February 18, 2011

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

Dear Ms. Walli,

RE: Kingston Hydro Corporation
EB-2010-0136 Cost of Service Rate Application
Responses to Board Staff Supplemental Interrogatories on Feb 4, 2011 Updated Evidence

Pursuant to the Board's Procedural Order No. 2, please find attached Kingston Hydro Corporation responses to Board Staff supplemental interrogatories on the February 4, 2011 evidence update, which have been filed electronically through the Board's RESS filing system and emailed to intervenors listed in Appendix "A" of the Order.

Respectfully submitted,

J.A. Keech, President & CEO
Kingston Hydro Corporation

Copy: Andrew Taylor, Energy Law (by email)
Energy Probe Research Foundation, Randy Aiken (by email)
School Energy Coalition, Jay Shepherd (by email)
Vulnerable Energy Consumers Coalition, Michael Buonaguro (by email)

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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 Kingston Hydro Corporation for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2011.

EVIDENCE UPDATE INTERROGATORIES OF

THE ONTARIO ENERGY BOARD

Kingston Hydro Corporation 2011 Electricity Distribution Rates Application
EB-2010-0136

<u>2011 CAPITAL EXPENDITURE FORECAST</u>

Board Staff Update IR#1

Reference: Evidence Update, Appendix A

The changes outlined in the settlement agreement for 2010 and the response to VECC IR #45 show that a number of 2010 capital projects have changed significantly from the original application to this update. These are:

Princess Street Reconstruction, down from $1,155,000 to $767,438: -$387,562 or 30%.
Transformer Vault 12, down from $403,000 to $207,815: -$195,185 or 48%.
Transformer Vault 10, up from $63,000 to $161,744: +$98,744 or 150%.
Transformer Vault 5, down from $22,000 to $zero.
RFP Structural Eng. Services, down from $20,000 to $zero.
Underground Cable Rebuilds, down from $100,000 to $zero.
Overhead Line Rebuilds, up from $1,015,000 to $1,271,429: +$256,429 or 12%.
Tools and Equipment, up from $115,000 to $154.028: +$39,029 or 34%.

a) What impact do the changes in the 2010 capital expenditures as shown in the response to VECC IR #45 (listed above) and the Settlement Agreement, have on the updated 2011 capital expenditures?

As noted at Exhibit 2, Tab 4, Schedule 8 “Asset Management Planning Process & Strategy”, Kingston Hydro establishes the capital expenditures through a top-down process whereby Kingston Hydro will undertake as many capital projects possible, subject to the following primary limiting factors:

(i) the funds that the Applicant has available through borrowing capacity;
(ii) maintaining an actual debt/equity structure that is consistent with the Board’s deemed debt/equity structure;
(iii) cash flow;
(iv) rate impact on customers. Kingston Hydro has numerous capital projects that it would like to complete immediately, but only sets capital budgets in accordance with these primary limiting factors.

We note that the impact of the revised 2011 capital budget (increased) and the settled 2010 capital budget (decreased) results in the 2011 total rate base being $729,974 lower than originally proposed in the Application.

This was an underlying principle used in increasing the 2011 Capital Expenditures as set out in the February 4, 2011 Updated Evidence, and the Applicant believes has established it with due consideration to reasonable levels from year to year.

Please refer to VECC #46 for clarification on the reconciliation.

b) There are an additional 9 new project categories in the table at response to VECC IR#45 which were not included in the original evidence. Why did this volume of new projects not have a greater impact on the 2011 capital project base, considering the 2011 project list is largely the same as the original filed (besides the updates noted above)?

Most of the additional 2010 projects were completed as a result of urgent requirements. Listed below are the projects that were added in 2010 and what triggered the project/purchase:

- Fairway Hills - Poletrans Replacement project was advanced from the 2011 capital plan, and therefore has been removed from the 2011 Capital Expenditures in the February 4, 2011 Updated Evidence.
- Transformer Vault 37 (TV37) and Transformer Vault 51 (TV51) projects were both triggered by a customer complaint that determined that both of the vaults had serious structural problems as well as leaking transformers that needed to be replaced urgently.
- Benson St. Transformer and Cabling project was driven by an inspection of the vault that determined that one wall was caving in. Immediate work was therefore undertaken to convert it to a pad-mount transformer.
- The Service Truck and Substation WorkVan were purchased but removed as part of the Settlement Agreement.
- Substation Equipment was purchased to replace failing test equipment.
- Radio Equipment was purchased to replace faulty base and portable radios.
- Metering Equipment was analyzing equipment that the Applicant was required to purchase to respond to customer 3-phase power quality complaints, and to determine circuit loading levels.

2011 OM&A FORECAST

Board Staff Update IR#2

Reference: Evidence Update, Appendix B

The update includes an increase in Property Insurance of $25,523 over previous levels, up 20% over the levels in the pre-filed evidence to $156,241. Please provide a detailed rationale for this increase.

The amounts for 2011 Property Insurance in the pre-filed evidence were based on an estimated increase of $5,000 for 2011 over 2010 budgeted insurance costs. Since the time of filing, the Applicant has received its actual insurance assessment for 2011. The total amount owing for 2011 is $156,241.

<u>2011 PILs SCHEDULE 1 ADJUSTMENT for FUTURE BENEFIT LIABILITIES</u>

Board Staff Update IR#3

Reference: Evidence Update, Appendix D & E

Reserves Included in Calculation of Test and Bridge Years Taxable Income Feb 4, 2011 PILs or Income Taxes Work Form; Feb 4, 2011 Appendix E/Letter from KPMG

As per the Feb 4, 2011 PILs or Income Taxes Work Form for the Bridge Year Taxable Income and Test Year Taxable Income, the reserves added to taxable income and deducted from taxable income do not match "Schedule 13 Tax Reserves Bridge". In addition there was no "Schedule 13 Tax Reserves Test" included in the Feb 4, 2011 PILs or Income Taxes Work Form to support the reserves addition to Test Year taxable income. However, this number ties to the Nov 15, 2010 response to Board Staff Interrogatory #44 where a "Schedule 13 Tax Reserves Test" was provided.

Please provide an update to the necessary tables and schedules in the application accordingly.

Please find attached an updated "Schedule 13 Tax Reserves Bridge" and an updated "Schedule 13 Tax Reserves Test" similar to Board Staff interrogatory 44.

PILS OR INCOME TAXES WORK FORM

Name of LDC: Kingston Hydro Corporation
File Number: EB-2010-0136
Rate Year: 2011

Schedule 13 Tax Reserves Bridge

CONTINUITY OF RESERVES

Description	Historic Utility Only	Eliminate Amounts Not Relevant for Bridge Year	Adjusted Utility Balance	Bridge Year Adjustments: Additions	Bridge Year Adjustments: Disposals	Balance for Bridge Year	Change During the Year	Disallowed Expenses
Capital Gains Reserves ss.40(1)	0		0			0	0	
Tax Reserves Not Deducted for accounting purposes								
Reserve for doubtful accounts ss. 20(1)(l)	0		0			0	0	
Reserve for goods and services not delivered ss. 20(1)(m)	0		0			0	0	
Reserve for unpaid amounts ss. 20(1)(n)	0		0			0	0	
Debt & Share Issue Expenses ss. 20(1)(e)	0		0			0	0	
Other tax reserves	0		0			0	0	
	0		0			0	0	
	0		0			0	0	
Total	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Financial Statement Reserves (not deductible for Tax Purposes)								
General Reserve for Inventory Obsolescence (non-specific)	0		0			0	0	
General reserve for bad debts	0		0			0	0	
Accrued Employee Future Benefits:	0		0			0	0	
- Medical and Life Insurance	1,006,338		1,006,338	79,449		1,085,787	79,449	
-Short & Long-term Disability	0		0			0	0	
-Accmulated Sick Leave	0		0			0	0	
- Termination Cost	0		0			0	0	
- Other Post-Employment Benefits	168,549		168,549			168,549	0	
Provision for Environmental Costs	0		0			0	0	
Restructuring Costs	0		0			0	0	
Accrued Contingent Litigation Costs	0		0			0	0	
Accrued Self-Insurance Costs	0		0			0	0	
Other Contingent Liabilities	0		0			0	0	
Bonuses Accrued and Not Paid Within 180 Days of Year-End ss. 78(4)	0		0			0	0	
Unpaid Amounts to Related Person and Not Paid Within 3 Taxation Years ss. 78(1)	0		0			0	0	
Other	0		0			0	0	
	0		0			0	0	
	0		0			0	0	
Total	**1,174,887**	**0**	**1,174,887**	**79,449**	**0**	**1,254,336**	**79,449**	**0**

PILS OR INCOME TAXES WORK FORM

Name of LDC: Kingston Hydro Corporation
File Number: EB-2010-0136
Rate Year: 2011

Schedule 13 Tax Reserves Test

CONTINUITY OF RESERVES

Description	Balance for Bridge Year	Eliminate Amounts Not Relevant for Test Year	Adjusted Utility Balance	Test Year Adjustments: Additions	Test Year Adjustments: Disposals	Balance for Test Year	Change During the Year	Disallowed Expenses
Capital Gains Reserves ss.40(1)	0		0			0	0	
Tax Reserves Not Deducted for accounting purposes								
Reserve for doubtful accounts ss. 20(1)(l)	0		0			0	0	
Reserve for goods and services not delivered ss. 20(1)(m)	0		0			0	0	
Reserve for unpaid amounts ss. 20(1)(n)	0		0			0	0	
Debt & Share Issue Expenses ss. 20(1)(e)	0		0			0	0	
Other tax reserves	0		0			0	0	
	0		0			0	0	
	0		0			0	0	
Total	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Financial Statement Reserves (not deductible for Tax Purposes)								
General Reserve for Inventory Obsolescence (non-specific)	0		0			0	0	
General reserve for bad debts	0		0			0	0	
Accrued Employee Future Benefits:	0		0			0	0	
- Medical and Life Insurance	1,085,787		1,085,787	290,099		1,375,886	290,099	
-Short & Long-term Disability	0		0			0	0	
-Accmulated Sick Leave	0		0			0	0	
- Termination Cost	0		0			0	0	
- Other Post-Employment Benefits	168,549		168,549			168,549	0	
Provision for Environmental Costs	0		0			0	0	
Restructuring Costs	0		0			0	0	
Accrued Contingent Litigation Costs	0		0			0	0	
Accrued Self-Insurance Costs	0		0			0	0	
Other Contingent Liabilities	0		0			0	0	
Bonuses Accrued and Not Paid Within 180 Days of Year-End ss. 78(4)	0		0			0	0	
Unpaid Amounts to Related Person and Not Paid Within 3 Taxation Years ss. 78(1)	0		0			0	0	
Other	0		0			0	0	
	0		0			0	0	
	0		0			0	0	
Total	**1,254,336**	**0**	**1,254,336**	**290,099**	**0**	**1,544,435**	**290,099**	**0**

Board Staff Update IR#4
Reference: Evidence Update, Appendix D & E

Reserves Included in Calculation of Test and Bridge Years Taxable Income Feb 4, 2011 PILs or Income Taxes Work Form; Feb 4, 2011 Appendix E/Letter from KPMG

With regard to Issue 7 of the EB-2008-0381 Settlement Agreement filed September 30, 2010, and accepted by the Board December 23, 2010. Complete settlement was reached on this issue as follows:

> ***"The Parties agree that the Board's methodology in place at the relevant times was that the liability for the post employment benefit obligations should be shown in the records of the company that directly employs the people and issues the federal government Statement of Remuneration Paid (T4s). The movement in this liability can be used in the SIMPIL true-up methodology only if the people are directly employed by the regulated distributor and the distributor issues the T4s for these people. Any post-employment benefit liabilities for staff employed by service companies, or other affiliated or associated non-regulated companies, would not be used in the distributor's SIMPIL reconciliations."***

As agreed in Issue #7 of EB-2008-0381, regulatory tax principles state that the liability and future obligation for post-employment benefits should sit on the books of the company that directly employs the people and issues the federal government Statement of Remuneration Paid (T4s). The movement in this liability or obligation can be used in the PILs provision calculation only if the people are directly employed by the regulated distributor and the distributor issues the T4s for these people. Any post-employment benefit liabilities or obligations for staff employed by service companies, or other affiliated or associated non-regulated companies, would not be used in the distributor's calculation of the PILs provision.

Kingston Hydro confirmed in the response to Supplementary Board Staff Interrogatory #9 that for the historic, bridge, and test years 2009 through 2011 that the number of full time employees actually directly employed or forecasted to be directly employed by Kingston Hydro, is zero. Kingston Hydro also confirmed in the response to the same interrogatory that for 2009, the number of full time employees for which Kingston Hydro issued the T4s is zero.

As per the Feb 4, 2011 PILs or Income Taxes Work Form, for the calculation of the 2011 test

year PILs provision, $1,544,435 of post-employment benefit reserves (end of year reserves) was included as an addition to book to tax adjustments and $1,254,336 (beginning of year reserves) of post-employment benefit reserves was included as a deduction to book to tax adjustments.

a) Please state why the Board should depart from regulatory tax principles, as articulated in EB-2008-0381, and permit the addition and deduction of post-employment benefit reserves in book to tax adjustments in the 2011 test year PILs provision, in light of these facts:

I. Kingston Hydro has zero full time employees actually directly employed or forecasted to be directly employed by Kingston Hydro

II. the number of full time employees for which Kingston Hydro issued T4s is zero for the tax year 2009.

The regulatory tax principles state that the liability and future obligation for post-employment benefits should sit on the books of the company that directly employs the people and issues the T4s. The movement in this liability or obligation can be used in the PILs provision calculation only if the people are directly employed by the regulated distributor and the distributor issues the T4s for these people. Any post-employment benefit liabilities or obligations for staff employed by service companies, or other affiliated or associated non-regulated companies, would not be used in the distributor's calculation of the PILs provision.

The Applicant wishes to note that based on the information contained in the Settlement Agreement (the "Settlement Agreement") in Board file No. EB-2008-0381, the agreement obtained with respect to issue no. 7, does not appear to adversely impact any of the parties involved in the settlement. The Settlement Agreement states "Barrie and Halton Hills did not pay for personnel services provided by an affiliated service company during the period 2001 to 2005. The OPEB liability on the balance sheets of Barrie and Halton Hills relate to the people who were directly employed by these distributors. EnWin directly employed the staff to which the OPEB liability relates." Since none of the parties in EB-2008-0381 were virtual utilities, the interests of virtual utilities in regard to issue no. 7 were not canvassed. As such, while the settlement on issue no. 7 may be the general rule regarding post-employment benefit liabilities, an exception should be recognized by the Board for virtual utilities.

In its Decision, the Board stated that the particular Settlement Agreement filed in that proceeding is not binding on any party but the parties to the Settlement Agreement.
Kingston Hydro notes that the Settlement Agreement noted that "The Parties further agree that this Agreement does not purport to be binding or enforceable with respect to any person, whether regulated entity or otherwise, that is not a party hereto, including without limitation any member of the Coalition of Large Distributors or the Electrical Distributors Association."

Further, the Settlement Agreement notes that "It is agreed that this Settlement Agreement is without prejudice to any of the Parties reexamining these issues in any subsequent proceeding and taking positions inconsistent with the resolution of these issues in this Settlement Agreement, and distributors other than the Applicants are not bound by the positions stated herein."

Based on the preceding paragraphs, Kingston Hydro maintains that the Settlement Agreement and subsequent Decision that was arrived at in this proceeding is not binding on Kingston Hydro in its rates proceeding, that the parties themselves reserve the right to reexamine any issues in a subsequent proceeding, and did not contemplate the unique circumstances of virtual utilities.

The Settlement Agreement also states "The Parties agree that the Board's methodology in place at the relevant times was that the liability for the post employment benefit obligations should be shown in the records of the company that directly employs the people and issues the federal government Statement of Remuneration Paid (T4s)."

The liability for post employment benefits does in fact show as a liability on the financial statements of Kingston Hydro's affiliate company, Utilities Kingston, as illustrated in Board Staff Second Round Interrogatory 9. However, there is also a corresponding receivable shown on Utilities Kingston's financial statements from Kingston Hydro for this liability. Because of this fact, the taxation records of Utilities Kingston does not show any add-back on its Schedule 1 as the receivable and payable are offset.

The actual expenses for this liability ultimately end up as expenses of Kingston Hydro and the tax effect of these expenses, in our view, should correspond to the Corporation that is incurring the expenses, which is Kingston Hydro. Kingston Hydro has been informed by its tax advisor, that Kingston Hydro is required to adjust its taxable income for the effect of the change in its liability in accordance with a specific provision of the *Income Tax Act* (Canada). Therefore, Kingston Hydro's actual PILs liability is affected by this required adjustment.

The Applicant would like to point out that the following statement was also made in the Settlement Agreement, "The general principle that was part of the Board's methodology at the relevant times was that tax liabilities included in the distributor's return should be included in the PILs calculation." Based on the above principle, Kingston Hydro's true tax liabilities should be and have been included its PILs calculation. In the Applicant's view, any deviation from the above methodology would be inconsistent with the principles of ratemaking and the Board's methodology.

Further, in its filing instructions for final recovery of regulatory assets for the May 1, 2006 electricity distribution rate adjustments issued June 16, 2005, the Board confirmed that there is "utility specific variability in the calculation of PILs."

Based on the above comments, Kingston Hydro maintains that it is appropriate to include the adjustment in the calculation of its PILs liability.

b) Please confirm that the number of full time employees for which Kingston Hydro issued T4s is zero for the tax year 2010. If this is not the case, please provide the relevant number.

Confirmed.

c) Regarding the Feb 4, 2011 Appendix E/Letter from KPMG, regarding the "Tax Treatment for PILs – Future Benefit Liabilities", please explain how this letter is relevant to regulatory tax principles, as articulated in EB-2008-0381.

The regulatory tax principles state that the liability and future obligation for post-employment benefits should sit on the books of the company that directly employs the people and issues the T4s. The movement in this liability or obligation can be used in the PILs provision calculation only if the people are directly employed by the regulated distributor and the distributor issues the T4s for these people. Any post-employment benefit liabilities or obligations for staff employed by service companies, or other affiliated or associated non-regulated companies, would not be used in the distributor's calculation of the PILs provision.

As articulated in the applicant's response to part a) of Board Staff Update IR#4, the Applicant believes that the above-noted regulatory tax principles referred to are part of a particular Settlement Agreement filed in Board file No. EB-2008-0381 is not binding on any party but the parties to the Settlement Agreement.

Kingston Hydro agrees that the regulatory tax principles state "The general principle that was part of the Board's methodology at the relevant times was that tax liabilities included in the distributor's return should be included in the PILs calculation." Therefore the letter from KPMG is relevant because it is providing Kingston Hydro with information on how to properly calculate the Applicant's PILs in order for the Applicant to comply with the above-noted principle.

d) As per the response to Supplementary Board Staff Interrogatory #9, the burden rate charged by Utilities Kingston to Kingston Hydro does not include a component for post-employment benefits. However, Kingston Hydro also stated in the response to the same interrogatory that Kingston Hydro is obligated to pay Utilities Kingston for these benefits under the terms of the UK/KH agreement.

I. Does Kingston Hydro agree that these are two contradictory responses? I.e. the burden rate charged by Utilities Kingston to Kingston Hydro does not include a component for post-employment benefits, so how is Kingston Hydro obligated to pay Utilities Kingston for these benefits? Please provide a full explanation.

Kingston Hydro does not agree that these are two contradictory responses. The burden rate charged by Utilities Kingston to Kingston Hydro does not include a component for post-employment benefits. The post employment benefits is charged at the end of each year based on the information detailed in response to Board Staff Second Round Interrogatory # 9. Both of these charges to Kingston Hydro are made pursuant to the Kingston Hydro/Utilities Kingston management agreement which was filed in the pre-filed evidence at Exhibit 1 Tab 2 Schedule 3 Attachment 3.

II. Does Kingston Hydro agree that if Kingston Hydro hired a third party contractor to provide services, rather than Utilities Kingston, Kingston Hydro would not accrue a liability or future obligation for post-employment benefits? Does Kingston Hydro agree that instead it would be part of the burden rate in the price for the labour billed to Kingston Hydro? Please provide a full explanation.

Kingston Hydro cannot comment on what a third party contractor may or may not include in their proposed charges to Kingston Hydro for utility services. Kingston Hydro and the third party contractor would likely negotiate the terms and conditions of the particular service agreement.

Kingston Hydro does agree that if the employees of Utilities Kingston were transferred to Kingston Hydro that it would have a similar affect on the Applicant's PILs as per the cost of service application submitted. This is because the liability would be recorded only on Kingston Hydro's books instead of the liability being flowed through Utilities Kingston as the service company. The resulting tax effect would be identical to the PILs return submitted.