Kingston Hydro

March 11, 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 Revised Submission in Chief of the Applicant**

Please find attached a Revised Submission in Chief of the Applicant, Kingston Hydro Corporation. We respectfully ask that the version filed yesterday, be replaced with this version filed today.

The foregoing has also been filed electronically through the Board's RESS filing system and emailed to intervenors of record.

Respectfully submitted,

J.A. Keech, President and 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)

P.O. Box 790 Kingston, Ontario Canada K7L 4X7 **p.** 613.546.1181 www.kingstonhydro.com

**ONTARIO ENERGY BOARD**

**IN THE MATTER OF** The *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Sched. B)

**AND IN THE MATTER OF** an application by Kingston Hydro Corporation for an Order or Orders pursuant to section 78 of the *Ontario Energy Board Act, 1998* approving or fixing just and reasonable rates and other service charges for the distribution of electricity and related matters.

**SUBMISSION IN CHIEF OF THE APPLICANT**

**Kingston Hydro Corporation**

## INTRODUCTION

On August 24, 2010 Kingston Hydro Corporation ("Kingston Hydro" or the "Applicant") submitted an application to the Ontario Energy Board (the "Board") pursuant to Section 78 of the *Ontario Energy Board Act, 1998*, as amended, (the "Act") for approval of its proposed electricity distribution rates and other charges for the rate year commencing May 1, 2011 (the "Application").

On October 12, 2010 the Board issued Procedural Order No. 1. The Procedural Order identified Energy Probe Research Foundation ("Energy Probe"), the School Energy Coalition ("SEC") and the Vulnerable Energy Consumers Coalition ("VECC") as having been granted intervenor status. Procedural Order No. 1 also provided for two rounds of interrogatories, the first concluding with responses from the Applicant on November 15, 2010 and the second round concluding with responses from the Applicant on December 7, 2010.

Kingston Hydro and three intervenors participated in a settlement conference on December 14th and 15th which concluded with the filing of a partial settlement proposal with the Board on January 12, 2011. All but seven issues were agreed to and accepted by the Board. The remaining seven issues were set out in Procedural Order No. 2 as follows:

1. Is it appropriate to use the half-year rule for depreciation for the years 2005-2010 as proposed by Kingston Hydro in its application?

2. Should the cost of power estimate for the determination of working capital allowance be based on the most current values (November, 2010 to October, 2011) as proposed by Kingston Hydro in the application, or the most current projected values (May, 2011 to April, 2012)?

3. Are the 2011 capital expenditures proposed by Kingston Hydro in the application appropriate?

4. Is the proposed interest income earned on funds held in the City of Kingston's bank account appropriate as proposed by the Kingston Hydro in the application?

5. Are the 2011 Operating, Maintenance and Administrative (OM&A) expenses as proposed by Kingston Hydro in the application appropriate?

6. Is the PILs Schedule 1 adjustment for future benefit liabilities as proposed by Kingston Hydro in the application appropriate?

7. Is the interest rate of 7.25% for the long-term debt instrument held by the City of Kingston as proposed by Kingston Hydro in the application appropriate for the purpose of setting rates?

A third round of interrogatories was concluded on February 18, 2011, based on updated evidence filed by Kingston Hydro on February 4, 2011 (the "Updated Evidence").

A panel of four witnesses appeared before the Board at an oral hearing on February 28, 2011.

Kingston Hydro agreed to twelve undertakings which were filed with the Board on March 3, 2011.

**SUMMARY OF UPDATED APPLICATION**

Kingston Hydro is seeking approval of the following for the 2011 Test Year:

- a May 1, 2011 implementation date;
- a total service revenue requirement of $12,743,052, (adjusted for the updated Cost of capital parameters issued March 3, 2011, the removal of the $26,138 in late payment penalty costs and the change in the power supply expenses for the updated October 1, 2010 commodity prices);
- OM&A expenses of $6,927,503; and
- Capital Expenditures of $5,433,500.

**THE UNSETTLED ISSUES:**

Kingston Hydro's submissions in chief for each unsettled issue are set out below.

1. ***Is it appropriate to use the half-year rule for depreciation for the years 2005-2010 as proposed by Kingston Hydro in its application?***

   Kingston Hydro submits that the half-year rule was appropriately applied for the years 2005-2011 for rate making purposes in accordance with Board instructions. Specifically, the Board's Filing Requirements for Transmission and Distribution Applications (the "Filing Requirements") provide:

   > "In particular, the Board's general policy for electricity distribution rate setting is that capital additions would normally attract six months (i.e. half-year) of depreciation expense in the year that they enter service. The applicant should identify its historical practice and its proposal for the test year. Variances from this "half-year" rule must be documented with supporting rationale." [Section 2.5.7]

   Kingston Hydro submits that this issue has already recently been considered by the Board in the Renfrew Hydro (EB-2009-0146) and Ottawa River Power (EB-2009-0165) decisions. In both of those decisions, the Board found that the application of the half-year rule historically was appropriate.

   As a result of the filing requirements and the above-referenced decisions, Kingston Hydro maintains its calculations of net fixed assets and resulting rate base are appropriate for rate-making purposes.

2. ***Should the cost of power estimate for the determination of working capital allowance be based on the most current values (November, 2010 to October, 2011) as proposed by Kingston Hydro in the application, or the most current projected values (May, 2011 to April, 2012)?***

   Section 2.3.4 Allowance for Working Capital of the Filing requirements states:

   > "The applicant should provide this calculation in table format showing all accounts and amounts included in the controllable expenses component as well as the cost of power and all individual rates and purchase levels used in its calculation. Cost of power rate estimates (i.e. RPP and non-RPP and transmission rates) should be identified."

   Kingston Hydro in its original submission used the cost of power estimates that were issued by the Board on April 15, 2010, as that was the most recent Board approved RPP rates report.

This was subsequently updated in response to Interrogatory 13 from Energy Probe to use the RPP calculation from the report issued by the Board on October 18, 2010.

It is Kingston Hydro understanding that the RPP calculation that is approved by the Board uses the Hourly energy price forecast for the 12 months from the implementation date of the new RPP rates, that is, typically April 1 and November 1. This is supported by the press release accompanying the latest RPP report issued by the Board on October 18 where it states:

> "RPP prices are based on a 12-month forecast and are designed to provide stable and predictable electricity pricing ..."

Therefore, it is our understanding that the 12 months November 1, 2010 to October 31, 2011 were used in the most recent calculation of RPP and non-RPP pricing. Projections for the six months beyond November 1, 2010 to April 30, 2011 are very likely to be subject to change.

In addition, the calculation of the RPP requires an estimate of the Global Adjustment in order to complete the calculation. The Global Adjustment does not appear to be forecast beyond this RPP period. Due to the design of the Global Adjustment, the Global Adjustment value tends to increase as Hourly energy prices decrease.

Therefore Kingston Hydro is of the view that the most recent in-effect 12 month projections that are used in the RPP calculation are the most accurate numbers to use in the calculation of cost of power and subsequently the calculation for working capital.

***3. Are the 2011 capital expenditures proposed by Kingston Hydro in the application appropriate?***

Kingston Hydro is requesting approval for Capital Expenditures during 2011 of $5,433,500. Exhibit 2, Tab 4, Schedule 7 of the Application provides details of the capital projects, while Appendix A of the Updated Evidence has the details for the single additional capital project. Table 1 of Appendix A lists the capital projects and is reproduced below.

**Table 1: 2011 Forecast Capital Project Expenditures (Revised February 4, 2011)**

| Project | Value |
|---|---|
| Substation No.11 Circuit Breakers | $584,000 |
| Substation No.12 Relays | $100,000 |
| Substation No.8 Transformer | $453,000 |
| Substation No.9 Protection Upgrades | $40,000 |
| Substation No.5 Relays | $39,000 |
| Transformer Vault 7 (TV7) | $112,000 |
| Transformer Vault 41 (TV41) | $230,000 |
| Transformer Vault 18 (TV18) | $50,000 |
| Westdale | $171,000 |
| Motorized 44kV Disconnect | $55,000 |
| Alfred Street | $549,000 |
| Annual Substation Battery Replacement | $60,000 |
| Annual Overhead & Underground Services | $60,000 |
| Annual Underground Cable Rebuilds | $200,000 |
| Annual Overhead Line Rebuilds | $1,300,000 |
| Annual RFP for Structural Engineering Services | $20,000 |
| SCADA | $127,000 |
| Meters | $100,000 |
| Tools & Equipment | $153,000 |
| Substation No.3 Circuit Breakers | $968,000 |
| Enterprise Asset Management System Implementation | $62,500 |
| **Total** | **$5,433,500** |

Parties may argue that an increase in the 2011 capital budget representing a 69% increase from the 2010 level, a 17% increase from the highest level (in 2009) and a 31% increase above the average of the three highest years since 2005 is an unreasonable level and it does not ensure smooth ratemaking. Kingston Hydro will of course respond to the Parties' particular submissions when received, but for now Kingston Hydro makes the following submissions.

Kingston Hydro's forecast 2011 capital additions are indeed 69% higher than its 2010 capital additions. Kingston Hydro submits that such comparison is too simplistic and misleading if not placed in the right context. Capital expenditures in 2010 were artificially low, caused by the circumstances surrounding the capital contribution to Hydro One. As discussed in the oral hearing [transcript page 35, lines 26+], 2010 capital expenditures were at a low level because instead of owing Hydro One $609,000 for the Gardiners TS, Kingston Hydro has received a refund of approximately $121,000. Had Hydro One provided Kingston Hydro with the information that it would be receiving a $121,000 refund in 2010, instead of a $609,000 capital contribution cost, Kingston Hydro would have spent the $609,000 budgeted cost and the $121,000 refund in 2010 on other projects. This would have increased the 2010 capital additions from $3,215,000 to $3,945,000. Further, Kingston Hydro would not have been able to increase its 2011 capital additions by the $609,000 and $121,000 as it did, which would have reduced the $5,433,500 capital additions to $4,703,500. Therefore, had Hydro One provided Kingston Hydro with the correct information in 2010, Kingston Hydro's variance in capital additions from 2010 to 2011 would have been approximately $778,000, or 20%. Kingston Hydro submits that this variance is more appropriate for consideration than the 69% variance, since Hydro One's actions should not impact Kingston Hydro's Board-approved 2011 capital budget. As well, by correcting for Hydro One's inaccurate estimate, capital expenditures in the Test Year would have been 1% higher than the highest year of 2009 instead of 17% as suggested by Energy Probe; and capital expenditures in the Test Year would have been approximately 8% higher than the average of the 3 highest years (2007, 2009, and 2010) instead of 31% as suggested by Energy Probe.

| | **Original Budget ($)** | **After Hydro One Correction ($)** |
|---|---|---|
| 2005 | 2,202,712 | 2,202,712 |
| 2006 | 2,673,516 | 2,673,516 |
| 2007 | 4,513,916 | 4,513,916 |
| 2008 | 2,519,141 | 2,519,141 |
| 2009 | 4,648,288 | 4,648,288 |
| 2010 | 3,215,000 | 3,935,000 |
| 2011 | 5,433,500 | 4,703,500 |

With respect to the 2011 level compared to previous years, again this must be placed in the right context. Section 2.1.1 of the Application and throughout the oral testimony provide a historical context on how past emphasis on keeping rates low has resulted in years of underfunding of capital reinvestment in the distribution system. This historic underfunding has resulted in lower rates, but has also taken a toll on the operational integrity of the distribution system.

Some examples of the underfunding are set out in Exhibit 2, Tab 4, Section 7 where:

- On page 2, details are provided attesting that over 2,900 of the wood distribution poles (i.e. 46% of the total) are over 50 years old;
- On pages 14, 17, 27, 56, 57, 65 and 66, photos provide evidence of needed investment in the underground distribution system.

This historic underfunding, along with a culmination of events in the latter part of the 1990's, have produced a rate base not capable of sustaining the investment in infrastructure on a go-forward basis to ensure public and employee safety and system reliability are at an acceptable level.

As noted in Exhibit 2, Tab 1, Schedule 1, and as testified at the oral hearing [transcript page 11, lines 23+], historically the focus for Kingston Hydro was to keep rates low, hook up new customers and then use any leftover funds for infrastructure improvements. This Cost of Service Rate Application is an attempt to address the problems brought about by the run-to-end-of-life, run-to-failure, "don't fix it if it isn't broken" philosophy.

Kingston Hydro agrees that rate smoothing should be a consideration in rate setting. However, there are many considerations that enter the rate making process. Rate smoothing is only one consideration. Its relative weight should be determined by the other considerations that also come in play. The circumstances of this case are such that there are many other considerations that should be viewed to be of critical importance. Rate smoothing should not jeopardize the operational integrity of Kingston Hydro's distribution system and the health and safety risks for its customers and employees. Moreover, the impact of capital additions in the determination of revenue requirement and rates is only fractional. A one dollar increase in capital expenditures translates to an increase of approximately seven cents to the revenue requirement. This is not to say that the level of capital expenditures should not matter. Rather, it is submitted that, again, the rate smoothing considerations arising from capital expenditures must be placed in the proper context regarding rate impact.

Parties may oppose the inclusion of the Substation No. 3 project in 2011 because it was not included in the original 2011 capital addition forecast. As Kingston Hydro explained [for example, Transcript Page 12] the utility's approach on capital projects is a top-down approach, in that our projects are selected on the basis of the availability of funds. Now that more funds have become available, Kingston Hydro submits that it is appropriate to undertake this project now, as this would be consistent with its changed philosophy of being proactive rather than reactive in restoring its distribution system to an acceptable operational level. To be clear, the Substation No.3 project did not come out of the blue. It was identified in Board Staff Interrogatory #31 in which Kingston Hydro was asked what project would be undertaken if more funds were available. The Substation No. 3 was identified at that point. Further, just because the Substation No. 3 project was originally deferred due to lack of funding does not mean that it is not needed in 2011. As explained in the oral hearing [Transcript Page 123, Lines 10-13], just because a project is delayed does not mean that it is not urgent.

Finally in this area, Kingston Hydro indicated that its analysis indicates that its rate base at the end of 2010 is about half compared to another LDC of similar size (Oral Hearing Transcript, Page 14). This testimony was not challenged by any of the parties in cross examination.

4. ***Is the proposed interest income earned on funds held in the City of Kingston's bank account appropriate as proposed by the Kingston Hydro in the application?***

As set out in Appendix B of Kingston Hydro's Updated Evidence, Kingston Hydro has proposed, as a revenue offset, an amount of $75,321 that it earns on funds that are held on deposit, in the City of Kingston's bank account. This amount is based on a 1.35% interest rate and a projected 2011 average balance of $5,579,323. The Applicant has an arrangement with the City whereby the funds held by the City for Kingston Hydro to pay Kingston Hydro expenses earn the same preferential rate of interest as the City earns from its bank.

Kingston Hydro believes that the 1.35% interest rate used to calculate the revenue offset (Prime less 1.65%) is a sufficient and more than reasonable rate of interest for funds in a bank account. These funds are needed in the bank account to pay Kingston Hydro's next month's expenses. As noted in the Oral Hearing [Transcript Page 43], Kingston Hydro's December, 2010 IESO bill due January, 17, 2011 was $6.2 million. In addition, approximately $500,000 of operating expenses are due in January, 2011. With approximately $6.7 million of invoices due in mid-January, Kingston Hydro believes that $5.5 million is a reasonable amount of funds to have on hand to meet that commitment.

In summary, the Applicant believes it has included a reasonable amount as a revenue offset for interest income for its funds that are in its bank account.

5. ***Are the 2011 Operating, Maintenance and Administrative (OM&A) expenses as proposed by Kingston Hydro in the application appropriate?***

The proposed "controllable" OM&A expenses level for 2011 is $6,927,503, plus $130,000 for account 6105 - taxes other than income taxes. The components are found in Exhibit 4 of the Application, Appendix B of the Updated Evidence and page 2 of the Oral Hearing Transcript and are reproduced below.

| | |
|---|---|
| Operation | $ 2,627,053 |
| Maintenance | 1,093,763 |
| Administrative Expenses | 3,206,687 |
| Total OM&A | $ 6,927,503 |
| Taxes Other Than Income Taxes | 130,000 |
| **TOTAL** | $ 7,057,503 |

Kingston Hydro will respond to the Parties' particular submissions when received, but for now, Kingston Hydro makes the following submissions.

Parties may argue that the average "controllable" OM&A increase from 2006 through 2010 is high when compared to the Ontario inflation rate over this period. To clarify the record, at page 49 of the transcript, there was a discussion between Mr. Aiken and Mr. Joyce, in which Mr. Joyce agreed that the information contained in the OM&A Expenses table at the top of page 19 of the Energy Probe's compendium (Exhibit K1.1) was correct, subject to check [at line 9]. Kingston Hydro has checked the information and wish to correct some discrepancies. The discussion focussed on the 8.5% average annual OM&A variance from 2006 to 2010, relative to the 1.7% average annual inflation rate during the same period. Kingston Hydro submits that its average annual OM&A variance from 2006 to 2010 is not 8.5% as indicated in the table. Rather, the average annual OM&A variance from 2006 to 2010 is 6.9% [(3.8% + 8.4% + 1.4% + 14%)/4 = 6.9%]. As well, the 1.7% average annual inflation rate in the table includes 2011 inflation, while the comparison was 2006 to 2010. Further, the 2008 through 2010 Ontario inflation rates used in the table were 1.5%, 1.2% and 2.0%. However, according to Statistics Canada, the 2008 through 2010 Ontario inflation rates were 2.3%, 0.4% and 2.5% respectively, resulting in an average annual inflation rate from 2006 to 2010 of 1.75%. As such, the difference between the 2006 to 2010 average annual OM&A variance relative to the 2006 to 2010 average annual inflation rate is not as pronounced as suggested by Energy Probe, nor is the 2006 to 2010 average annual OM&A variance "five times" the average annual inflation rate during that same period as suggested by Energy Probe[Transcript Page 49, Lines 16-18].

In any event, comparing OM&A increases to increases in inflation is not determinative of the reasonableness of OM&A expenses for the year. Kingston Hydro is not aware of Board Decisions on cost of service reviews where the inflation rate was used as the determinative factor. This would resemble an IRM review. Kinston Hydro submits that the Board approved OM&A level should be based on the evidence adduced in support of the requested level.

In this regard, a parallel context can be drawn to that made regarding capital. Low rates and underfunding have impacted these areas as well, also impacting system reliability and safety. Similar to capital this cost of service rate application is seen as the first opportunity to correct this problem.

The proposed increases in OM&A expenses are linked to capital expenditures, and they are largely driven by the need to hire workers. This need is driven by a combination of preparing for upcoming retirements, returning staffing levels in the technical trades to what existed, striving to be proactive in Kingston Hydro's operating and maintenance practices, and addressing the requirements of other regulatory bodies impacting our industry to a level beyond that which has been historically the case.

In addition, the expectations of customers in regard to the timeliness and availability of information has increased dramatically. This covers a number of issues from the traditional technical questions regarding equipment placement and service interruptions, to changes impacting our industry as a result of legislative changes and provincial programs. As noted during the oral hearing [Transcript Page 165, Line 20], the expectations from Kingston Hydro's customers utilizing social media are that they now expect updates to such items (i.e. power outages, construction schedules) almost on a real-time basis.

Kingston Hydro's growth in staff levels are mainly in the technical service areas, not what may be considered as “soft” areas. Kingston Hydro's operating and maintenance practices have, historically, primarily been reactive. Though this practice has kept rates quite low, it introduced higher levels of risks and problems, as was recently demonstrated in September 2010, when maintenance activities undertaken at Substation No.3 uncovered that 8 out of a total of 11 circuit breakers would fail to operate properly during a fault occurrence, [response to Energy Probe Interrogatory #52]. That failure could have led to public and worker injury, but was prevented through Kingston Hydro's proactive maintenance work. This reinforces the Applicant's requirement that staffing be at a level that can sustain the infrastructure in a reasonable state and in accordance with accepted industry standards and codes.

Trades and technical staff require an overlap to facilitate a reasonable transfer of knowledge and skills, and years to gain their proficiencies. With the requirement to bring the current staffing levels in the trades area back up closer to what they were five years ago, and with the large number of trade staff retirements that are anticipated to occur over the next few years, Kingston Hydro cannot risk having those hires delayed any further. Competent staff are necessary to allow the much needed capital and maintenance work to be undertaken, and to ensure that emergency operational needs are met.

Failure to appreciate the importance of ensuring that there are adequate levels of proficient staff is risking the safety of both employees and the public. The increased influence that other regulatory bodies are having on Kingston Hydro's operations is reflective of that same recognition, and the Applicant is wholly cognizant of its responsibilities to satisfy the new standards, codes and expectations.

Kingston Hydro cannot overemphasize that the additional staff in these technical areas are both necessary and prudent for implementing and maintaining the much needed renewal, not just today but over the next four years before the Applicant has its next opportunity for rebasing.

Parties may argue the proposed increase of 13 FTEs is too high and they may attempt to demonstrate that by growth patterns in recent years. This kind of analysis would miss the testimony given by the Applicant that the number of employees was artificially low. As Mr. Keech noted during the oral hearing (Transcript, Page 10),

> Immediately following amalgamation, we went into the changes that have affected our electric industry, with the White Paper of the Energy Competition Act, and in Kingston, as I think probably in a number of other communities, there was thought given to the possible sale of the electric utility.
>
> And the direction that we got at that time from our political leaders, that if there was going to be a sale, they wanted the impact on staff to be at a minimum. What I mean by that is, if a sale happened, they wanted staff levels to be kept to a minimum so there would be less staff affected.
>
> So, as a result of that, we made our best efforts to keep staffing levels and expenses to a minimum, and what that resulted in, the point I am trying to get to here, is that in 1999, the year of our initial unbundling, the year that we initially set our rates as a corporation, our operating expenses were the lowest level that they had been since 1990, and this was an artificially low operating expense.

Or, Parties may argue the proposed OM&A increase in 2011 is too high and they may attempt to demonstrate that by growth patterns in recent years. This kind of analysis would again miss the facts. As noted in the Application at Exhibit 4, Tab 1 Schedule page 3, and again in the response to Energy Probe Interrogatory 19 (b), Kingston Hydro has traditionally ranked very low in operating expenses per customer amongst its cohorts. From 2006 to 2009, Kingston Hydro was consistently ranked near the bottom of OM&A expense per customer. In 2009, the last year published data is available, Kingston Hydro's OM&A expense per customer was $197, 11% lower than the average of its cohorts of $221. In fact, Kingston Hydro was $112 per customer lower than the highest ranking cohort of $309 per customer. Over the period 2006 through 2009, Kingston Hydro's OM&A expense per customer was $24 to $37 lower than the average of its cohorts. This further illustrates the historic under spending on operating expenses and the need for Kingston Hydro to increase its operating and maintenance activities.

***6. Is the PILs Schedule 1 adjustment for future benefit liabilities as proposed by Kingston Hydro in the application appropriate?***

Kingston Hydro is proposing to add back the ending balance of its future benefit liability of $1,544,435 and subtracting the beginning balance of its future benefit liability of $1,254,336 when calculating its taxable income. The adjustment is made because these liabilities are only deductible for tax purposes when actually paid and not when accrued as required by Generally Accepted Accounting Principles. The Applicant's tax advisor, KPMG, has confirmed this tax treatment and has instructed the Applicant that these liabilities are not deductible. Please refer to Appendix E of Kingston Hydro's Evidence Update for a copy of this letter.

These liabilities are in fact liabilities of Kingston Hydro as they are responsible for these expenses and liabilities in accordance with the Service Level Agreement provided at Exhibit 1, Tab 2, Schedule 3 Attachment 3. These annual expenses and resulting liabilities have been recorded in the audited financial statements for years.

As stated in Kingston Hydro's response to Board Staff Update IR#4, the Settlement Agreement (the "Settlement Agreement") in Board file No. EB-2008-0381, none of the parties in EB-2008-0381 were virtual utilities, so 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. The Settlement Agreement notes that "It is agreed that this Settlement Agreement is without prejudice to any of the Parties re-examining 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."

Also, as stated in the response to Board Staff Update IR#4, 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." Kingston Hydro maintains that its Schedule 1 adjustment for future benefit liabilities alters it tax liability and the resultant full actual liability should be recognized in 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. The Board has recognized in the past that there is "utility specific variability in the calculation of PILs" Kingston Hydro agrees with the Board on this statement as Kingston Hydro is a distributor that does in fact have utility specific variability in calculating its PILs liability.

Kingston Hydro believes that it is not appropriate to apply the same principle to its rate case as the facts are different and needs to be reconsidered as part of its rate application to allow for the adjustment as filed by the Applicant.

7. ***Is the interest rate of 7.25% for the long-term debt instrument held by the City of Kingston as proposed by Kingston Hydro in the application appropriate for the purpose of setting rates?***

Kingston Hydro has in its current rates and in its 2011 cost of service application, embedded shareholder debt at a rate of 7.25%. This rate has been in effect since 2000, the deemed debt rate at the time of issuance.

The Applicant noted in its application on Exhibit 5, Tab 1, Schedule 1 that it applied the Board's guidelines for the cost of capital, as outlined in the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities* (the "Report"), issued December 11, 2009.

On page 53 of the Report, the Board wrote "For affiliate debt (i.e., debt held by an affiliated party as defined by the Ontario *Business Corporations Act, 1990*) with a fixed rate, the deemed long-term debt rate <u>at the time of issuance</u> will be used as a ceiling on the rate allowed for that debt." Kingston Hydro has affiliate debt with a fixed rate of 7.25% and has included in its application this fixed rate that was the deemed long term debt rate at the time of issuance.

On page 54 of the Report, the Board wrote, "For debt that is callable on demand (within the test year period), the deemed long-term debt rate will be a ceiling for the rate allowed for that debt. Debt that is callable, but not within the period to the end of the test year, will have its debt cost considered as if it is not callable." Kingston Hydro has provided a copy of its 2011 resolution at Exhibit 5, Tab 1, Schedule 1, Attachment 4 that confirms that this debt is not callable during the Test Year.

Therefore, based on the Board's own Report, Kingston Hydro submits that the proposed interest rate of 7.25% for the long-term debt instrument held by the City of Kingston is appropriate for the purpose of setting rates.

**Other:**

In the oral hearing, there was a discussion regarding the mechanics of Kingston Hydro's request that the intervenors confirm that Kingston Hydro's forecast of intervenor costs closely approximates the intervenors' actual costs. The intervenors raised the issue that if they provide an estimate and then their costs are subsequently reduced, Kingston Hydro will over-recover on its intervenor costs. Kingston Hydro submits that a simple mechanism to deal with this potential circumstance would be a variance account to record the variance between the forecast and actual intervenor costs. Should the intervenors' costs be reduced, any over-recovery by Kingston Hydro could be returned to its ratepayers.

Kingston Hydro submits that the intervenors are in the best position to forecast their own costs. If they know that their costs are higher than Kingston Hydro's forecast, they should be required to correct Kingston Hydro's forecast to ensure that the rates set by the Board are just and reasonable.

All of which is respectfully submitted. March 11, 2011

Andrew Taylor