February 1, 2011

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

Dear Ms. Walli:

Re: Guelph Hydro Electric Systems Inc.'s Response to the Board Staff, VECC, and SEC Submissions

2011 IRM3 Distribution Rate Application - Board File No. EB-2010-0130

In accordance with the Notice of Application and Hearing, please find attached Guelph Hydro's Response to the Board Staff, VECC, and SEC submissions in the above proceeding.

Guelph Hydro has submitted via RESS and emailed electronic copies of the following to all other registered parties to this proceeding.

Respectfully Submitted,

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On January 12, 2011, Guelph Hydro received the Board Staff, VECC, and SEC submissions on its 2011 IRM3 Distribution Rate Application. The Board Staff and both intervenors recommended the Board to approve Guelph Hydro's application for 2011 Electricity Distribution Rates, including the request for an Incremental Capital Adjustment[1].

Guelph Hydro's response to the Board Staff submission

Project Alternatives

In regards to Guelph Hydro's Incremental Capital Module application, the Board Staff noted that:

"Guelph Hydro did not file a Connection Cost Responsibility ("CCRA") with Hydro One with respect to bypassing Hydro One's transmission system and providing its own supply." [2]

Guelph Hydro is not at the stage in our project to have received a CCRA from Hydro One. The New MTS is planned for new load growth beyond the rated capacity of Hanlon TS, and Guelph Hydro will not bypass the existing Hydro One facilities.

It is Guelph Hydro's view that, according to the Transmission System Code section 6.7.5, and 6.7.9, the transmitter (i.e. Hydro One) shall not require bypass compensation from Guelph Hydro.

Transmission Assets

In its submission, the Board staff noted that
"the New MTS - Clair will be tapped off lines B5G and B6G of the 115 kV Guelph Hydro Networks Transmission System between Hanlon TS and Puslinch TS. As a

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[1] Board Staff Submission – page 5; VECC submission – page7 & 8; SEC submission – page 2

[2] Board Staff Submission – Project Alternatives – page 4

result, the transformer station will provide transformation connection service, meaning that Guelph Hydro would be considered to be operating as a transmitter under the *Transmission System Code* ("TSC"). Guelph Hydro would have to acquire a transmission licence, or request that the New MTS - Clair be deemed a distribution asset to ensure compliance with the TSC.
Guelph Hydro indicated that it intends to request that the Board deem the new transformer station a distribution asset under S.84 (a) of the *OEB Act*."[3]

Guelph Hydro states that it will use the New MTS solely for purposes of serving its immediate distribution customers.

Guelph Hydro is requesting that the Board deem the new transformer station a distribution asset.

If such a request is not permitted at this time, Guelph Hydro will make the request in the next cost of service proceeding for 2012 electricity distribution rates.

<u>Project Need</u>

Board staff submitted[4] that from the evidence, it is unclear whether Guelph Hydro will be required to make payments to Hydro One in respect of bypass, and that could affect Guelph Hydro's analysis of the total costs of alternatives presented.

Guelph Hydro states that the New MTS is intended for new load growth and the cost analysis is based on incremental load growth. Guelph Hydro does not plan on bypassing any Hydro One facilities thus we did not include any such cost in our calculations.

Board staff also noted that there has been little evidence presented to demonstrate that Guelph Hydro has shown consideration for supply optimization in the context of

[3] Board Staff Submission – Transmission Assets – page 4
[4] Board Staff submission- Project Need – page 6

regional supply planning and that the Board may want to encourage the company to enhance the cooperation with neighboring utilities for future planning activities.

Guelph Hydro's adjacent utility is Hydro One Distribution who operates at incompatible voltages of 27.6kV and 8.32kV as compared to our distribution system voltage of 13.8 kV.

Guelph Hydro submits that it has participated with neighboring utilities on a number of occasions for regional bulk supply planning. Guelph Hydro staff have been meeting monthly with representatives from the OPA, IESO, Hydro One transmission and distribution, Cambridge and North Dumfries Hydro, Kitchener Wilmot Hydro and Waterloo North Hydro since early 2010 regarding regional transmission supply planning.

<u>Risks of Self-Build</u>

Board staff submitted that it is unclear from Guelph Hydro's evidence the duration of warranties and cost of insurance.

Guelph Hydro submits that warranties have been secured on the following major material for the New MTS as presented in the following table:

	Quantity	Warranty
Power Transformer	2	5 Years
Medium Voltage Switchgear	1	5 Years
Disconnect Switches	4	7 Years
High Voltage Circuit Breakers	2	5 Years

Guelph Hydro budgeted the insurance cost for the New MTS as $6,000 in 2011 and $18,900 in 2012.
Please note that these costs have not been included in the determination of the revenue requirement for the New MTS but they typically are included in revenue requirement for rate setting purposes.

Smart Meter Funding Adder

Guelph Hydro agrees with Board Staff's position.

Guelph Hydro's response to VECC submission

Revenue Requirement Analysis

In its submission, VECC specified two concerns[5] regarding the calculation of the incremental revenue requirement. The first is that in determining the Return on Rate Base Guelph has used the capital structure (4% - Short Term Debt; 49.3% - Long Term Debt and 46.7% - Equity) as approved for its 2008 Rate Application. VECC noted that Guelph Hydro's transition to Board's deemed capital structure (4% - Short Term Debt; 56% - Long Term Debt and 40% - Equity) was completed with the approval of Guelph's 2010 rates.
Guelph Hydro followed the Board Staff's model instructions which specify:
"Sheet B1-4 Detailed Re-Based Revenue from Rates – […] User will input all green highlighted cells utilizing most current Revenue Requirement Work form."[6] Guelph Hydro's most current approved Revenue Requirement Work form (i.e. 2008 year rate) calculates the 2008 approved revenue requirement based on 2008 Return on Rate Base structure (i.e. 4% - Short Term Debt; 49.3% - Long Term Debt and 46.7% - Equity).

However, Guelph Hydro agrees that the 2011 rates should reflect the Board's deemed capital structure and that the incremental revenue requirement arising from the requested capital adjustment should be calculated using the same capital structure.

[5] VECC submission- Sections 2.13 – page 5
[6] User Instructions for Completion of 2011 IRM3 Incremental Capital Workform for Electricity Distributors – Sheet B1-4- page 3

VECC's second concern[7] is with respect to the calculation of the associated depreciation expense and rate base. VECC noted that in the Supplemental Report of the Board, it was determined that the ½ year rule would not apply "so as to not build in a deficiency for subsequent years in the term of the plan", and that in Guelph's case there are no "subsequent years" since Guelph rates will be rebased in 2012. As a result, VECC submitted that there is no reason to depart from the Board's standard practice of applying the ½ year rule for the determination of depreciation and rate base.

Guelph Hydro followed the Board's Supplemental Report on 3rd Generation Incentives Regulation for Ontario's Electricity Distributors (the Report) rules in regards to Incremental Capital Module calculation.

On page 31, the Report states:

"In calculating the rate relief, the Board *has determined not to apply the half-year rule* so as not to build in a deficiency for subsequent years in the term of the plan."

The Incremental Capital Module and the Incremental Revenue Requirement calculation should apply according to the Board's policy, uniformly for all LDCs regardless of the IRM year in which the distributor is in the IRM cycle. In Guelph Hydro's view, to follow the suggestion outlined by VECC would be against the Board's policy (EB-2007-0673 – The report).

Moreover, Guelph Hydro expensed in 2009 and 2010 an additional amount of $2.3M ($0.14M in 2009 and $2.16M in 2010) with the New MTS project, and that this amount has not been taken in the incremental revenue requirement calculation.

Guelph Hydro also reiterates there are no OM&A costs associated with the New MTS in the incremental revenue requirement calculation.

[7] VECC submission – Section 2.14 – page 5

With financial pressure associated with the incremental capital expenditures, Guelph Hydro's first intent was to submit an early re-basing application for 2011 electricity distribution rates.

On March 16, 2010 Guelph Hydro advised the Board that it intends to submit a forward test year cost of service distribution rate application in August of 2010 for 2011 distribution rates, with an effective date of May 1, 2011, mentioning two matters that have prompted it to file an early rebasing application:

1. The construction of a new municipal transformer station ("New MTS") in the Hanlon Expressway corridor

2. The actual loads have been significantly lower than those forecast in Guelph Hydro's 2008 cost of service

On April 20, 2010 the OEB delivered a letter advising LDCs seeking rate rebasing in advance of their next regularly scheduled cost of service proceeding, that they would be required to justify why an early rebasing is necessary notwithstanding that the "off ramp" conditions have not been met. The OEB letter noted that the panel of the Board (OEB) hearing the application may determine, as a preliminary issue, whether the application for rebasing is justified or whether the application as framed should be dismissed. Further, the OEB panel may disallow some or all of the regulatory costs associated with the preparation and hearing of that application, including the Board's costs and intervenor costs.

On May 11, 2010, Guelph Hydro indicated that it had considered the Board's letter on early rebasing application as it relates to Guelph Hydro and the recent RPP price increase effective May 1, 2010 and the bill impact on Guelph Hydro's customers of an additional increase in distribution rates if Guelph Hydro were to submit an early rebasing application for 2011 distribution rates. Further, Guelph Hydro notified the Board that it had determined to remain in the Incentive Regulation Mechanism (IRM) schedule for 2011 rates and apply for 2012 cost of service distribution rate application.

On June 25, 2010 the Board notified Guelph Hydro that it expects Guelph Hydro to adhere to the process for 2011 IRM3 distribution rate application and to file a cost of service application for 2012 rates.

Therefore, Guelph Hydro complied and submitted an IRM application including the request for the Incremental Capital Module for 2011 rates. Guelph Hydro's decision on remaining in the IRM plan was driven by a financial analysis and ICM expectations based on a full year approach consistent with the Board's policy.

Incremental Revenue Not Recovered Elsewhere

In section 2.21 VECC noted there is some question as to the level of incremental revenue for 2011, and in section 2.22, advised the Board to consider reducing the incremental revenue requirement approved for rate setting to recognize the incremental 2011 revenue from the new GS 1000 to 4999 kW customer.

Guelph Hydro confirms that the correct incremental revenue expected from GS 1000 to 4999 kW customer is $12,632, the amount calculated by the Economic Evaluation Model.

Guelph Hydro sustains its position that the incremental cost related to connecting new customers would more than offset the initial year's incremental revenue[8].

Furthermore, the additional distribution revenue will be included in the economic evaluation model for any new development serviced by the New MTS, which in turn will be used to reduce the capital contribution from the developer for the costs associated with the new development not the New MTS. The additional distribution revenue does not offset the costs associated with the New MTS.

[8] VECC submission – Section 2.20 – page 7

In addition, Guelph Hydro asserts that the actual loads and revenues from rates have been lower than those forecast in Guelph Hydro's 2008 cost of service. Guelph Hydro's load growth calculated in operating revenue is a decrease of 0.34%, and the 2011 expected incremental revenue of $12,632 does not offset the revenue deficit.

Based on the above considerations, it is Guelph Hydro's view that the Incremental Revenue Requirement associated with the planned capital spending on the New MTS should not be reduced by the expected distribution revenue from the new GS 1000 to 4999 kW customer.

Guelph Hydro's response to SEC's submission

Term of Rider

In section 5 and 6 of its submission[9], SEC disagreed with the ICM rate adder sunset date December 31, 2011, pointing a revenue requirement shortfall to be collected by the Applicant relative to 2011.

Guelph Hydro agrees that this is a complication of the disjunction between fiscal year and rate year.
According to the Supplemental Report of the Board, at the time of rebasing, the Board will carry out a prudence review to determine the amounts to be incorporated in rate base, and it also make a determination of differences between forecast and actual spending during the IR plan term.
Therefore, in Guelph Hydro's view, the Board will determine any revenue shortfall caused by a shorter recovery period to be incorporated in the 2012 rate base.

[9] SEC submission – Section 5 and 6- Term of Rider, page 2

Conclusion

1. Guelph Hydro submits that it has complied with the policies and filing requirements of the 2011 IRM3 and Incremental Capital Module regulation (EB-2007-0373), and of the Smart Meter Funding and Cost Recovery Guideline (G-2008-0002).
2. Guelph Hydro has not received a CCRA from Hydro One and it expects no bypass charges given that the New MTS is planned for new load growth beyond the rate capacity of Hanlon TS.
3. Guelph Hydro is requesting that the Board deem the new transformer station a distribution asset.
4. Guelph Hydro has been cooperating with neighboring utilities for future planning, but there are technical restrains from neighboring with Hydro One Distribution who operates incompatible voltages.
5. Guelph Hydro agrees with VECC's position that the 2011 rates should reflect the Board's deemed capital structure and that the calculation of the incremental revenue requirement should be calculated using the 2010 approved capital structure.
6. Guelph Hydro believes that VECC's position applying the half-year rule for determination of depreciation and rate base is against the Board's policy stated in the Supplemental Report of the Board file number EB-2007-0673.
7. It is Guelph Hydro's position that the additional distribution revenue does not offset the costs related to connecting the new customer, and it does not offset the costs associated with the New MTS. The additional distribution revenue is included in the economic evaluation model which in turn is used to reduce the capital contribution for new developments.
8. Guelph Hydro agrees with the Board Staff that the calculation of the Incremental Capital (IC) rate rider can only be made on the basis of the information available at this time and that the appropriate sunset date for the IC Rate Rider is April 30, 2012. Guelph Hydro believes that at the time of its 2012 Cost of Service application, adjustments could be made to reflect the Board's decision in that proceeding regarding the alignment of the fiscal year with the rate year.