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October 14, 2010

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

**Subject: Hydro Ottawa Limited – EB-2010-0133
Reply Argument on Preliminary Issue**

Dear Ms. Walli,

Further to Procedural Order #3, issued by the Ontario Energy Board (the "Board") on September 24, 2010, please find attached Hydro Ottawa Limited's reply argument pursuant to the preliminary issue. Two copies have been couriered to the Board today.

Should you have any further questions, please contact the undersigned at (613) 738-5499 extension 7499, directly, or email to janescott@hydroottawa.com.

Best regards,

Original signed by

Jane Scott
A/Director, Regulatory Affairs
Hydro Ottawa

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.

**REPLY SUBMISSIONS OF
HYDRO OTTAWA LIMITED
ON PRELIMINARY ISSUE**

Hydro Ottawa Limited (Hydro Ottawa) has received submissions from four parties on the preliminary issue identified in Procedural Order No. 3. The four parties that made submissions are Consumers Council of Canada (CCC), Energy Probe Research Foundation (Energy Probe), School Energy Coalition (SEC) and Vulnerable Energy Consumers Coalition (VECC).

The submissions of the four parties address both general policy and practices with respect to rebasing and Hydro Ottawa's specific reasons for filing a cost of service application for 2011. The intervenors also make a number of assertions about the implications of Hydro Ottawa seeking to have its 2011 rates approved on a cost of service basis. Accordingly, in its Reply argument, Hydro Ottawa will begin by responding to submissions about the general approach to rebasing; it will then address assertions that have been made about the implications of the 2011 cost of service application; and, finally, it will respond to submissions about the particular reasons for rebasing presented in this application.

General Approach to Rebasing

Energy Probe begins its argument with comments about the Report of the Ontario Energy Board (the Board) on the 3rd Generation Incentive Regulation (IR) model for electricity distributors. Notwithstanding these comments about the 3rd Generation IR model, however, Energy Probe does not disagree with the position of Hydro Ottawa that a cost of service methodology can be used in an application to set rates for a test year before a "scheduled rebasing application".¹ Energy Probe's position is supported by both CCC and VECC. Similarly, SEC "strongly supports the Board's policy and practice

¹ Submissions of Energy Probe Research Foundation ("Energy Probe") on Preliminary Issue (Energy Probe Submissions), page 4, para.2.

of allowing applications by any utility at any time, and ... would not like to see that approach watered down".²

In essence, then, many of the arguments on the preliminary issue turn on the nature of the justification provided by Hydro Ottawa for its cost of service application. While the evidence reveals that the confluence of a number of operational imperatives brought Hydro Ottawa to the decision to file a cost of service application,³ the intervenors offer their views about whether these factors constitute "justification" for the application. There can be no doubt, though, that Hydro Ottawa has filed a thoughtful cost of service application supported by lengthy and detailed evidence. Hydro Ottawa submits that this application should not be rejected at a preliminary threshold on the basis of subjective, preconceived, or even arbitrary, notions of appropriate "justification" for a cost of service application.

It is submitted that a decision by the Board not to give due consideration to an application by way of the Board's normal processes should be made, if at all, only in the most exceptional of cases. The views expressed by intervenors about the "justification" for the application fall very far short of making this one of the exceptional cases where the Board might entertain the notion of denying an application before it has been given full and fair consideration through the Board's normal processes.

On the contrary, the evidence reveals that Hydro Ottawa is at a juncture where a number of very important decision-points, referred to in the evidence as "operational imperatives", have come together in a common time-frame. These important decision-points relate to matters such as the conclusion of the smart meter program, workforce planning, the Facilities Strategy, capital spending and the Green Energy Act plan.⁴ Regardless of preconceived or subjective views about what might constitute "justification" for a cost of service application, the public interest is not served by discouraging an applicant like Hydro Ottawa from coming to the Board when faced with operational imperatives or decision-points such as those described in the evidence.

SEC's position is that Hydro Ottawa should be allowed to proceed with its cost of service application, but that "collateral benefits" associated with "jumping the queue" should be deferred.⁵ In support of its comments about "jumping the queue", SEC uses the analogy of a movie theatre proprietor whose new feature is very popular, thereby giving rise to line-ups.⁶ Hydro Ottawa submits, though, that SEC has not followed

² Submissions of the School Energy Coalition on the preliminary issue (SEC Submissions), page 2, para.

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³ Exhibit A1-2-2.

⁴ Exhibit A1-2-2.

⁵ SEC Submissions, page 8, para. 41.

⁶ SEC Submissions, page 2, paras. 9-10.

through on its analogy with due regard to the context of the Board's letter of April 20, 2010 to electricity distributors.

There were 18 electricity distributors listed in the April 20th letter. Of these 18 LDCs, four are now proceeding with IRM applications: thus, to continue SEC's analogy, four distributors are not going to see the movie after all. Five of the distributors have indicated that they are going to be late in filing their cost of service applications: in other words, five distributors are going to a later showing of the movie. In the result, Hydro Ottawa is not "jumping the queue"; it has merely joined the end of a line that is much shorter than it might have been thought to be at the time of the April 20th letter. Further, and more importantly, these developments confirm that there is a level of acceptable - and indeed necessary - fluidity in the filing of rate applications by the electricity distributors. It is presumably the need to allow for this fluidity that causes all four intervenor groups to accept at least the general proposition that it is open to Hydro Ottawa to put forward a case for 2011 rates to be determined on a cost of service basis.

SEC supports the proposition that the Board should retain its flexibility to "listen to any application that a utility files",⁷ but it expresses concern about an applicant being allowed to "pick and choose" Board policies, "rather like a menu".⁸ While SEC's suggestion is that Hydro Ottawa is being inconsistent in its approach to Board policies, Hydro Ottawa submits that the inconsistency actually lies in SEC's position. An important reason why the Board should retain flexibility to hear any application by a utility is because one or more of the Board's policies may not work for a particular utility. Given that, as advocated by SEC, the Board should "defend" its flexibility to hear any application,⁹ it follows that the Board should apply this flexibility to give an applicant utility the opportunity to explain which policy (or policies) does (or do) not work for the applicant.

Energy Probe and SEC also make submissions about cost of service applications by Toronto Hydro Electric System Limited (THESL) and Hydro One Networks Inc. (Hydro One) that have proceeded before the Board. Energy Probe submits that a comparison between Hydro Ottawa and THESL is not appropriate because THESL "has never been under the 3rd Generation IR Plan".¹⁰ With respect, however, this submission misses the fundamental point. As recognized by SEC,¹¹ the point is that neither THESL nor Hydro One was required to meet the preliminary threshold for cost of service ratemaking that Hydro Ottawa has been asked to meet in this case. Further, if Energy Probe's submission about THESL is accepted, it would mean that utilities that do not adopt a

⁷ SEC Submissions, page 1, para. 3.

⁸ SEC Submissions, page 2, para. 5.

⁹ SEC Submissions, page 8, para. 42.

¹⁰ Energy Probe Submissions, pages 9-10.

¹¹ SEC Submissions, page 4, para. 24.

new IR regime retain greater flexibility going forward than those that make an effort to work within the IR regime. Hydro Ottawa submits that the Board should not follow this line of thinking, because its outcome is to discourage utilities from embarking on future generations of the IR model.

It should be noted that THESL was specifically authorized to file a Cost of Service application in the Board's letter of April 20, 2010 and therefore, no issues should arise about whether THESL should be applying for 2011 rates, or whether there should be any consequences for it doing so, as suggested by SEC.¹²

Intervenors suggest that the Board's decision on the preliminary issue should take into account the message that will be sent by the decision to other electricity distributors. SEC says explicitly that acceptance of its recommendations will "send a message" about the flexibility of the Board's processes and the use of those processes to "gain benefits".¹³ CCC's argument is that a decision by the Board to consider Hydro Ottawa's application would set a "dangerous precedent" sending an "implicit invitation" to other electricity distributors.¹⁴ However, to the extent that there is any "precedent" or any "message" for other electricity distributors, it can already be found in the approach that has been taken to cost of service applications by THESL and Hydro One.

Despite the use of cost of service ratemaking for THESL and Hydro One, the Board's regulatory processes have not fallen into disarray or disorder. On the contrary, as pointed out in Hydro Ottawa's argument in chief, it now seems clear that rate applications to the Board by electricity distributors will be reasonably well balanced as between 2011 and 2012 and that full consideration of Hydro Ottawa's 2011 cost of service application will not cause any undue disruption to the regulatory workload.¹⁵ Hydro Ottawa submits that, in considering the general approach to rebasing, the Board should not be influenced by a concern expressed by CCC that has not in fact materialized. Further, Hydro Ottawa urges the Board not to treat this 2011 rate application as an opportunity to "send a message" to other electricity distributors; rather, the Board should give full and fair consideration to the application on its own merits.

Implications of the Application

In its submissions, CCC refers to letters written by the Minister of Energy and Infrastructure to Ontario Power Generation Inc. (OPG) and Hydro One regarding the impact on ratepayers of proposed rate changes. However, CCC's attempt to make a

¹² SEC Submissions, page 5, para. 27.

¹³ SEC Submissions, page 8, para. 42.

¹⁴ Submissions of the Consumers Council of Canada on the preliminary issue (CCC Submissions), page 2.

¹⁵ Submissions of Hydro Ottawa Limited on Preliminary Issue, page 4.

comparison to the potential impact of rate proposals by other utilities is totally inapt and overlooks the evidence filed by Hydro Ottawa in support of this application. Simply put, Hydro Ottawa's 2011 cost of service application, if approved, would have relatively modest rate impacts and, indeed, bill impacts for 2011 under this application could be less than those under 3rd Generation IR.

The maximum impact of Hydro Ottawa's 2011 application on the total bill to ratepayers is 4.9%.¹⁶ For the majority of customers, the impact will be well below this level, because of the benefit to customers from the clearance of deferral and variance accounts. A typical residential customer using 800 KWh per month would see the delivery portion of the bill increase by 1.1%, with an overall bill increase of 0.6%.¹⁷ At this time the IPI-X factor under 3rd Generation IR is not known, but the impact of this factor, together with the Smart Meter adder and the potential of an Incremental Capital Adjustment Adder or a Green Energy adder, or both – without the clearing of deferral and variance accounts – could mean a higher bill impact under 3rd Generation IR than under cost of service.

CCC also argues that Hydro Ottawa's cost of service application is an attempt to generate more revenue "with no corresponding benefit to ratepayers".¹⁸ However, the benefits to ratepayers are made clear in the evidence.¹⁹ Investment in aging infrastructure and staff will position Hydro Ottawa to maintain its reliability levels. Investment in the customer service strategy and in environmental strategies will allow Hydro Ottawa to better serve both customers and the community at large. Clearing of deferral and variance accounts will return money to ratepayers that otherwise would remain on the books of Hydro Ottawa.

Energy Probe argues that allowing Hydro Ottawa's 2011 cost of service application will result in a denial of the benefit to customers from the stretch factor included in the X-factor for the price cap under 3rd Generation IR.²⁰ Again, this submission overlooks the evidence filed by Hydro Ottawa in support of its cost of service application. Hydro Ottawa continues to work to improve efficiencies and its 2011 cost of service application includes a \$1 million productivity target.²¹ Further, under the 2011 cost of service application, customers will benefit from the full reduction in tax rates, whereas customers would receive only one-half of this benefit under 3rd Generation IR.

¹⁶ Exhibit H1-6-1, Attachment AK, page 5.

¹⁷ Exhibit H1-6-1, page 1.

¹⁸ CCC Submissions, page 2.

¹⁹ Exhibit A1-2-2.

²⁰ Energy Probe Submissions, page 9.

²¹ Exhibit D1-1-2, Table 2.

Rationale for Rebasing

To a large extent, intervenors do not disagree with the existence of the circumstances that form the basis of Hydro Ottawa's rationale for rebasing. The main thrust of intervenor arguments about the reasons for rebasing is to re-characterize some or all of these reasons as "collateral benefits" (SEC Submissions) or as grounds that do not meet a particular intervenor's subjective view of appropriate "justification" for rebasing (Energy Probe Submissions, supported by CCC and VECC).

The evidence is that Hydro Ottawa must cope with circumstances that are very similar to those that have driven cost of service applications by THESL, namely, aging infrastructure, an aging workforce and declining loads.²² As to infrastructure and workforce issues, Energy Probe and SEC say essentially that Hydro Ottawa is not unique.²³ Clearly, the point is not that Hydro Ottawa is unique: the evidence states very plainly that "Hydro Ottawa has the same issues that were expressed by THESL in its 2010 EDR".²⁴ The point is that the circumstances of Hydro Ottawa – and any other utility – should be judged on their own merits and not on someone's view about which utilities may or may not be unique.

As far as capital spending is concerned, Energy Probe submits that the use of the "incremental capital model within the IR plan" is the approach that Hydro Ottawa should be taking.²⁵ This, in fact, is not at all responsive to Hydro Ottawa's evidence on capital spending in the Rationale for Rebasing, because the evidence explains in some detail that the Incremental Capital Module does not work in Hydro Ottawa's circumstances.²⁶

On the subject of declining loads, the evidence is that, as an early adopter of conservation programs, Hydro Ottawa has experienced a significant participation in these programs.²⁷ Energy Probe's argument in response to this evidence is that the kWh forecast for 2011 is virtually identical to the weather normalized actual level recorded in 2009.²⁸ The appropriate comparison, however, is between the forecast load for 2011 and the approved forecast of 2008 load that was used as the basis for rates in 2008 and subsequent adjustments in accordance with 3rd Generation IR parameters. This comparison reveals a 1.62% kWh reduction from the 2008 approved number to the forecast load for 2011.²⁹

²² Exhibit A1-2-2, pages 2-3.

²³ Energy Probe Submissions, pages 10-11 and SEC Submissions, pages 5-6.

²⁴ Exhibit, A1-2-2, page 3.

²⁵ Energy Probe Submissions, pages 10-11.

²⁶ Exhibit A-1-2-2, pages 4-6.

²⁷ Exhibit A1-2-2, page 7.

²⁸ Energy Probe Submissions, page 11.

²⁹ Exhibit C1-1-2, Table 1

In addition to drivers such as declining load and aging infrastructure and workforce, the 2011 rate application provides an opportunity for the Board to consider a number of matters that can only be addressed in a cost of service proceeding. One of these, for example, is approval of Hydro Ottawa's initial Green Energy Act Plan. Hydro Ottawa believes that leadership on green energy issues is important at this time and that its effort to bring a Green Energy Act Plan forward for the approval of the Board is a positive initiative that should be viewed with favour by the Board. Energy Probe, though, calls this an "excuse" to file a cost of service application.³⁰ In doing so, Energy Probe reveals the subjective view-point through which it has assessed Hydro Ottawa's reasons for rebasing. Hydro Ottawa submits that if, in the context of a cost of service application, it has important matters to bring forward for consideration that can only be addressed in a cost of service case, this forms part of the legitimate rationale for proceeding on a cost of service basis.

Another matter that Hydro Ottawa considers to be of importance is a change in the effective date for rates to January 1st. On this issue, Energy Probe's subjective view of the rationale for rebasing emerges again when it says that Hydro Ottawa's desire is to "earn additional revenues by changing the effective date of new rates".³¹ As stated in the evidence, Hydro Ottawa's desire is to align costs with revenues.³² The fact that customers have previously benefitted from the lag between rates and costs does not mean that it is unfair in the future for rates to be set to recover costs over matching periods. Hydro Ottawa is not seeking to earn additional revenue, but to shift the receipt of revenue to match costs.

The issue of aligning rates and costs has been a matter of concern to Hydro Ottawa for a number of years.³³ In April of 2010, the Board gave direction that it will only consider requests for a January 1st effective date in cost of service applications. In the context of a cost of service application to address matters such as declining loads, workforce planning and aging infrastructure, Hydro Ottawa has brought forward an issue that has been of concern to it for years and that the Board has said can only be dealt with in a cost of service case. This is not a "collateral benefit"; it is a request made in direct compliance with explicit Board policy.

Similarly, Hydro Ottawa's request for approval of the reset and refined Return on Equity (ROE) resulting from the Report of the Board on the Cost of Capital for Ontario's regulated utilities is made in direct compliance with Board policy and is not a "collateral benefit". CCC submits that, if the Board proceeds to hear this cost of service

³⁰ Energy Probe Submissions, page 13.

³¹ Energy Probe Submissions, page 4.

³² Exhibit A1-2-3 and response to CCC Interrogatory #1.

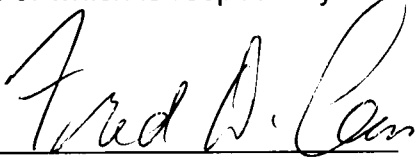
³³ Exhibit A1-2-3, page 1.

application, the new formula ROE should not be embedded into rates until 2012.³⁴ The import of this submission is that, even in a cost of service application, Hydro Ottawa should be denied the return that was found to meet the Fair Return Standard in the cost of capital proceeding. As the Board stated in the Cost of Capital Report, however, meeting the Fair Return Standard is not optional; it is a legal requirement.³⁵

Conclusion

For all of these reasons, Hydro Ottawa respectfully submits that the Board should give the 2011 rate application full and fair consideration in accordance with the Board's usual processes. It is also submitted that the Board should reject proposals made by intervenors that would effectively eviscerate the application by denying implementation in 2011 of aspects of Hydro Ottawa's proposals that are appropriate matters for consideration in a cost of service proceeding.

All of which is respectfully submitted on October 14, 2010.



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³⁴ CCC Submissions, page 2

³⁵ EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, page *i*.