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February 26, 2010

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: EB-2009-0260 (Cambridge and North Dumfries Hydro Inc.)

Please find enclosed the submissions of VECC in the above noted proceeding.

Yours truly,

Michael Buonaguro
Counsel for VECC
Encl.

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an Application by Cambridge and North Dumfries Hydro Inc. pursuant to section 78 of the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for the delivery and distribution of electricity.

FINAL SUBMISSIONS

On Behalf of The

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

February 26, 2010

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1 The Application

- 1.1 Cambridge and North Dumfries Hydro Inc. ("CNDH") filed an application ("the Application") with the Ontario Energy Board ("the Board" or "the OEB") on August 31, 2009, under section 78 of the Ontario Energy Board Act, 1998 for electricity distribution rates effective May 1, 2010.
- 1.2 The process included a Settlement Conference held on January 20, 2010. Subsequently, a Revised Partial Settlement Agreement was filed with the Board on February 17, 2010. This Partial Settlement Agreement was accepted by the Board on February 18, 2010.
- 1.3 The Agreement included Attachment A, entitled List of Unsettled Matters, which the parties agreed would be addressed through written submissions. The following argument provides VECC's submissions on several of the unsettled issues where VECC wishes to make specific comments.

2 Issue 2 b): Are the Amounts Proposed for the Rate Base Appropriate

- 2.1 CNDH's 2010 capital expenditure forecast includes an estimated \$392,671 in Provincial Sales Tax¹. The specific issue that is unsettled is the appropriate treatment of Ontario's shift to a Harmonized Sales Tax and the fact that CNDH has made no adjustments to its capital expenditure forecast to account for the effective elimination of PST as of July 1, 2010².
- 2.2 VECC submits that with the harmonization of GST and PST distribution utilities will experience a reduction in capital (and OM&A) expenditures equivalent to the PST provision currently included in such expenditure and that this reduction should be passed on to rate payers. To accomplish this, the estimated impact³ of the introduction of the HST in 2010 should be removed from the 2010 capital additions, the 2010 rate base should be reduced accordingly and a variance

¹ Energy Probe #1 g)

² Energy Probe #1 e)

³ ½ of \$392,671

account should be established to track the difference between this amount and the retail tax savings in 2010.

- 2.3 In its Argument-in-Chief CNDH raises a number of concerns regarding the establishment of a variance account⁴. If the Board deems that a variance account is not warranted or too costly to administer then the 2010 rate base should still be reduced by the forecasted impact of the introduction of the HST.
- 2.4 In Its Argument-in-Chief, CNDH also states that the impact with respect to capital expenditures is not considered to be material⁵. VECC notes that the impact for 2010 is \$196,336, which is in excess of the materiality threshold used by CNDH for capital projects⁶. As result, VECC submits that the Board should reject CNDH's position that the impact of PST harmonization can be ignored on the grounds that it is immaterial.

3 Issue 2 c): Has the Working Capital Allowance been Determined Appropriately

- 3.1 In the current Application CNDH has calculated the 2010 working capital allowance based on 15% of its OM&A and projected 2010 cost of power expenses⁷. VECC notes that, based on the supporting schedules filed with the Settlement Agreement, the working capital component of CNDH's rate base is \$17,537,926⁸. Using CNDH's weighted average cost of capital⁹ consistent with the Board's new Cost of Capital policy this translates into \$1,183,810 in terms of 2010 revenue requirement – even before any allowance for PILs. This means that each percentage point of the 15% working capital allowance increases the annual revenue requirement by almost \$80,000 – without even considering tax impacts. Over the course of a four-year IRM period this translates into more than \$300,000 per percentage point.

⁴ Pages 4-5

⁵ Pages 5-6

⁶ Exhibit 2, page 56

⁷ Exhibit 2, page 92

⁸ Attachment D, page 2

⁹ 6.75% per Attachment D, page 2

- 3.2 VECC notes that lead-lag studies undertaken by other Ontario electricity distributors have resulted in working capital allowances that are less than 15% of OM&A and cost of power expenses. The most recent example is Hydro One Networks' 2010/2011 Rate Application where the working capital was just under 12% for each year¹⁰.
- 3.3 VECC submits that, given the evidence that a lead-lag study could reduce the requirement for working capital by a couple of percentage points and the material impact this would have on CNDH's revenue requirement, CNDH should be directed to undertake a lead-lag study as part of its next rebasing rate application. In VECC's view the likely cost of such a study is more than offset by the potential benefits to customers over the rebased year and subsequent IRM years.

4 Issue 3 a): Is the Load Forecast and Methodology (Including Weather Normalization) Appropriate

- 4.1 At issue here is the appropriateness of CNDH's load forecast, including the impact of CDM initiatives, for the 2010 test year.

Load Forecast Methodology

- 4.2 CNDH's load forecast methodology consists of the following steps¹¹:
- First, a weather normalized forecast of monthly system purchases is developed based on a multifactor regression analysis that includes weather, population, economic output and seasonal calendar variables as independent explanatory variables. The regression equation was developed using monthly data for the period 1996-2008¹². Average weather conditions over the period 1996-2008 are used to determine the weather normalized purchased forecast which is 1,522,594 MWh for 2010¹³.
 - Second, the forecast is adjusted for losses to produce a weather-normalized

¹⁰ EB-2009-0096, Exhibit D1-1-4, page 1

¹¹ Exhibit 3, page 12

¹² Exhibit 3, pages 12-17

¹³ Exhibit 3, page 17

billed energy forecast¹⁴. The resulting forecast of billed energy for 2010 is 1,483,750.

- Third, based on customer count forecasts and trends in non-weather normalized per customer use forecasts of total (non-weather normalized) use are developed for each customer class. These forecasts are then adjusted (based on the relative weather sensitivity of each class) so that the sum of individual customer class forecasts equals the total billed kWh forecast developed in Steps #1 and #2¹⁵.

4.3 In terms of the methodology used in Step #1 to develop the total system purchases forecast, VECC's primary concern is that the coefficient for population is negative suggesting that purchased load will decrease if the population in CNDH's service areas increases¹⁶. CNDH speculates that the result is due to CDM savings after 2005¹⁷. CNDH goes on to explain that the population variable was left in as it produced a prediction model with a higher R square value.

4.4 VECC submits that this is not the appropriate approach, indeed inclusion of additional variables will always increase the R-square value regardless of whether they actually have any explanatory value (i.e. are statistically significant) or yield results that are intuitively correct (i.e., have the right sign). VECC submits that as well as looking at the goodness of the fit (i.e., the adjusted R-square value), CNDH should also focus on identifying those variables that make a "significant" contribution to explaining changes in purchases energy and consider whether the variables lead to counter-intuitive results. As a result, VECC submits that the Board can not have confidence that the model developed by CNDH produces reasonable results.

4.5 In order to examine CNDH's claim that CDM was accounting for recent decline in load, VECC requested that an alternate prediction model be developed that included a "CDM flag". The resulting model produced coefficients for the various

¹⁴ Exhibit 3, page 19

¹⁵ Exhibit 3, pages 20-24

¹⁶ Energy Probe #16 a)

¹⁷ Board Staff #9 a)

explanatory variables that were intuitively correct and CNDH is now proposing to use the resulting prediction, updated for the most recent economic outlook, as the basis for its 2010 Rate Application. The new purchased sales forecast for 2010 is 1,420,552 MWh¹⁸.

- 4.6 CNDH claims that this forecasts addresses the counter-intuitive results of its first forecast and is a “superior forecast”¹⁹. However, in VECC’s view, these results are also highly suspect. The coefficient on the CDM flag has a value of - 292,813²⁰. When combined with the CDM monthly flag values for 2010 (i.e., 49, 50, ...,60), this yields a CDM adjustment for 2010 of 191,493 MWh. This suggests that the purchased loads would be 13.5% higher without CDM.
- 4.7 VECC notes that the 2010 CDM savings forecasted by the OPA in the IPSP were estimated to be less than 5% of the reference load forecast for that year²¹. Based on this forecast, VECC submits that the CDM savings implicit in CNDH’s 2010 purchased load forecast are far too high which, in turn, suggests that the revised prediction model does not produce reasonable results.
- 4.8 To illustrate the issue, one need only contrast the results of CNDH’s revised prediction model with the results for one that excluded population and the seasonal variable, as provided in response to Board Staff 9 c). This alternative model has virtually the same adjusted R-square value (94.0% vs. 95.4%) as the original model and the resulting 2010 purchased sales projection of 1,541,693 MWhs is are roughly 8% higher than what CNDH’s new model produced²² (1,429,225 MWh) based on the original economic outlook.
- 4.9 CNDH also states that its new forecast is consistent with the actual 2009 purchases of 1,450,836 MWh²³. VECC’s first concern with this argument is that

¹⁸ VECC #14 c) & f) and Argument-in-Chief, page 6

¹⁹ Argument-in-Chief, pages 6-7

²⁰ Energy Probe #63 a) – Attached excel spreadsheet

²¹ IPSP, Exhibit D-1-1, page 2 and D-4-1, page 3 – set out a 2010 Reference Load Forecast of 159 TWh and 2010 CDM savings of 6.9 TWh.

²² Argument-in-Chief, page 7

²³ Argument-in-Chief, page 8

the 2009 actual purchases value CNDH refers to is not in Evidence in this proceeding and therefore should not have been raised by CNDH and should not be considered by the Board in its determinations. The number has not been “tested” and there is no information as to what the value would have been on a weather normalized basis – which is the appropriate basis for comparing with the 2010 projection.

- 4.10 Having said this, VECC submits that the 2009 value quoted is not consistent with CNDH’s revised forecast. With population growing²⁴ and positive GDP growth of 2% projected for 2010²⁵ one would have expected 2010 purchases to be higher than those for 2009 – not lower as projected by CNDH.
- 4.11 In Step #3 of CNDH’s approach, VECC has concerns regarding the process for determining and adjusting what CNDH deems to be a “non-weather normalized” forecast so that it reconciles with the forecasted weather normalized use²⁶. CNDH’s forecast of non-weather normalized use in each customer class is calculated based on i) the projected customer count as discussed above and ii) a projected average use per customer which, in turn, is calculated by escalating the actual 2008 per customer use by the average growth rate in the class’ per customer use over the 2003-2008 period.
- 4.12 The problem with the second part of this approach is that by using the geometric mean the growth rate calculated only really reflects weather conditions in 2002 and 2007²⁷. It therefore, is specifically affected by the weather conditions those two years and does not reflect average weather conditions.
- 4.13 Finally, with respect to Step #3, VECC has concerns regarding the adjustment process CNDH uses to reconcile its non-weather normal forecast by class with its projection of total weather-normalized loads. CNDH’s assumption that the Residential and GS<50 classes are 100% weather sensitive while the GS 50-999

²⁴ VECC #13 b)

²⁵ Argument-in-Chief, page 7

²⁶ Exhibit 3, pages 21-22

²⁷ VECC #15 c)

and GS>1,000-4,999 classes are 48% and 23% respectively weather sensitive is based on an interpretation of Hydro One Networks weather normalization work to provide data for CNDH's cost allocation filing²⁸. However, in VECC's view, CNDH has not adequately substantiated that Residential and GS<50 customers' loads are 100% weather sensitive²⁹. Indeed, VECC submits that it is intuitively obvious that they are not³⁰.

Load Forecast Results

4.14 In response to VECC #41 a) & b), CNDH has provided the retail sales by customer class consistent with its revised load forecast. The resulting average use by customer class is summarized below and contrasted with the 2008 values. The table also compares CNDH's 2010 forecast by customer class with one based on the 2008 average use values (both actual and weather normalized).

CNDH Average Use and 2010 Forecasts

	<u>Average Use (kWh)</u>			<u>2010 Cust. Count</u>	<u>2010 Forecast Sales (MWh)</u>		
	<u>Revised Forecast</u>	<u>2008 Actual</u>	<u>2008 W. N.</u>		<u>Revised Forecast</u>	<u>Using 2008 Act</u>	<u>Using 2008 WN</u>
Residential	8,059	8,892	9,197	45,218	364,408	402,078	415,870
GS<50	34,327	37,836	39,133	4,582	157,268	173,365	179,307
GS 50-999	661,448	693,233	704,625	724	479,206	501,901	510,149
GS 1000-4999	8,511,951	8,923,923	8,993,801	25	212,799	223,098	224,845
GS>5000	79,652,551	76,765,918	76,765,918	2	159,305	153,532	153,532
Street Lights	745	762	762	12,717	9,470	9,690	9,690
USL	3,662	4,612	4,612	507	1,856	2,338	2,338
Total					1,384,312	1,466,002	1,495,731

Sources: Revised 2010 Forecast - VECC #41 a) & b)
2008 Actual - Exhibit 3, page
2008 WN - VECC #15 h)
2010 Sales Using Actual and Weather Normalized Average Use and
forecast customer count

4.15 VECC submits that the average use values underpinning CNDH's revised 2010

²⁸ Exhibit 3, page 22

²⁹ VECC #15 f)

³⁰ Both the Residential and GS<50 classes have lighting loads which are not weather sensitive.

load forecast are too low when compared to the 2008 actual and weather normalized values. In the case of Residential and GS<50 the 2010 average weather normalized use values are lower by more than 12%³¹. VECC submits the even with a cumulative reduction of 1.5% in GDP³² and increased CDM this reduction is too large. As noted previously, with total CDM savings from 2006 forward only forecasted to be in the order of 5% by 2010, the savings between 2008 and 2010 will be lower still. As a result, even the 5%-6% reduction for the GS>50-999 and GS 1000-4999 classes is likely too high.

4.16 VECC submits that the results using the actual 2008 average use values are more reasonable. VECC notes that for the Residential and GS<50 classes the 2008 actual average use is 3.3% less than the weather normalized values. In VECC's view this provides a reasonable allowance for the impact of the GDP decrease and CDM between 2008 and 2010. Similarly, for the GS 50-999 class the 2008 actual average use value is 1.6% less than the weather normalized result, again providing some allowance for differences in economic conditions and CDM between 2008 and 2010 (weather normalized).

4.17 While not perfect, VECC submits that a 2010 forecast based on the actual 2008 average use is a more reasonable forecast and the one that should be adopted by the OEB.

5 Issue 3 c): Is the proposed amount of Other Revenue appropriate?

5.1 CNDH has given notice to the City of Cambridge and the Region of Waterloo that it will cease to provide water and sewer billing/collection services beyond October 1, 2010³³. CNDH estimates that for 2010 this will result in a reduction of \$110,920 in the recovery of shared and general costs³⁴. At issue is whether the 2010 revenue requirement should reflect the \$110,920 in lost revenue offsets or a "normalized" value based on four years worth of revenue offsets. CNDH forecasts

³¹ VECC #41 b)

³² Argument-in-Chief, page 7

³³ SEC #13 a)

³⁴ Energy Probe 24 f)

the annual lost revenue offset to be \$440,000 and that the 4-year normalized revenue offset value would be \$357,500³⁵.

- 5.2 In its Argument-in-Chief³⁶, CNDH submits that there is “no dispute” as to the accuracy of the \$110,000 in lost offset in 2010 and the \$440,000 in lost offset for 2011, 2012 and 2013. It also, makes reference to a recent Board Decision regarding Greater Sudbury Hydro, where the Board allowed the distributor to include in its 2009 approved revenue requirement a “normalized” maintenance cost for its ERP System, even though the cost would not be incurred until 2010.
- 5.3 First VECC disagrees that there is an agreement that the lost revenue offsets will be \$440,000 per annum after 2010. The Settlement Agreement clearly characterizes the \$440,000 as a “CNDH forecast”. Indeed, the \$440,000 represents an allocation of shared and general costs in 2010. This allocation would have been subject to change in future years based on the activity level required for water and sewer billing relative to that for CNDH’s electricity distribution-related activities.
- 5.4 Also, VECC disagrees with the proposition that all of these costs (particularly the general overhead costs) would continue throughout the entire IRM period even after the provision of the water and sewer billing services to the City and the Region were discontinued. It is VECC’s submission that, through time, there would be some reduction in general costs to reflect this reduction in overall activity level of CNDH.
- 5.5 However, in VECC’s view, the more fundamental issue for the OEB is the matter of when costs (or benefits) not associated with the test year should be considered and “normalized” values used instead. As noted above, CNDH has referenced a previous Board Decision where future costs were included (on a normalized basis) in the test year revenue requirement. It has also been the general practice of the Board to normalize the costs of preparing the test year application over both the

³⁵ Argument-in-Chief, pages 8-9

³⁶ Page 9

test year and the subsequent IRM years. However, this practice is not standard.

- 5.6 In its EB-2008-0235 Decision regarding London Hydro, the Board did not accept the Utility's proposal to "normalize" its PILs allowance to reflect the one-time nature of the CCA allowance for its CIS system. In making this decision the Board stated³⁷:

"Normalizing or amortizing expenses over an IRM period should be an exceptional activity. The Board has routinely done it for regulatory expenses but that is because the regulatory expenses for the rebasing proceeding relate to some extent to the entire IRM period. The CCA amortization proposed by London is of a different nature. London seeks to amortize the CCA because it forecasts that its PILs in the balance of the IRM period will be substantially higher. To do so amounts to forecasting a key element of the revenue requirement beyond the test year. If the Company were to do so, then a comprehensive multi-year revenue requirement forecast would be required. The Board has little or no evidence as to future tax rates, OM&A expenditures, capital expenditures, etc; nor has London requested a multi-year cost of service. The Board finds that there is therefore no basis to grant the relief requested by London and that to do so would be inappropriate."

- 5.7 VECC shares the Board's concerns, as set out in its London Decision, and notes that as the use of "normalization" increases the distinction between a single test year followed by an IRM period and a multi-year test period becomes blurred. However, in choosing between the two, VECC submits that normalization of a "selected number" of elements is not the preferred approach. In VECC's view "normalization" should be the exception and limited to those instances where not only is the circumstance unique but the costs and the benefits of the activity can be clearly documented and are separable from the distributor's other activities.
- 5.8 In VECC's view the lost revenue offset does not meet these criteria. As noted above the lost revenue offset beyond 2010 is not known. Indeed, part of the reason for this is that the offset is the result of an allocation of shared and general costs. This suggests that the revenue offset is not separable from the other future activities of the distributor.

- 5.9 VECC also notes that there are other revenue offsets, such as interest and

³⁷ Page 26

dividend income, where the 2010 values are materially different from past levels (\$280,000 in 2010 vs. \$507,000 in 2009) due lower Bank of Canada forecasts during the first half of 2010³⁸. There has been no suggestion on CNDH's part that these revenues should be normalized over the next four years to reflect the likelihood of higher interest rates in the future. In VECC's view this clearly demonstrates the problem with selecting only certain aspects of the revenue requirement for "normalization" and the need for the Board to limit the applicability of "normalizing" costs for the test year period.

- 5.10 Overall, VECC submits that Board needs to establish clearer guidelines regarding the practice of cost normalization for a test year and that, in the present case, the Board should reject CNDH's proposal to normalized its lost revenue offsets.

6 Issue 4 a): Are the overall levels of OM&A budgets appropriate?

- 6.1 There are two unsettled issues related to OM&A. The first is the appropriate treatment of Ontario's shift to a harmonized sales taxes and the resulting (effective) elimination of PST on OM&A effective July 1, 2010. The second is related to the OM&A associated with the implementation of CNDH's new CIS system in November 2010 and whether the 2010 revenue requirement should reflect the actual 2010 OM&A costs (\$42,500) or a normalized value of \$312,000 that incorporates the post-2010 annual costs.

Elimination of PST associated with OM&A

- 6.2 With respect to this matter, VECC refers the Board to its submission regarding the treatment of the PST related to capital spending. VECC notes that the same systems would be used to track PST on spending, whether it be capital or OM&A. Therefore, in considering the materiality of the issue, the Board should look at the overall PST levels involved which would be one-half of the projected 2010 value of \$82,985 for OM&A and \$392,671 for capital spending.

³⁸ Exhibit 3, page 35

CIS OM&A Cost Normalization

- 6.3 VECC comments here similar to those set out under Section 5. In the case of the CIS OM&A costs VECC acknowledges that the activity involved and the associated costs are more clearly documented and separable than was the case for revenue offsets. However, even in this case, VECC notes that one of the main benefits of the new CIS system is that it enables CNDH to move to monthly billing³⁹. While CNDH has made some allowance for cost savings⁴⁰ as a result of introducing monthly billing, it has not included any reduction in bad debt expense⁴¹ in its forecast costs. Also, while it has reflected the impact in its cash balances and resulting 2010 interest income, the valuation is based on the unprecedented low interest rates projected for 2010⁴².
- 6.4 As VECC concluded in Section 5, the Board needs to establish clearer guidelines regarding the practice of cost normalization for a test year. In the case of the CIS OM&A, VECC submits that the costs and savings have not been sufficiently separated out and documented. Should the Board decide to approve “normalization” for these costs, VECC submits there should be some nominal reduction (e.g. at least 10%) to allow for unaccounted for benefits.

7 Issue 5 a): Are the proposed Capital Structure and Rate of Return on Equity appropriate?

- 7.1 The two unsettled issues are the appropriateness of the 4% allowance for short term debt included in the deemed capital structure and the ROE resulting from the application of the Board’s 2009 Cost of Capital Report. VECC’s comments are limited to the latter issue.
- 7.2 VECC has reviewed a draft of Energy Probe’s submissions on this issue and supports those submissions: VECC submits that as a general principle, any costs which are not incurred by the utility, i.e., in this case flotation costs as included in

³⁹ Exhibit 2, page 75

⁴⁰ Energy Probe #27 a)

⁴¹ Board Staff #18 a)

⁴² Energy Probe #27 b) - See also paragraph 5.9 of these submissions.

the ROE through a 50 basis point adder but not incurred by the utility, should not be recovered from the ratepayer.

- 7.3 VECC notes that the Board has just issued its Cost of Capital Parameter Updates for 2010 Cost of Service Applications. The 2010 rate year values for Return on Equity and the deemed Long-Term Debt rates are 9.85% and 5.87% respectively. During the recent consultation process established by the Board to review its existing approach to determining the cost of capital parameters (EB-2009-0084), there was general consensus that the spread between the borrowing costs for electric distribution utilities and their allowed ROE should be in the order of 200 to 300 basis points⁴³.
- 7.4 In light of this, VECC submits that the allowable ROE for CNDH for 2010 should be no more than 325 basis points in excess of the 5.87% deemed long term debt rate set by the Board for 2010 and that the Board's "calculated" value of 9.85% is unreasonable. There is nothing unique about CNDH's circumstances that would suggest its ROE should fall outside these norms. As result, VECC submits that the ROE for CNDH should be set at no more than 9.12%.

8 Issue 9 a): Is the proposal for the amounts, disposition and continuance of Deferral and Variance accounts appropriate?

- 8.1 The Settlement Agreement acknowledges Board Staff's interest in the approach used by CNDH to refund/recover the balance in Account #1588 RSVA Power Account – Global Adjustment Subaccount. The issue is whether the amounts allocated to each class should be recovered from all customers or just from non-RPP customers.
- 8.2 VECC submits that the use of a separate rate rider for non-RPP customers is the appropriate resolution of this issue in principle. However, VECC recognizes that "... CNDH confirms that its billing system is not capable of creating distinctions

⁴³ Transcript Volume #1, pages 73, 95 and 137 and Volume #2, page 122

among members of the same class with respect to rate riders”⁴⁴.

- 8.3 Whether the cost of a patch or upgrade to permit such intra-class rate riders is justified by the benefits is unknown since there is no evidence as to what a patch or upgrade of CNDH's existing billing system would cost or how long it would take to implement. VECC further notes that billing systems do not have an infinite life but rather are upgraded or replaced more frequently than most other utility assets.
- 8.4 Hence, in the medium term, a viable and possibly attractive solution to address the current billing system deficiency might be to ensure that the acquisition of the next billing system that CNDH acquires assesses the costs of benefits of such functionality.

9 Recovery of Reasonably Incurred Costs

- 9.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

Respectfully Submitted on the 26th Day of February 2010.

⁴⁴ Argument-in-Chief, page 13