge year forecast included in the filing of $13,331,700. This is a reduction of approximately $465,000. KW Hydro attributes most of the 2009 reduction to 4 power line technician vacancies that were not filled until December, 2009. However, even accounting for these vacancies, the 2009 updated OM&A figure is lower than that originally forecast.

In light of the decline in inflation (see below) Energy Probe submits that an increase of 4.0% over the forecasted 2009 figures is a reasonable increase for 2010 OM&A expenses. Based on the 2009 forecast of $13,241,700 (with $90,000 in charitable donations removed), a 4% increase would result in a 2010 cost of $13,771,368. This level of expenditures is about $329,000 lower than the 2010 forecast provided by KW Hydro (excluding the charitable donations).

In summary, Energy Probe submits that on an envelope basis, a reduction in the 2010 OM&A expense forecast of $329,000 is appropriate.

b) Specific Adjustments

The following is a list of adjustments that Energy Probe submits are reasonable in light of the evidence provided in this proceeding. Where noted, KW Hydro has accepted the reductions in their Submission-in-Chief.

i) IFRS

KW Hydro included $43,000 in the 2010 revenue requirement for costs associated with implementation of IFRS (Exhibit 4, page 10 and Table 3). KW Hydro has indicated that these costs should be removed from the 2010 revenue requirement and included in the deferral account established by the Board for tracking the IFRS transitional costs. Energy Probe supports this proposal.

ii) Rate Rebasing Costs – Part 1

The total costs associated with this rates rebasing application have been forecast by KW Hydro to be $302,000 (Board Staff Interrogatory #14). KW Hydro has proposed to amortize a portion of these costs over 4 years. In particular, as indicated in Exhibit 4, page 31, KW Hydro has amortized costs associated with additional staff ($63,000), consultant and legal costs ($165,000) that total $228,000 over four years, resulting in $57,000 included in the 2010 revenue requirement. The remaining $74,000 of the $302,000 is identified in the response to Board Staff Interrogatory #14 as being related to the need for an oral hearing. As shown in the original evidence (Exhibit 4, Table 8), KW Hydro had not proposed to amortize this cost over 4 years. However, given the fact that there is no oral component to this application, KW Hydro has agreed to remove the $74,000 from the 2010 revenue requirement (Submission-in-Chief, paragraph 43). Energy Probe accepts this reduction as being appropriate.

Energy Probe also agrees that the amortization over 4 years is appropriate given the expected application of the IRM rates methodology for three years following this cost of service application.

iii) Rate Rebasing Costs – Part 2

Energy Probe submits that the remaining total cost of $228,000 is significantly too high. As shown in the following table, the approved regulatory costs associated with the 2009 rebasing distributors are significantly lower than $228,000. As the table illustrates, the average approved cost is less than $130,000.

File No.	Distributor	Approved Regulatory Cost
EB-2008-0222	CNPI - Eastern Ontario Power	75,000
EB-2008-0223	CNPI - Fort Erie	100,000
EB-2008-0224	CNPI - Port Colborne	241,197
EB-2008-0225	Centre Wellington Hydro Ltd.	163,000
EB-2008-0226	COLLUS Power Corp.	140,000
EB-2008-0233	Innisfil Hydro Distribution System Limited	148,000
EB-2008-0234	Lakeland Power Distribution Ltd.	104,000
EB-2008-0236	Midland Power Utility Corporation	125,000
EB-2008-0237	Niagara-on-the-Lake Hydro Inc.	100,000
EB-2008-0241	Peterborough Distribution Inc.	50,000
EB-2008-0245	Thunder Bay Hydro Electricity Distribution Inc.	99,000
EB-2008-0246	Tillsonburg Hydro Inc.	106,000
EB-2008-0247	Welland Hydro-Electric System Corp.	95,000
EB-2008-0248	WestCoast Huron Energy Inc.	140,000
EB-2008-0250	Westario Power Inc.	240,000
	Average	128,413
	Average excl. two highest and two lowest	120,000
	Median	106,000

Note - Does not include costs for London Hydro, PowerStream, Bluewater or ENWIN. In each of these cases these distributors had Decisions or Settlement Agreements that approved an overall level of OM&A expenses, with no Board Approved or Settlement Amount related to the COS rebasing expense.

The above table reflects 2009 rates proceedings where the majority of the proceedings followed the same process as that for KW Hydro. In particular, there were two rounds of interrogatories and no oral component to the proceeding. In some instances, such as the CNPI group of companies, there was an oral component to the proceeding that increased costs.

Energy Probe notes that included in the $228,000 forecast of KW Hydro is $15,000 for an LRAM/SSM consultant and $40,000 for an Asset Management consultant. These costs may not have been incurred by the distributors that rebased in 2009. As a result, Energy Probe submits that the recovery of these costs as proposed by KW Hydro over a four year period is appropriate.

Adjusting for these costs, the total amount of rebasing costs is reduced from $228,000 to $173,000. Energy Probe submits that a further reduction is warranted. In the July 10, 2009 Decision for Tillsonburg Hydro Inc. in EB-2008-0246, the Board found that the one-time consulting costs of $175,000 associated with the rebasing application to be *"excessively high"*. The Board reduced these costs by $100,000 to $75,000 which was in line with consulting costs for other distributors.

In this application KW Hydro has effective one-time consulting costs of $133,000. These costs relate to legal costs of $40,000, rate consultant costs of $30,000 and $63,000 for an additional staff position. Energy Probe submits that these one-time costs are excessive and should be reduced by $40,000. This would reflect one-time costs of $93,000 which is nearly 25% above the level approved by the Board in the Tillsonburg case noted above. This would reduce the rate rebasing costs, excluding the asset management and LRAM/SSM costs from $173,000 to $133,000 which is more in line with the costs approved by the Board in the 2009 rate rebasing applications.

Amortized over 4 years, the cost of $188,000 ($133,000 proposed above plus $15,000 for LRAM/SSM consultant plus $40,000 for asset management consultant) would be $47,000, a reduction of $10,000 from the forecast of $57,000 currently included in the 2010 test year revenue requirement.

iv) Elimination of the Provincial Sales Tax

As noted below in Section F – Taxes, part c) HST Harmonization, Energy Probe submits that a reduction of $60,000 related to the elimination of the provincial sales tax effective July 1, 2010 is appropriate.

v) LEAP Funding

KW Hydro has included $46.976 for funding associated with the Low Income Energy Assistance Program (Exhibit 4, Table 3). These are new costs (Board Staff Interrogatory #12).

KW Hydro has acknowledged that the Board's letter of September 28, 2009 indicated that the Board was deferring further work on LEAP as a result of a request from the Ministry of Energy. In that letter the Board noted that the Minister of Energy and Infrastructure requested that the Board not proceed to implement new support programs for low-income energy consumers in advance of a ministerial direction.

As a result, KW Hydro has agreed that the LEAP related costs should be removed from the revenue requirement. Energy Probe concurs.

vi) Wage Increases

KW Hydro contends that even with the current economic conditions and the low rate of inflation that a 3% annual increase in unionized wages is appropriate (Energy Probe Interrogatory #22). The response indicates that the distributor must pay competitive wages within the industry in order to attract and retain skilled and professional staff. KW Hydro also indicated in the response to the Energy Probe interrogatory that it had recently reached a new agreement with its outside union for an economic increase of 3% per annum.

KW Hydro has forecast the same 3% increase in both 2009 and 2010 for non-union employees as that for unionized employees. Energy Probe submits that the increase for this group of employees is excessive in 2010, given the economic conditions and low rate of inflation (see below). In the response to Energy Probe Interrogatory #22 (d), KW Hydro has indicated that the 3% increase budgeted for 2010 for all non-unionized employees amounts to an increase in costs of $66,107. Energy Probe submits that a reasonable increase for non-union employees is 2%. This is still more than the rate of

inflation and follows a number of years where the increases were substantially above the inflation rate. Reducing the increase to 2% for these employees would reduce the revenue requirement by approximately $22.000.

vii) Meter Maintenance

KW Hydro has forecast an increase of $100,000 in meter maintenance costs (Exhibit 4, Table 3). This has been labeled as "catch up" meter maintenance and this is defined more precisely on page 10 of Exhibit 4. In particular, KW Hydro states that it will need to get caught up on its meter maintenance on its non-smart meters.

Energy Probe submits that it appears that at least a portion of the incremental $100,000 cost is a one-time cost to "catch up". Any such costs should be amortized over 4 years to reflect the one-time nature of it in the test year.

As shown in the response to Board Staff Interrogatory #8, KW Hydro is forecasting meter maintenance costs of $220,000 in 2009 and $320,000 in 2010. Both of these levels are substantially below the levels recorded in previous years and reflect the switch to smart meters for the vast majority of customers (residential) over the 2009 through 2010 period. Energy Probe submits that a reasonable approach to the "catch up" is to assume that by the end of 2010 KW Hydro will have caught up with any maintenance issues for the GS < 50 kW meters and that an appropriate normalized forecast cost for these meters for the years beyond the 2010 "catch up" years is to average the 2009 and 2010 forecasts. This would reflect normal maintenance and would result in a forecast of meter maintenance costs of $270,000 in each of 2011, 2012 and 2013.

Based on the costs of $270,000 in each of 2011, 2012 and 2013 and the forecast, including "catch up" for 2010 of $320,000, the average cost over the 2010 through 2013 period is $282,500. Energy Probe believes this "normalization" is a reasonable approach given that any one-time "catch up" costs in the test year should be effectively normalized over the IRM period. The impact is a net reduction in the costs associated with meter maintenance of $37,500 in the test year.

viii) Non-Labour Inflationary Increase

The evidence states that KW Hydro removes inflationary costs due to labour increases and then estimates inflationary increases for the remainder of the OM&A expenses (Exhibit 4, page 9). In particular, KW Hydro has reduced the total OM&A costs by the total labour costs with the remaining amount multiplied by the inflation factor. For 2010 KW Hydro has used an inflation forecast of 2.25%. The impact of the inflation adjustment is an increase in OM&A costs of $130,255 in the test year (Exhibit 4, Table 3). This estimate was confirmed in the response to Energy Probe Interrogatory #47. That response also indicates that a 10 basis point change in the rate of inflation has an impact of $5,789.

Energy Probe submits that the Board should direct KW Hydro to update the impact of inflation on the non-labour OM&A costs to reflect the GDP IPI FDD inflation factor used to adjust rates for those distributors under the incentive regulation mechanism. KW Hydro has stated that it "agrees that the year-to-date inflation factor for 2010 for non-labour expenses should be used as an adjustment when the Board makes its Decision in this case" (Energy Probe Interrogatory #23 (e)).

Based on information for the first 3 quarters of 2010 available from Statistics Canada, the GDP IPI FDD inflation index is averaging 1.73%. Application of this rate would result in a reduction in the inflation forecast of 0.52% with an associated cost reduction of $30,000. Energy Probe has used this estimate in the summary table below, but notes that the inflation factor of 1.73% shows a declining trend in the first 3 quarters of 2009, from 2.79% in the first quarter, to 1.78% in the second quarter and to 0.62% in the third quarter. If this trend were to continue through the fourth quarter of 2009, the inflation factor could be even lower than the 1.73% used here.

ix) Summary

The following table summarizes the specific submissions of Energy Probe with respect to the reductions in OM&A proposed in this submission.

IFRS	($43,000)
Rate Rebasing Costs – Part 1	($74,000)
Rate Rebasing Costs – Part 2	($10,000)
Elimination of the Provincial Sales Tax	($60,000)
LEAP Funding	($46,976)
Wage Increases	($22,000)
Meter Maintenance	($37,500)
Non Labour Inflation Increase	($30,000)
Total	($323,476)

The total shown in the above table of $323,476 approximates the $329,000 overall reduction in OM&A costs calculated by Energy Probe on an envelope approach based on the envelope approach applied to the amended 2009 updated forecast of OM&A costs presented earlier in this submission.

Energy Probe submits that a reduction of approximately $325,000 based on both approaches shown above is reasonable.

E - DEPRECIATION & AMORTIZATION

a) Depreciation Rates Used

Energy Probe submits that the depreciation rates used by KW Hydro (Exhibit 4, Table 22) are consistent with the rates found in Appendix B of the 2006 Electricity Distributors Rate Handbook and should be accepted by the Board.

b) Half Year Rule

In its evidence KW Hydro indicated that it has used the half year rule for calculating the test year depreciation expense (Exhibit 4, page 53). However, as shown in the response to VECC Interrogatory #29, KW Hydro has calculated a full year of the depreciation associated with 2010 capital additions for some accounts.

In particular, KW Hydro has clarified that it calculates a full year of depreciation in the year in which pooled assets are added, but for assets that are not pooled, the depreciation is calculated based on the in-service month (Exhibit 4, page 53). KW Hydro has indicated that for the test year non-pooled asset additions, the assumption used is that all

additions will be subject to 6 months depreciation – in essence, the half year rule is applied (Energy Probe Interrogatory #53 (b), part (v)).

Energy Probe submits that there is no valid reason to record a full year of depreciation for additions related to pooled assets, while acknowledging the use of the half year rule for non-pooled assets. The half year rule as applied to non-pooled assets is a simplified forecast for in-service dates for the assets that comprise the non-pooled asset categories and assumes that these assets go into service in the middle of the test year.

The same approach should be used to reflect the in-service dates for pooled assets. The current approach as proposed by KW Hydro assumes that all pooled assets have an in-service date on the first day of the test year. This is no more realistic than assuming that none of these assets go into service until the last day of the test year. The use of the half year rule reflects the simplified approach that, on average, all the pooled assets go into service in the middle of the test year.

Energy Probe submits that KW Hydro has failed to follow the Board's policy that has established the use of the half year rule for calculating the depreciation expense in the test year and has significantly overstated the 2010 depreciation expense.

In the EB-2008-0230 Decision and Order dated December 1, 2009 for Greater Sudbury Hydro Inc., the Board stated that it's *"policy has established the half-year rule for all electricity distributors and this has been implemented by all distributors in the 2008 and 2009 cost of service proceedings."* (page 28) Energy Probe submits that the Board should direct KW Hydro to recalculate its depreciation expense based on the Board's policy and submit the details as part of the draft rate order.

Energy Probe submits that the Board should direct KW Hydro to use the half year rule for depreciation for all asset classes. Based on the response to VECC Interrogatory #56 (b), this would result in a decrease to the test year depreciation expense of $517,066.

c) Changes to Capital Expenditures

If the Board makes any changes to the capital expenditure forecast for 2009 and/or 2010, then Energy Probe submits that these changes should be reflected in the calculation of the depreciation expense calculated for the 2010 test year.

F - TAXES

Energy Probe submits that the distributor should calculate its income and capital taxes using the most recent information available, including tax rates that are expected to be applicable to 2010. This would include any changes that result from federal and provincial budgets that are known to the Board and other parties when the Decision is issued. Further, the appropriate tax rates should be applied. There are different federal and provincial tax rates that are applicable at different levels of taxable income.

a) Ontario Capital Tax

i) The Calculation

The calculation of the Ontario capital tax is shown in Table 27 of Exhibit 4. The calculation reflects the use of the forecasted rate base for 2010 less the exemption of $15 million with the difference multiplied by 0.150% for a total cost of $222,170.

In its response to Board Staff Interrogatory #15, KW Hydro acknowledged that the capital tax for 2010 should one-half of this amount or $111,085 to reflect the elimination of this tax as of July 1, 2010. This reduction is also acknowledged in the response to VECC Interrogatory #58. Energy Probe submits that this revised calculation is correct and should be accepted by the Board.

ii) Update to Rate Base

Energy Probe submits that if the rate base is changed as a result of the Board's Decision, then the capital tax calculation should also be updated to reflect the revised rate base figure.

b) Income Tax

i) General Income Tax Rates

As shown in Exhibit 4, Table 26, KW Hydro has used a federal tax rate of 18.0% and a provincial tax rate of 12.99% for 2010. The federal tax rate reflects a decline from 19.0% in 2009. The provincial rate of 13.0% reflects the current 2009 rate of 14.0% and the reduction in this rate effective July 1, 2010 to 12.0%.

Energy Probe submits that these tax rates are appropriate.

ii) Provincial Small Business Deduction and Surtax

The provincial small business deduction provides a lower provincial corporate income tax rate of 5.5% on the first $500,000 of business income. The benefit of this reduction is gradually phased out on taxable income between $500,000 and $1.5 million. This is achieved through the application of 4.25% surtax on taxable income between $500,000 and $1.5 million. If the taxable income is in excess of $1.5 million, there is no tax savings for a corporation.

Effective July 1, 2010, the small business tax rate is reduced from 5.5% to 4.5% on the first $500,000 of taxable income. The effective rate for 2010 is the average of these figures, or 5.0%. Also effective July 1, 2010, the surtax of 4.25% has been eliminated. For 2010, this means that the effective surtax rate applicable to taxable income between $500,000 and $1.5 million is 2.125%.

Energy Probe has estimated that these changes in the small business tax rates results in a reduction in income taxes payable for a distributor with taxable income in excess of $1.5 million to be $18,750 in 2010. KW Hydro has regulatory taxable income in excess of $1.5 million for the 2010 test year as shown in Exhibit 4, Table 26.

The $18,750 reduction in taxes is the difference between the small business reduction and the claw back associated with the surtax, as explained below.

The reduction associated with the first $500,000 in taxable income reflects the difference between the 13.0% general provincial tax rate and the small business tax rate of 5.0%. This 8.0% differential in the tax rate, when multiplied by the $500,000, results in a reduction of $40,000. The surtax claws back a portion of this reduction. Application of the 2.125% surtax rate to the $1.0 million difference between the $500,000 and $1.5 million of taxable income results in a claw back of $21,250.

KW Hydro has acknowledged that these tax savings total $18,750 (Energy Probe Interrogatory #36) and has reflected this reduction as a required adjustment in the response to VECC Interrogatory #58. Energy Probe agrees that this reduction should be applied to the KW Hydro revenue requirement.

iii) Adjustments to Utility Income

KW Hydro has made a number of adjustments to the utility income before taxes, as shown in Exhibit 4, Table 26. Energy Probe accepts the adjustments are appropriate, but notes that the figures provided may change based on the Board Decision related to the calculation of the depreciation expense added to income and capital additions in 2009 and 2010 that would flow through to the capital cost allowance deduction. Both of these figures should be updated to reflect the appropriate figures based on the Decision.

iv) Apprenticeship Training and Co-operative Education Tax Credits

As can be seen in the evidence at Exhibit 4, Table 26 and specifically in the line labeled "Less: ATTC", KW Hydro has made a deduction of $25,000 to reduce taxes for available tax credits. Energy Probe submits that this amount should be changed and that KW Hydro should include some of these credits as an addition to their taxable income.

In the response to Board Staff Interrogatory #16, KW Hydro has provided a revised forecast for the apprenticeship training tax credits for both 2009 and 2010. In particular, based on the number of apprentices forecast for 2010, 10 positions are eligible for the provincial tax credit. The provincial tax credit is 35% of qualifying wages to a maximum

of $10,000 per position and the eligibility period is 48 months in duration. Based on these parameters, KW Hydro has calculated the 2010 provincial apprenticeship tax credit to be $100,000. KW Hydro has acknowledged the increase from $25,000 to $100,000 as being appropriate, as indicated in the response to VECC Interrogatory #58.

In response to Energy Probe Interrogatory #30, KW Hydro indicated that it expects to employ 2 co-op students in 2010, with an associated Co-operative Tax Credit of $6,000. KW Hydro has acknowledged this as a required adjustment in their response to VECC Interrogatory #58.

KW Hydro is also eligible for a federal training tax credit of a maximum of $2,000 per eligible employee. As indicated in the response to Energy Probe Interrogatory #49 (b), KW Hydro did not include any federal training tax credit as it was not aware that such a credit was available. Based on the availability of this credit for the first 24 months of employment, KW Hydro has forecast a federal tax credit of $16,000 for 2010. Energy Probe submits that this amount is correct. KW Hydro has also acknowledged this as a required adjustment in their response to VECC Interrogatory #58 (c).

Energy Probe submits that the three tax credits noted above are appropriate and should be approved by the Board. However, it is not clear whether or not KW Hydro has included these tax credits in the calculation of the regulatory taxable income shown in Table 26 of Exhibit 4.

In addition to the inclusion of the tax credits as a direct reduction to the amount of tax payable, two of the tax credits need to be reflected as an addition to income. In other words, the net impact of the tax credits is the after tax value of the credits claimed. In particular, the provincial apprenticeship training tax credit and the co-operative education tax credit are both taxed in the year in which they are claimed. The federal tax credit claimed in any year is to be included in income in the following year and thus should not be included in the 2010 taxable income.

The impact of the total of $122,000 in tax credits to be claimed in 2010 will result in the addition to the regulatory taxable income. The $100,000 associated with the provincial apprenticeship tax credit and the $6,000 in the co-operative education tax credit would both be included in the adjustment to taxable income. The federal credit of $16,000 would not be included in the 2010 taxable income, as it is to be included in the following year. In total, Energy Probe submits that the addition to taxable income in 2010 related to the two tax credits should be $106,000 ($100,000 + $6,000).

Based on the addition of $106,000 to the taxable income and the application of the total tax rate of 30.99% this would increase taxes payable by $32,849. Application of the tax credits in the amount of $122,000 will result in a net reduction in taxes of $89,151.

v) Capital Cost Allowance

Energy Probe has reviewed the capital cost allowance continuity schedules shown at Exhibit 4, Tables 32 & 33 for 2009 and 2010 and believes they accurately reflect the capital additions for both years and the proper allocation of the capital expenditures to the CCA classes.

Energy Probe submits that any changes to the capital additions in 2009 and 2010 resulting from the Board's Decision should be reflected as changes in the CCA additions.

vi) Update to Regulatory Taxable Income

Energy Probe submits that if the regulatory taxable income is changed as a result of the Board's Decision, then the income tax calculation should also be updated to reflect the revised level of regulatory taxable income.

c) HST Harmonization

i) The Impact

The provincial sales tax ("PST") and the goods and services tax ("GST") have been combined into a harmonized sales tax ("HST") effective July 1, 2010. The PST is included as part of the expense included in an OM&A expense and as part of the cost of capital expenditures. This is different from the GST. The GST is not included as part of the cost of an OM&A expense or as part of the cost of a capital expenditure. The GST paid by a utility is a credit that is used an offset to the amount of GST collected. The difference between the amount collected and amount paid is remitted to the government.

The HST will operate in a similar manner to the GST. The effect of this change for businesses will be a reduction in OM&A expenses and capital expenditure costs related to the PST.

In response to Energy Probe Interrogatory #1, KW Hydro provided the costs related to the PST included in OM&A and capital expenditures for the 2006, 2007 and 2008 historical years, along with a September year-to-date figure for 2009. KW Hydro also indicated that it had not made any adjustments to either the OM&A expense forecast or the capital expenditure forecast to reflect the elimination of the PST effective July 1, 2010.

The total PST paid in 2006 through 2008 averaged more than $800,000 per year. This is obviously a significant cost to the distributor. KW Hydro further indicated in the interrogatory response that between 80 to 90% of the total PST paid is applied to capital with the remainder going to OM&A. Based on this split, Energy Probe submits that about $680,000, or 85% of the total PST cost is associated with capital expenditures with the remaining $120,000, or 15% associated in OM&A costs.

Energy Probe submits that the OM&A expense forecast for 2010 should be reduced by one-half of the forecasted PST cost of $120,000, or $60,000 to reflect the July 1, 2010 implementation date for the HST. Similarly, Energy Probe submits that the capital expenditures should be reduced by one-half of the $680,000 or $340,000.

ii) Need for a Variance Account

As indicated in the responses to Board Staff Interrogatory #27, KW Hydro would follow any direction from the Board and track the savings associated with the elimination of the PST in a deferral or variance account. However, as indicated in that response, KW Hydro is concerned about the amount of effort to track these savings. Energy Probe submits that a reduction of more than $800,000 on an annual basis is significant and should be tracked by the distributor.

Energy Probe respectfully submits that the establishment of a variance account to track the difference between any expenses incurred for which PST would have been paid and for which the distributor is now eligible for an HST input tax credit and the expenditure reductions forecast by KW Hydro is appropriate. It will provide necessary protection to both the distributor and its ratepayer from a government mandated change.

Energy Probe further submits that the Board should give consideration to the methodology outlined by KW Hydro in the response to part (b) of the response to Board Staff Interrogatory #27. If this methodology can provide a reasonable approximation for the PST savings, then Energy Probe submits that it should be adopted by the Board to help alleviate the concerns expressed by KW Hydro.

d) Property Tax

KW Hydro has included a property tax forecast of $529,300 in 2009 and $550,500 in 2010, as shown in Exhibit 4, Table 36.

As shown in the response to Energy Probe Interrogatory #31, the actual 2009 property tax was $394,862, a reduction of more than $130,000 from the level forecast for the bridge year. As shown in the same interrogatory response, the 2010 forecast has been reduced to $410,656, a reduction of just under $140,000. The increase in 2010 is based on a 4% increase that was based on historical trends and actual market value assessments.

Energy Probe submits that the revised forecast of $410,656 as provided in the response to Energy Probe Interrogatory #31 is appropriate and should be approved by the Board. It reflects a forecasted increase of 4% from the actual level of 2009 property taxes. This would result in a reduction in the revenue requirement from that originally filed of $139,844.

G - LOSS ADJUSTMENT FACTOR

KW Hydro has calculated its total loss factor based on the average wholesale and retail kWh for a five year historical period from 2004 through 2008 (Exhibit 8, Table 10). However, Table 10 has a calculation error contained in it. This error was corrected in the revised table provided in the response to Board Staff Interrogatory #20. This revised table supports the proposal to adjust the total loss factor to 1.032, as requested in Exhibit 8, at page 10.

Based on the revised table and calculation, Energy Probe accepts the total loss factor as estimated by KW Hydro to be 1.032 for 2010 is appropriate.

H - COST OF CAPITAL

The EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities dated December 11, 2009 indicates that the result of the Report is Board policy and that the process was not a hearing process that did not, and indeed could not, set rates. The Report goes on to state that the refreshed cost of capital policies will be considered through rate hearings for the individual utilities, at which it is possible that specific evidence may be proffered and tested before the Board. Specifically, the Report states:

> *"Board panels assigned to these cases will look to the report for guidance in how the cost of capital should be determined. Board panels considering individual rate applications, however, are not bound by the Board's policy, and where justified by specific circumstances, may choose not to apply the policy (or a part of the policy)."* (page 13)

Energy Probe submits that based on the December, 2009 Report of the Board and the evidence on the record in this proceeding there are two adjustments that Board should make to the cost of capital for the distributor. The first of these adjustments relates to the deemed capital structure and the second relates to the allowed return on equity.

a) Deemed Capital Structure

Short-term debt was not factored into electricity distribution and transmission rate-setting prior to 2008. As part of the December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, the Board adopted a deemed short-term debt component of 4% of the capital structure. As part of that Board Report, the Board stated:

> *"As a general principle for ratemaking purposes, the Board believes that the term of the debt should be assumed to be similar to the life of the assets that are to be acquired with that debt. This suggests that, in theory, for an industry with long-lived assets, the majority of debt should be long-term. However, in reality, some short-term debt is a suitable tool to help meet fluctuations in working capital levels."* (page 10)

As noted in the December, 2009 Report of the Board, capital structure was not a primary focus of the consultation. The Board determined that the split of 60% debt and 40% equity is appropriate for all electricity distributors (page 50). The Board did not explicitly state that the 60% debt component of the capital structure should remain at 56% long term debt and 4% short term debt, although Table 2 provided in the Summary section of the Board Report reflects the continuation of these figures.

Energy Probe submits that the evidence in this proceeding indicates that the 4% deemed level of short-term debt is not reasonable and that the incremental costs imposed on ratepayers by this are neither just nor reasonable.

Energy Probe agrees with the Board's comments provided in the December, 2006 Report of the Board that the term of the debt should mirror the life of the assets that the debt is used to finance. By its very nature, equity is long-term financing. This leaves the mix of long-term and short-term debt to be used to provide an appropriate balance within the capital structure to reflect the actual mix of assets being financed.

As noted by the Board in the December, 2006 Report, short-term debt is a suitable tool to help meet the fluctuations in working capital levels. As explained in Exhibit 2, page 50, the working capital allowance has been calculated using the 15% factor. This effectively represents in average lag of 54.75 days between when a distributor pays its expenses and when they collect revenue from the customers. This reflects the short-term nature of the working capital.

As illustrated in Table 10 of Exhibit 2 the working capital allowance component of rate base in 2010 is $23,297,338. This represents 14.3% of the total rate base of $163,113,438. The same table illustrates that this percentage has been very stable. Over the 2006 through 2008 period, the actual percentage has averaged 14.9%, fluctuating within a narrow band of 14.6% to 15.1%.

At the same time, using the 4% deemed shot-term debt component to finance total rate base, the deemed amount of short-term debt is only $6,524,538 in 2010 (Exhibit 5, Table 1). The resulting shortfall in deemed short-term debt in 2010 as compared to the working capital level is $16,772,800.

Energy Probe submits that this mismatch between the level of deemed short-term debt and the working capital level included in rate base is not appropriate. The distributor is effectively financing short term assets through long-term debt. This means that ratepayers are being asked to pay long-term interest rates on short-term assets.

The impact on the revenue requirement of this unjustified mismatch can be calculated based on the difference between the long-term and short-term interest rates as shown in Exhibit 5, Table 1. In particular, the following table utilizes the long-term debt rate of 7.62% and the short-term debt rate of 1.33%.

	2010
Long-term Debt Rate	7.62%
Short-term Debt Rate	1.33%
Difference	6.29%
Deemed Shortfall	$16,772,800
Interest Cost Impact	$1,055,009

Energy Probe is aware that the differential between the long-term and short-term interest rates is likely to be substantially less than that shown in the above table, based on the methodologies to be used as described in the Board's December, 2009 Report. The difference in the rates is likely to be around 3.0%. Even at this lower differential, the interest cost impact is more than $500,000. This amount represents a significant proportion of the total revenue requirement of just over $39 million (Exhibit 6, Table 1).

As noted above, the distributor is effectively financing a significant portion of short-term assets with long-term financing at a higher rate. It has a significantly different level of short term working capital levels in relation to rate base than a deemed short-term debt component of 4% would imply.

Energy Probe submits that it is neither just nor reasonable for the Board to expect ratepayers to pay long-term interest costs to finance short-term assets. This is no more appropriate that if the distributor applied a high depreciation rate associated with computer software to a long lived asset such as poles that should have a low depreciation rate. In both cases the resulting revenue requirement is artificially inflated.

As noted earlier, the Board, in its December, 2009 Report indicated that panels assigned to individual utility rate cases are not bound by the Board's policy where justified by specific circumstances. Energy Probe submits that the evidence is clear. A 4% deemed short-term debt component is not appropriate when the distributor has a short-term asset component of rate base of more than 14%.

It should be noted that the distributor has actual long-term debt of less than $77 million (Exhibit 5, Table 3), while the deemed long term debt is more than $91 million (Exhibit 5, Table 1). The difference between the deemed long-term debt and the level of actual long-term debt is $14,381,383. If this amount was simply classified as short-term debt, the short-term debt component of rate base would increase to about 12.8%, much closer to the appropriate level. Based on a 3.0% differential in rates, this would reduce the revenue requirement by more than $430,000.

It should also be noted that moving the difference between the deemed long-term debt and the actual level of long-term debt to short-term debt has no negative impact on the distributor since it does not have an actual cost associated with the unfunded long-term debt.

Finally, Energy Probe notes the Board's comments at page 52 of its December, 2009 Report:

> *"The Board wishes to emphasize that the long-term debt guidelines relating to electricity distribution utilities are expected to evolve over time and are expected to converge with the process used by the Board to determine the amount and cost of long-term debt for natural gas distributors."*

Energy Probe submits it is time for the evolution to begin.

b) Allowed Return on Equity

The Board has determined a methodology to determine the return on equity as part of the December, 2009 Board Report. Based on this methodology and based on the September, 2009 information the return on equity would be 9.75%. This figure will be updated by the Board based on January, 2010 information.

The Board determined the 9.75% figure based on a long term Government of Canada bond yield of 4.25% and an initial equity risk premium of 550 basis points. This equity risk premium includes an implicit 50 basis point for transactional costs (page 37 of the December, 2009 Report). This is the same amount included in the equity risk premium as determined in the Boards December, 2006 Report. In that Report the Board noted that it would continue to include an implicit premium of 50 basis points for floatation and transaction costs. The Board further noted that this inclusion had been the case ever since the Board first introduced the premium in the early 1990s.

Flotation costs of capital are applicable in cases where a particular distributor releases some new stocks in the market or if it issues debt. These costs generally consist of charges for underwriters, commissions to be paid to brokers, legal fees and cost of administration.

As shown in Exhibit 5, Table 1, the common equity forecast for 2010 is $65,245,375. Based on this figure, the 50 basis point allowance for the floatation and transactional costs represent a significant amount of the revenue requirement. This cost amounts to $326,227 and when grossed up for taxes is more than $470,000.

Energy Probe submits that inclusion of the implicit 50 basis points for transactional costs is not appropriate for this distributor. There is no evidence to support that the distributor expects to incur any floatation or transaction costs in the test year. There simply is no evidence to suggest that this distributor will incur any of these costs.

As noted above, the inclusion of some provision for floatation or transactional costs in the equity risk premium component of the return on equity has been long standing at the Board, and indeed, at other regulators across North America. Energy Probe submits that distributors that have such costs should be able to recover them. Energy Probe makes no comments as to whether an allowance of 50 basis points is appropriate, is too high, or is too low. In any case, that is irrelevant in the current situation.

The evidence in this proceeding is that the cost for this distributor is $0.

As noted earlier in the submissions on the capital structure, the Board panel assigned to individual utility rate cases are not bound by the Board's policy where justified by specific circumstances.

Energy Probe submits that the evidence is clear. The specific circumstance in this case is that there are no floatation or transaction costs associated with equity that needs to be recovered from ratepayers.

The Board should not, indeed cannot, allow a distributor to recover costs that the Board knows do not exist. To do so would not result in just and reasonable rates.

The Board would not allow a distributor to include a capital expenditure that it knew would not take place in the test year to be added to rate base. The Board would not allow a depreciation expense to be included in the revenue requirement if that depreciation expense was calculated on an asset that did not exist. The Board would not allow an OM&A expense to be included in the revenue requirement if the evidence indicated that the money would not be spent or the addition to staff was not going to take place. The Board would not allow a cost of debt of 6% if the evidence indicates that the forecasted cost of debt for the test year is 5.75%. Why would the Board allow recovery of any cost that the evidence clearly indicates does not exist?

Energy Probe submits that it would be grossly unfair to ratepayers to expect them to pay for equity-related costs that do not exist.

Energy Probe also submits that this would be unfair to other distributors that do have floatation and transaction costs. In the case of such a distributor, it would earn 9.75% on its deemed equity and some portion of that would be related to costs that were actually incurred. If the 50 basis point allowance is appropriate and accurate, then the shareholder effectively earns an after cost return on equity of 9.25%. The shareholder of the distributor that has no such costs, however, is allowed to earn an after cost return on equity of 9.75%.

Energy Probe submits that the Board should not discriminate on this basis. Shareholders of all distributors should be allowed the opportunity to earn the same after cost return on equity.

c) Short Term Debt Rate

Energy Probe submits that the short term debt rate should be updated to reflect the Board's methodology as outlined in Appendix D of the EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities.

d) Long Term Debt Rate

KW Hydro has promissory notes with each of its shareholders, the City of Kitchener and the Township of Wilmot in an aggregate amount of just under $77 million. KW Hydro has no other long term debt as of the time of filing.

KW Hydro indicates that since the promissory note is with an affiliate and is callable, it is requesting a return on this long term debt in the test year of 7.62%, subject to the update of this rate to reflect January, 2010 market information.

As can be seen in the promissory note, which is included in the evidence at Exhibit 5, pages 9 – 12, the interest rate is variable. The rate is adjusted periodically to reflect the deemed rate as set from time to time by the Ontario Energy Board.

Energy Probe submits that all of the long term debt held by KW Hydro is from an affiliate, and has a variable rate. As such, the deemed long term debt rate as calculated based on the methodology outlined in Appendix C of the EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities should apply to this debt.

I - DEFERRAL AND VARIANCE ACCOUNTS

a) Accounts and Amounts to be Cleared

Energy Probe submits that the accounts and the amounts proposed to be rebated by KW Hydro, as shown in Table 2 in Exhibit 9 of $5,773,603 are appropriate.

b) Allocation to Customer Classes

KW Hydro provided the allocation of the amounts to be recovered/rebated to customers and the calculation of the associated rate riders, including that associated with the Global Adjustment sub-account in Exhibit 9, Table 5. Energy Probe submits that the allocation of the amounts to the rate classes is appropriate.

Energy Probe submits that the Board should adopt a separate rate rider for recovery of the Global Adjustment sub-account whenever the distributor is able to apply different rate riders to different customers within a rate class, as this follows the cost causality principle.

As shown in Table 5 of Exhibit 9, there is a total of $145,796 allocated to the residential class from the Global Adjustment account. Based on the kWh's shown for the residential class in Table 3 of the same exhibit, recovering this balance from all residential customers would cost each residential customers consuming 800 kWh a month about $2.15 ($145,796 / 650,038,341 kWhs x 800 kWh x 12 months). Each RPP residential

customer would be providing a subsidy to non-RPP customers of $2.15. On the other side, the subsidy received by each non-RPP residential customer consuming 800 kWh a month would be $21.10 ($145,796 / 66,321,050 kWh x 800 kWh x 12 months).

It is submitted that the subsidy calculated above is not appropriate. However, Energy Probe is concerned with the potential costs that may be incurred to have a separate rate rider for non-RPP customers and that these costs may outweigh the benefits in the test year.

At the same time, however, Board is aware that the Global Adjustment is an adjustment sub-account that is likely to have balances that need to be cleared on an annual basis going forward. Over the long term, therefore, a large expenditure may be justified. Energy Probe submits that the Board should direct KW Hydro to investigate the cost of being able to have different rate riders for different customers within a rate class.

The Board should initiate a consultative to review who can and who cannot dispose of the Global Adjustment to non-RPP customers only, and what are the likely costs and benefits for those distributors and their ratepayers that currently cannot follow the principled approach.

c) Recovery Period

KW Hydro originally proposed to dispose of the balances in the deferral and variance accounts over a four year period (Exhibit 9, pages 12 – 13). The rationale provided was that a one year disposition would create significant rate shock for customers both at the onset of the rate rider and upon its discontinuance.

In its Submission-in-Chief, KW Hydro has revised its proposal to a two year period (paragraph 66). This change would help mitigate rate increases in 2010, including the impact of the higher allowed return on equity. Energy Probe submits that the disposition over a two year period is appropriate.

J - COST ALLOCATION & RATE DESIGN

KW Hydro has summarized its proposals related to the revenue-to-cost ratios in paragraphs 54 through 57 in its Submission-in-Chief. and provides a summary in Table 14 of that document.

All of the rate classes have revenue-to-cost ratios that are well within the Board target ranges, with the exception of the Unmetered Scattered Load class. The USL ratio is well above the 120% upper limit established by the Board.

KW Hydro proposes to reduce the ratio for the USL class to 110.81%, well below the maximum of 120%. This brings this class closer to the ratios of other classes and has little impact on other rate classes. As a result, Energy Probe supports the proposal as outlined in the Submission-in-Chief.

K - LRAM & SSM

Energy Probe has had the opportunity to review the submissions of VECC related to the LRAM and SSM issues. Energy Probe supports the submissions of VECC.

L - SMART METER FUNDING ADDER

Energy Probe notes that KW Hydro is proposing to continue to use the current approved smart meter adder of $1.00 per meter per month for 2010 rates (Exhibit 9, page 20). Energy Probe accepts this proposal as appropriate.

M - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Recognizing the size of Kitchener-Wilmot Hydro, Energy Probe has attempted to minimize its time on this application, while at the same time ensuring a thorough review.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

January 28, 2010

Randy Aiken

Consultant to Energy Probe