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February 2, 2011

Kirsten Walli
Board Secretary
Ontario Energy Board,
2300 Yonge St.
Suite 2700, P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

Re: OEB File No. EB-2010-0104
Oakville Hydro Electricity Distribution Inc.
2011 Distribution Rate Adjustment Application

Please find accompanying this letter, two copies of Oakville Hydro's reply to the written submissions of Board staff, the School Energy Coalition and the Vulnerable Energy Consumers Coalition.

Should there be any questions, please contact me at the number below.

Respectfully Submitted,

Maryanne Wilson

Maryanne Wilson
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EB-2010-0104

IN THE MATTER of the *Ontario Energy Board Act 1998*, Schedule B to the *Energy Competition Act*, 1998, S.O. 1998, c.15;

AND IN THE MATTER OF an Application by Oakville Hydro Electricity Distribution Inc. for an Order or Orders approving just and reasonable rates and other service charges for the distribution of electricity, effective on May 1, 2011.

Oakville Hydro Electricity Distribution Inc. (OHEDI)

Reply Submission

Filed: February 2, 2011

1. INTRODUCTION

1.1 Oakville Hydro Electricity Distribution Inc. ("OHEDI") filed an application with the Ontario Energy Board (the "Board") on September 17, 2010 under section 78 of the *Ontario Energy Board Act, 1998* (the "OEB Act"), seeking approval for changes to its rates effective May 1, 2011 (the "Application"). The Application was filed under the Board's 3rd Generation Incentive Regulation Mechanism (IRM). The Application included a request for an Incremental Capital Module ("ICM") Adjustment as provided for in the Chapter 3 of the Board's Filing Requirements for Transmission and Distribution Applications issued July 9, 2010.

1.2 The Board issued a Notice of Application and Hearing (the Notice) on October 7, 2010. In the Notice, the Board advised that it intended to proceed with the application by way of a written hearing and requested that intervenors and/or Board staff wishing information and material in addition to the evidence filed with the Board request it by November 12, 2010. The notice also directed intervenors and Board staff to file written submissions by January 12, 2011. OHEDI was directed to file its response to those submissions by February 2, 2011.

2. BACKGROUND

Incremental Capital Claim

2.1 OHEDI became aware of the need for a new municipal transformer station ("MTS") in October 2007. At that time, a project to review the various options available to OHEDI with regard to the ownership of the MTS was approved by OHEDI's Board. OHEDI retained the services of Costello Associates to conduct the review and on July 23, 2009, OHEDI's Board approved the MTS project option which included building and putting into service the MTS, to be owned solely by OHEDI[1], by June 2011.

[1] Response to Board Staff Interrogatories, 10 c)

2.2 In its 2010 Cost of Service Application (EB-2009-0271), OHEDI advised the Board that its 2011 budget included the costs to design and construct a municipal transformer station in North Oakville to maintain reliable supply and meet anticipated growth.[2] At that time, OHEDI had completed the study of capacity alternatives and concluded that the best option was the construction of the transformer station by OHEDI. OHEDI did not include any of the costs of the transformer station in its 2010 revenue requirement.

2.3 In its 2011 IRM application, OHEDI requested approval of incremental capital expenditures related to the design and construction of the municipal transformer station to provide relief for the critical shortage of supply to Oakville and to meet the needs of the Town of Oakville's planned development in the north east area of Oakville[3]. OHEDI submitted that the forecasted capital expenditures clearly exceeded the ICM Threshold as defined in the Filing Requirements; that it was clearly non-discretionary; and that, in choosing to design and build the municipal transformer station (MTS#1), OHEDI had made a prudent decision. Materiality, need and prudence are elaborated on in the following paragraphs.

2.4 Additionally, in the course of reviewing and responding to interrogatories in this proceeding, OHEDI determined that it inadvertently did not make its request for a determination under *Section 84 of the Ontario Energy Board Act, 1998* (the "OEB *Act*") as part of this application. In its response to Board staff interrogatories OHEDI respectfully requested that the Board determine, in making its Decision in this proceeding, that the transformer station is a distribution asset[4]. OHEDI will address this below.

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[2] EB-2009-0271, Exhibit 2, Tab 4, Schedule 5, Pages 18 to 20
[3] EB-2010-0104, Manger's Summary, Page 9
[4] Response to Board Staff Interrogatory Number 16 a)

Materiality

2.5 The 2011 IRM3 Incremental Capital Work Form issued by the Board on April 10, 2010 calculated OHEDI's materiality threshold as $13,633,026.[5] OHEDI requested approval for the recovery of the revenue requirement related to the MTS based on a capital expenditure of $20,488,489 through a variable rate rider. In response to School Energy Coalition ("SEC") interrogatory number 3, OHEDI updated its forecasted capital expenditures to $21,360,209 for the reasons set out in OHEDI's response.[6] OHEDI notes that had the revised forecast not included a reduction for two items (a reduction in the capital interest rate from 5.33% to 4.01% to reflect the Board's prescribed rate and a reduction in the capitalized interest period from 8 months to 6 months) the revised capital expenditure would have been 21,660,876.[7]

Need

2.6 In its application, OHEDI submitted that there was a shortfall of supply capacity of 28 MW and that new transformer station capacity was urgently required to provide relief for reduced capacity from Hydro One and to accommodate new load growth[8]. In response to Board Staff interrogatories, OHEDI submitted that, although it had experienced a significant loss of industrial load since its last rebasing application its actual peak load in 2010 was 355.1 MW as compared to the forecast of 355.6 MW prepared in 2008 and relief was still urgently needed. Had the loss of industrial load not occurred, OHEDI's 2010 peak would have been approximately 364 MW, increasing the risk of outages due to system capacity constraints.[9]

[5] EB-2010-0104, Manager's Summary, Page 11
[6] Response to SEC Interrogatory number 3 b)
[7] Response to Board Staff Interrogatory number 24 a)
[8] EB-2010-0104, Manager's Summary Page 15
[9] Response to Board Staff Interrogatory number 13 b)

Prudence

2.7 In its 2011 IRM application, OHEDI presented the three project alternatives that it had evaluated. These options included the OHEDI self-build (MTS#1); Hydro One MTS in Burlington; and Hydro One MTS in North Oakville. In selecting the OHEDI self-build, OHEDI selected the lowest cost option.[10] Additionally, as OHEDI advised in response to Board staff interrogatories, OHEDI issued a Request for Proposal to six firms and, retained the expertise of Costello Associates to review and evaluate the bids, and OHEDI had selected the alternative with the highest score on OHEDI's criteria matrix.[11]

Deferral and Variance Accounts

2.8 In its Application, OHEDI proposed that the disposition of the balance of the Group 1 deferral and variance accounts as at December 31, 2009 be deferred to a later application. The balance of the Group 1 deferral and variance accounts was a credit of $3,807,145 at December 31, 2009 and a credit of $1,186,618 as at August 31, 2010.[12] OHEDI's proposal to defer the disposal of the Group 1 deferral and variance accounts was intended to provide rate stability for customers since a continuation of the trend could result in a debit balance.

2.9 In response to Board Staff interrogatories, OHEDI suggested that the balances of the Group 1 accounts as at December 31, 2009 be disposed of if the balance at December 31, 2010 exceeded the threshold of $0.001 per kWh[13].

2.10 The unaudited balances of the Group 1 accounts as at December 31, 2010 exceed the threshold of $0.001 per kWh. OHEDI will discuss the appropriate treatment of these balances later in this submission.

[10] EB-2010-0104 Manager's Summary Page 19
[11] Response to Board Staff Interrogatory number 25 b)
[12] EB-2010-0104, Manager's Summary, Page 7
[13] Response to Board Staff Interrogatory Number 26 b)

3. SUBMISSIONS

Incremental Capital Claim

Project Need

3.1 Board Staff and intervenors submitted that OHEDI had provided adequate evidence to demonstrate that the MTS#1 project is non-discretionary and submitted that OHEDI's request for incremental capital funding should be approved.

3.2 OHEDI agrees with the Board Staff and intervenor submissions that OHEDI has provided adequate evidence to demonstrate the need for an MTS to address current transformation shortages and to meet future load growth, and that OHEDI's request for incremental capital funding associated with the design and construction of a municipal transformer station should be granted.

Prudence

3.3 Board staff submitted that OHEDI had demonstrated that it had chosen the lowest cost alternative, that the proposed MTS#1 resulted in the least rate impacts and that it was in the best interest of Oakville Hydro's ratepayers that MTS#1 be built. The Vulnerable Energy Consumers Coalition ("VECC") submitted that in considering a number of options, the RFP process and in selecting the lowest cost option, OHEDI had demonstrated the prudency of the expenditures.

3.4 However, Board staff submitted that the costs associated with bypass payments to Hydro One and OHEDI's consideration of supply optimization in the context of regional supply had not been adequately addressed in OHEDI's evidence.

3.5 With respect to the issue of costs associated with payment to Hydro One in respect of bypass, OHEDI submits that, as noted by Board staff in its submission, OHEDI provided the Connection Cost Recovery Agreement ("CCRA") with Hydro One with respect to MTS#1 in response to Board Staff interrogatories.[14] In a letter attached to the CCRA, Hydro One further clarified the implications of bypass, stating that:

> "Moving load from an existing station to the new MTS for the purpose of avoiding Transformation Connection payments is considered to be bypass, and is subject to the bypass provisions as set out in the Transmission System Code. Bypass is considered to have occurred if the loading at existing facilities has been reduced to below the "Existing Load" as defined in the Transmission System Code and noted in the CCRA".[15]

OHEDI submits that it has no plans to move load from existing stations to the MTS#1 for the purpose of avoiding Transformation Connection payments and therefore OHEDI will not be required to pay bypass charges to Hydro One.

3.6 With respect to regional planning, OHEDI submits that it evaluated the option of co-ownership of the North Oakville TS with Milton Hydro and Hydro One's proposal for the construction of a transformer station that would provide new capacity for OHEDI, Burlington Hydro and Milton Hydro[16]. OHEDI understands that this is one of the areas that is being addressed in the Board's *Renewed Regulatory Framework for Electricity*. OHEDI will continue to work with neighbouring utilities in future planning activities in accordance with the Board's guidance.

Risk Assessment

3.7 Board staff submitted that OHEDI had taken reasonable steps to protect itself and its ratepayers from unplanned costs as a result of failures associated with MTS#1 but that it was unclear from OHEDI's evidence the duration of warranties, cost of insurance, and collaboration with neighboring utilities to reduce supply risk. In response to Board staff's concerns regarding these matters, OHEDI makes the following submissions.

3.8 The warranty duration for each power transformer is 5 years. With respect to the cost of insurance, coverage will commence once the facility has been roofed and closed in,

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[14] Response to Board Staff Interrogatory, Appendix 8
[15] Response to Board Staff Interrogatory Number 17 a)
[16] EB-2010-0104, Manager's Summary, Page 17

with additional coverage being added as the equipment is installed. Annual cost of insurance will be an operating expense and is projected to be in the $60,000 to $70,000 range, which will be finalized upon project completion. The cost of insurance would not have altered OHEDI's decision to proceed with the MTS#1 project. OHEDI has not included the estimated OM&A costs of $242,000 associated with the new MTS, including the estimated cost of insurance, in the incremental revenue requirement associated with its incremental capital claim.

3.9 In the event of a catastrophic failure beyond the warranty period, the transformer pad and spill containment have been designed and constructed with the flexibility to accept a replacement transformer either with tank-mounted or remote-mounted cooling radiators. OHEDI plans to take advantage of this flexibility by collaborating with other utilities such as Hydro One and PowerStream towards an agreement to gain access to a spare transformer.

Transmission Assets

3.10 Board staff submitted Oakville Hydro had taken the appropriate steps for the safe connection of MTS#1 to the transmission system and submitted that the Board may reasonably approve Oakville Hydro's request to have its transmission assets deemed as distribution assets. No intervenors made submissions in this regard.

3.11 OHEDI respectfully requests that the Board approve OHEDI's request that the Board deem MTS#1 to be a distribution asset pursuant to section 84(a) of the *OEB Act* in order that it may recover the revenue requirement related to MTS#1 through distribution rates.[17]

Appropriate Amount for Recovery

3.12 Board staff submitted that OHEDI's updated calculation of capitalized interest was correct. VECC submitted that a revision to the forecasted spending associated with the

[17] Response to Board Staff Interrogatory, Number 16 a)

MTS#1 was required to reflect the revised capital cost of $21,360,209 provided by OHEDI in response to SEC interrogatories.[18] VECC also submitted that a revision would likely be required to reflect the Board's prescribed interest rates.

3.13 OHEDI notes that it updated its forecasted capital expenditures for the MTS#1 to $21,360,209 in response to SEC interrogatory number 3[19]. OHEDI confirms that the revised forecast of $21,360,209 includes a reduction in the amount of capitalized interest to reflect the reduction in the capital interest rate from 5.33% to 4.01% to reflect the Board's prescribed rate and a reduction in the capitalized interest period from 8 months to 6 months. OHEDI submits that it has made the revisions requested by Board staff and the intervenors and requests that the updated incremental capital spending of 21,360,209 be approved.

Incremental Revenues

3.14 Board staff made no submissions with regard to incremental revenues. Both SEC and VECC submitted that OHEDI's revenue requirement calculation should be reduced by the forecasted amount of incremental revenue associated with load growth.

3.15 In response to interrogatories, OHEDI explained that it had not included incremental revenues in its incremental capital claim, as the incremental revenue would be used to reduce capital contributions needed from developers for the distribution costs associated with new development[20].

3.16 While SEC submitted that OHEDI had not included capital contributions in its 2011 budget, OHEDI submits that it is its practice to budget Services (new development) based on net capital expenditures.

3.17 OHEDI's 2011 capital forecast of $600,000 under the Services category is comprised of $1,250,000 in capital expenditures less $650,000 in capital contributions. OHEDI

[18] Response to SEC Interrogatory Number 3
[19] Response to SEC Interrogatory Number 3 b)
[20] Response to VECC Interrogatory Number 7 b)

has updated the presentation of its 2011 capital budget in the table below to clarify 2011 capital spending. The offsetting revenue will be included in the economic evaluation model for the new developments, which in turn will be used to reduce the capital contribution from the developer for the costs associated with the new development, and not to reduce the revenue requirement related to the MTS. Put simply, the offsetting revenue does not offset the costs associated with the new MTS. On the contrary, rather than receiving additional revenues as SEC has suggested, OHEDI will incur additional OM&A costs associated with the MTS of $242,000 which it is not recovering. Accordingly, OHEDI submits that the Board should not make the adjustment proposed by the intervenors to the calculated revenue requirement.

Oakville Hydro Electricity Distribution Inc.
2011 Capital Spending

Category	2011 Forecast
Substations	750,000
Transformer Stations	21,360,209
Rebuild for Road Widening / Railway Work	165,000
Alterations & Improvements for Load Transfer & Sys Sec.	300,000
Voltage Conversion	280,000
Transformer Replacements	150,000
27.6 kV Additions	2,000,000
Rebuild Underground Distribution System	1,500,000
Rebuild Overhead Distribution System	3,500,000
Services	1,250,000
Capital Contributions (Services)	(650,000)
Supervisory Control & Communications	300,000
Metering	500,000
Vehicles	500,000
Tools	150,000
Information Technology	930,000
Buildings	115,000
Total Budget	33,100,209

3.18 OHEDI also notes that the calculation of eligible capital proposed by VECC and SEC reflects $650,000 in capital contributions as part of the 2011 forecast of $33,100,209. OHEDI reiterates that its incremental claim should not be reduced by the amount of the offsetting revenues as they are used in the determination of capital contribution for new developments.

Value to be Used in Calculating the Incremental Revenue Requirement

3.19 Board staff made no submissions on OHEDI's application of the materiality threshold. VECC and SEC submitted that OHEDI had improperly applied the threshold value in determining the eligible capital spending. VECC submitted that eligible capital spending should be calculated as the difference between total capital spending for 2011 of $32,228,000 and the materiality threshold of $13,633,026. VECC also acknowledged that adjustments to the capital cost of the MTS#1 were required but suggested that those revisions would not affect the amount of the eligible capital.

3.20 OHEDI has two concerns with the VECC and SEC position: these relate to the appropriate treatment of the materiality threshold; and the accurate calculation of OHEDI's eligible capital amount. With respect to the treatment of the materiality threshold, OHEDI submits that in preparing its Application, OHEDI viewed the materiality threshold as an eligibility test for an incremental capital claim. Having exceeded the materiality threshold, OHEDI included a request based on the total capital spending on the MTS#1 project. OHEDI submits that this project is an extraordinary, one-time capital project for which total capital spending related to the project should be considered for relief. This is not a situation in which OHEDI can choose to complete only portions of a project in order to remain within the threshold. The project is justified, and must be completed in its entirety. OHEDI submits that the total capital spending of $21,360,209 should be approved. OHEDI also notes that the revenue requirement associated with the new MTS does not include the normalized OM&A costs of approximately $242,000 per year during the IRM period, which typically would be included in the determination of the revenue requirement. Having already foregone the OM&A component of the revenue requirement attributable to the MTS#1 until its next rebasing, OHEDI submits that it would be inappropriate to increase the amounts to be foregone by OHEDI by an additional amount of approximately $138,000 by reducing the amount to be used in calculating the revenue requirement.

3.21 Beyond issues related to the threshold, OHEDI respectfully submits that VECCs view that the incremental capital amount would not be affected by increased capital spending on the MTS#1 is incorrect. VECC has submitted that adjustments to the planned MTS#1 expenditures are required. Accordingly, the 2011 total non-discretionary capital expenditures will increase to $33,100,209. OHEDI submits that the application of the threshold as suggested by VECC and SEC would result in eligible capital of $19,467,183 as illustrated in the table below rather than $18,594,974 as suggested by VECC. Even if the Board were to accept the VECC and SEC position, that the eligible capital amount is the difference between the total capital spending and the materiality threshold, OHEDI submits that the VECC calculation is incorrect. Accordingly, in no event should the eligible capital amount be less than $19,467,183.

Oakville Hydro Electricity Distribution Inc.
2011 Capital Spending

Category	2011 Budget	2011 Forecast
Substations	750,000	750,000
Transformer Stations	20,488,000	21,360,209
Rebuild for Road Widening / Railway Work	165,000	165,000
Alterations & Improvements for Load Transfer & Sys Sec.	300,000	300,000
Voltage Conversion	280,000	280,000
Transformer Replacements	150,000	150,000
27.6 kV Additions	2,000,000	2,000,000
Rebuild Underground Distribution System	1,500,000	1,500,000
Rebuild Overhead Distribution System	3,500,000	3,500,000
Services	1,250,000	1,250,000
Capital Contributions	(650,000)	(650,000)
Supervisory Control & Communications	300,000	300,000
Metering	500,000	500,000
Vehicles	500,000	500,000
Tools	150,000	150,000
Information Technology	930,000	930,000
Buildings	115,000	115,000
Total Budget	32,228,000	33,100,209
Materiality Threshold	13,633,026	13,633,026
Incremental Capital Spending	18,594,974	19,467,183

Deferral and Variance Account Disposition

3.22 Board staff submitted that the Board should direct OHEDI to dispose of its Group 1 Deferral and Variance Account balances as of December 31, 2009. No intervenors made submissions in this regard.

Group 1 Accounts		Audited Dec-09 Balances	Unaudited Dec-10 Balances
Low Voltage	1550	474,105	675,628
Wholesale Market	1580	(479,576)	(2,094,752)
Network Services	1584	171,911	1,672,860
Network Connection	1586	(865,459)	(145,638)
Power	1588	(5,017,651)	(6,065,617)
Global Adjustment	1588	1,890,251	3,321,967
Recovery of Regulatory asset Balances	1590	19,274	-
		(3,807,145)	(2,635,551)
Billed kWh		1,488,242,062	1,488,242,062
Total Claim Per kWh		(0.0026)	(0.0018)

3.23 However, OHEDI is cognizant of the fact that the Ontario's Long Term Energy Plan indicates that over the next 5 years residential electricity prices are expected to rise by about 7.9% annually (or 46 per cent over five years).[21] OHEDI understands that the Board plans to "issue policy guidance setting out the Board's requirements for distributors capital plans including requirements in respect of regional planning, reliability and the assessment of total bill impact on consumers"[22] In keeping with the Board's objectives of mitigating the total bill impact on customers, OHEDI requests that the Board approve the disposition of the deferral and variance account balances as at December 31, 2009 over a two-year period in order to mitigate the rate impact on consumers.

[21] Ontario Energy Board 2011-2014 Draft Business Plan, January 4, 2011, Page 3
[22] Ontario Energy Board 2011-2014 Draft Business Plan, January 4, 2011, Page 5

2011 Residential Bill Impacts

Disposition Period	Distribution Revenue	Total Bill
As Filed	4.0%	1.3%
1 Year Disposition	-7.8%	-1.6%
2 Year Disposition	-1.9%	-0.1%
3 Year Disposition	0.0%	0.3%

3.24 Board staff submitted that OHEDI's Application indicated in the Deferral and Variance Account Workform that the Global Adjustment Rate Rider would be recovered through the electricity component of the customer's bill. Board staff noted that the Board had approved this approach in 2010 IRM applications only in cases where the distributor could not readily accommodate a separate rate rider that would apply to non-RPP customers and submitted that this approach be continued. No intervenors made submissions in this regard.

3.25 On April 26, 2010, OHEDI filed a Settlement Agreement with respect to its 2010 rebasing application. The Agreement provided for disposition of the Global Adjustment Sub-Account account through a Rate Rider for Global Adjustment Sub-Account Disposition, Applicable only for Non-RPP Customers to be recovered through the electricity component of the customer's bill.[23] OHEDI had proposed recovery based on the electricity component of the customer's bill on the grounds that it is consistent with the way in which the customers were billed the Global Adjustment (Provincial Benefit) rate. In its Decision on OHEDI's 2010 rebasing application, the Board approved the settlement agreement but reminded parties that elements of a settlement agreement do not create a precedent for the Board.[24]

[23] EB-2009-0271, Decision and Rate Order, Appendix A, Page 75
[24] EB-2009-0271, Decision and Rate Order, Page 4

3.26 OHEDI's Tariff of Rates and Charges, effective May 1, 2010 provides for a Rate Rider for Global Adjustment Sub-Account Disposition based on the electricity component of a customer's bill that is effective until April 30, 2013. Should the Board direct OHEDI to dispose of its Group 1 Deferral and Variance Account balances as at December 31, 2009, OHEDI would appreciate the Board's guidance on whether the rate rider should be recovered through the electricity component or the delivery component of a non-RPP customer's bill.

Revenue to Cost Ratio Adjustments

3.27 VECC submitted that, in response to interrogatories, OHEDI made a number of revisions to the Revenue-Cost Ratio Adjustment Work Form and that once these changes have been made the Revenue-Cost Ratio Adjustment Work Form will have been completed appropriately.

3.28 OHEDI concurs with VECC's submission.

4. CONCLUSION

4.1 For the foregoing reasons, OHEDI respectfully requests the following:

- That the Board approve OHEDI's incentive regulation rate adjustments as filed subject to the corrections to the Revenue to Cost Ratio adjustments, the proposed amendments to its incremental capital claim and its request for disposition of Group 1 Deferral and Variance Accounts; and

- that its request for recovery of the revenue requirement related to the capital expenditures of $21,360,209 associated with a new municipal transformer through a variable rate rider with a sunset date of April 30, 2014 station be approved; and

- that the Board approve the disposition of OHEDI's Group 1 Deferral and Variance Accounts as at December 31, 2009 over a period of two years; and

- that the Board provide guidance with respect to the appropriate billing determinant for the disposition Rate Rider for Global Adjustment Sub-Account.

All of which is respectfully submitted this 2nd day of February, 2011.

OAKVILLE HYDRO ELECTRICITY DISTRIBUTION INC.

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Lesley Gallinger

VP, Corporate and Regulatory Affairs and CFO