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BORDEN
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March 5, 2010

Delivered by E-mail and Courier

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

Re: Cambridge and North Dumfries Hydro Inc. – 2010 Cost of Service Electricity Distribution Rate Application – Board File No. EB-2009-0260

We are counsel to Cambridge and North Dumfries Hydro Inc. ("CND") in the above captioned matter.

Please find accompanying this letter CND's Reply Submission in this proceeding.

Should you have any questions or require further information, please do not hesitate to contact me.

Yours very truly,
BORDEN LADNER GERVAIS LLP

Original Signed by James C. Sidlofsky

James C. Sidlofsky
JCS

cc. Theodore Antonopoulos, Ontario Energy Board
Keith Ritchie, Ontario Energy Board
John Grotheer, Cambridge and North Dumfries Hydro Inc.
Intervenors of Record

::ODMA\PCDOCS\TOR01\4306377\1

Vancouver • Toronto • Ottawa • Montréal • Calgary

EB-2009-0260

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 Cambridge and North Dumfries Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2010.

CAMBRIDGE AND NORTH DUMFRIES HYDRO INC.

REPLY SUBMISSIONS ON UNSETTLED MATTERS

DELIVERED MARCH 5, 2010

INTRODUCTION:

1. Cambridge and North Dumfries Hydro Inc. ("CND") owns and operates the electricity distribution system in its licensed service area in the City of Cambridge and the Township of North Dumfries. CND serves approximately 50,000 Residential, General Service, Large User, Street Light and Unmetered Scattered Load customers and connections. CND also provides Low Voltage facilities to Hydro One Networks Inc. and Waterloo North Hydro Inc.

2. CND filed an application (the "Application") with the Ontario Energy Board (the "Board") on August 31, 2009 under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that CND charges for electricity distribution, to be effective May 1, 2010. The Board assigned the File Number EB-2009-0260 to the Application. Three parties requested and were granted intervenor status: Energy Probe ("EP"), the School Energy Coalition ("Schools"), and the Vulnerable Energy Consumers Coalition ("VECC").

3. The Board issued Procedural Order No. 1 on October 23, 2009. Board staff filed interrogatories on November 5, 2009, and all registered intervenors filed interrogatories by November 9, 2009. CND filed responses to interrogatories on November 30, 2009. The Board issued Procedural Order No. 2 on December 14, 2009. That Procedural Order provided for supplemental interrogatories and a

Settlement Conference. CND responded to supplemental interrogatories from Board staff and certain of the intervenors on January 13, 2010. The evidence in this proceeding (referred to herein as the "Evidence") consists of the Application and CND's responses to both the initial and supplemental rounds of interrogatories.

4. The Settlement Conference was conducted on January 20, 2010, at the Board's offices, with Kenneth Rosenberg acting as facilitator. Representatives of the Applicant and intervenors (EP, Schools and VECC) participated in the Settlement Conference, and Board staff participated in accordance with their role as set out in the Board's Settlement Conference Guidelines.

5. The parties achieved a partial settlement in this proceeding. A Settlement Agreement was filed on February 10, 2010, with an updated version reflecting a reduction in the PILs calculation filed on February 17, 2010. By a Decision dated February 18, 2010, the Board approved the Settlement Agreement and confirmed that the unsettled matters would be addressed by way of written submissions. CND's Argument-in-Chief was delivered on Friday, February 19, 2010, followed by Board staff and intervenor submissions on Friday, February 26, 2010.

6. In the Settlement Agreement, the parties set out the unsettled matters and proposed that they would be the subject of written submissions. In their February 26th submission,[1] Board staff listed the unsettled matters as follows, and CND will address the staff and intervenor comments on those matters in the order set out by staff:

- Load Forecasting
- Normalization and recovery of expenses previously recovered in part through Other Revenues for Water and Sewage Billing which is ceasing in Q4 of 2010;

[1] Board staff submission, at pp.1-2

- Normalization of Customer Information System ("CIS") Operations, Maintenance and Administration ("OM&A") expenses [relating to implementation of monthly billing];
- Working Capital Allowance – The need for a Lead-Lag Study for C&ND Hydro's next cost of service rebasing application;
- Cost of Capital
    - Return on Equity
    - Short-term Debt Component of the Deemed Capital Structure;
- Deferral and Variance Accounts – Account 1588 Global Adjustment Sub-account; and
- Harmonized Sales Tax ("HST").

REPLY SUBMISSIONS ON THE UNSETTLED MATTERS:

7. CND offers its submissions on these matters below. CND repeats and relies upon its submissions in its Argument-in-Chief, and will not repeat those submissions here except to the extent necessary to respond to the staff and intervenor submissions.

- **LOAD FORECASTING:**

8. CND has used an econometric model based on a regression analysis to generate the 2010 proposed billed load forecast of 1,384.3 GWh excluding Embedded Distributor. The 2010 proposed forecast for Embedded Distributors is 54.6 GWh. For the purposes of this reply submission CND will concentrate its discussion on 1,384.3 GWh as it is this amount which is contentious among the parties. Board staff and intervernors made no submissions with regard to suggested changes to the proposed forecast for Embedded Distributors. CND submits the Embedded Distributors forecast has been accepted by all parties and should be approved by the Board.

9. The load forecasting method used by CND is outlined in detail in Exhibit 3 of the Application and summarized by Board staff, EP and VECC in their submissions. SEC did not make any comments on the load forecast in its submission.

- **The positions of Board staff and intervenors:**

10. Board staff and intervenors have identified two specific concerns with the load forecasting methodology used by CND. The first concern relates to the negative coefficient for the "population" resulting from the regression analysis, which Board staff and intervenors suggest is conceptually counter-intuitive because it implies that load decreases as population increases. The second concern relates to including the Spring/Fall Flag as variable in the regression analysis as this variable does not have statistical significance. In other words, this variable does not contribute significantly to producing a better forecasting model.

11. In order to address these concerns, Board staff, EP and VECC provided three different alternatives to forecast the 2010 load for CND. The following table provides a summary of the load forecast for these three method along with the proposed 2010 load forecast outlined in the Application and the revised CND forecast.

	2010 Purchased Forecast (kWh)	2010 Billed Forecast (kWh)
Board staff	1,541,693,000	1,502,331,904
EP	1,533,020,000	1,493,910,199
VECC(*)		1,466,002,000
CND - Application	1,522,593,844	1,483,750,031
CND - Revision	1,420,552,318	1,384,311,748

(*) Billed amount only provided

12. Board staff and EP both based their proposals using the response to Board staff interrogatory #9c. This response assumes the regression equation reflects the removal of the population variable that has a counter-intuitive signs and the Spring Fall Flag variable which is not statistically significant. The 2010 purchased load

forecast from this response is 1,541.7 GWh. Board staff have adopted this value as their preferred forecast for 2010. EP has taken the 1,541.7 GWh and adjusted it by 8.7 GWh for a total 2010 purchased load forecast of 1,533.0 GWh to reflect the lower Ontario GDP forecast provided in the response to VECC interrogatory #14c. The EP proposal also address a request raised by Board staff in that they state on page 8 of their submission "An option would be to require C&ND Hydro to provide estimates for 2009 and 2010 based on the updated economic data as used in the response to VECC IR # 14 f) but based on the model estimated in Board staff IR # 9". For 2010, the estimated amount is 1,533.0 GWh.

13. CND submits that even though the resulting load forecasting equation from Board staff interrogatory #9c may have better statistical outcomes it is not appropriate to use the equation since over the last three years of history from 2006 to 2008 (i.e. the historical period in which the CDM flag, discussed below, is applied), as shown in the following table, testing the predicted amount compared to the actual amount showed significantly overall greater differences using Board staff interrogatory #9c than in the revised load forecast provided in response to EP interrogatory #63.

	Application - Load Forecast as per Board staff IRR #9 b and c		Application - Load Forecast w/o Population and Spring Fall Flag as per Board staff IRR #9 b and c		Revised Load Forecast w/CDM Flag as per EP IRR #63a	
Year	Variance Predicted to Actual (kWh)	% of Actual	Variance Predicted to Actual (kWh)	% of Actual	Variance Predicted to Actual (kWh)	% of Actual
2006	(4,965,647)	(0.3%)	(1,916,582)	(0.1%)	13,983,047	0.9%
2007	26,390,388	1.6%	29,771,437	1.9%	8,361,921	0.5%
2008	30,861,600	2.0%	38,437,989	2.5%	(9,795,994)	(0.6%)
Total	52,286,341		66,292,844		12,548,974	

14. With regard to the VECC proposal, this is an updated version of the Normalized Average use per Customer ("NAC") approach used by a number of 2008 and a few 2009 cost of service/rebased rate applications. Particularly in the case of the 2008 applications, the Board, Board staff and intervenors, including VECC, had concerns with this approach in that it was not using the correct year of data for the forecast (i.e. 2004 data was used for 2008) and it was based on only one year of historical data. CND submits that this is still the issue with the approach being proposed by VECC in that 2008 data is used to forecast 2010 and only one year of data is being used. To use 2008 data as the basis for the forecast and not adjust for the decline in the Ontario GDP of negative 1.5% from 2008 to 2010 and not reflect the results of CDM is not suitable. The impacts of CDM could be in the range of 1% to 2% per year in 2009 and 2010. When the estimated GDP and CDM impacts are applied to the VECC forecast the resulting forecast is in line with the CND 2010 billed forecast of 1,384.3 GWh.

15. In addition, VECC suggests that there is a problem using the geometric mean analysis to determine an average growth rate and the assumptions on weather sensitivity for Residential and GS < 50 kW classes are not reasonable. CND is unable to respond to these concerns since VECC does propose a solution to these two issues which CND would be able to comment on if they did.

- **CND submissions:**

  - ***The Recent History of Load Forecasting in Distribution Rate Applications***

16. CND would like to begin by reminding the Board of the relatively recent history of steps that distributors have taken to provide a weather normalized load forecast in their cost of service rate applications in a manner that is transparent and cost effective. Prior to 2008, distributors did not conduct weather normalization load forecasting studies within their companies. Any weather normalization requirements were generally provided by HONI for the distributors but the HONI methodology was not transparent and was quite expensive.

17. In 2008, CND observed that in order to control expenses, cost of service applicants generally used the NAC approach to prepare the weather normalized load forecast. Board staff, intervenors and to a certain degree the Board expressed concerns during the 2008 EDR process regarding the use of the NAC approach as it focused on one year of data from 2004. In response to this concern, CND observed that a number of 2009 cost of service applicants adopted a regression analysis approach to produce a weather normalized load forecast for system purchases. The system purchased load forecast was adjusted by a historical loss factor to derive the system wide billed energy forecast. The system-wide billed energy forecast was allocated to a rate class using a forecast of customer numbers and historical usage per customer. Again, Board staff, intervenors and to a certain degree the Board expressed concerns during the 2009 EDR process regarding the use of the regression analysis approach as applicants did not conduct the regression analysis on a individual rate class basis.

18. In response to the concerns raised during the 2009 EDR process, CND attempted to improve the regression analysis approach by conducting the analysis on an individual rate class basis but the statistical results of this exercise were not acceptable. As a result, CND used a regression analysis approach similar to the 2009 cost of service applications. Board staff and intervenors are concerned that the negative coefficient on one variable is counter-intuitive and another variable is statistically insignificant. While CND acknowledges this concern, CND submits that having a variable with a negative coefficient and a statistically insignificant variable does not, in and of itself, invalidate the results of the regression analysis particularly where the negative coefficient can be adequately explained and statistically insignificant variable has very little impact on the results.

19. CND submits that load forecasting is a common element to all applications, and one in which the Board ultimately has to select a preferred approach. With that in mind, CND believes that it would assist the industry, and all parties to the rate-making process, if the Board established a process – whether through a

consultation, a generic hearing, or otherwise – to review the various models in a disciplined way, and reach conclusions on which approach or approaches are acceptable in electricity distribution rate applications. CND believes it is now time to establish standards, considering that in this proceeding alone there are at least four different proposals on how to determine the load forecast for the test year (i.e. one from each of Board staff, EP and VECC as well as the Application itself). In addition, Board staff have raised issues such as including pricing variables in the regression analysis. CND suggests that even though this could be a valid point it could very well be another point of contention amongst parties which would use additional customer dollars to argue and counter argue the inclusion or exclusion of the variable. Having standards will improve the overall quality of rate applications; provide consistency across distributors, and save substantial amounts of time and money that the distributors would probably prefer to use in other ways for their customers. CND submits that any proposed standard should produce a load forecast methodology that is transparent and not overly costly to customers.

20. On a positive note it appears to CND that at this point in the evolution of load forecasting for electricity distributors, the current issues are around "fine tuning" the methodology to ensure items such as counter-intuitive negative coefficients and variables that are statistically insignificant are addressed prior to future applications. CND would expect that the next step in the evolution of load forecasting will be to agree on the appropriate dependent variables to be used in the regression analysis and the assumptions used to allocate the total system billed energy forecast to rate classes.

CND Submissions:

21. For the reason outlined below, CND submits that a 2010 billed load forecast of 1,384.3 GWh is a reasonable forecast for purposes of designing rates in this Application.

22. As stated in the evidence, Exhibit 3, Pages 14 and 15 CND was aware of the negative coefficient on population and attempted to take steps to address the situation. However, when CND took these steps it did not produce a result that reasonably reflected the impact of CDM programs and the recent economic downturn for CND's service area. As a result, CND concluded the negative coefficient on the population variable was an acceptable result because it addressed the results of various CDM programs and to certain a degree the additional economic downturn specific to the CND service area that was not captured in the provincial GDP values.

23. For 2009, the bridge year, CND's revised load forecast proposes a billed load forecast of 1,427.2 GWh on a weather normalized basis. The following table outlines CND's actual 2009 purchased and billed results on a weather actual basis. The table also provides the 2009 predicted purchases; the 2009 weather normalized predicted purchases; the 2009 weather correction factor; and the 2009 weather normalized billed forecast from the load forecast that supports the 2010 weather normalized billed forecast of 1384.3 GWh.

	2009 Purchased	2009 Billed
Actual	1,450,835,586	1,402,816,320
Predicted	1,458,851,970	
Weather Normalized Predicted	1,464,592,474	1,427,228,369
Weather Correction Factor = Weather Normal Predicted/Predicted	1.0039	

24. The weather normalized billed amount based on actual 2009 data is 1,408.3 GWh which is the actual 2009 billed amount of 1,402.8 GWh adjusted for a weather correction factor of 1.0039. When the 2009 actual weather normalized billed load is compared to the 2009 forecast from the CND revised forecast, the variance is 18.9 GWh (i.e. 1,427.2 – 1,408.3). This is a significantly smaller variance compared to the 2009 weather normalized billed forecast than would occur from all other proposals.

25. As per the Board staff submission, Board staff's proposal would forecast a 2009 weather normalized billed amount of 1,504.2 GWh which is a variance of 95.9 GWh compared to 2009 actual results. For the EP proposal, as a conservative estimate, the variance in the Board staff proposal would be reduced by 8.7 GWh to 87.2 GWh to reflect, as mentioned above, the lower Ontario GDP forecast provided in the response to VECC interrogatory #14c. When the VECC NAC approach is applied to 2009 customers/connections the resulting billed forecast is 1,447.6 which is a variance of 39.3 GWh.

26. The load forecasting method used by CND to forecast weather normalized billed load for 2009 is consistent with the method used for 2010. Since the CND 2009 weather normalized billed forecast is closest to the 2009 actual weather normalized billed amount than any other approach, this suggests that the CND weather normalized 2010 billed load forecast would be more consistent with actual 2010 weather normalized results than the proposals from Board staff and Intervenors. As a result, CND submits that the proposed 2010 billed load forecast amount of 1,384.3 GWh is reasonable for purposes of designing rates in this application.

27. With regard to the negative coefficient on population, CND understand there was a similar issue addressed in the recent Burlington Hydro Decision, and the Board stated this indicated the regression analysis used by Burlington Hydro is not sufficiently robust to use for the purposes of deriving rates. CND understands the Board's concerns and has addressed this issue in response to VECC interrogatory #14(c). CND developed a revised load forecast that was based on a regression model that included a CDM flag. The CDM flag is an increasing number from 1 to 60 starting in January 2006 through to December 2010. This produces a regression analysis that does not have any independent variables with a negative coefficient that are counter-intuitive. Considering CND is an active participating distributor in CDM programs, this assumption in CND's view is reasonable. It is

also reasonable to start the flag in January 2006 as this was essentially the time period that third tranche funded CDM programs began.

28. CND has actively participated in educating and promoting energy conservation to the community from 2005 to 2008. The focus was on conservation awareness and responsibility for all ages across our service territory. Programs were tailored to total customer base, residential customers, business customers, government and instructional customers and the LDC corporate asset base.

29. The programs were very successful based on the evaluation results required by the Board as part of the annual CDM reporting. For example, the total life evaluation of the CDM plan shows the Cumulative Total Life-to-Date Net TRC value of -$599,111 and a benefit to cost ratio of 0.16. Presented below is CND's total life evaluation of its CDM programs (Appendix D from its 2008 CDM Annual Report).[2]

[2] CND's 2008 CDM Annual Report is available on the Board's website, at http://www.oeb.gov.on.ca/OEB/_Documents/RP-2004-0203/2008_annual_report_Cambridge.pdf

Appendix D - Total Life Evaluation of the CDM Plan

Table is to be completed manually by totalling the information from each year of activity

	5 Cumulative Totals Life-to-date	Residential	6 Low Income	Commercial	Institutional	Industrial	Agricultural	LDC System	4 Smart Meters	Total Customer Base	Other #2
Net TRC value ($):	-$ 599,111	$ 205,418	$ -	$ 17,184	-$ 1,684,962	$ -	$ -	-$ 243,124	$ -	$ 1,106,373	$ -
Benefit to cost ratio:	0.16	0.81	-	1.55	-1.12	-	-	-1.15	-	4.65	-
Number of participants or units delivered:	76,472	18,567	-	926	1,163	-	-	399	120	55,297	-
Lifecycle (kWh) Savings:	69,220,523	18,294,061	-	2,048,129	17,211,146	-	-	2,209,821	-	29,457,366	-
Total kWh saved (kWh):	8,469,478	755,265	-	236,205	1,730,236	-	-	113,954	-	5,633,818	-
Total peak demand saved (kW):	2,149	603	-	57	362	-	-	41	-	1,086	-
Total kWh saved as a percentage of total kWh delivered (%):	0.18	0.05	-	0.02	0.11	-	-	0.01		0.36	-
Peak kW saved as a percentage of LDC peak kW load (%):	0.23	0.19	-	0.02	0.12	-	-	0.01		0.35	-
1 Gross C&DM expenditures ($):	2,166,635	798,198	-	48,699	484,254	136,228	-	362,215	93,186	243,855	-
2 Expenditures per KWh saved ($/kWh):	$0.03	$0.04	-	$0.02	$0.03	-	-	$0.16	-	$0.01	-
3 Expenditures per KW saved ($/kW):	$1,008	$1,324	-	$854	$1,338	-	-	$8,835	-	$225	-
Utility discount rate (%):	7.50										

1 Expenditures are reported on cumulative basis.
2 Expenditures include all utility program costs (direct and indirect) for all programs which primarily generate energy savings.
3 Expenditures include all utility program costs (direct and indirect) for all programs which primarily generate capacity savings.
4 Please report spending related to 3rd tranche of MARR funding only. TRC calculations are not required for Smart Meters. Actual expenditures for the total third tranche period need to be reported.
5 Includes total for the reporting year, plus prior years, if any (for example, 2008 CDM Annual report for third tranche will include 2007, 2006, 2005 and 2004 numbers, if any).
6 Includes totals from Low Income programs that fall under both commerical and residential.

30. The following is a summary list of CDM programs and activities in which CND has participated during 2005 to 2008:[3]

1.0 Total Customer Base

1.1 Customer Education Campaigns

1.2 Compact Fluorescent Bulb Giveaways

1.3 Earth Day Celebration

1.4 Conservation Kits

1.5 Every Kilowatt Counts Coupon Campaign

1.6 Switch to Cold Campaign

2.0 Residential Customer Base

2.1 Residential Energy Audits

2.2 Geothermal Heating/Solar Water Heating Installation Incentive

2.3 Regional Housing Program

2.4 Seasonal LED Light Strings

2.5 Fridge/Freezer Replacement Program

2.6 Heat Bank Program

2.7 Smart Thermostats

3.0 Small Business Customer Base

3.1 On-site Energy Audits

3.2 Clean Air Foundation's – Cool Shops Program

3.3 Church Energy Audits

[3] 2008 CDM Annual Report, at p. 2.

4.0 Mid to Large Scale Customers

4.1 Power Factor Correction Program

4.2 Installation of Interval Meters and Data Consulting

5.0 Government and Institutional Customer Base

5.1 Street Light Upgrades

5.2 LED Traffic Light Conversions

6.0 LDC Corporate Asset Base

6.1 Lighting Retrofit on Corporate Office

6.2 LCD Monitor Replacements

6.3 Rooftop Heating Equipment Upgrades

6.4 Outdoor Conservation Sign

6.5 Capacitor Bank Installations

31. With the passing of the *Green Energy and Green Economy Act, 2009*, distributors will have CDM targets included in their distribution licence conditions . As a result, the emphasis on CDM will continue if not increase. Based on the above discussion CND submits that it would be reasonable to expect to achieve growth in CDM results which provides justification for the CDM flag.

32. In addition, similar to its position on the negative coefficient on the population variable, CND also believes the CDM flag is picking up the additional economic downturn specific to the CND service area that was not captured in the provincial GDP values. Or in the words of Board staff “this large result would suggest that the CDM trend is collinear with the income variable, which is consistent with the impacts of model coefficients and t-statistics”.

33. With regard to the economic downturn specific to the CND service area the following examples of events that support this position.

34. In 2008 CND had three large users and twenty-eight GS >1000 to 4999 kW customers. In 2009 the number of large user customers was two and the GS>1000 to 4999 kW was twenty five. This was result of customers closing down, multinationals moving jobs offshore or back to the USA, or restructuring operations. The lost revenues from these customers represent a significant portion of CND's total kWh.

35. Some of the companies that closed operations in Cambridge were foundry and plating companies. Based on the nature of their operations those buildings and land tend to remain vacant due to environmental issues and as such CND does not expect replacement for those companies. Many of the customers in CND service territory are related to the automotive industry (for example Toyota employees and suppliers). The economic downturn and the chaos in the automotive industry have had a significant impact on these customers and their electricity consumption.

36. In addition, the following table outlines the actual purchases for CND from 1996 to 2008 as provided in Exhibit 3, Table 6 of the Application:

Year	Actual Purchases MWh
1996	1,126,779
1997	1,202,822
1998	1,272,551
1999	1,350,815
2000	1,392,174
2001	1,420,978
2002	1,519,145
2003	1,523,718
2004	1,570,406
2005	1,640,989
2006	1,599,360
2007	1,609,194
2008	1,557,523

37. As shown in the above table, from 1996 to 2005 there is a steady increase in purchases but from 2006 to 2008 the purchases are declining. In CND's view it is critical that a forecasting model address this relatively recent pattern of decline. It is the CDM flag that is addressing this decline in the forecast.

38. The revised regression analysis including the CDM flag resulted in a 2010 weather normal billed forecast of 1,384.3 GWh in 2010 as compared to 1.483.8 GWh in the Application. The resulting regression analysis does have variables that could be classified as being statistically insignificant but are not causing the forecast to be reduced.

39. In summary, based on the above discussion CND submits that the 2010 forecast of 1,384.3 GWh is reasonable for rate setting purposes.

- **Customer Forecast:**

40. The following table outlines the 2010 customer/connection forecast from CND's rate application. (Exhibit 3/Page 20/Table 11

2010 Test Year Customer/Connection Count Forecast	
Rate Class	**Customers/Connection**
Residential	45,218
GS<50 kW	4,582
GS>50 kW to 999kW	724
GS>1000 kW to 4999kW	25
GS>5000 kW	2
Street Lights	12,717
Unmetered Scattered Load	507
TOTAL	**63,774**

41. Board staff and intervenors made no submissions with regards to suggested changes to the proposed 2010 customer/connection forecast. CND submits the

2010 customer/connection forecast has been accepted by all parties and should be approved by the Board.

- **Billed kW Forecast:**

42. In its submission, EP highlighted that CND has used the average kW/kWh ratio over the 2003 through 2008 period to forecast the kW for these rate classes in 2009 and 2010. EP submits that this approach is not appropriate given the trend in the ratios shown in Table 20 of Exhibit 3. A review of these ratios reveals trends that are not being captured through the use of the averages over the 2003 through 2008 period. EP suggest this is particularly so in the GS 1000 to 4999, GS > 5000 and Street Lights classes. In both of the GS classes, there is a clear trend to higher kW/kWh ratios shown between 2003 and 2008. Street Lights have a clear trend to a lower kW/kWh ratio over this period. Only the GS 50 to 999 class is relatively stable over this period.

43. EP submits that the Board should direct CND to use the 2008 kW/kWh ratios to forecast the kW billing determinants for the 2010 Test Year. These ratios reflect trends over the 2003 through 2008 period and provide a more accurate forecast for the Test Year.

44. CND submits the methodology used to determine kW/KWh ratio used for forecasting purposes is reasonable. CND has used the average ratio over the period 2003 through 2008 as the ratio to be used in the 2009 and 2010 forecast of kW for GS>50 kW to 999kW, GS>1000 kW to 4999kW, GS>5000 kW and Street Light classes. The kW/KWh ratio reflects the relationship between kWh and kW in a rate class and in CND's view this is largely influenced by how each individual customer in the class is operating the equipment within its establishment. Operational characteristics vary from year to year and between individual customers which means it would be difficult to determine a trend in the kW/KWh ratio as the movement in the ratio would most likely not be influenced on a class

basis but on a individual customer basis. As a result, in this situation the forecasted kW/KWh should be based on the average ratio over a reasonable historical period such as 2003 to 2008.

- **OTHER REVENUES:**

45. As discussed in the Settlement Agreement, CND forecasts that it will lose the sum of $110,000 in the 2010 Test Year as a result of the discontinuation of water and sewer billing services to the City of Cambridge and the Region of Waterloo as of September 30, 2010.[4] In other words, the forecast shared services-related net revenue offset of $440,000 will be reduced to $330,000 in the 2010 Test Year. CND further forecasts it will have a net revenue shortfall of $440,000 for each year of the IRM period as it will no longer be providing these services. The Parties have agreed that the question of whether the appropriate amount for inclusion in CND's 2010 Revenue Requirement should be the 2010 forgone revenue ($110,000 per CND's forecast) or a "normalized" value of the 2010-2013 expenditure ($357,500 - representing $110,000 for 2010 plus three years at $440,000 per CND's forecasts) will be the subject of written submissions.

  - **Board staff and intervenor submissions:**

46. Board staff "do not disagree with C&ND Hydro's evidence that it will lose revenues and that costs will remain."[5] However, staff disagree with CND's proposal to normalize the lost revenues over the October 1, 2010 – December 31, 2013 period.

47. The intervenors do not accept[6] that the forgone net revenue offsets will be $440,000 after 2010, and none of the intervenors supports normalization.

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[4] This was addressed in CND's responses to Schools Interrogatory #13(a) and EP Interrogatory #24(f)
[5] Staff submission, at p.10
[6] For example, see Schools submission, at p.3; VECC submission, at p. 9

- **CND submissions:**

48. The fact is that CND has had an agreement with one of its municipal shareholders to provide water and sewer billing services. For that service, CND would be paid a net amount of $330,000 in the 2010 Test Year (for the January-September period). Accordingly, the forecast of $440,000 (net) per year through the IRM period is not random – it is based on the existing billing arrangement between CND and the municipality. If the contract with the City of Cambridge were ongoing, then it is reasonable to estimate that there would be a $440,000 (net) revenue offset in the Test Year. Because that service will no longer be provided after September 2010, CND will receive approximately $330,000 (net) in the Test Year instead of $440,000 (net). The $110,000 (net) that will not be received in the Test Year must be recovered through rates, and this is accepted by Board staff and the intervenors. However, to end the analysis there ignores the fact that an additional $330,000 (net) will not be received for this service in each year of the IRM period that follows. As discussed in the Argument-in-Chief, the assumption when dealing with revenue offsets that the offset will continue through the IRM period. This is clearly not the case here.

49. CND acknowledges staff's submission[7] that "In this particular case, where there is a known and discrete event, Board staff suggests that a separate and explicit approach is warranted." In the event that the Board does not accept the CND approach to normalization, CND submits that the staff approach would be an appropriate alternative. However, CND submits that it has concerns about the staff approach to amortization.

50. Staff suggest[8] that the forgone revenue offset "be reduced by ¼ in each of the succeeding years, so that it will be zero for C&ND Hydro's next rebasing for 2014. This reduction each year is to reflect either replacement revenues from new

[7] Staff submission, at p.11
[8] *Ibid.*

sources or cost savings or redeployment to other operations that the utility's management should be expected to effect to offset the revenues from Water and Sewer Billing being lost."

51. CND respectfully submits that the staff assumption that the revenues can be replaced or the resources can be redeployed does not reflect the reality of the situation. The postage to send the electricity bills will no longer be shared nor can it be redeployed. The supervisory staff that are in place will not be redeployed or eliminated but were included in the previous revenue requirement. CND's single sheet bill, return envelope and envelope costs cannot be redeployed.

52. Staff refer[9] to the IRM price cap adjustment formula and note that that formula "expects that there will be process, technological or other innovations effected by a utility to mitigate inflationary cost pressures, and the I-X price cap formula both incentivizes the firm to search for these and ensures a 'sharing' of productivity gains between shareholders and customers. This is expected to occur over the IRM period from the rebased rates in any event."

53. CND takes no issue with this staff comment – CND acknowledges that like all rate regulated distributors in the province, it is subject to adjustments in the IRM period to reflect expected productivity improvements – failure to find efficiencies can put the recovery of the full Board-approved ROE at risk. The staff, proposal, however, would in effect penalize CND for no longer having the water and sewer billing contract by imposing an additional productivity factor on the utility beyond that imposed on other distributors. CND submits that this is not appropriate. While CND accepts the responsibility for finding efficiencies in the context of the IRM adjustment process, it is not reasonable to further reduce CND's revenues by compounding the required productivity-related adjustments.

[9] *Ibid.*

54. The intervenors refer to the Board's Decision in London Hydro Inc.'s 2009 cost of service application[10] in support of their request that the normalization of the loss of water and sewer billing revenues be rejected. In that case, London Hydro proposed to amortize its CCA related to its new (in 2009) CIS system over the four year Test Year/IRM period. This was because with the CCA deduction included in rates for the Test Year, rates would be sufficient to recover PILs in 2009 and 2010, but once that deduction was gone after 2010, London Hydro would experience a significant increase in PILs with a corresponding shortfall in revenue, since its rates would no longer be sufficient to meet its PILs liability.

55. In summarizing the staff submission, the Board wrote (at page 25, in part) in its August 21, 2009 Decision:

> "Board staff submitted that London's proposed CCA "normalization" to balance out PILs expense is inconsistent with Board practice and policy. While the Board has allowed averaging of costs, such as regulatory expenses, over the period of rebasing and IRM, such treatment has not been allowed for PILs. The Board's practice is that the tax or PILs expense allowed is what the utility is expected to remit to tax authorities for the test rate year based on the estimated revenue requirement. London's proposal would over-recover its 2009 PILs even if, absent other tax changes, it collects about the same as it expects to remit over the four-year period until it next rebases. Board staff noted that the Board has not accepted similar "normalization" of taxes or PILs in other situations for electricity distributors; for example, where a distributor had a loss carry-forward available to reduce tax/PILs liability in the test year, the Board took it into account when setting rates for the test year. Staff also stated that it was unaware of any instances where this "normalization" has been applied to PILs calculation, although it has been applied to OM&A, regulatory assets and, in some cases, capex and efficiency gains."

56. The Board denied London Hydro's request for the normalization of the CCA deduction, noting (in part) that "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

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[10] EB-2008-0235 – available at:
http://www.oeb.gov.on.ca/OEB/_Documents/2009EDR/dec_order_LondonHydro_20090821.pdf

substantially higher. To do so amounts to forecasting a key element of the revenue requirement beyond the test year."

57. CND has the following comments in this regard. First, in contrast to the situation in London Hydro, this is not a PILs-related matter (which staff submitted in the London proceeding had received different treatment from other situations in which normalization had been applied) – here, there is no issue as to what the tax regime may be in two years; rather, the Board has before it a revenue offset that will no longer exist after September 2010, but a rate making regime that, without the treatment requested by CND, assumes that it will continue to exist through the IRM period. As with regulatory expenses, the lost revenue offset relates to the entire IRM period. There is no question that water and sewer billing services are ending. CND will still need its billing staff and will still be producing at least as many bills as it did prior to the termination of the water and sewer billing service. CND submits that the current situation is more consistent with that of Greater Sudbury Hydro, in that the expenses are known but the revenues to meet them will not be available without the relief requested.

58. As discussed in CND's Argument-in-Chief, there should be no distinction between the treatment of an expense (the Sudbury situation) and the loss of a revenue offset (the CND case) – in both cases, the distributor will not have the appropriate level of revenue to offset its costs through the IRM period. CND submits that the Board's approach in the Greater Sudbury case is the correct approach in the current case as well – in this way, by including $357,500 in the 2010 Test Year revenue requirement, CND will recover the "appropriate level of revenue to offset its costs."

59. Accordingly, CND requests that the Board approve the proposed normalization of the forgone water and sewer billing-related revenue offsets as set out in the Argument-in-Chief. In the alternative, CND requests that the Board approve the staff proposal with respect to amortization of this forgone offset.

- **NORMALIZATION OF CUSTOMER INFORMATION SYSTEM ("CIS") OPERATIONS, MAINTENANCE AND ADMINISTRATION ("OM&A") EXPENSES [RELATING TO IMPLEMENTATION OF MONTHLY BILLING];**

60. This matter was described in the Settlement Agreement as follows:

> "Parties agree that CND will incur an OM&A expenditure in the 2010 Test Year in the amount of $42,500 related to CND's change to monthly billing as part of the implementation of its new CIS system in November 2010. The Parties agree that CND's annual costs related to this change during the IRM period will be $312,000. The submissions will address the question of whether the appropriate amount for inclusion in CND's 2010 Revenue Requirement should be $42,500 or a "normalized" value of the 2010-2013 expenditure of $244,625 (representing $42,500 for 2010 plus three years at $312,000)."

61. In its Argument-in-Chief, CND advised that its comments on this matter were similar to those related to the loss of water and sewer billing-related revenue offsets, and referred the Board to them. This remains the case in this reply submission, and CND refers the Board to its comments above. CND will have additional comments on this matter below.

62. As noted in the Argument-in-Chief, the change to monthly billing was discussed in Exhibit 4, at pages 32 and 33. The annual cost of $312,000 consists of $255,000 in third party costs plus staffing increases with a value of $57,000.[11] CND has also provided for cost savings in the amount of $19,184.[12] As in the Greater Sudbury case, CND will be incurring higher costs in the IRM period than would be incorporated into the Test Year revenue requirement. In Greater Sudbury's case, none of those costs were being incurred in the Test Year; in CND's case, only a small portion of the ongoing costs are being incurred in the Test Year. Limiting CND's recovery to the $42,500 to be spent during the 2010 Test Year will mean that CND will have insufficient funds to meet its revenue requirement through the IRM period.

[11] See CND's response to Energy Probe Interrogatory #34(d).
[12] See CND's response to Staff Interrogatory #18.

63. CND maintains that the inclusion of $244,625 in the 2010 Test Year revenue requirement will allow for the recovery by CND of the "appropriate level of revenue to offset its costs" through the Test Year and the IRM period.

- **Board staff and intervenor submissions:**

64. Board staff distinguish between their position on the forgone water and sewer billing-related revenue offset and their position on the monthly billing-related costs. Here, staff support normalization of those costs, but suggest that the basis for the incremental costs for monthly billing "may not be well supported and C&ND Hydro has not well explored or supported offsetting savings." Staff offer two options[13] – rebasing in a subsequent year; or an "admittedly arbitrary" reduction in the normalized amount – to $142,500 – as halfway between the 2010 incremental costs and the $244,625 proposed by CND.

65. The intervenors submit that there should be no normalization. VECC acknowledges that "the activity involved and the associated costs are more and separable than was the case for revenue offsets",[14] and while VECC acknowledges that CND has made some allowance for cost savings as a result of the move to monthly billing, the support for normalization is insufficient for VECC, and VECC submits that CND has not accounted for reductions in bad debt expenses. While VECC acknowledges that CND has reflected the impact in its cash balances and 2010 interest income, that is not sufficient for VECC because in VECC's view the 2010 interest rates are too low. In the event that the Board does permit normalization, though, VECC proposes a nominal reduction of at least 10% to allow for unaccounted for savings. EP presumes savings reductions in bad debt and collection expenses, and in working capital, and creates a calculation that completely eliminates the amount requested by CND. Schools supports VECC

[13] Staff submission, at p.14
[14] VECC submission at p.12, para.6.3

and refers to Schools' submissions on the proposed water and sewer billing-related normalization.

- **CND submissions:**

66. With respect to the staff submission, CND submits that the option of a rebasing application is not reasonable. CND respectfully suggests that it makes little sense to incur hundreds of thousands of dollars in application-related costs, Board costs and intervenor costs, on a proceeding the purpose of which essentially is to verify the costs related to monthly billing. With respect to the option of the arbitrary reduction, CND has some difficulty in understanding the basis for this. While it may provide an incentive to operate within the envelope, the envelope bears no relationship to the costs, approximately 82% of which are third party costs.

67. CND submits that staff should not consider it illogical that customers may be asking for monthly billing when, all else being equal, that may result in increased costs and hence rates. While staff mention in their submission[15] that one reason given for moving to monthly billing was that customers have been asking for it, they do not mention any of the other eight reasons given in CND's response to Board staff interrogatory #18(b). For the Board's assistance, CND's response to Board staff interrogatory #18 was as follows:

> "a) Please provide C&ND Hydro's views as to whether a move to monthly billing should not result in a decrease in bad debt, as it would more quickly allow the utility to identify and deal with delinquent customers.
>
> b) Please provide C&ND Hydro's views as to the benefits for customers, including operational productivity gains by the utility, that result from the new billing system and the move to monthly billing. Please identify whether these are reflected in the proposed revenue requirement, and if so, where.
>
> Response
>
> a) With the move to monthly we anticipate a possible decrease in bad debts. We do not anticipate that the number of write offs will decrease but that average amount written off, especially in skip situations (i.e. customer leaves before utility is aware they are gone), should be lower.
>
> b) The identifiable savings arising out of the move to monthly billing are small compared to the increased costs. As noted in the Energy Probe Interrogatory #27 (a) an estimated amount of

[15] staff submission, at p. 14..

$19,184 is reflected as savings that has been netted against increases. The decision to move to monthly billing is driven by many factors, including the following customer benefits and operational productivity gains:

- Customers currently receive monthly billing for most other services (natural gas, telephone, cable).
- Monthly billing provides a better opportunity for customers to manage their cash flow.
- The OEB and Ministry continue to promote the need for monthly payments.
- Monthly billing provides customers with more timely information of how much power they have used and the potential impact on their conservation efforts.
- The switch to monthly at this time is a lead into the switch to Time of Use. Time of Use impacts and associated education will be much more relevant with monthly billing.
- High bill complaint calls should be easier to handle based on shorter time span.
- Customers have been asking for monthly billing.
- It provides consistency for small business customers. Currently some are monthly and others are bi-monthly.
- The new CIS template is designed for monthly only. Extra costs of modifications were high."

68. It is clear from this response that there are many benefits to monthly billing, including the fact that it meets customer needs with respect to budgeting and more timely information about electricity usage and costs. It is also consistent with Board and Ministry expectations. It is not unreasonable to expect that there would be incremental costs associated with these benefits. CND observes that in the case of conservation programs, which CND would expect many if not all customers would agree are beneficial, the distribution portion of the bill, including rates, will increase to address reductions in load forecasts due to conservation, and to address other items such as LRAM and SSM.

69. Moreover, as discussed in the context of the forgone water and sewer billing-related revenue offset, CND, like all other rate regulated electricity distributors, is subject to productivity-related adjustments as part of the IRM process – CND is therefore already incented through the Board's rate making regime to find efficiencies and look for more cost-effective ways of providing distribution services, including billing. There is no justification for compounding those productivity adjustments by allowing for normalization but arbitrarily reducing the normalized amount.

70. With respect to the intervenor submissions, CND submits that it has accounted for savings in its calculations. VECC may suggest[16] that additional guidance is needed from the Board with respect to normalization, but the fact is that it is this Application that is before the Board, and normalization is not new or unprecedented.

71. CND submits that its proposed approach to normalization, and the resulting amount proposed for inclusion in CND's revenue requirement, is reasonable. If the Board accepts the staff submission that some reduction is reasonable, then CND submits that it is far more appropriate make the 10% reduction mentioned by VECC; while there is no basis for this, it at least bears a more reasonable relationship to the incremental costs.

- **WORKING CAPITAL ALLOWANCE – THE NEED FOR A LEAD-LAG STUDY FOR C&ND HYDRO'S NEXT COST OF SERVICE REBASING APPLICATION:**

72. As discussed in the Argument-in-Chief, CND used the Board approved "15% allowance" approach to the working capital allowance, in accordance with section 2.3.4 of Chapter 2 of the Filing Requirements for Transmission and Distribution Applications issued by the Board on May 27, 2009.

73. CND understands that for distributors that were a similar size to CND and that rebased in 2009 through cost of service applications, the Board did not require those distributors to complete a lead-lag study as a result of the significant cost of the study.

  - **Board staff and intervenor submissions:**

74. At pages 15-16 of their submission, Board staff suggest that:

> "This methodology [the 15% approach] was inherited from the regulation of the electricity distribution sector by Ontario Hydro prior to restructuring and was documented in the 2000 Electricity Distribution Rate Handbook….Board staff submits that it would be both timely and appropriate for C&ND Hydro to support its WCA proposal at its next rebasing application with a

[16] VECC submission, at p.12, para.6.4

lead-lag study….In the event that the Board conducts a generic lead-lag study in advance of C&ND Hydro's next rebasing application, C&ND Hydro should either adopt the results of this study or conduct its own study in support of its WCA proposal in its next cost of service application."

75. While not mentioned in the staff submission in this proceeding, CND understands from the staff submission in at least one other proceeding[17] and from the Board's March 1, 2010 Decision in the cost of service application of Burlington Hydro Inc. (EB-2009-0259) that Board staff are already planning to conduct a generic lead-lag study which is anticipated to be completed by March 2012, and that Board staff intend to include participation of electricity distributors in this study.

76. EP and VECC, supported by Schools, submit that CND should be required to prepare a lead-lag study for its next cost of service application, or (in EP's submission), if the Board is concerned about the costs of a full study, then a study related to the cost of capital component of the working capital allowance.

- **CND submissions:**

77. In its rate applications to date, including the current Application, CND has complied with the Board's policies with respect to the calculation of its working capital allowance. This includes the use of the "15% formulaic approach".

78. CND believes that if there is to be any change in the use of this accepted approach, it should be the result of a generic consultation by the Board, and not the result of determinations made on a random, application-by-application basis. To date, CND is not aware of any Board policy that would suggest that an individual lead-lag study is warranted for a distributor of CND's size, and submits that it should not be required to incur the expense associated with a utility-specific study.

79. CND submits the Board's findings in its June 1, 2009 Decision in the Peterborough Distribution Inc. cost of service distribution rate application (EB-2008-0241) remain appropriate. In that proceeding, as in others in the 2008-2011 cycle of rebasing

[17] EB-2009-0269 – Haldimand County Hydro Inc.

applications, VECC was asking the Board to require a utility-specific lead-lag study, and in that Decision, as in others, VECC's request was denied. In its Decision, the Board found:

> "VECC did not object to the use of the "15% rule" for purposes of this proceeding, but submitted that PDI should be required to submit a lead-lag study in the future.
>
> …
>
> In response to VECC's request for a lead-lag study, PDI submitted that lead-lag studies can be costly for individual utilities. If the OEB considers that such studies should be required, they should be conducted in a generic manner across the province through a consultation process led by the Board. PDI noted that VECC and at least one other intervenor have made similar requests in other 2009 applications by distributors, and that these requests have been rejected by the Board.
>
> **Board Findings**
>
> …
>
> The Board will not direct PDI to undertake a lead-lag study at this time. It might not be the most cost effective way for testing the reasonableness of the current default provision for working capital, which is used by all, except two, electricity distributors."

80. CND submits that, particularly where Board staff have advised that a generic proceeding is to be undertaken, it would be inappropriate to require CND to undertake a utility-specific lead-lag study as part of its Decision in the current cost of service proceeding. It would be equally inappropriate to impose a requirement at this time that CND either use the results of the generic study at the time of its next rebasing or submit its own study at the time of its next rebasing. CND suggests that such a requirement prejudges the options that may come out of the generic proceeding. CND expects that if a generic proceeding takes place, any policies that flow from it will be reflected in the Board's Filing Requirements, with which CND will be required to comply at the time of its next rebasing application. CND submits that the reasonable approach to this matter is for the generic proceeding to take its course.

81. Moreover, CND suggests that its position in this regard is consistent with the Board's findings in the March 1, 2010 Burlington Hydro Decision. There, the Board found:

> "The Board agrees with Board staff that further work on the formulaic WCA approach is warranted. The Board expects to initiate a generic proceeding / consultation on determining a new working capital methodology in advance of Burlington's next cost of service filing. The Board will not direct Burlington to conduct an independent lead-lag study at this time."

82. CND notes that Burlington Hydro has approximately 60% more customers than CND.

83. If, notwithstanding the upcoming generic proceeding and the lack of any particular reason for requiring a utility-specific lead-lag study for CND where it has not been required for other distributors, the Board determines that it is appropriate at this time to require CND to prepare a study, CND again wishes to express its concern about the cost of such a study and notes that it has not included the costs of a lead-lag study in its forecast. If the Board requires CND to complete such a study prior to its next rebasing application, CND requests that it be permitted to track the costs of the study in a deferral account to reflect the unexpected and incremental nature of the expense, with the balance to be disposed of at its next rebasing application, at the same time that it files its completed lead-lag study.

- **COST OF CAPITAL**

84. In its Application, CND's deemed debt capitalization includes 4% of short term and 56% of long term debt in compliance with the Board's December 20, 2006 Cost of Capital Report (the "December 2006 Report"). 2009 cost of capital parameters (8.01% for ROE and 1.33% for short term debt) were used as placeholders for the updated cost of capital parameters for 2010 cost of service applications, which would be issued early in 2010.[18] The parties have settled on CND's long term debt rate, and that was addressed in the Settlement Agreement – it is not among the unsettled matters.

85. The December 11, 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the "December 2009 Report"), which was the result of a lengthy consultation by the Board, recognized (at page 56) that "The short-term

[18] See Exhibit 5, p.2 of the Application

debt rate, and deemed 4% component of the capital structure was introduced in Cost of Service applications for 2008 distribution rates", and the Board did not alter the deemed debt capitalization percentages for short and long term debt. The percentages were confirmed in the December 2009 Report (see, for example, the summary at Section 4.5, Table 2, page 59 of the December 2009 Report). The December 2009 Report is a guideline, but departures from the methodology in the report are expected to be adequately supported. While the December 2009 Report was issued subsequent to this Application, the Report states that the revised guidelines apply to applications for rates effective in 2010 or later and determined through review of Cost of Service applications. Thus the December 2009 Report supplements the guidelines documented in the December 2006 Report and both reports apply to this Application.

86. Accordingly, CND submits that the short term debt percentage of rate base should be 4% and the long term debt component should be 56% for 2010 rate setting purposes. CND submits that any changes to this approach, which has now been in place for several years of cost of service applications, including 2010 cost of service applications, can only come about through a sector-wide review process, and must not be the result of *ad hoc* requests by specific intervenors in individual cost of service applications.

87. Similarly, with regard to ROE, CND submits that the methodology for determining the ROE for the 2010 Test Year is as set out in the December 2009 Report, and that the Return on Equity applicable to CND should be determined on that basis, consistent with the Board's approach to other rebasing distributors. As the Board noted at page VI of that Report, based on September 2009 data, the base ROE is set at 9.75%. Once again, any changes to this approach can only come about through a sector-wide review process, and must not be the result of *ad hoc* requests by specific intervenors in individual cost of service applications.

88. On February 24, 2010, the Board issued its Cost of Capital Parameter Updates for 2010 Cost of Service Applications (the "2010 Updates"). The 2010 Updates provide as follows (in part):

> On December 11, 2009 the Board issued its *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*. The Report sets out the Board's approach to the cost of capital, and the methods the Board will use to determine the values for the ROE and the deemed LT and ST debt rates (collectively, the "Cost of Capital parameters") for the purpose of setting utility rates. At the time of that Report, the ROE formula was reset resulting in a base ROE of 9.75%.
>
> Based on the methods set out in that Report, the Board has determined that the updated Cost of Capital parameters for 2010 cost of service rate applications are summarized in the table below. The 10 basis point increase in the ROE reflects rising bond yields in the market since the issuance of the Report. The Board considers these Cost of Capital parameter values and the relationships between them reasonable and representative of market conditions at this time and for the 2010 rate year.

Cost of Capital Parameter	**Value for 2010 Cost of Service Applications** (assuming May 1, 2010 implementation date for rate changes)
ROE	9.85%
Deemed LT Debt rate	5.87%
Deemed ST Debt rate	2.07%

> These values will be applied by the Board in its consideration of 2010 electricity Cost of Service applications."

89. Based on the December 2006 Report, the December 2009 Report and the 2010 Updates, the deemed capital structure for 2010 cost of service applications is 56% long term debt, 4% short term debt and 40% equity, and the ROE is 9.85%.

90. CND will be updating its Application to reflect the 2010 Updates in the draft Rate Order that will follow the Board's Decision on the unsettled matters.

- **The positions of Board staff and intervenors:**

91. With respect to the cost of capital issue (which includes both of the unsettled matters), Board staff advise at page 18 of their submission that:

> "*Discussion and Submission*
>
> C&ND Hydro has affirmed that the cost of capital parameters are to be updated in accordance with the Board's guidelines based on data available at the time of the Board's decision. Between the

time of the initial application filing and now, the Board issued the 2009 Report; however, this was the culmination of an extensive consultative process Board staff submits that C&ND Hydro's proposals for Cost of Capital, as amended through discovery, comply with the guidelines documented in the 2009 Report."

92. Intervenors (in particular, EP) have made submissions on both the allowable ROE and the appropriate amount of short term debt in the capital structure.

o **ROE**

93. The issue with respect to ROE relates primarily to 50 basis points of the total 9.85% established by the Board as the ROE for 2010 cost of service applications. EP acknowledges that for almost 20 years, the Board has included an implicit 50 basis points for transactional costs, and that this is a long-standing practice with other regulators across North America. Now, however, on an *ad hoc* basis, EP would have the Board remove 50 basis points from the ROE of those distributors in whose 2010 cost of service applications EP has chosen to intervene. VECC and Schools support the EP submission. VECC would make further *ad hoc* adjustments to reduce the ROE to 9.12%, notwithstanding the December 2009 Report and the 2010 Updates, on the basis that there should be no more than 325 basis points between the deemed long term debt rate and the ROE. VECC cites the "general consensus" that the spread between the borrowing costs for distribution utilities and their allowed ROE should be in the order of 200-300 basis points.

- **CND submissions:**

94. EP suggests that CND should not qualify for the 9.75% (now updated to 9.85%) ROE figure on the basis that the 50 basis point transactional costs are not appropriate for CND. CND submits that EP is recommending a dramatic departure from Board's policy in respect of ROE. The Board has never before asked distributors to produce evidence of its flotation and transaction costs to support recovery of the full allowable ROE – not in the Board's 2000 Distribution Rate Handbook; not in the Board's 2006 Distribution Rate Handbook; not in the

December 2006 Report; and not in December 2009 Report, all of which were developed through extensive hearing and/or consultation processes. There is also no such requirement in the Board's Filing Requirements with respect to these applications.

95. CND submits that EP's approach creates an entirely new, unexpected and unprecedented burden of proof that would open the floodgates to numerous arguments about all aspects of the allowable ROE – requiring utilities to hire costly consultants to justify a proposed ROE and subjecting the Board to lengthy administratively cumbersome proceedings on disputed ROE allowances. CND submits that the Board should reject EP's approach and affirm CND's use of a 9.85% ROE in compliance with the December 2009 Report and the 2010 Updates.

96. CND submits that if there is any need for the Board to consider departing from its policy (and CND submits that there is not), the appropriate manner is not through an *ad hoc* process in which individual cost of service applications are adjusted depending on whether a particular intervenor has decided to take an interest in the proceeding.

97. CND notes that in its March 1, 2010 Decision on Burlington Hydro's 2010 cost of service application, the Board rejected an identical submission from EP. The Board's discussion of the cost of capital-related matters can be found at pages 23-30 of that Decision. In short, though, at pages 26-28 of that Decision, the Board found:

> "The issue is whether the Board should apply the policy or whether it should adjust the application of the policy for the specific circumstances of Burlington. The Board concludes that the policy should be applied unadjusted.
>
> In its 2009 Report the Board established an initial ROE for purposes of resetting the formula. Energy Probe suggests the ROE should be adjusted downward to remove the implicit 50 basis points for flotation costs to reflect the specific circumstances of Burlington, namely that it does not intend to issue equity in the test year. Burlington is not unique in not issuing equity; very few of Ontario's regulated entities issue equity even indirectly and even those who have would not necessarily have done so in every year. This is true for both the gas industry and the electricity industry. This situation has existed for considerable time, even before 2000 in the gas industry, and would have been understood throughout the evolution of the Board's approach to setting the ROE

for electricity utilities. The Board has never differentiated the ROE awarded on the basis of whether an entity issued equity.

Energy Probe's adjustment would have the Board make an adjustment to one component of an empirical methodology based on a specific fact situation as it applies to a specific component. As has already been noted, experts have included this component in their estimates, including Dr. Booth, without qualifying it as being only applicable to entities with equity issues in the test period. In addition, the adjustment has been characterized in a variety of ways, including as an allowance for "financial flexibility", which suggests that the allowance is not limited to consideration of specific transactions. The Board finds that it would be inappropriate to adjust the operation of the formula without evidence as to the appropriateness of such an adjustment in terms of the overall methodology in the context of Burlington's circumstances. This evidence would need to address, for example, whether such an adjustment for Burlington is appropriate under the "stand alone" utility principle and whether the allowance is related only to specific transactional costs or whether it has broader application.

It might be suggested that the applicant has some onus to provide evidence to support the new ROE policy, and indeed Energy Probe has suggested that Burlington, and presumably other distributors, would need to provide evidence of actual transaction costs to support a claim for the full ROE allowed under the new policy. The Board does not agree. The 2009 Report makes clear that the existing filing requirements remain valid and that the need for supporting evidence is specifically relevant if the applicant seeks a treatment which differs from the established Board policy."

98. CND submits that EP's submissions with respect to ROE should be similarly rejected in the current case.

99. With respect to the manipulation of the Board's parameters suggested by VECC, CND submits that they too should be rejected. It is the Board's findings in its December 2009 Report and the parameters established in its 2010 Updates that are relevant. VECC may not be pleased about the outcome of that consultation or with 9.85% as the permitted ROE, but the Board's findings and parameters with respect to ROE are clear. CND respectfully submits that the Board should not allow a single distributor's cost of service application that complies with that Report and the ROE parameter to become a platform for one intervenor to revisit the Board's lengthy consultation process, nor should the Board accept that intervenor's arbitrary modification to the Board's ROE parameter.

- **Short-term Debt Component of the Deemed Capital Structure**

100. Similar to its generic position on ROE, and notwithstanding that the 56% long term debt/4% short term debt/40% equity deemed capital structure was established

over three years ago and that this is the third year of rebasing applications in which it has been used, EP is now taking the position, in individual applications in which it is involved, that the Board should depart from its well-established approach to capital structure to effect an increase in the deemed short-term debt component of CND's capital structure.

101. At page 7 of what appears to be a generic submission, EP suggests that there is an inappropriate "mismatch" between the level of deemed short-term debt and the working capital level included in CND's rate base. The implication is that the Board's well-established policy is not appropriate in CND's case.

102. EP relies on the Board's commentary at page 13 of the December 2009 Report, included in response to specific concerns regarding the scope of outcome from the Board's consultation process, as authority for its argument. The relevant portion of the December 2009 Report provides:

> "The final "product" of this process, of course, is a Board policy. This was not a hearing process, and it does not - indeed cannot - set rates. The Board's 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. 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)."

103. Schools makes no submissions on EP's short term debt rate position. VECC supports EP.

- **CND submissions:**

104. CND submits that EP has failed to raise circumstances sufficient to justify the Board departing from its well established policy on Cost of Capital. At page 49 of the December 2009 Report, the Board states that (emphasis added):

> "**The Board's current policy with regard to capital structure for all regulated utilities continues to be appropriate.** As noted in the Board's draft guidelines, capital structure should be reviewed only when there is a significant change in financial, business or corporate fundamentals."

105. The Board's current policy is articulated in the Board's December 2006 Report, where the Board adopted a single deemed capital structure for all distributors for

rate-making purposes – fixing a split of 60% debt, 40% equity for all distributors and including a short-term debt amount fixed at 4% of rate base. The Board has been rightfully hesitant in past proceedings to depart from its policy on deemed capital structure. The policy is the result of a broad ranging public consultation process and it has created much-needed certainty for both distributors and intervenors in the Board's rate setting process.

106. The Board justified its deemed short-term equity amount at page 9 of the December 2006 Report, noting (emphasis added):

> Based on filings of distributors pursuant to the Board's Electricity RRR and in 2006 rate applications, it is clear that many distributors use short-term debt. The actual average for the industry is about 4%. Some distributors use it extensively as a substitute for long-term debt. **This may be advantageous in a period characterized by low inflation and interest rates, but such a practice exposes the distributor – and its customers – to inordinate risk if rates climb.**

107. To take advantage of the low interest rates currently applicable to short-term debt, EP argues that the Board should abandon its well established policy and increase the short-term debt component of CND's capital structure beyond the deemed amount of 4%.

108. The Board has previously considered and rejected as problematic an approach that would use the actual short-term debt of a distributor to determine the appropriate percentage of the distributor's capital structure. Specifically, page 11 of the December 2006 Report states (emphasis added):

> Although using a distributor's actual short term debt component may seem to be a more accurate approach, **it may be problematic.** Short-term debt is optimally used as an interim solution for managing a firm's financing requirements. It may fluctuate, although generally within a limited range. **Using a firm's actual short-term debt component would be administratively challenging given the number of electricity distributors and the associated volume of data that would need to be reported and verified.**

109. CND submits that the EP approach is similarly problematic. Specifically, if the Board accepts EP's argument the Board will create a tremendous administrative challenge as it opens the floodgates to numerous parties making a wide variety of arguments to change the deemed capital structure based upon a mix of evidence of a distributor's current capitalization rates and other evidence drawn from

elsewhere in the rate application which has no direct relationship to the capital structure of the utility. Indeed, EP does not make reference to CND's actual short-term debt to suggest that the deemed rate is inappropriate. Instead, it makes a leap in logic to imply that the working capital component of CND's rate base is somehow equivalent to what CND's actual short-term debt amount should be.

110. CND submits that its proposed working capital allowance was prepared strictly for the purposes of contributing to the rate base component of the Application. The working capital allowance has no real correlation to CND's actual level of short-term debt nor should it be used as a proxy for the level of short-term debt the Board will use for rate setting purposes. CND submits that its proposed capital structure, including the short-term debt component, complies with the December 2009 Report and is appropriate for rate setting purposes.

111. In the alternative, CND submits that EP has erred in suggesting that all working capital should be financed through short-term debt. CND submits that this is simply not the case, and that EP's argument equating working capital to short-term debt is misleading in this regard.

112. At page 10 of its December 2006 Report, the Board states that (emphasis added):

> 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.

113. It is a well understood principle of corporate finance that firms need both a long-term (or permanent) investment in working capital and a short-term or cyclical one. The permanent working capital investment provides an ongoing positive net working capital position, that is, a level of current assets that exceeds current liabilities. This allows CND to operate with a comfortable financial margin and minimizes the risk of being unable to pay its employees, vendors, lenders, or the government (for taxes). To have a continuous positive net working capital, a company must finance part of its working capital on a long-term basis.

114. Beyond this permanent working capital investment, CND also needs seasonal or cyclical working capital. Since the demand for power and CND's controllable expenses vary over the course of a year, CND needs to finance these costs to prepare for its peak sales period and accounts receivable until cash is collected. CND acknowledges that cyclical working capital can sometimes be financed by short-term debt since the seasonal build-up of assets to address seasonal demand will be reduced and converted to cash to repay borrowed funds within a short predictable period. However, CND does not accept the suggestion that the cyclical portion of working capital should be used as a proxy for the short-term debt applicable to a utility's capitalization structure.

115. For illustration purposes only, CND has conducted a simplified month-by-month analysis of the fixed and variable components of its 2009 working capital requirement and has found that approximately 68% of its monthly working capital needs remain constant over the year while about 32% exhibits a seasonal variation that changes over the course of the year (the seasonal change is primarily due to changes in the cost of power).

116. CND submits that, in light of the foregoing, EP has failed to raise circumstances sufficient to justify the Board departing from its well established policy on Cost of Capital.

117. Moreover, as with ROE, CND submits that if there is any need for the Board to consider departing from its policy (and CND submits that there is not), the appropriate manner is not through an *ad hoc* process in which individual cost of service applications are adjusted depending on whether a particular intervenor has decided to take an interest in the proceeding.

118. The Board's policy was developed after a lengthy consultative process conducted by the Board; CND submits that any possible changes to the Board's policy should be approached in a similar way.

119. CND acknowledges that the foregoing submissions are similar to those of Burlington Hydro's response to EP's generic submission in its 2010 cost of service application. As in the case of ROE, the Board rejected EP's generic submission on short term debt in that proceeding.

120. At pages 29-30 of its Decision, the Board found:

> **"Board Findings**
>
> The Board will make no adjustment to the deemed capital structure of 56% long-term debt and 4% short-term debt. As acknowledged by all parties, the Board's uniform deemed capital structure and uniform approach to setting the WCA have both been in place for considerable time. The Board is not prepared to depart from these policies on the basis of the record in this proceeding. Energy Probe has asserted that the WCA should align to short-term debt in the capital structure, but it has not provided any evidence to support this contention, theoretically or practically; nor has Burlington had the opportunity to respond with rebuttal evidence. However, as indicated earlier, the Board may review the formula approach to determining the WCA. In the context of that review it may be appropriate to examine the levels of WCA across utilities and consider whether any refinement to the deemed capital structure is warranted."

121. In that case, the Board confirmed that its established capital structure of 56% long term debt, 4% short term debt at the 2010 deemed rate of 2.07%, and 40% equity should apply. CND respectfully submits that this is the appropriate approach in the current case as well.

- **DEFERRAL AND VARIANCE ACCOUNTS – ACCOUNT 1588 GLOBAL ADJUSTMENT SUB-ACCOUNT:**

122. As noted in the Settlement Agreement and the Argument-in-Chief, Board staff have inquired as to whether CND's billing system is capable of assigning the balance in the Account 1588 RSVA Power Account – Global Adjustment Sub-Account only to non-RPP customers. The parties took no position in this regard, although CND noted that its billing system is not capable of creating distinctions among members of the same class with respect to rate riders. The parties mentioned the matter in the Settlement Agreement in order to ensure that Board staff would have an opportunity to comment on it in the submissions that would follow the Board's approval of the Settlement Agreement. As noted in the Settlement Agreement, this was a severable issue, in that the Board's determination of this matter would not affect the settlement among the parties.

123. In its Argument-in-Chief, CND confirmed that its billing system is not capable of creating distinctions among members of the same class with respect to rate riders and requested that the Board take this into consideration when it renders its decision on this issue.

- **The positions of Board staff and intervenors:**

124. At pages 19 and 20 of their submission, staff suggest deferring the disposition of the Account 1588 Global Adjustment sub-account for CND for the purposes of setting 2010 distribution rates, so that CND could deal with disposition of that balance as part of its 2011 IRM rate application. Staff suggest that in that way, the necessary capability to handle a separate rate rider for non-RPP customers could be built into its new CIS and billing systems – staff suggest that this could be done at little additional cost as those systems are now under development. Staff suggest a 24 month period for the disposition of the balance in this sub-account.

125. EP expresses concern that the costs of implementing a separate rate rider for the non-RPP customers may outweigh the benefits. EP suggests that the Board direct CND to investigate the cost of being able to have different rate riders for different customers within a rate class, and that the Board initiate a consultative process to review who can and cannot dispose of that balance to non-RPP customers only, and the likely costs and benefits to those distributors who cannot adopt that approach, and to their rate payers.

126. VECC has similar concerns about costs, and suggests that a viable and possibly attractive solution might be to ensure that in the acquisition of its next system CND assesses the costs of that functionality.

- **CND submissions:**

127. The balances in the Account 1588 Global Adjustment subaccount continue to experience increases and will therefore be dealt with in future approvals for dispositions. CND therefore requests that the requested dispositions not be

delayed, and that they be dealt with as presented in the Application. Based on the feedback from the Board, CND will develop the necessary functionality in its new CIS so that future dispositions may include separate rate riders for non-RPP customers.

- **HARMONIZED SALES TAX ("HST"):**

128. As discussed in the Argument-in-Chief, and in accordance with its response to Board staff Supplemental Interrogatory #42, CND believes that this is an industry-wide issue that should be addressed consistently for all distributors across the sector. CND suggests that this requires a decision from the Board that could be the result of a public consultation process whereby all of the viable alternatives are discussed.

129. In the event that the Board directs all electricity distributors to capture the reductions in OM&A and capital expenditures resulting from the change to HST in variance accounts, CND would follow the Board's direction and record all incremental reductions.

130. At paragraphs 8 - 11 of the Argument-in-Chief, CND discusses the additional work and costs that would be required for the recording of differences stemming from PST and GST harmonization, and the basis for those increases. CND also indicated that, the cost impact on CND of the switch from PST to HST is unknown at this time and may never be accurately determined. The cost impact will consist of the (effective) removal of an 8% tax component on both capital goods and other operating supplies and services, offset by the fact that depending on market conditions for each of these goods and services, prices will increase as suppliers fail to pass through the full tax reduction in prices. Information on the degree to which prices fail to reflect the full tax change will necessarily be speculative and in all probability could not form the basis for accounting entries. Therefore, CND does not accept the suggestion that accurate entries could be made in such a deferral account if it were established.

131. CND proposed, as an alternative with respect to OM&A, a reduction in the monthly fixed charges for all customers in all utilities (i.e. rate rebasing and IRM) effective May 1, 2010. The amount could be $0.10 per month per customer to reflect the implementation date of July 1, 2010 for HST impacts. However, CND again stressed that any such approach should be the result of a sector-wide consultation, and not imposed on an application-by-application basis.

132. With respect to capital expenditures, CND considered the impact of the change to not be material. This is because the amortization periods spread any savings that might exist over long time periods and the rebasing process will capture the changes in a timely manner.

- **The positions of Board staff and intervenors:**

133. Board staff believe[19] that "Cautions from CND Hydro and other distributors about the administrative burden and costs about harmonization are at odds with the provincial and Federal governments' pronouncements regarding the stimulative and competitive results of harmonization. While the costs and savings are not clear at this point, Board staff submits that tracking of these is warranted at this point and that, per government pronouncements, the potential savings for corporations like C&ND Hydro could be significant." Board staff do not support CND's alternative approach of $0.10 per month per customer to reflect the implementation date of July 1, 2010 for HST impacts. Staff acknowledge "the perspective that this is a generic issue that has arisen recently and that affects the whole industry", but submit that the Board must decide in this proceeding on just and reasonable rates. In the absence of evidence on forecast PST savings, staff suggest[20] that the Board "may wish to consider establishing a deferral account to track any savings that may arise so that these savings could be returned to customers in the future."

[19] Staff submission, at p.21
[20] Staff submission, at p.22

134. VECC believes that the impact of the change with respect to capital expenditures is material,[21] and that it cannot be ignored. VECC takes a similar position with OM&A-related PST. While not explicit in its submission, VECC appears[22] to want money now, regardless of whether savings can actually be determined. Schools and EP take a similar position. EP wants OM&A expenses reduced by $43,009 and capital expenditures reduced by $169,209.[23] Costs related to PST implementation, and the question as to whether there will in fact be any savings as a result of harmonization, appear irrelevant to the intervenors.

- **CND submissions:**

135. CND reiterates its submissions in its Argument-in-Chief.

136. CND requests that the Board reject EP's and the other intervenors' submissions with respect to arbitrary reductions from CND's revenue requirement. Any approach that ignores costs associated with implementation and ignores the question of whether savings will materialize effectively amounts to an arbitrary penalty of hundreds of thousands of dollars over the Test Year and IRM period. CND submits that while no deductions or variance accounts are appropriate at this time, this arbitrary approach is definitely not appropriate. Even if savings are passed on by suppliers (CND submits that whether this happens in Ontario, and whether government pronouncements on savings are borne out remains to be seen), the fact is that the intervenors would have CND ignore any incremental costs associated with this new regime – CND discussed these factors in its Argument-in-Chief, at paragraphs 10-11.

137. CND submits that the appropriate treatment of HST is a matter that requires a sector-wide approach. It should not be addressed on a case-by-case basis, but

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[21] VECC submission, at p.2, para.2.4
[22] VECC submission, at p.11, para.6.2
[23] EP submission, at p.14

instead should be the subject of a generic consultation in which a variety of possible approaches is considered.

138. In the event that the Board directs all electricity distributors to capture the reductions in OM&A and capital expenditures resulting from the change to HST in variance accounts, CND would follow the Board's directions in this regard. However, CND submits that any variance account that does not account for incremental costs related to HST in addition to any savings is incomplete. CND submits that the variance account, if adopted by the Board, should also provide for the inclusion of costs related to the implementation and collection of HST as well as the tracking of savings.

CONCLUSION:

139. For all of the foregoing reasons, as set out in its Argument-in-Chief, CND respectfully requests that the Board:

a) deal with the shift to HST on a consistent industry-wide basis through an appropriate consultation process;

b) not require CND to prepare a lead-lag study for its next cost of service application;

c) approve CND's load forecast of 1,420,552 GWh, which incorporates revisions through its responses to VECC interrogatories 14(c) and (f);

d) allow the inclusion of $357,500 in its 2010 Test Year revenue requirement, which recognizes the loss of $110,000 in water and sewer billing-related revenue offsets for the 2010 Test Year and $440,000 per year for each of the three IRM years that follow;

e) allow the inclusion of $244,625 in its 2010 Test Year revenue requirement, which recognizes $42,500 in costs related to the shift to monthly billing for the 2010

Test Year plus costs of $312,000 per year for each of the three IRM years that follow;

f) confirm that CND's deemed debt capitalization will be 4% of short term and 56% of long term debt in accordance with the Board's December 20, 2006 Cost of Capital Report;

g) confirm that the methodology for determining the Return on Equity for the 2010 Test Year is as set out in the December 11, 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, and that the Return on Equity applicable to CND will be 9.85%; and

h) approve CND's proposed disposition of the balance in the Account 1588 RSVA Power Account – Global Adjustment Sub-Account – with no distinction between RPP and non-RPP customers.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 5TH DAY OF MARCH, 2010:

BORDEN LADNER GERVAIS LLP
Per:

Original signed by James C. Sidlofsky
James C. Sidlofsky
Counsel to Cambridge and North Dumfries Hydro Inc.

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