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HydroOttawa

November 30, 2007

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

Attention: Kirsten Walli
Board Secretary

**Re: Interrogatory Responses – Electricity Distribution Rates
EB-2007-0713**

Attached please find Hydro Ottawa's responses to the interrogatories sent by Board Staff, Energy Probe, the Consumers Council of Canada, the School Energy Coalition and the Vulnerable Energy Consumers Coalition for the above noted proceeding. Responses to the supplementary interrogatories sent by Board Staff on November 23, 2007 (#75 through #84) will be filed in the next few days.

If further information is required, please contact the undersigned at 613-738-5499 ext 527 or lynneanderson@hydroottawa.com.

Yours truly,

Lynne Anderson

Lynne Anderson
Chief Regulatory Affairs and Government Relations Officer
Hydro Ottawa

Interrogatory

1. <u>A1/T2/S1</u>

HO is seeking approval of not only rates for the rate year, but approval to recover a revenue deficiency for the period Jan. 1, 2008 to April 30, 2008. Please provide HO's expectation as to what period the 3rd Generation would apply to. On what basis does HO believe it is permitted to effectively change rates Jan. 1, 2008, whereas other LDCs are not changing rates until May 1, 2008?

Response

Hydro Ottawa assumes that the reference to "3rd Generation" is a reference to the Board's eventual 3rd Generation Incentive Regulation Mechanism ("3GIRM") and, if so, it expects that the 3GIRM will apply to the post-2008 rate years during the term of the 3GIRM. Hydro Ottawa does not believe "it is permitted to effectively change rates Jan. 1, 2008" – hence the application for the order described in paragraph 13.0(b) of Exhibit A1-2-1 and paragraphs 2 and 3 of Exhibit A1-4-1. Please see also Hydro Ottawa's responses to Board Staff Interrogatories #57 a) and #57 c).

Interogatory

2. A1/T5/S2/p. 1

HO has indicated that it uses its own system of accounts (“SOA”), one that differs from the Uniform System of Accounts (“USoA”). Please provide a list of all differences between HO’s SOA and the USoA. Please indicate the impact of these differences on the test year revenue requirement.

Response

Hydro Ottawa’s SOA has several thousand accounts that are mapped to the related USoA. There is no impact on the revenue requirement due to the use of Hydro Ottawa’s SOA.

Hydro Ottawa’s SOA categorizes some types of interest expense as part of OM&A; however, this interest is backed out of OM&A before determining the OM&A for the revenue requirement. Interest expense for the revenue requirement is based on a deemed debt per the OEB requirements. Any charitable donations, other than allowable charitable donations, are removed from OM&A and are not part of the revenue requirement.

Hydro Ottawa’s SOA categorizes work for others expense as OM&A rather than as an offset to Other Revenue, as required by the USoA. These mapping differences have no overall impact on the revenue requirement, only the individual line items.

The costs of CDM are recovered through other means, and therefore are not included in the revenue requirement.

The complete reconciliation of Hydro Ottawa’s OM&A expenses and Other Revenue can be found in Exhibits A3-3-1, A3-3-2 and A3-3-3.

Interrogatory

3. <u>A1/T7/S2/p.2</u>

Please indicate the number of employees in Hydro Ottawa Holding Inc. Please identify all of the positions in the holding company. Also, please indicate how employee costs to the holding company are allocated to other companies. What level of those costs is allocated to Hydro Ottawa Limited? Regarding the senior positions in the holding company, please explain what is meant by the statement, "Operational activities related to those functions remain within Hydro Ottawa."

Response

The Holding Company currently employs 18 individuals; please see the organization chart provided in the response to EP Interrogatory #1b) (the position of Director, Business Development has yet to be filled). Employee costs form part of the total costs of the Holding Company, which are allocated based on the methodology described in the response to Board Staff Interrogatory #34. Approximately 39% of these costs are allocated to Hydro Ottawa as indicated in Exhibit D1-2-1 at page 2, lines 29 to 30.

As noted in Exhibit A1-7-1 at page 2, the principal business of the Holding Company is the strategic oversight of Hydro Ottawa and the other subsidiaries. The role of the Holding Company in this regard is described in the detail at lines 4-10.

As for the quoted statement – "Operational activities related to those functions remain within Hydro Ottawa" – please see the response to EP Interrogatory #1.

Interrogatory

4. A2/T1/S2/p. 1

The evidence sets out the Revenue Deficiency for 2008. Does this table refer to the deficiency associated with the rate year beginning May 1, 2008 or January 1, 2008? Please explain.

Response

The Revenue Deficiency of $25,195k for 2008 that is shown on Table 1 of Exhibit A2-1-2 pertains to calendar 2008. It is calculated as the difference between the 2008 load/customer forecast multiplied by the 2008 rates minus the 2008 load/customer forecast multiplied by the 2007 rates (without the Smart Meter adder). The Board requires all LDCs to use the calendar year as their test year for rate-making purposes. The resultant rates will not be in effect throughout calendar 2008, though, because they will not come into effect until May 1, 2008. The resultant rates, in other words, will be in effect for the 12-month period from May 1, 2008 to April 30, 2009 (i.e., the rate year). Hydro Ottawa's 2007 rates will remain in effect for the first four months of calendar 2008.

Interrogatory

5. A2/T2/S1/p. 1

How was the 2% budget guideline determined? If it is based on inflation what evidence does HO have that all OM&A costs track inflation? Please provide that evidence. Does the 2% incorporate an amount for productivity? If not, why not? Does the budget process allow for reductions to the base budget where possible? If not, not?

Response

It is important to note that the budget guidelines were clear that a zero-based budgeting approach was required for 2008. Each department was required to create a bottom-up budget taking in to account both increases and decreases to its base budget. Some items increased by more than 2% while others decreased.

The 2% was the overall corporate target set for the change in gross OM&A from the 2007 budget to the 2008 base budget, before the addition of strategic programs, such as the apprenticeship program. Once the zero-based budgeting was completed, the results were reviewed to ensure that the target was met. Inflation was a consideration in setting the 2% limit. In addition, Hydro Ottawa considered its negotiated labour agreements. Hydro Ottawa entered into a new three-year collective agreement with the IBEW in 2007. This agreement included a 3.25% wage increase for each of 2008 and 2009. Since annual compensation is forecast at $51.8M in 2008, this represents close to 60% of the total costs for gross OM&A. Therefore, to keep to within 2% overall for the 2008 base budget, the total of all other expenses had to remain relatively unchanged from the 2007 budget. Some of these costs will track to inflation, while others, like material costs, may exceed inflation. Ongoing budget monitoring will be employed at a departmental and corporate level to try to stay within the 2%

target. Productivity improvements are also required in order to manage within the budgeted increase.

The Board's Filing Requirements mandate the filing of Budget Directives and Guidelines. Hydro Ottawa filed the guidelines provided to each department as Exhibit A2-2-1. Since these were internal budgeting guidelines, they are based on Hydro Ottawa's System of Accounts ("SOA"), not the Board's USoA. The process of mapping from the SOA to the USoA occurs after the budget in the SOA is completed. Therefore, in some areas there are differences. Of particular relevance to the 2% target is that in Hydro Ottawa's SOA, the gross OM&A for the 2008 forecast is $99.5M but the same items when mapped to the USoA result in an amount of $87.5M. The $12M difference relates to the mapping of internal allocations.

Interrogatory

6. A2/T2/S1/p. 1

Please provide copies of all memos provided to HO's staff related to the development of the 2008 budget.

Response

Exhibit A2-2-1 reproduces the budget guidelines communicated to the organization through the senior management team. These guidelines have driven the development of the 2008 budget and are the only formal documents provided to Hydro Ottawa's staff, as they define the targets that were to be met.

Interrogatory

7. A2/T2/s1/p. 4

Please provide a detailed rationale for the $1 million target to reduce general plant in 2008. Please provide a detailed rationale for the $2 million target to reduce fleet, facilities, and IT in 2009 from the preliminary capital plan.

Response

These targets were based on management's assessment of the preliminary plans put together for 2008 and 2009. Note that the CIS upgrade project would occur in 2008 and 2009 resulting in increased General Plant spending in those years (the total CIS project cost is estimated at $7M). When major projects of this type occur, management assesses whether spending in other areas can be deferred in order to provide smoother capital spending levels each year.

Hydro Ottawa has been implementing an asset management strategy over the past few years to ensure that the age of its fleet meets target lifecycles standards. It was determined that, given the spending on the CIS, the fleet strategy could be extended by a year in order to reduce costs in 2008 and 2009. It was also determined that certain capital expenditures on facilities could also be deferred. There is always some risk that capital curtailments of this kind will result in higher operating costs; however, this risk is low within a two-year period.

Interrogatory

8. <u>A2/T2/S1/p. 5</u>

The budget guidelines indicate that CDM is not funded through distribution rates and therefore all aspects of CDM programs must be kept completely separate. Please explain, in detail, how the CDM costs are tracked and allocated.

Response

Two business units have been set up in Hydro Ottawa's accounting system to track costs for CDM. One business unit is for the programs funded by rates approved by the Board, and the other is for programs funded by the OPA. Employees that work on CDM programs record the hours worked on each program and the corresponding costs are charged to the appropriate CDM business unit directly. External invoices and other CDM related expenses are also recorded to each CDM business unit directly, as appropriate.

Interrogatory

9. A3/T2/S1/Attachment N

Please provide a column that sets out 2006 Board approved.

Response

Attached is a revised version of Attachment N to Exhibit A3-2-1 with a column for 2006 Board-approved. Please note that a row has been added to allow for the inclusion of adjustments for Low Voltage Charges and Smart Meters as per Table 5.1 of the Board's Decision with Reasons in EB-2005-0381.

Hydro Ottawa Limited
Statement of Income

$ Thousands	2006 Board-Approved	2006 Actuals	2006 Normalized	2007 Estimate	2008 Forecast
Revenues					
Power recovery	575,112	541,817	541,817	549,328	554,674
Distribution sales	122,400	113,908	113,908	125,084	138,954
Other revenue	4,077	10,147	10,147	10,213	7,820
	701,590	665,872	665,872	684,625	701,448
Expenses					
Purchased Power	575,112	541,817	541,817	549,328	554,674
Operating, maintenance and admin.	43,988	51,325	51,325	53,816	62,219
Smart Meter and Low Voltage Adjustment (see note*)	2,057				
Provincial capital tax	1,631	1,346	1,346	1,800	1,568
Provision for write-down (recovery) of regulatory assets	-	(24,882)		-	-
	622,788	569,606	594,488	604,944	618,461
EBITDA	78,801	96,266	71,384	79,681	82,987
Amortization of capital assets	33,970	32,980	32,980	37,347	39,290
EBIT	44,831	63,286	38,404	42,334	43,697
Interest coverage ratio		*5.1*	*3.1*	*3.1*	*2.9*
Interest expense - net	15,872	12,347	12,347	13,830	15,317
Gain on disposal of assets	-	(298)	(298)	(49)	-
Payments in lieu of income taxes	10,805	11,375	9,655	13,485	10,260
	26,677	23,424	21,704	27,266	25,577
Net income (loss)	18,155	39,862	16,700	15,068	18,120
ROE Realized		19.98%	8.37%	6.98%	8.44%
ROE Deemed	9.00%	9.00%	9.00%	9.00%	8.81%

* Note: Hydro Ottawa's Final Decision for EB-2005-0381 included adjustments for Low Voltage Charges and Smart Meters that were not shown broken down into component parts (OM&A, amortization, return and PILs). Therefore, these amounts have been entered as a lump sum in this separate line item

Interrogatory

10. A3/T2/S1/Attachment N

The Statement of Income indicates that HO's actual ROE was 19.98%, but the normalized ROE was 8.37%. Please provide a detailed explanation for the variance between actual and normalized ROE for 2006.

Response

The reconciliation of the 2006 actual and normalized Return on Equity is set out on the next page.

2006 Return on Equity (ROE) Reconciliation:
($ Thousands)

	Non-Recurring item	Tax Rate Used	Net Income
2006 Net Income as reported in Audited Financial Statements:			39,862
Adjustments: Temporary differences between accounting and tax basis of assets and liabilities (as per Audited Financial Statements Note #12)			(7,476)
Adjustments for non-recurring items on Financial Statements (net of tax):			
Recovery of provision for regulatory assets write-down	(23,139)	37%	(14,587)
Recovery of transition costs	(1,743)	37%	(1,099)
Normalized 2006 Net Income			16,700

2006 Shareholder's Equity (per Audited Financial Statements)	219,480
2005 Shareholder's Equity (per Audited Financial Statements)	179,618
Shareholder's Equity (Average)	199,549
ROE Actual = (2006 Net Income as reported/Shareholder's Equity (Average))	19.98%
ROE Normalized = (2006 Normalized Net Income/Shareholder's Equity (Average))	8.37%

Interrogatory

11. <u>B1/T1/S1/p. 3</u>

HO's Capital Spending on smart meters for 2006 is $16.4 million, $16.9 million for 2007 and $9.7 million for 2008. Please indicate to what extent the 2008 rate increase over 2007 is related to smart meter expenditures.

Response

For a Residential customer using 1,000 kWh/month, the impact of incremental Smart Meter funding (including recovery of Stranded Meter costs) in 2008 over 2007 is 1.3% on the total electricity bill.

Interrogatory

12. <u>B1/T2/S3/p. 3</u>

With respect to HO’s IT functions what are the expected cost savings associated with centralizing all of these functions? If cost savings are expected why is HO not pursuing this initiative in 2008?

Response

To the extent that centralization promotes business objectives, Hydro Ottawa will continue to centralize IT functions to optimize processes, reduce costs and strengthen expertise in technology and related business functions and services. This evaluation occurs on an on-going basis and is part of the sustainment plan evaluation as projects transition from development/implementation to sustaining/on-going operations. Hydro Ottawa evaluates the appropriate management of each IT system on a case-by-case basis taking into account all factors, including costs. For example, Hydro Ottawa’s MDM/R data integration project is in development/implementation mode and therefore is managed by the project team. As part of the project plan, a decision was made for Hydro Ottawa’s IT group to take on the ongoing management of the data integration infrastructure and specifically the operational management of the MDM/R data interfaces. The IT group is expected to perform a similar function for further data integration of Hydro Ottawa systems, and therefore this approach provided the best synergies.

Interrogatory

13. <u>B2/T1/S1</u>

Please indicate whether the approved and actual rate base numbers on Table 1 are comparable given the statement provide at Note 1 that the actual rate base includes stranded meters.

Response

The approved and actual rate base values on Table 1 of Exhibit B2-1-1 are comparable as they both included the meters that have been stranded, as is stated in footnote #1.

Interrogatory

14. B2/T1/S1

Please provide a list of all capital projects that were included in the 2006 Board Approved Capital Expenditures, but have been deferred until 2007 or 2008. Please explain why each of the projects was deferred.

Response

The following list of projects were included in the 2006 Board-Approved Capital Expenditures, but have been deferred until 2007 or 2008. Projects that have been deferred until 2009 and 2010 have also been included.

Table 1: Deferred Capital Projects

Project	Budget Category	Scheduled Construction
South Urban Nepean Trunk Supply	Distribution Sustainment	2009
Vault Rehabilitation or Removal	Distribution Sustainment	2007
44 kV tie line between Greenbank & Woodroffe	Distribution Sustainment	2009
44 kV Overhead Line Didsbury to Beaverbrook	Distribution Sustainment	to be determined

South Urban Nepean Trunk Supply

The area of the extension was to be impacted by the City of Ottawa LRT project. The final design of the LRT route and station in this area was not completed in 2006, prior to the LRT project cancellation. The reason for the delay was to ensure design of the distribution system was coordinated with the final LRT design to ensure there were no conflicts with the design and to take advantage of construction coordination if suitable. Civil works were constructed in 2006 where there was no expected conflict with the LRT construction. This project is now planned for 2009.

Vault Rehabilitation or Removal

The Vault Rehabilitation or Removal program was planned to continue in 2006 per the description in Exhibit B1-2-2, section 2.9 at pages 20-21. The 2006 plan was to replace six sidewalk vaults and one underground switching centre.

The City of Ottawa North-South LRT project involved abandonment and reconstruction of underground civil structures within the downtown area to make way for the LRT lines along Albert and Slater Streets. The full scope of the impact of these works was not finalized at the beginning of 2006, but was certain to impact a number of sidewalk vaults. The sidewalk vault replacement plan was postponed until the LRT project impacts were finalized, rather than risk performing work that would be abandoned or require alteration within a few years.

Planning for the replacement of the switching centre (SSW2) was started in 2006 but work has not yet been completed as it is taking longer than expected to secure indoor easements from a customer for the replacement location.

44kV tie line between Greenbank & Woodroffe

This project requires obtaining land access from third parties prior to construction. Delays in obtaining the land access have resulted in Hydro Ottawa re-evaluating the route from along private property to along a public road right of way. The final routing is under review. Construction has been tentatively scheduled for 2009.

44 kV Overhead Line Didsbury to Beaverbrook

There is a proposed development in the Didsbury area. The City has not finalized the design of the new road. Hydro Ottawa will not begin construction until the design is finalized to ensure the new distribution plant is installed in the ultimate location. Hydro Ottawa has not been provided with a timeline of the design or the construction.

Interrogatory

15. B4/T1/S1

With respect to HO's proposal for a capital adjustment factor (CAF), if the 3GIRM provides sufficient relief for HO regarding capital additions made in 2009 and 2010 would HO be bound by the Board's decision in this case? Or in the alternative should HO be free to choose its preferred approach at that time.

Response

Hydro Ottawa can envision a number of different scenarios as follows:

a) **The Board approves Hydro Ottawa's capital expenditures for 2009 and 2010 as well as Hydro Ottawa's methodology for applying a CAF to rates.** In this case, Hydro Ottawa's rates for 2009 and 2010 would be based on the CAF applied to the capital portion of the 2008 revenue requirement and on the 3GIRM for the operating portion of the 2008 revenue requirement.

b) **The Board approves Hydro Ottawa's capital expenditures for 2009 and 2010 but defers judgement on the CAF methodology until after the 3GIRM Decision is issued.** If the 3GIRM methodology provides relief for capital additions, Hydro Ottawa would apply the 3GIRM by using Hydro Ottawa's approved capital expenditures for 2009 and 2010 (not historical capital spending). If the 3GIRM mechanism does not include relief for capital additions, Hydro Ottawa would proceed to seek Board approval of the CAF methodology.

c) **The Board defers judgement on both the capital expenditures for 2009 and 2010 and the CAF methodology until after the 3GIRM**

Decision is issued. On that basis, Hydro Ottawa would have the option of adopting the 3GIRM mechanism or proceeding with Board approval for its capital expenditures and CAF after the 3GIRM Decision is issued.

Interragotory

16. B4/T1/S1

Please explain the relief HO is seeking in this proceeding regarding capital. Is HO effectively asking the Board panel in this case to approve a portion of the overall revenue requirement for 2009 and 2010?

Response

The specific approval being sought is set out in Exhibit A1-2-1, paragraph 13.0 at page 5 and in Exhibit A1-4-1, paragraphs 4 and 5 at page 2.

Hydro Ottawa is asking the Board to approve its capital expenditures for 2009 and 2010. This approval would set Hydro Ottawa's rate base for 2009 and 2010 based on the capital additions resulting from these capital expenditures. The overall revenue requirement for 2009 and 2010 would also increase by the amount of the proposed capital adjustment factor methodology, for which Board approval is also sought. In the alternative, Hydro Ottawa is asking the Board to approve deferral accounts for 2009 and 2010

Interrogatory

17. B4/T2/S1

HO is projecting a decrease in overall capital expenditures in 2009 and 2010 relative to 2008. Why would a capital adjustment factor be required which is based on growth?

Response

The capital adjustment factor that Hydro Ottawa is requesting is not based on growth but, rather, on the forecasted capital additions for the year. Whether the capital expenditure level is higher or lower than the previous year is irrelevant; what is relevant is the level of capital additions in each year (the amount by which the rate base would increase in the year). The capital adjustment factor would properly compensate Hydro Ottawa for the return on rate base, amortization and PILS resulting from those capital additions.

Interrogatory

18. <u>C1/T2/S1</u>

HO has chosen Itron Inc.'s advanced statistical modeling software MetrixND and notes that there are currently 500 MetrixND users worldwide. Please provide a list of Canadian users of this software and indicate all cases in which Canadian regulators have approved the load forecasts developed by this software.

Response

The following is a list of Canadian users of *MetrixND* software, as provided by Itron Inc.:

Hydro Quebec
Independent Electricity System Operator (IESO)
Manitoba Hydro
Region of Peel
Ontario Power Generation (OPG)
BC Hydro
New Brunswick Power Corp.
Enersource Hydro Mississauga
TransAlta
Alberta Electricity System Operator (AESO)
Enmax Power Corp.
Enmax Corp.
Union Gas Limited.

Hydro Ottawa is not aware of any case in which any Canadian regulator has approved a load forecast developed by this software.

Interrogatory

19. C2/T1/S1

The 2006 actual levels of Other Revenue exceeded Board approved levels by over $4 million to the benefits of the shareholders. Please provide a detailed explanation as to why the variance was so significant. If these items are so difficult to forecast would HO be willing to use a deferral account to record any variances going forward? If not, why not?

Response

A detailed discussion of the variance between the 2006 Board-Approved amount and the 2006 Actual amount is provided in Exhibit C2-1-2. This provides reasonable explanations for each aspect of the variance. Explanations included:

- A reclassification of $900k in expenses netted against revenue in the 2006 Board-Approved amount to OM&A in the 2006 Actuals (i.e., expenses that were budgeted as a reduction to revenues, but recorded as expenses for the actual results).

- Accounting entries of $400k that reversed in 2007 (i.e., negative revenue in 2007) due to accrual estimates and a reclassification of revenues,

- $300k in interest income related to the funds raised for Hydro Ottawa by the Holding Company ($50M in 30-year debentures), for which Hydro Ottawa incurred new costs,

- $300k related to an amount approved by the Board until a new transformer station was included in rate base (this adjustment essentially results from the difference between the calendar year and rate year; that is, it provided some compensation for the fact that rates were not implemented until May 1, 2006).

- $200k in revenue related to 2005 and prior years pole attachments that were not resolved until 2006, following the Board's pole attachment Decision with Reasons. This revenue would normally have been accrued to 2005 but negotiations were still underway.

- $100k in revenue related to street lighting services for the City of Ottawa extended for a few months into 2006. Hydro Ottawa no longer provides street lighting services for the City of Ottawa.

Other than these amounts, there were two key areas in which the forecast was different that the actual results.

- Hydro Ottawa had ongoing issues related to its former customer information system ("CIS") that meant that there was no solid basis on which to forecast late payment charges. Hydro Ottawa's forecast had been based on historical activity; however, this was $800k lower than the actual results for 2006. With the implementation of the new CIS in 2004, and resultant new processes, Hydro Ottawa now has a stable basis and historical results on which to base a forecast.

- Hydro Ottawa had underestimated the revenue from service desk activities by $600k. Throughout 2006, Hydro Ottawa undertook a thorough review of its Conditions of Service and re-issued it in early 2007. This involved a detailed review of all amounts charged to customers through the service desk based on the costs of providing these services. As a result of this review, Hydro Ottawa is confident that the accuracy of the revenue forecast for service desk activities has significantly improved.

For the reasons discussed above, Hydro Ottawa does not believe that a deferral account for other revenue is required for 2008.