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BY RESS and EMAIL

January 13, 2011
Our File No. 20100074

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2010-0074 – Chatham-Kent 2011 Rates

We are counsel for the School Energy Coalition. These are SEC's final submissions in this matter, restricted in scope to the proposed revenue-to-cost ratios.

Our concern with the proposed revenue-to-cost revenues has two components, which we will deal with in turn.

Settlement Agreement in EB-2009-0261

At the broadest level, it is SEC's submission that this Application is a breach of the Settlement Agreement in the EB-2009-0261 proceeding, to which the Applicant and SEC were parties. In our submission, the Board should sanction the Applicant for that breach.

The relevant analysis is as follows:

1. ***The Agreement.*** The Settlement Agreement in EB-2009-0261 provides as follows:

   "The Parties agree that the revenue-to-cost ratios for customer classes (all classes except Residential and General Service <50 kW) that are outside of the Board's guidelines would be moved to the range over a three year period. The Parties agreed that the migration to the lower or upper band, as

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applicable, will be done by moving half-way to the applicable boundary in 2010, and then the rest of the way in equal increments in 2011 and 2012 (see Appendix L)." [emphasis added]

2. ***The Application.*** Contrary to the Settlement Agreement, the Application proposes that all classes under 100% revenue-to cost ratio be increased to well above the bottom band of their range in 2011, and increased further in 2012. By way of example, General Service >50KW, which includes most schools, is proposed to increase to 100% over two years 2011 and 2012, rather than to 80%, the bottom of the band. [Application p. 4]

3. The Applicant did not disclose in the Application that it was proposing a result that was contrary to the Settlement Agreement. Instead, the Applicant described the relevant provision in the Settlement Agreement as follows [Application, p. 4]:

   "In EB-2009-0261, it was agreed that CKH would migrate revenue-to-cost ratios in equal increments over the next two years in order to adjust outliers, such that all rate classes will be within Board guideline ranges by 2012. In the IRM 3 Model, [sic] proposes the following adjustment to revenue to cost ratios:"

   There follows the table of revenue to cost ratios proposed, which is not in compliance with the Settlement Agreement.

4. This description of the Settlement Agreement provision is misleading, as the agreement was to move to the upper or lower band, consistent with Board policy, not to move to "within Board guideline ranges". The wording of the Application implies that the table of proposed revenue-to-cost ratios is an implementation of the terms of the Settlement Agreement. That is not true.

5. Nowhere in the Application does the Applicant disclose that it is proposing to alter the agreed RTC levels.

6. ***The Problem.*** The Applicant advises the rationale for the adjustments in its answer to SEC interrogatory #1 [Exhibit B2.1]. In that response, the Applicant notes that "when the Settlement Agreement is applied literally", the changes in revenue from the various classes are not revenue neutral. That is, the reductions in revenue from reducing the Intermediate class RTC were greater than the aggregate increases in revenue from increasing the other classes.

7. The Applicant apparently assumed that, in those circumstances, it was free to simply propose any revenue to cost ratios it wanted, without advising the other parties to the Agreement that it was doing so. The solution it came to, and includes in the Application <u>as if it complies with the Settlement Agreement</u>, is to raise General Service > 50kW, for example, to 86.5% in 2011 (instead of 76.5%, as required by the Settlement Agreement), and to 100% in 2012 (instead of 80%, as required by the Settlement Agreement).

8. The result, for GS>50kW, is to impose an extra 18.4% increase in rates in 2011 ($333,766/ $1,812,264), which increases to a 36.8% increase in 2012 ($667,532/$1,812,264). SEC, a party to the Settlement Agreement, did not agree to these rate increases. What SEC agreed to (and what was reported to SEC by us at the time) were rate increases (over and above IRM) of 4.7% in 2011

($85,787/$1,812,264) and 9.4% in 2012 ($171,573/$1,812,264). Similar results apply to smaller classes, although the major impact is on GS>50kW.

9. ***What Should the Applicant Have Done?*** If the terms of the Agreement do in fact produce an unexpected result, it is legitimate to ask what the Applicant should have done to deal with it.

10. In our submission, what is crystal clear is that the Applicant should not have filed an Application inconsistent with the Agreement they entered into, and without telling anyone that they had decided to alter the terms of the Agreement unilaterally.

11. From a strictly legal point of view, if a contract produces a result that one party feels was not intended by the other parties, the proper response is to contact the other parties and agree on amending terms that accomplish the result intended. The Applicant made no attempt to do so, and in our submission should be sanctioned by the Board for that failure.

12. We note that, in a commercial context, if a party finds that a contract produces an unintended result, and the other parties do not agree to modify it to produce the correct result, the first party can apply to court in an action for rectification of the agreement. Evidence has to be filed as to the true intention of the parties, and the court assesses a) whether there was indeed an error in the agreement, and b) if so, what adjustments will correct the error while still keeping all parties as close to what they expected as is possible.

13. In this case, because the Agreement became a Board order through its approval in EB-2009-0261, any proposal to modify the terms of that order should technically have been done by way of a Motion for Review or similar process of rectification, so that the Board would be aware that an error was alleged, and could consider in a transparent and conscious way the best approach to correcting the error while still being as true as possible to the parties' expectations in the original Settlement Agreement.

14. As a practical matter, it was never necessary for the Applicant to take this step. If the Applicant had done what it should have done, and approached the other parties to the Agreement to get it "fixed", the parties could easily have agreed on what should be done, and then jointly approached the Board to rectify the Board order in EB-2009-0261.

15. Of course, as will be clear from our submissions below, the solution that would have been agreed would not have been the one proposed by the Applicant, which is clearly incorrect. However, we would expect that a reasonable result would have been agreed, to ensure that the changes in revenue to cost ratios were revenue neutral (which was not agreed in the Settlement Agreement, but was expected by the parties to it), and that all parties got a result that was reasonably close to what was expected when they entered into the Agreement.

16. ***The Implications.*** SEC's concern with the Applicant's actions in this case extends far beyond the revenue to cost ratio issue. Many of the rate proceedings before the Board in the last few years have been resolved by comprehensive and often creative settlements of the issues by the parties. This has improved the efficiency of Board processes, and has fostered an increasingly constructive and co-operative relationship between utilities and intervenors. While some issues are still more appropriately dealt with by the Board in a hearing (for example where new policy issues are being

considered), the extent to which compromise has supplanted conflict in the rate process has been a positive development.

17. But, to allow settlements to work, parties to those settlements must be able to rely on the agreement, once approved by the Board, being implemented as agreed. Utilities should not have the discretion to apply subsequently for rates that are inconsistent with what they have agreed. If that were the case, then the tradeoffs and compromises that take place in a settlement negotiation would be for nothing.

18. In our submission, the Board should send a message to the Applicant, in the strongest possible terms, that once a Settlement Agreement is entered into and approved, all parties are expected to honour both the letter and spirit of the Agreement. The Board should make clear, we believe, that lack of respect for such agreements by the parties will not be tolerated.

Appropriate Revenue to Cost Ratios for 2011 and 2012

19. ***What To Do Now?*** Of course, as a practical matter the horse has already left that barn, in the sense that the Applicant did not do what it should have done, and the Board still has to set rates for 2011. In theory, the Board could simply refuse to consider the Application, on the basis that it is not compliant with the Settlement Agreement and the Board's order in EB-2009-0261. As tempting as it might be to suggest that, it would leave 2011 rates still non-compliant with the Settlement Agreement, and would in effect be punishing some ratepayers, and rewarding others, for the error of the utility. This is not, in our view, an appropriate result.

20. The problem, as we see it, is that the parties agreed to a Settlement Agreement that is not revenue neutral. We believe that is appropriately solved in two steps:

    a. Determine the amount of the revenue shortfall resulting from the Settlement Agreement. In this regard, we believe the Applicant's calculation is materially incorrect.

    b. Determine who should bear the cost of that revenue shortfall, in what proportions. This involves altering the revenue to cost ratios from what the Settlement Agreement anticipated, but not in the manner proposed by the Applicant. Instead, a solution should be fashioned that leaves everyone as close as possible to the position they reasonably expected when they entered into the Agreement.

21. ***What is the Shortfall?*** The Applicant claims that the revenue shortfall is $442,321 in 2011, and $884,642 in 2012 [VECC interrogatory 3, Attachment 2, Ex. B3.3]. This figure is incorrect.

22. The problem with the Applicant's calculation is that it assumes that the upper bound of the Intermediate rate class [General Service 1000 to 4,999 kW] is 115%. As a result, the revenue from that class has to be reduced by $546,866 in 2011, and $1,093,732 in 2012.

23. The upper bound of the Intermediate class is not 115%. According to the Board's EB-2007-0667 Report on Cost Allocation, the range for all classes from 50 kW to 4,999 kW is 80% to 180% [SEC interrogatory #3, Ex. B2.3]. This is not disputed, and is a clear Board policy. Indeed, many schools in the GS > 50kW class suffer from high rates because their revenue to cost ratio is well above 100%, but still below 180%. Any sample of other LDCs that have Intermediate rate classes will find that

they all have an RTC band of 80% to 180% for this class, in keeping with Board policy. [See, for example, EB-2010-0145, Ex. 7/1/2, p. 3.]

24. The Applicant has two reasons for saying that the range of 85% to 115% should be applied instead.

25. First, the Applicant notes [SEC #3] that the customers in that class were formerly in the Large User class, and so should have the upper and lower bounds of that rate class applied. This, in our submission, is patently wrong. The Applicant moved these customers from one rate class to another. There is no precedent or logic to apply only some of the attributes of the new rate class, but not others. If they are properly in the new class, then the Board's policies and the rates applicable to that class should apply.

26. Second, the Applicant points to Appendix L of the Settlement Agreement, which apparently in error sets out the bounds of the Intermediate class as 85% to115%. We say apparently in error because there is no agreement in the Settlement Agreement to use a range different than the Board's range, and to the best of our knowledge it was not discussed in the EB-2009-0261 proceeding. What we do know is that, in presenting the Settlement Agreement to the Board for approval, the Applicant did not advise the Board panel making the decision that the bounds of the Intermediate class were not the Board's bounds, but new ones being proposed by the Applicant.

27. In any case, the Settlement Agreement does not refer to new upper and lower bounds. Rather, it expressly refers to the ranges in "the Board's guidelines".

28. What is interesting about this is that the large revenue shortfall is directly the result of the Applicant's use of this new upper bound for the Intermediate class. If the correct upper bound, 180%, is used, the shortfall is $161,345 in 2011, and $322,590 in 2012. A total shortfall over the two years of $1,326,923 is actually, based on the Board's ranges, $483,935.

29. It is therefore submitted that the Board should implement what the parties agreed and the Board approved, i.e. movement over 2011 and 2012 to the Board's upper bound for the Intermediate class, not a new and artificial upper bound preferred by the Applicant.

30. ***How Should the Shortfall be Recovered?*** It is at least arguable that the shortfall, approximately 1% of revenue requirement in 2011 and 2% in 2012, is simply not recoverable by the Applicant. The Applicant entered into an agreement on certain terms, and should live with the results.

31. However, it is SEC's view that the parties, in entering into the Settlement Agreement, expected that the resulting revenue to cost ratios would be revenue neutral, i.e. that the Applicant would recover its full revenue requirement. Thus, in our view other rate classes – those below the 100% level – should be increased to recover this shortfall. The increase should be pro rata, such that all of those classes are treated fairly.

32. In our submission, the result of this should be as follows:

    a. The RTCs of Intermediate, USL and Intermediate with Self Generation, all of which are below their 80% lower bounds, should be increased to the same percentages in each of 2011 and 2012. Those percentages should be calculated to result, with the adjustment in (b) below,

in the total revenue of the Applicant being the full approved costs. We expect this will likely result in a 2011 RTC for these three classes of approximately 79.2%, and a 2012 RTC for these three classes of approximately 85.8%.

b. The RTCs of Streetlights and Sentinel Lights, each of which are below their 70% lower bound, should be increased pro rata with the increases to the other three classes. We expect this will likely result in a 2011 RTC for these classes of approximately 71.0% and a 2012 RTC for these classes of approximately 74.0%.

33. We note that the effect of this, which treats all classes fairly, would be a special increase for GS>50kW, including schools of about 8.4% in 2011 and 16.9% in 2012. This is significantly more than the GS>50kW customers expected when they signed the Settlement Agreement, but substantially less that the 18.4% and 36.8% increases proposed by the Applicant.

Conclusion

34. Subject to our comments above, it is therefore submitted that:

a. The Board should order a modification to the Board-approved Settlement Agreement to maintain as closely as possible the intention of the parties with respect to revenue to cost ratios, while obtaining a result that is revenue neutral for the utility, all as set forth in para. 32 above.

b. The Board should admonish the Applicant for failing to comply with the Settlement Agreement, for failing to contact the other parties to that Agreement when a problem with its implementation was identified, and for applying for rates in this proceeding without advising the Board or the other parties to the Agreement that the Application was inconsistent with the Board-approved Settlement Agreement.

35. ***Costs.*** SEC submits that it has participated in this proceeding in a responsible and focused manner with a view to assisting the Board, and requests that the Board order payment of its reasonably incurred costs of that participation.

All of which is respectfully submitted.

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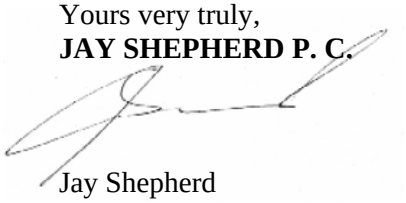
Yours very truly,
JAY SHEPHERD P. C.



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cc: Wayne McNally, SEC (email)
Interested parties (email)