Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2009-0265

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

BEFORE: Cathy Spoel
Presiding Member

DECISION AND ORDER

Haldimand County Hydro Inc. ("Haldimand" or the "Applicant") filed an application with the Ontario Energy Board (the "Board"), on August 28, 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 Haldimand charges for electricity distribution, to be effective May 1, 2010. Haldimand owns and operates the electricity distribution system in its licensed service area in Haldimand County, serving approximately 20,843 Residential, General Service, Street Lighting, Sentinel Light and Unmetered Scattered Load customers and two Embedded Distributors. The total service territory for Haldimand is 1,252 square kilometers consisting of rural areas and six communities: Caledonia, Cayuga, Dunnville, Hagersville, Jarvis and Townsend.

Haldimand is one of about 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan for the years 2007-2010. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission*

and Distribution Applications on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year.

On January 29, 2009, the Board indicated that Haldimand would be one of the electricity distributors to have its rates rebased for the 2010 rate year. Accordingly, Haldimand filed a cost of service application based on 2010 as the forward test year.

In its Application, Haldimand requested a service revenue requirement of $13,938,978 which produced a deficiency in gross distribution revenue of $1,584,943 at current rates for the 2010 Test Year. If the application were approved as filed, a residential customer consuming 800 kWh per month would experience an increase of approximately 15% to the current delivery charges.

The Board assigned the application file number EB-2009-0265 and issued a Notice of Application and Hearing on September 16, 2009. Energy Probe Research Foundation ("Energy Probe"), School Energy Coalition ("SEC") and the Vulnerable Energy Consumers Coalition ("VECC") applied for and were granted intervenor status and were found to be eligible for costs. The Board also granted intervenor status to a residential ratepayer, Ms. Lisa Pryor.

In Procedural Order No. 1 issued on October 14, 2009, the Board indicated that it would proceed by way of a written hearing and outlined the dates for filing written interrogatories and responses to interrogatories. In Procedural Order No. 3 issued on December 11, 2009, the Board provided dates for filing supplemental written interrogatories and outlined the dates for a settlement conference between the Applicant and intervenors with the objective of reaching a settlement among the parties on the issues.

A settlement conference was held on January 21st and 22nd, 2010 in the Board's hearing room. All parties with the exception of Ms. Lisa Pryor participated in the settlement conference.

The Board issued Procedural Order No. 4 on February 10, 2010 establishing dates to file a settlement agreement, written submissions on unsettled issues and reply argument.

Haldimand filed a Settlement Agreement on February 12, 2010. The parties reached a settlement on all issues with the exception of the following:

1. Load forecast
2. Lead / Lag Study – the appropriateness of a lead / lag study for Haldimand's next rebasing application
3. Harmonized Sales Tax– the appropriate treatment of Ontario's shift to a Harmonized Sales Tax, planned for implementation effective July 1, 2010, with respect to both capital and operating expenditures.
4. Return on Equity and Capitalization
5. RSVA Account 1588 – Sub-account Global Adjustment (separation by RPP/Non-RPP)

Although the parties reached a settlement on Deferral and Variance Accounts, the agreement provided for Board staff to make a submission on the narrow issue of RSVA Account 1588 (Sub-account Global Adjustment).

On February 18, 2010 the Board issued its Decision on the Settlement Agreement accepting it as filed. The Board also determined that the unsettled issues would be addressed through written submissions as noted in Procedural Order No. 4.

Board staff and intervenors filed their written submissions on the unsettled issues on February 18th and 19th, 2010 respectively. The Applicant filed its Reply on March 5, 2010. The Board's decision and reasons on the unsettled issues are addressed in the following section.

Load Forecast

The Applicant used historical data to determine the 2008 Bridge Year and 2009 Test Year customers/connections count by class, and to determine the kWh forecast by customer class (and the kW forecast for appropriate classes). It presented variance analyses in support of these forecasts.

Load Forecast Methodology

Haldimand's load forecast was developed in a four-step process:

- a total system weather normalized purchased energy forecast was developed based on a multifactor regression model that incorporated historical load, weather, economic data, population and calendar factors.
- the predicted 2008 weather normalized purchases were adjusted by the negative growth factors outlined in the Independent Electricity System Operator ("IESO") 18-Month Outlook to produce a 2009 and 2010 forecast of weather normalized purchases.
- the weather normalized purchased energy forecast was adjusted by Haldimand's proposed total loss factor to produce a weather normalized billed energy forecast.
- the total billed energy forecast was disaggregated into forecasts for the rate classes using a forecast of customer/connection numbers and their historical usage patterns.

Haldimand incorporated the IESO-18 Month Outlook to forecast the 2009 and 2010 weather normalized purchases. The IESO forecasted a 4.0% decline in Ontario energy demand for 2009 and an additional 0.3% decline for the year 2010. Haldimand incorporated the IESO outlook as the majority of Haldimand's wholesale consumption is purchased through the IESO and also because Haldimand had experienced a decline in retail and wholesale consumption (kWh) since 2007 and into 2009.

The 2010 forecasted customer/connection count was 24,586, a 0.5% increase over the previous year.

The result was a total weather normalized billed energy forecast for 2010 of 343.1 GWwh. This is 2.5% lower than the actual billed volume of 352.1 GWh in 2008.

Haldimand's regression model coefficients for population and Gross Domestic Product ("GDP"), were negative, a result that Board Staff and the intervenors argued was counter-intuitive.

In response to Board Staff supplementary interrogatory No. 3, Haldimand submitted a revised regression model that excluded Ontario real GDP and Population but included a

Conservation and Demand Management ("CDM") flag. The CDM flag was a factor which increased monthly from 1 to 36 from January 2006 to December 2008. This factor was cubed in the regression model. The resulting billed load forecast was 343.2 GWh for 2010.

Board staff and the intervenors argued that the Applicant had not provided a rationale for using a CDM flag and that the way the CDM flag is used in the model suggests an exponential impact of CDM which is not supported by the evidence. They argued that this alternate model should not be accepted.

Board staff noted that Haldimand's evidence indicated that Residential load is forecast to decline from 9,415 kWh per customer in 2008 to 9,292 in 2009 and 9,170 in 2010, a reduction of 1.3% in each year.[1].Board staff argued that Haldimand had not provided any evidence that the economic downturn has had such a significant impact on residential load, and that an analysis of the Historical Annual Usage per Customer/Connection[2] revealed no clear trend. In fact, average use increased in two of the past seven years (2005 and 2007).

Energy Probe, VECC and Board staff also disagreed with the IESO-18 Month Outlook incorporated into the Applicant's forecast for 2009 and 2010. Energy Probe and VECC submitted that the annual growth rate in IESO sales is not correlated with Haldimand's annual growth in purchases. While the average growth rate over the 2004 through 2008 period for normalized energy purchases at Haldimand was 0.47%, the corresponding figure for Ontario was -0.30%[3]. Energy Probe submitted that the difference between the growth rates is 0.77% which is significant over the five year period.

Board staff and Energy Probe argued that an alternate model[4] that excludes Population, GDP, Number of Peak Hours and Blackout Flags should be used, as these variables either produced a negative coefficient that was counter-intuitive or they were statistically insignificant.

The model suggested by Energy Probe used a 2008 Weather Normalized Predicted volume of 390.1 GWh as the starting point. Energy Probe argued that the IESO

[1] Table 12 (Exh 3 / Tab 2 / Sch.2 / Pg.6)
[2] Table 17 (Exh 3 / Tab 2 / Sch.2 / Pg.18)
[3] VECC Interrogatory No. 8(j)
[4] Energy Probe Interrogatory No. 12

forecasts should be adjusted by 0.77%, so that the 4% reduction for 2009 becomes 3.23% and the 0.3% reduction for 2010 becomes an increase of 0.47%. The resulting 2009 forecast is 377.5 GWh and the 2010 forecast is 379.3 GWh, compared to the forecast in the original evidence[5] of 366.4 GWh. Applying the total loss factor of 1.068, the billed energy forecast would be 355.2 GWh, which Energy Probe argued is a reasonable forecast for 2010.

Board staff preferred Energy Probe's model without the adjustment of 0.77% to the IESO's forecast reductions. The result was a weather normalized system purchase forecast of 374.5 for 2009 and 373.4 GWh for 2010.

Board Staff submitted that the Board should use the 2009 number (i.e. 374.5 GWh) to set the 2010 rates. Board staff's view was that since the Applicant's model did not provide a basis for the substantial reduction in residential load, the Board should not reduce it by an additional 0.3% from 2009 to 2010 for the purpose of calculating the 2010 load forecast.

Board staff submitted that a system purchase forecast of 374.5 GWh, which translates to a billed forecast of 350.7 GWh, for 2010 was appropriate as compared to the Applicant's forecast of 373.4 GWh.

In Reply, Haldimand argued that even though the model proposed by Energy Probe has better statistical outcomes than its model, it should not be used since the predicted actual amount (i.e. not weather normalized) for 2008 of 385.6 GWh was unreasonably higher than the 2008 actual amount of 376.4 GWh. This represented a 2.4% variation between predicted and actual which was significantly higher than the same measured variation for any year from the load forecasting equation proposed in the Application, which ranged from -0.97% to +0.70%[6].

With respect to the 0.77% adjustment to the decline in demand forecasted by IESO, Haldimand argued that it was highly unlikely that the IESO and Haldimand used the same weather normalization techniques, which would make Energy Probe's analysis incorrect.

[5] From Table 13 in Exhibit 3/Tab 2/Schedule 2/ Pg.14
[6] Table 13 in Exhibit 3/Tab 2/Schedule 2/ Pg.14

VECC argued that several assumptions used by Haldimand in developing their load forecast were inappropriate. Haldimand's forecast of non-weather normalized use in each customer class was based on the projected customer count and the projected average use per customer, which was calculated by escalating the actual 2008 per customer use by the average growth rate in the class per customer use over the 2002 to 2008 period. VECC submitted that this approach was problematic as by using the geometric mean the growth rate only reflected weather conditions in 2002 and 2007, and did not reflect average weather conditions.

VECC also argued that the growth rate for the GS>50 class was based on incorrect data, as the average use values for the class reported in Table 12[7] do not reconcile with the annual usage and customer count values reported in Table 11[8] which overstated the negative growth rate. In addition, VECC argued that Haldimand had not adequately substantiated that Residential and GS<50 customers' loads were 100% weather sensitive[9]. Based on the above arguments, VECC submitted that there were serious flaws with Haldimand's load forecast methodology.

VECC submitted its own forecast using the 2008 actual average use. VECC used the actual 2008 consumption and customer count for the major customer classes (Residential, GS<50 and GS>50) and Haldimand's 2010 forecast for the remaining customer classes. VECC provided the following table showing the forecast.

Class	2010 Customer #	Haldimand Forecast Avg. Use kWh	Haldimand 2010 Forecast GWh	2008 Avg. Use kWh	2010 VECC Forecast GWh
Residential	18,534	9,145	169.5	9,415	174.5
GS<50	2,357	25,848	60.9	24,973	58.9
GS>50	143	765,454	109.5	863,540	123.5
Street Light	2,879	809	2.4		2.3
Sentinel Light	589	711	.4		.4
USL	84	5,741	.5		.5
Total (not exact due to rounding)			343.1		360.1

[7] Exhibit 3 / Tab 2 / Schedule 2
[8] Exhibit 3 / Tab 2 / Schedule 2
[9] VECC Interrogatory No. 11(e)

VECC Final Argument 4.13
Sources: Haldimand Forecast – Exhibit 3, Tab 2, Schedule 2, Pg.24
2008 Average Use – Derived from Table 11

VECC used the 2008 Average Use number as VECC argued that Haldimand's 2010 Residential average use value of 9,145 kWh (almost 3% less than 2008 actual average use) was too low even if additional CDM impacts were accounted for. Similarly, VECC argued that given the net change in GDP between 2008 and 2010 was projected to be 1.5%[10], the 10% reduction in average use between 2008 and 2010 for the GS>50 class was overly pessimistic. VECC submitted that the forecast based on 2008 actual average use of 360.1 GWh was reasonable and should be adopted by the Board.

In Reply, Haldimand argued that VECC's proposed version of the Normalized Average use per Customer ("NAC") was not accepted by the Board or intervenors as a robust methodology in the 2008 applications, since it did not use the correct year of data for the forecast (i.e. 2004 data was used for 2008) and it only represented one year of data. Haldimand submitted that to use 2008 data as the basis for the forecast without adjusting for the decline in Ontario GDP and without reflecting the results of CDM was inappropriate.

Haldimand submitted that a load forecast of 343.1 GWh was reasonable for purposes of determining 2010 rates. In Haldimand's Application, the 2009 forecasted billed weather normalized amount is 344.1 GWh. The predicted weather normal amount based on actual historical data is 347.0 GWh. The difference between actual and forecasted data is 0.8% which it argued would not be achieved by any of the approaches proposed by Board staff and intervenors.

Haldimand further submitted that its revised load forecast was based on a regression model that excludes variables with a negative coefficient (Population and GDP) and includes a CDM flag. The CDM number used in the regression has been cubed indicating that CDM activity in Haldimand's franchise area is growing exponentially by the power of 3. Haldimand argued that since it is a very active participant in CDM programs, this assumption was reasonable. It also indicated that it was reasonable to start the flag in January 2006 as this was the time that third tranche funding programs were implemented. Haldimand indicated that it has actively participated in OPA

[10] VECC interrogatory No. 8(g)

conservation programs since their inception in 2006/2007 and has registered for all such programs currently available for 2010. The EnerSpectrum Group Report in the Application[11] noted that the 2006 impact of 2,091,508 kWh and the 2007 impact of 3,407,305 kWh represented a year over year increase of 62.9%. Haldimand submitted that with the passing of the Green Energy and Green Economy Act 2009 along with growing emphasis on CDM, the 3.4 GWh achieved in 2007 could grow to 14.7 GWh in 2010.

The results of the various methodologies are summarized in the following table

		2009 (GWh)		2010 (GWh)	
		Purchased	Billed	Purchased	Billed
1	Haldimand proposal: Regression Anaylsis (including negative coefficient for residential and GDP)	367.5	344.1	366.4	343.1
2	Haldimand Proposal: Regression analysis excluding variables with negative coefficients with CDM			366.5	343.2
3	Energy Probe Proposal with adjustments to IESO forecast	377.5	353.5	379.3	355.2
4	Board Staff Proposal IESO forecast, no CDM	374.5	350.6	374.5	350.6
5	VECC Proposal Mix of Actual Averages and Haldimand's forecast			384.6	360.1

Board Findings

The Board acknowledges Haldimand's work on the multifactor regression model. The Applicant has demonstrated responsiveness to Board direction in previous decisions. However, there are weaknesses in the regression model. The negative coefficients for customer/connection count and GDP are counter-intuitive and cast doubt on the resulting load forecast.

[11] Exhibit 10, Tab 1, Appendix A

The Board accepts Haldimand's 2010 customer/connection forecast of 24,586 as filed.

VECC proposed an alternate forecast using the NAC methodology. The Board does not find that it is appropriate to revert to the NAC methodology. The Board has noted the limitations of that methodology in prior proceedings and noted the improvement that regression analysis can provide, with the appropriate inputs.

The regression models proposed by Energy Probe and Board staff are also unsatisfactory as they simply leave inconvenient data out of the regression analysis, while tweaking other data such as the IESO forecast. The difficulties presented by using "generic" data are highlighted by the Applicant's comment in its reply argument that it was not clear if the weather normalization technique used by Haldimand was the same as that used by IESO.

In addition to adjusting the IESO factors upwards, Energy Probe's model makes no allowance for reduction in residential consumption whether a result of CDM, economic downturn or other factors. This seems to the Board to be unrealistic. This model also produces a larger gap between predicted and actual consumption when applied to historical data.

Unlike Energy Probe, Board staff did not propose adjustments to the IESO outlook, but did question the reduction of 1.3% in the residential average use for 2009 and 2010, essentially saying that one factor would offset the other. While that may work in this case, it is not a particularly robust approach.

Haldimand did not address the significant forecasted decline in average residential consumption, except to suggest it was mainly a result of CDM. The Board acknowledges the efforts Haldimand is making with CDM, and is confident that it will have an effect, but is concerned that the forecast of the impacts may be overly optimistic. While a factor which rises exponentially at a power of 3 may be observed at the very beginning of a programme, it cannot be maintained for long.

A number of load forecasts have been suggested by the parties. In the Board's view they all have deficiencies, with the Applicant's models likely overstating the effects of CDM and the others understating them. As Energy probe's model gives no effect to them whatsoever, the Board finds that a reasonable approach in the circumstances is to use the average of the Applicant's and Board Staff's models which is approximately 347 GWh. The Board concludes that 347 GWh is the test year forecast that will be adopted.

Working Capital – Lead / Lag Study for next cost of service application

The Applicant has not undertaken a lead-lag study to determine the working capital allowance. In accordance with Chapter 2 of the Filing Requirements for Transmission and Distribution Application issued May 27, 2009, Haldimand has used a working capital allowance factor of 15%. This is similar to a number of other electric utilities that have come before the Board for rebasing in 2008 and 2009.

Intervenors and Board staff raised concerns about the appropriateness of the standard 15% formulaic approach. Board staff and Energy Probe submitted that the practice dates back to the prior regulation of the municipal utilities by the former Ontario Hydro. The restructuring of the industry, unbundling of rates, introduction of competition in generation and marketing, and the corporatization of distributors as commercial, profit-seeking entities have altered the business environment and the distributors themselves. Current initiatives, such as smart metering and Time-of-Use pricing, and renewable generation contracts, will have further impacts on working capital requirements for all distributors.

Board Staff argued that while 15% may be appropriate at this time, new evidence should be required at Haldimand's next rebasing application to support the requested working capital allowance

Board staff noted it intends to conduct a generic lead-lag study which is anticipated to be completed by March 2012. Board staff submitted that Haldimand should either adopt the outcome of the generic study or submit its own study at the time of its next rebasing.

Energy Probe noted that the 2010 working capital allowance of $5,460,259 represents approximately 13.6% of the total rate base, which means that even a relatively small change in the level of the working capital allowance results in a significant impact on the revenue requirement.

Given that Haldimand has never undertaken a lead/lag study, VECC submitted that Haldimand has never provided any evidentiary support as to the appropriateness of the costs related to using the 15% rule to calculate the working capital allowance. All parties

therefore argued that the Board should direct Haldimand to provide an up-to-date lead/lag study for its next rebasing application.

VECC noted that Haldimand had not provided the estimated cost of conducting a lead/lag study[12]. Energy Probe submitted that in previous cases the Board had expressed concerns about the potential costs of conducting a lead/lag study for distributors with a small working capital requirement and the resulting cost/benefit. In this regard, VECC and Energy Probe submitted that the cost of a lead/lag study should not be significant and can be completed by using primarily internal resources.

Energy Probe further submitted that the Board may want to hold a workshop and/or publish a generic methodology on how a distributor could complete its own lead/lag study with minimal external costs.

In Reply, Haldimand cited the Peterborough Distribution Inc. cost of service distribution rate application (EB-2008-0241) that supported Haldimand's submission that it should not be required to incur expenses associated with a utility specific lead/lag study. Haldimand submitted that it would be inappropriate for the Board to impose a requirement at this time that Haldimand either use the results of a generic study or submit its own study at the time of its next rebasing. Haldimand further submitted that if a generic proceeding was initiated, policies that would flow from the study would be reflected in the Board's Filing Requirements which Haldimand would comply with.

Haldimand indicated that its position was consistent with the Board's finding in its March 1, 2010 Decision in Burlington Hydro Inc.'s 2010 cost of service application which did not direct Burlington to conduct an independent lead/lag study. Haldimand also expressed a concern with the costs of a lead/lag study and requested that in the event that the Board required Haldimand to complete a lead/lag study for its next rebasing application, the costs of such a study should be tracked in a deferral account for disposition at its next rebasing application.

Board Findings

The Board agrees with Board staff and intervenors that further work on the formulaic Working Capital Allowance approach is warranted. The Board expects to initiate a generic proceeding / consultation on determining a new working capital methodology in

[12] Response to VECC Supplemental interrogatory No. 28

advance of Haldimand's next cost of service filing. The Board will not direct Haldimand to conduct an independent lead/lag study at this time.

Cost of Capital

Background

Haldimand provided its proposed Cost of Capital in Exhibit 5. This proposal was revised in the Applicant's Final Argument. The following table summarizes its updated proposals in this area:

Table 3

Cost of Capital Parameter	Haldimand County Hydro's Proposal
Capital Structure	Requesting Board approval of a capital structure of 60% debt and 40% equity. This is to comply with the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*, issued December 20, 2006 (the "Board Report").
Short-Term Debt	Requesting a 4% short-term debt component with a rate of 2.07% in accordance with the letter from the Board of February 24, 2010 regarding cost of capital updates for 2010 cost of service applications, consistent with the Board's Report
Long-Term Debt	Proposing a long term debt rate for 2010 of 5.58% revised to 5.13% as a result of the Settlement Agreement of February 12, 2010
Return on Equity	Proposing a return on equity rate for the 2010 Test year of 9.85% in accordance with the Board's February 24, 2010 Update.

Discussion and Submission

Capital Structure

Haldimand's proposed capital structure of 60% debt and 40% equity is consistent with the Board Report on *Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*, issued December 20, 2006.

Short Term Debt

Haldimand included a 4% short-term debt component as part of its proposed capital structure and proposed a short-term debt rate for the 2010 Test year of 1.33% without prejudice to any revisions that may be adopted by the Board in early 2010.

Energy Probe maintained that the December 20, 2006 Board Report did not explicitly state that the 60% debt component of the capital structure should remain at 56% long term debt and 4% short term debt. Energy Probe submitted that the 4% deemed level of short-term debt is not reasonable and that the incremental costs imposed on ratepayers was neither just nor reasonable.

Energy Probe noted from Appendix C of the Settlement Agreement that the working capital allowance component of rate base represented 13.6% of the total rate base of $40,157,330. On a percentage of total rate base, the working capital allowance ranged from 13.8% to 15.1% over the 2006 through 2009 period[13]. Using the 4% short term debt, Energy Probe estimated the deemed amount of short-term debt to be $1,606,293 in 2010 (calculated as 4% of $40,157.330). The resulting shortfall of $3,853,966 in deemed short-term debt as compared to the working capital was not appropriate according to Energy Probe.

Energy Probe submitted that the Applicant was effectively financing short-term assets through long-term debt. Energy Probe submitted that it was neither just nor reasonable for the Board to expect ratepayers to pay long-term interest costs to finance short-term assets. Energy Probe estimated that ratepayers were being asked to pay between $96,000 and $146,000 annually more than they should based on the difference between short-term and long-term debt rates.

Energy Probe further submitted that a 4% deemed short term debt component was not appropriate when the Applicant had a short-term component of rate base of more than 14%.

VECC and SEC did not make a submission on this issue.

[13] Exhibit 2, Tab 1, Schedule 1

In Reply Haldimand submitted that Energy Probe had failed to raise circumstances sufficient to justify the Board's departure from its well established policy on Cost of Capital. At page 49 of the Board's December 2009 Report, the Board states that:

> "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."

Haldimand added that the Board justified its deemed short-term equity amount at page 9 of the Board's December 2006 Report, noting:

> 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.

Haldimand submitted that Energy Probe wanted the Board to abandon its well-established policy and increase the short-term debt component of Haldimand's capital structure beyond the deemed amount of 4% in order to take advantage of low short-term interest rates.

Haldimand argued that 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. Haldimand submitted that if the Board were to accept Energy Probe's argument, the Board would 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.

Haldimand further submitted that Energy Probe's argument equating working capital to short-term debt was erroneous. Haldimand argued that firms require 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. Beyond this

permanent working capital investment, it also requires seasonal or cyclical working capital. This allows Haldimand 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. In addition, Haldimand needed to finance power costs and controllable expenses that vary over the course of a year to prepare for its peak sales period and accounts receivable until cash is collected.

In light of these arguments, Haldimand submitted that the established capital structure that includes 4% short-term debt was appropriate.

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 working capital allowance ("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 Haldimand 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.

Common Equity

In its Reply Argument Haldimand revised its proposed return on equity ("ROE") rate for the 2010 Test year in accordance with the Cost of Capital Parameter Updates for 2010 Cost of Service Applications issued by the Board on February 24, 2010. The ROE in the Board's February 24th Update and that requested by the Applicant is 9.85%.

Energy Probe argued that the Board's *Report on Cost of Capital for Ontario's Regulated Utilities* issued on December 11, 2009 includes an equity risk premium of 550 basis points. This equity premium includes an implicit 50 basis points for transactional costs. In its Report, the Board noted that it would continue to include an implicit premium of 50 basis points for floatation and transaction costs.

Energy Probe submitted that floatation costs were applicable in cases where a particular distributor issued new stock or debt. Energy Probe submitted that there was no evidence to suggest that Haldimand expected to incur any floatation or transaction costs in the Test Year.

Energy Probe further submitted that the Board should not allow a distributor to recover costs that do not exist and doing so, would not result in just and reasonable rates. VECC and SEC supported Energy Probe's submission on this issue. SEC submitted that the floatation cost was an estimate of an actual cost that a company would pay to obtain equity. Since the floatation cost is an estimate of an actual cost and not a proxy for a fair return, SEC submitted that it should not apply in cases where there is evidence that the utility will not incur the cost.

In Reply, Haldimand claimed that Energy Probe's suggestion was a dramatic departure from the Board's policy with respect to ROE. The Applicant submitted that Board had never asked distributors in any proceeding or consultation to produce evidence of its floatation and transaction costs to support recovery of the allowable ROE. Haldimand submitted that Energy Probe's approach created an entirely new and unprecedented burden of proof for utilities.

Haldimand further submitted that the Board should reject Energy Probe's submission with respect to the ROE in this proceeding just as it has done in Burlington Hydro's 2010 Cost of Service Application.

Board Findings

The Board will not make the adjustment to the method of determining the ROE proposed by Energy Probe. The Board notes the following from page 63 of the 2009 Board Report:

> The Board will apply the methods set out in this report annually to derive the values for the ROE and the deemed long-term and short-term debt rates for use in cost of service applications.

This approach is qualified by the Board at page 13 of the 2009 Report:

> 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).

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 Haldimand. 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 floatation costs to reflect the specific circumstances of Haldimand, namely that it does not intend to issue equity in the test year. Haldimand 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. In the recently issued 2010 cost of service decision of Burlington Hydro Inc. (EB-2009-0259), the Board made a similar finding even though Burlington will not be issuing any equity.

Energy Probe's proposal 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 Haldimand's circumstances. This evidence would need to address, for example, whether such an adjustment for Haldimand 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.

The Board's expectations regarding the application of the new policy are set out at page 61 of the 2009 Report:

> The policy set out in Chapter 4 of this report will come into effect for the setting of rates, beginning in 2010, by way of a cost of service application.
>
> The Board's "Minimum Filing Requirements for Natural Gas Distribution Cost of Service Applications" and the Board's "Filing Requirements for Transmission and Distribution Applications" are sufficient for purposes of implementing the policies set out in this report. Those requirements include information to be filed in support of a utility's proposed cost of capital in a cost of service application. There is no need for additional filing requirements. The onus is on an applicant to adequately support its proposed cost of capital, including the treatment of and appropriate rates for debt instruments. The Board notes that this is being done in cost of service applications. However, the Board wishes to point out the increased emphasis that it is placing on applicants to support their existing and forecasted debt, and the treatment of these in accordance with the guidelines, or to support any proposed different treatment.

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 Haldimand, 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. The relevant passage from section 2.6 of the filing requirements reads as follows:

> The applicant may apply for a utility-specific cost of capital and/or capital structure. If the applicant wishes to take such an approach, it must provide appropriate justification for its proposal.
>
> Alternatively, the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (the Cost of Capital Report) of December 20, 2006 and the subsequent updates providing the Board's deemed capital structure and cost of capital rates can be used. The applicant is only required to provide justification of forecast parameters that differ from the Board's deemed rates.

Sections 2.6.2 and 2.6.3 are also relevant:

> 2.6.2 Cost of Capital
>
> The applicant must provide the following information for each year:
>
> - Calculation of cost for each capital component;
> - Profit or loss on redemption of debt and/or preference shares, if applicable;
> - Copies of any current promissory notes or other debt arrangements with affiliates; and
> - If the applicant is proposing any rate that is different from the Board guidelines, a justification of forecast costs by item including key assumptions.
>
> 2.6.3 Calculation of Return on Equity and Cost of Debt
>
> These requirements are outlined in the Cost of Capital Report.

The emphasis in the 2009 Report regarding the need to support an application refers particularly to long-term debt and the proper application of the Board's policy, an area which has drawn considerable attention in several cost of service applications in the past few years. With respect to adjustments to the ROE, such as that proposed by Energy Probe, the Board finds that the evidentiary burden rests with the party proposing a departure from the policy. Depending upon the circumstances this could be either the applicant or an intervenor.

In summary, the Board finds that the weighted average cost of capital for Haldimand will be 6.90%. The table below sets out the Board's conclusions for Haldimand's deemed capital structure and cost of capital. It incorporates the Board's recent updated cost of capital parameters.

Capital Component	**% of Total Capital Structure**	**Cost Rate**
Long-Term Debt	56%	5.13%
Short-Term Debt	4%	2.07%
Equity	40%	9.85%
Weighted average cost of capital		**6.90%**

Harmonized Sales Tax ("HST")

Board Staff noted that the provincial sales tax ("PST") and goods and services tax ("GST") will be harmonized effective July 1, 2010 pursuant to Bill 218 which received Royal Assent on December 15, 2009. Unlike the GST, the PST is currently included as an Operations, Maintenance and Administration ("OM&A") expense and is also included in capital expenditures. When the GST and PST are harmonized, corporations will realize a reduction in OM&A expenses and capital expenditures that has not been reflected in the current application for 2010 rates.

In response to an interrogatory,[14] Haldimand stated that it has not made any adjustments to its 2010 OM&A and capital expenditure forecasts to reflect the elimination of the 8% PST costs starting on July 1, 2010. At the same time, Haldimand was not able to provide the amount of provincial sales tax paid in either of the historical actual or forecast OM&A expenses and capital expenditures.

Haldimand did not support the establishment of a deferral account to track resulting savings from the implementation of the HST[15] and also expressed concern with the additional administrative process of determining and tracking the resulting savings in a deferral account.

SEC submitted that under the current framework ratepayers will be paying the PST portion of HST twice – once as an embedded cost in the OM&A and capital budget forecasts and again as a direct charge on their electricity bills.

Energy Probe submitted that since the HST will result in lowering OM&A and capital expenditures related to the PST, it is important that ratepayers receive the benefit of the lower costs associated with the elimination of PST. Accordingly, all intervenorss supported the creation of a deferral account to track the savings from July 1, 2010. Energy Probe and SEC submitted that the wording for such a deferral account could be adopted from Toronto Hydro Electric System Limited's 2010 Cost of Service Settlement Agreement.

Energy Probe submitted a second alternative in response to the Applicant's concern about the administrative costs associated with trying to track the PST paid after July 1, 2010. Energy Probe submitted that the Board could use the percentages representing the PST related to OM&A and capital as provided by Burlington Hydro as a proxy for

[14] Response to Energy Probe interrogatory #1

[15] Response to Energy Probe interrogatory #1(h) and Board staff supplemental interrogatory #11

Haldimand. Using the proxy numbers[16], Haldimand's capital expenditure amount would be reduced by $64,590 while OM&A would be reduced by $17,000.

In Reply, Haldimand submitted that the cost impact of the switch from PST to HST may never be accurately determined. The cost impact will depend on market conditions and it is possible that prices may increase as suppliers fail to pass through the full tax reduction in prices. Haldimand questioned whether accurate entries could be made in a deferral or variance account if it were established, since that assumes that pricing will stay constant and that only the tax component of the total cost of the good or service will change as a result of the move to HST. Haldimand therefore recommended that the next rebasing may be an appropriate time to consider what, if any, savings or additional costs can be attributed to the move to HST.

Nevertheless, Haldimand agreed to follow the Board's direction if the Board directed all electricity distributors to capture the reductions in OM&A and capital expenditures resulting from the change to HST in variance accounts. In such a case, Haldimand argued that the Board should also provide for the inclusion of costs related to the implementation and collection of HST and the tracking of savings. Haldimand maintained that the recording of differences stemming from PST and GST harmonization would require a substantial effort. The ultimate tracking of inventory items would be highly complex and would require additional staff time and training, since staff currently did not perform such analysis.

Haldimand further submitted that according to the Ontario Ministry of Finance guidelines, most companies with annual taxable sales in excess of $10 million would be unable to claim input tax credits, applicable only to the provincial portion of the tax, for the first 5 years on certain inputs, including telecommunication services other than internet access or toll-free numbers and road vehicles weighing less than 3,000 kilograms (and parts and certain services) and fuel to power those vehicles. Haldimand therefore submitted that if a variance account was established, it should only record the difference between any expenses incurred for which PST would have been paid and for which the utility is now eligible for an HST input tax credit.

With respect to Energy Probe's submission recommending a second alternative with a proportionate reduction in OM&A and capital expenditures, Haldimand argued that the Board should reject an arbitrary deduction from its revenue requirement. Haldimand

[16] Burlington Hydro estimated the provincial sales tax to be 3.9% of the total capital expenditures and 0.49% of the OM&A expenditures.

maintained that the fact that one utility had arrived at a revenue requirement reduction that it could accept should not be determinative of the Board's treatment of other distributors.

Haldimand further submitted 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 instead should be the subject of a generic consultation.

Board Findings

The Board notes Haldimand's argument that recording of differences stemming from PST and GST harmonization could require a substantial effort. However, the Board is of the view that it would not be an additional effort for distributors to track the incremental input tax credit ("ITC") amounts as the distributor will need to file this information in its GST/HST returns. The final amounts will be confirmed by the tax authorities. The intervenors and Board staff are suggesting tracking that is in the nature of a deferral account, not a variance account, and therefore there is no need to compare these amounts with PST levels reflected in existing rates.

The Board therefore directs that, beginning July 1, 2010, Haldimand shall record in deferral account 1592, (PILs and Tax Variances, Sub-account HST / OVAT Input Tax Credits), the incremental ITC it receives on distribution revenue requirement items that were previously subject to PST and become subject to HST. Tracking of these amounts will continue in the deferral account until the effective date of Haldimand's next cost of service rate order.

The Board may issue more detailed accounting guidance in the future. In that event, the Applicant should make the appropriate adjusting accounting entries, if any are required.

Retail Settlement Variance Account ("RSVA") 1588 – Sub-account Global Adjustment

Although disposition of the deferral account balances was a settled issue, the Settlement Agreement allowed Board staff to make a submission on the appropriate disposition of the balance in the RSVA Account 1588 – sub-account global adjustment. The proposed balance is a debit of $240,786.

In Board staff supplemental interrogatory No. 18, staff inquired whether Haldimand had the capability in its billing system to exclude MUSH ("Municipalities, Universities, Schools and Hospitals") sector customers to which the separate rate rider for the disposition of the account 1588 sub-account Power (Global Adjustment) balance would apply. In response, Haldimand clarified that it did not have the capability in its billing system to apply a separate rate rider to only non-RPP customers.

Board staff submitted that recovering the Global Adjustment sub-account balance solely from non-RPP customers is a more appropriate way to recover the under-collection from those customers who were originally undercharged. Board staff requested Haldimand to confirm in Reply whether its billing system could be modified to apply the associated rate rider only to non-RPP customers.

VECC and SEC questioned the cost/benefit of upgrading the system to permit intra-class rate riders. VECC noted that since billing systems are replaced more frequently than most other assets, the Board could direct Haldimand to provide estimated costs of alternative solutions in its next rebasing application. Energy Probe also recommended that Haldimand investigate the cost of being able to charge different rate riders within a rate class.

Energy Probe submitted that in the short term the cost of implementing a system change to implement separate rate riders may outweigh the benefits, but over the long term, the expenditure may be justified as it results in a better allocation among rate classes.

In Reply, Haldimand agreed in principle with Board staff's opinion that the Residential and General Service<50 kW rate class that pay RPP should not be responsible for the recovery of the variance in the RSVA 1588 Account (sub-account Global Adjustment).

In response to Board staff submission Haldimand contacted its vendor which confirmed that the existing system is capable of applying a rate rider to non-RPP customers within the various rate classes without software upgrades. However, Haldimand expressed concern about the staff time required to implement it.

Haldimand also expressed concern that the application of different rate riders within a single rate class could cause customer confusion. Haldimand submitted that it preferred that the rate rider be applied uniformly across all customers within a rate class.

Board Findings

No party objected with the quantum proposed by Haldimand for the Global Adjustment sub-account. The Board approves the proposed balance for disposition.

The Board will adopt Board staff's proposal for the recovery mechanism to be used. The Board directs that a separate rate rider be developed for the Global Adjustment sub-account and that this rider will apply to the non-RPP customers, including those in the MUSH sector. The Board acknowledges Haldimand's observation that this increases the administrative complexity of the disposition, but it is appropriate to recover the account balances as accurately as is practical. Recovery should occur from the customer group that drove the variance (non-RPP customers), and should not involve the customer group that is already paying its share of the Global Adjustment through the semi-annual RPP price adjustment. While customer migration makes this an imperfect solution, a separate rate rider applied only to non-RPP customers going forward will achieve this objective to a greater degree than recovering the Global Adjustment sub-account balance from all customers along with the other account balances.

MicroFit Generator Service Classification and Rate

Ontario's Feed-In Tariff (FIT) program for renewable energy generation was established in the *Green Energy and Green Economy Act, 2009*. The program includes a stream called microFIT, which is designed to encourage homeowners, businesses and others to generate renewable energy with projects of 10 kilowatts (kW) or less.

In its EB-2009-0326 Decision and Order, issued February 23, 2010, the Board approved the following service classification definition, which is to be used by all licensed distributors:

MicroFIT Generator

> *This classification applies to an electricity generation facility contracted under the Ontario Power Authority's microFIT program and connected to the distributor's distribution system.*

In addition, the Board approved the establishment of a single province-wide rate to be applied by all distributors. The Board also adopted September 21, 2009 (the date of the establishment of the interim rate) as the effective date for the new rate. The February 23 decision required all distributors to provide the Board with specific cost elements in

order for the Board to determine the final province-wide rate. On March 17, 2010, the Board issued the Rate Order to set the province-wide fixed monthly charge related to microFIT Generator at $5.25.

As part of its draft Rate Order material, Haldimand shall identify the MicroFit Generator service classification on its Tariff of Rates and Charges and include the approved monthly service charge.

IMPLEMENTATION

The Board has made findings in this Decision which change the 2010 revenue requirement and therefore change the distribution rates from those proposed by Haldimand. In filing its draft Rate Order, it is the Board's expectation that Haldimand will not use a calculation of the revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects Haldimand to file detailed supporting material, including all relevant calculations showing the impact of this Decision on Haldimand's revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Supporting documentation shall include, but not be limited to, filing a completed version of the Revenue Requirement Work Form excel spreadsheet, which can be found on the Board's website. Haldimand should also show detailed calculations of the revised retail transmission service rates and variance account rate riders reflecting this Decision.

Haldimand applied for rates effective May 1, 2010. The Board approves a May 1 effective date and notes that there is sufficient time to implement the rates as of May 1, 2010.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. The Board will determine eligibility for costs in accordance with its *Practice Direction on Cost Awards*. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's *Practice Direction on Cost Awards*. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

All filings with the Board must quote the file number EB-2009-0265, and be made through the Board's web portal at www.errr.oeb.gov.on.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must be received by the Board by 4:45 p.m. on the stated date. Parties should use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.oeb.gov.on.ca. If the web portal is not available, parties may e-mail their documents to the attention of the Board Secretary at BoardSec@oeb.gov.on.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's *Practice Directions on Cost Awards*.

THE BOARD ORDERS THAT:

1. Haldimand shall file with the Board, and shall also forward to intervenors, a draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates including the Revenue Requirement Work Form in Microsoft Excel format.

2. Intervenors shall file any comments on the draft Rate Order with the Board and forward to Haldimand within 5 days of the date of filing of the draft Rate Order.

3. Haldimand shall file with the Board and forward to intervenors responses to any comments on its draft Rate Order within 3 days of the date of receipt of intervenor submissions.

4. Intervenors shall file with the Board and forward to Haldimand their respective cost claims within 25 days from the date of this Decision.

5. Haldimand shall file with the Board and forward to intervenors any objections to the claimed costs within 32 days from the date of this Decision.

6. Intervenors shall file with the Board and forward to Haldimand any responses to any objections for cost claims within 39 days of the date of this Decision.

7. Haldimand shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto**,** March 31, 2010

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary