October 7, 2010

BY EMAIL & COURIER

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

Dear Ms. Walli:

Board File No. EB-2010-0133
Hydro Ottawa Limited – 2011 Cost of Service Application
Energy Probe – Preliminary Issue Submissions

Pursuant to Procedural Order No. 3, issued by the Board on September 24, 2010, please find the Submissions of Energy Probe Research Foundation (Energy Probe) in respect of the preliminary issue in the EB-2010-0133 proceeding for consideration by the Board. An electronic version of this communication will be forwarded in PDF format.

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

Yours truly,

David S. MacIntosh
Case Manager

cc: Jane Scott, Hydro Ottawa Limited (By email)
Fred Cass, Aird & Berlis LLP (By email))
Randy Aiken, Aiken & Associates (By email)
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EB-2010-0133

Ontario Energy Board

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 Hydro Ottawa Limited for an order approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2011.

SUBMISSIONS OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")
ON PRELIMINARY ISSUE

October 7, 2010

A - INTRODUCTION

The Ontario Energy Board (the "Board") issued Procedural Order No. 3 on September 24, 2010 in relation to the cost of service rebasing application of Hydro Ottawa Limited ("Hydro Ottawa"). This procedural order noted that in a letter sent to distributors dated April 20, 2010 (the "Letter"), the Board indicated that a distributor filing a cost of service application, if it was not on the list attached to the Letter, must demonstrate that it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period, and as such, is applying for early rebasing.

The Letter further indicated that the Board may determine, as a preliminary matter or issue, whether the application is justified, and if not justified, that it may disallow some or all of the costs associated with the preparation and hearing of the application.

In Procedural Order No. 3, the Board determined that it would consider the preliminary issue in advance of further procedural steps with respect to the current application.

Hydro Ottawa Limited filed its submissions on this preliminary issue on September 29, 2010.

This is the submission of the Energy Probe Research Foundation ("Energy Probe") on the preliminary issue.

B - REPORTS OF THE BOARD ON 3RD GENERATION INCENTIVE REGULATION FOR ONTATRIO'S ELECTRICITY DISTRIBUTORS

The July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors was the result of consultations that

"... considered all of the necessary elements of an IR mechanism framework including the form and term of the plan, the inflation and productivity factors, the potential for earnings sharing, and the treatment of unforeseen events. The consultations also included a focus on specific issues associated with capital investment to support infrastructure maintenance and development, lost revenue due to changes in electricity consumption and distributor diversity." (page 2)

The elements of the plan, as set out in the Report of the Board that are relevant to the current application by Hydro Ottawa include the term of the plan, off-ramps and the stretch factor included in the X-factor,

With regards to the term of the IR plan, the Board determined that the plan term for the 3rd Generation IR would be fixed at three years (i.e. rebasing year plus three years). The Board further stated that:

"The rates of the distributor are not expected to be subject to rebasing before the end of the plan term other than through an eligible off-ramp." (page 7)

The Board`s policy with respect to off-ramps is that the 3rd Generation IR plan would include a trigger mechanism with an annual ROE dead band of +/- 300 basis points. In particular, when a distributor performs outside of this earnings dead band, a regulatory review may be initiated.

In particular, the Board determined that a distributor would be required to make a report to the Board no later than 60 days after the company's receipt of its annual audited financial statements in the event that the distributor falls short of or exceeds its ROE by 300 basis points. This report would be reviewed to determine if further action by the Board would be warranted. Any such review could result in modifications to the IR plan, a termination of the IR plan, or the continuation of the IR plan. The Board indicated that this was to be an early warning mechanism rather than necessarily terminating the IR plan.

In the September 17, 2008 Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors the Board noted that stretch factors are consumer benefits and that they are somewhat analogous to earnings sharing mechanisms (pages 19-20). The Board set stretch factors of 0.2%, 0.4% and 0.6% for Group I, II and III distributors, respectively. The definition of these groups of distributors was based on benchmarking evaluations.

C - JUSTIFICATION FOR A COST OF SERVICE REBASING APPLICATION

In its September 29, 2010 submissions on the preliminary issue, Hydro Ottawa indicates that it has the right to use a cost of service methodology in an application to set rates for a test year before its schedule rebasing application under the 3rd Generation IR plan. Energy Probe does not disagree with this position.

Energy Probe also does not disagree with the Hydro Ottawa position that the April 20th letter from the Board makes clear that the discretion to use a cost of service methodology in the determination of rates for 2011 has not been fettered.

Energy Probe does note, however, the Board's expectation that a justification must be provided for a 2011 cost of service application by a distributor. It is the submission of Energy Probe that Hydro Ottawa has failed to justify the need for a 2011 cost of service methodology application for rates.

D - FAILURE TO JUSTIFY

Energy Probe submits that Hydro Ottawa has failed to justify its need to set rates under a cost of service application for the 2011 test year. It is further submitted that the factors prompting Hydro Ottawa to rebase early include a desire to earn a higher return on equity and the desire to earn additional revenues by changing the effective date of new rates from May 1 to January 1 in 2011. Neither of these factors, in the view of Energy Probe, justifies the early rebasing application.

Energy Probe submits that the early rebasing application by Hydro Ottawa should be denied by the Board based on the following submissions.

a) Off-Ramp and Term

As noted in section B above, the Board policy is that the 3rd Generation IR plan would be fixed at a rebasing year, followed by three years under the IR price cap mechanism. The Board policy is also clearly stated in that the rates of the distributor would not be expected to be subject to rebasing before the end of the plan other than through an eligible off-ramp. The only off-ramp identified in the Report of the Board occurs when a distributor performs outside of the earnings dead band of +/- 300 basis points.

Hydro Ottawa had its rates determined based on a cost of service application (EB-2007-0713) for the 2008 test year. As a result, the IR plan would include the setting of rates based on the price cap for 2009, 2010 and 2011. Hydro Ottawa is attempting to rebase one year earlier than would be the case under the Board's policy.

Hydro Ottawa has confirmed that it did not meet the condition of an off-ramp in 2009 (Tab C - Energy Probe Interrogatory Responses, Interrogatory # 1 (c)). Further, as noted in the response provided in Tab D - VECC Interrogatory Responses, Interrogatory # 12 (b)) the actual ROE for 2009 was 10.7%. The Board approved return on equity included in the 2008 rates was 8.57%. The difference between the actual ROE of 10.7% and the Board approved level of 8.57%, or 2.13%, represents an amount of approximately $5.2 million (Technical Conference Transcript, September 22, 2010, page 141).

Moreover, Hydro Ottawa is not projecting that it would trigger an off-ramp based on the 2010 bridge year financial results. The estimated ROE for 2010 is 8.9% (Tab D - VECC Interrogatory Responses, Interrogatory # 12 (b)) and as shown in the response to Undertaking JT1.15, based on six months of actual and six months of forecast data, the ROE for the bridge year has risen to 9.3%, again in excess of the Board approved return on equity approved in 2008 of 8.57%.

Finally, as shown in the Revenue Requirement Work Form attached to Exhibit A2, Tab 1, Schedule 2, at current approved rates, the 2011 test year return on equity is projected to be 6.52% (line 15 of the Revenue Sufficiency/Deficiency sheet). This figure for 2011, which assumes no increase in distribution revenues associated with a price cap change in 2011 and is untested, is still significantly above the bottom of the range for earnings dead band of 5.57% (8.57% - 300 basis points).

Energy Probe notes that Hydro Ottawa identified an error in the original filing related to revenue offsets that, when corrected, will increase the other operating revenue offsets - net line in the Revenue Sufficiency/Deficiency page of the Revenue Requirement Work Form noted above by $558,000. This figure is identified at Tab A - OEB Interrogatory Responses, Interrogatory # 11 and was confirmed at the technical conference (Technical Conference Transcript, September 22, 2010, page 147). After taking into account the increased taxes on this revenue, Energy Probe estimates that the return on equity at existing rates would increase from 6.52% to approximately 6.7%.

Over the 2009 through 2011 period, the average ROE earned and projected to be earned by Hydro Ottawa is an average of 8.9% (10.7% in 2009, 9.3% in 2010 and 6.7% in 2011), which is still in excess of the Board approved return on equity of 8.57% included in 2008 rates.

Moreover, the response to Undertaking JT1.5 provides further information on the projected ROE for 2010 and 2011. In the December 10, 2009 presentation to the Board of Directors, at page 9, the material indicates that the distribution revenue is guided by 3GIRM in 2010 and 2011 and that rebasing is scheduled for 2012. The presentation material indicates that under this scenario, also shown at page 9, that the return on equity ranges from 8.5% to 9.3%. In fact, the table on page 11 of the presentation to the Board of Directors shows a return on equity of 10.4% for 2009, 9.3% for 2010 and 8.5% for 2011. The first two of these figures are generally consistent with the figures provided in the evidence and noted earlier in this submission. The third figure, however, is substantially higher than the 2011 figure provided in the application. It is noteworthy that the 2011 ROE as shown to the Board of Directors in December 2009 is in line with the Board allowed ROE in the 2008 rates.

In summary, Energy Probe submits that no off-ramp has been triggered based on 2009 actual results and no off-ramp will be triggered based on Hydro Ottawa`s (untested) bridge and test year forecasts for 2010 and 2011, respectively.

b) The Return on Equity

Despite the presentation to the Board of Directors on December 10, 2009 that 2011 would see a ROE of 8.5% based on the application of 3GIRM, Hydro Ottawa states in Exhibit A1, Tab 2, Schedule 2, at page 1, that it began working on a cost of service application for rates effective January 1, 2011 in January of 2010, only one month after the presentation to the Board. Hydro Ottawa has not provided any evidence or justification for the abrupt change that took place between December 10, 2009 and January 2010.

The only significant regulatory change that took place in this time frame was the issuance on December 11, 2009 of the EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (one day after the Board of Directors Meeting) that provided for a significant increase in the allowed return on equity. However, as noted on page 61 of that Report, this change in the ROE would come into effect for the setting of rates beginning in 2010 only by way of a cost of service application.

Energy Probe submits that this increase in the ROE is one of the factors driving the filing of a cost of service rebasing application a year earlier than contemplated under the Board's policy. This is confirmed response to an interrogatory filed at Tab E - SEC Interrogatory Responses, Interrogatory #2. In particular, Attachment 2 to part (l) of the response provides the March 26, 2010 presentation to the Board of Directors. Slide 5 (on page 3 of the attachment) states that *"Hydro Ottawa had previously determined that at 8.01% ROE, a major cost of service rate application was roughly breakeven for base distribution business"* and that *"At a 9.75% ROE, the economics change and a full cost of service rate application is now warranted".*

Hydro Ottawa has forecast a revenue deficiency of $11.7 million based on a return on equity of 9.85%. At the current embedded ROE of 8.57%, the revenue deficiency would be $7.1 million. Both of these figures are shown in table provided in the response to

Undertaking JT1.4. In other words, the change in the return on equity accounts for $4.6 million or nearly 40% of the total deficiency forecast.

Energy Probe submits that the opportunity to take advantage of a higher Board approved ROE is not a reason that the Board should accept as a justification for an early rebasing application.

c) Effective Date for Rates

Energy Probe submits that the second factor driving the filing of a cost of service rebasing application a year earlier than contemplated under the Board's policy is the desire the increase rates four months earlier than the May 1 implementation date that has been used for rate changes in previous years, allowing Hydro Ottawa to align its fiscal year with the rate year.

The Board had a consultative process (EB-2009-0423) that dealt with this issue. On April 15, 2010 the Board issued a letter re: Alignment of Rate Year with Fiscal Year for Electricity Distributors. In that letter the Board concurred with all of the filings from interested stakeholders that any proposal for an alignment of the rate year with the fiscal year be made in a cost of service application.

At page 9 of Exhibit A1, Tab 2, Schedule 2, Hydro Ottawa indicates that this is a reason that it is filing a cost of service application at this time.

As shown in the response in Tab E - SEC Interrogatory Responses, Interrogatory #3, the impact of the change in rates effective January 1, 2011 instead of May 1, 2011 as compared to the 2010 existing rates staying in place until May 1, 2011 results in an accelerated recovery of revenue by more than $4.4 million over this four month period.

Energy Probe submits that this is obviously a very important reason in the view of Hydro Ottawa to move forward its cost of service application by a year.

However, Energy Probe submits that the desire to align the fiscal year with the rate year is not a rationale that the Board should take into account when determining if the early rebasing application is justified. As indicated in the Board's April 15, 2010 letter related to the alignment of the rate year with the fiscal year, the Board stated that it would allow each distributor the discretion to apply to align its rate year with the fiscal year, but only as part of a cost of service application. The Board **did not** indicate that the alignment of the fiscal year with the rate year was a justification for an early rebasing application.

d) Loss of Consumer Benefits

As noted earlier in these submissions, the Board included a stretch factor into the X-factor portion of the price cap under the 3rd generation IR plan. This stretch factor was characterized as consumer benefits. By arbitrarily shortening the length of the IR plan from 3 years under the price cap/productivity/stretch factor methodology from 2 years to 3, Hydro Ottawa is effectively denying the full consumer benefits that would accrue to consumers if the Board's policy with respect to the term in the absence of an off-ramp is not followed.

Energy Probe notes that Hydro Ottawa is in the Group II of distributors that represent distributors that are in the middle two quartiles on OM&A unit cost comparison and have been assigned a stretch factor of 0.4%.

e) Not Comparable to THESL

In both its evidence at Exhibit A1, Tab 2, Schedule 2 and in its Submission on the Preliminary Issue, Hydro Ottawa brings up the situation of Toronto Hydro Electric System Limited ("THESL"). Hydro Ottawa attempts to cast itself in the same light as THESL and notes that THESL has applied on a cost of service basis in respect of rates for each year in 2008 through 2011.

Energy Probe submits that the comparison to THESL is not appropriate. As noted in the response provided to Interrogatory #1 (d), THESL has never been under the 3rd Generation IR plan, whereas Hydro Ottawa has been under the plan for rates in 2009 and 2010.

f) Hydro Ottawa Justifications

In its submission dated September 29, 2010, Hydro Ottawa lists 6 considerations for the justification that it is relying on to support the early rebasing application. Energy Probe provides submissions on each of these considerations below.

> *1. As the distributor of electricity to the nation's capital, Hydro Ottawa strives to fulfill an Asset Management Plan that aims to support the timely renewal of aging infrastructure and ongoing investment in new assets. The Incremental Capital Model provided for under IR does not address Hydro Ottawa's capital spending planned for 2011 to deal with aging infrastructure and other significant emerging capital requirements.*

Hydro Ottawa has not provided any evidence as to whether or not it would qualify to use the incremental capital model provided for under IR for the 2011 test year.

If Hydro Ottawa does not qualify for the incremental capital model, then Energy Probe submits that there is no justification for bringing forward a cost of service application based on a claim that capital spending is one of the reasons for doing so. A review of Exhibit B2, Tab 1, Schedule 1 shows that the forecasted (and untested) gross capital expenditure forecast for the 2011 test year is approximately $95 million. Gross capital expenditures have ranged from $81.5 million to more than $97 million in the 2006 through 2009 period, meaning that the 2011 forecast is within the range of previous spending.

On the other hand, if Ottawa Hydro does qualify for the incremental capital model, then Energy Probe submits that the distributor has not provided any evidence that the incremental capital model will not provide it with sufficient relief to deal with the issue of capital additions required. In other words, Energy Probe submits that use of the incremental capital model within the IR plan, as allowed for by the Board, is the approach that Hydro Ottawa should be taking, not a cost of service rebasing application.

> 2. *Hydro Ottawa has developed a comprehensive strategy to ensure that long-term workforce requirements continue to be met, including an expansion of its apprenticeship program and other key initiatives. Given the need for material expansions of workforce programs, these programs are most appropriately considered as part of a cost of service application.*

The long-term workforce requirements are not unique to Hydro Ottawa and do not provide any justification for a cost of service rebasing application one year ahead of schedule. Indeed, given that the workforce requirements are a long-term issue, it is hard to see how coming forward one year in advance of the scheduled rebasing application would have any significant impact on the distributor. In any event, Energy Probe submits that this is not a justification for a cost of service rebasing application.

> 3. *As an early adopter of CDM programs, Hydro Ottawa has achieved significant participation in these programs and is already experiencing the impacts of these programs. Given the mandatory CDM targets that Hydro Ottawa will be required to achieve between 2011 and 2014, it expects that decreasing usage per customer will not only continue, but will accelerate. This cost of service application is an opportunity to incorporate the effects of CDM on load in 2011, to revise the load forecast to reflect current conditions and to reset the baseline upon which future Lost Revenue Adjustment Mechanism ("LRAM") determinations will be made.*

Energy Probe submits that the mandatory CDM targets and the impact that achieving those targets may have on the load forecast are not unique to Hydro Ottawa. These changes are being faced by most distributors across the province. In fact, many distributors are facing reductions in their load forecast. However, as seen in the updated system forecast on page 2 of 2 of Tab B - CCC Interrogatory Responses, Interrogatory #19 updated on 2010-09-22, the kWh forecast for 2011 is virtually identical to the weather normalized actual level recorded in 2009. The kW forecast for 2011 is actually a small increase over the normalized levels recorded in 2009. It would thus appear based on Hydro Ottawa's updated evidence that the overall forecast load for 2011 will be at or above the levels recorded in 2009.

As a result, it is the submission of Energy Probe that CDM and load forecasts do not provide any justification for the early rebasing application.

> 4. *Given that substantial completion of its Smart Meter program will be achieved by the end of 2010, Hydro Ottawa seeks approval of the prudence of all Smart Meter spending and inclusion of capital additions to the end of 2010 in 2011 rate base, such that all future expenditures will be treated as part of normal business. This can only be done as part of a cost of service application.*

Energy Probe agrees that the inclusion of the capital additions to the end of 2010 related to smart meter spending can only be included in rate base as part of a cost of service application. However, Hydro Ottawa can continue to avail itself of the variance accounts as noted on page 9 of Exhibit I2, Tab 1, Schedule 1. This means that Hydro Ottawa would continue to collect amounts from customers through the Smart Meter Rate Adders through 2011 and then deal with the balances in these accounts and the inclusion of the capital additions into rate base as part of the rebasing application for 2012.

Energy Probe submits that the desire to end the smart meter rate adder and include the capital additions into rate base in 2011 rather than continuing with the status quo approach until 2012 is not a justification for early rebasing.

> 5. *Hydro Ottawa has filed its initial Green Energy Act Plan as part of this application and it seeks to proceed with initial pilot projects for implementing the smart grid and identified projects to facilitate the connection of renewable generation. Hydro Ottawa therefore seeks approval of the Green Energy Act Plan and guidance regarding the spending that is contemplated by the Plan.*

As part of the EB-2009-0397 Filing Requirements: Distribution System Plans - Filing under Deemed Conditions of Licence dated March 25, 2009, the Board indicated that a GEA Plan must be filed as part of a distributor's cost of service rate application and that this requirement applies to applications for rates for 2012 and subsequent rate years, unless the Board otherwise requires that a distributor prepare and submit a GEA Plan at an earlier or other date (page 5).

The Board also indicated the GEA Plans may be filed with cost of service applications or rates for 2011 if the distributor has sufficient reliable information regarding renewable generation connection in its service area to support proposed projects and activities. Energy Probe submits that this means that a distributor filing a 2011 cost of service application can include its GEA Plan as part of that application. It does not mean, however, that a distributor can use a GEA Plan as an excuse to file an early cost of service rebasing application. Again, the justification proposed by Hydro Ottawa for th early rebasing application is without foundation.

> 6. *In this cost of service application, Hydro Ottawa seeks a January 1st effective date for rates. The effective date for rates has been a matter of concern to Hydro Ottawa for a number of years and, when it advised the Board in January of 2010 that it would apply for 2011 rates on a cost of service basis, Hydro Ottawa noted that it would seek a January 1st effective date. In April of 2010, the Board indicated that it would consider proposals for a January 1st effective date, but only in cost of service applications.*

Energy Probe has already made its submissions with respect to the effective date in part (c) above. In summary, Energy Probe submits that a change to the effective date for rates is not a justification for an early rebasing application. The Board's April 15, 2010 letter provided guidance to distributors that they may propose an alignment of the rate year with the fiscal year, but only as part of a cost of service application. It did not provide guidance to indicate that a distributor may file a cost of service application instead of a 3rd generation IR filing so that it could adjust its rate year to match its fiscal year. Indeed, that was an issue that Board sought comments from parties on in the EB-2009-0423 consultation. There never was any consideration given to the possibility of rebasing early under 3rd generation IR in order to allow the alignment of fiscal and rate years.

E - SUMMARY

In the April 20, 2010 letter related to the Early Rebasing Applications, the Board indicated that a distributor "*that seeks to have its rates rebased in advance of the its next regularly scheduled cost of service proceeding must justify, in its cost of service application, why an early rebasing is required notwithstanding that the "off ramp" conditions have not been met*".

The Board went on to state that *"Specifically, the distributor must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period"*.

Energy Probe submits that Hydro Ottawa has not justified why an early rebasing is required. Nor has Hydro Ottawa demonstrated that it cannot adequately manage its resources and financial needs during the one year remaining in its IRM plan.

Energy Probe respectfully submits that the Board should find that there is no justification or need for Hydro Ottawa to terminate the 3rd Generation IRM plan in advance of its scheduled rebasing application for the 2012 test year.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

October 7, 2010

Randy Aiken

Consultant to Energy Probe