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Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

Kingston Hydro Corporation
2011 Distribution Rates

EB-2010-0136

March 29, 2011

Kingston Hydro Corporation
Application for 2011 Distribution Rates

EB-2010-0136

Board Staff Submissions
March 29, 2011

Introduction

Kingston Hydro Corporation ("Kingston Hydro") filed its 2011 distribution rate rebasing application (EB-2010-0136) on August 23, 2010. Kingston Hydro distributes electricity to approximately 27,000 customers in the City of Kingston.

The Board issued a Notice of Application and Hearing on September 14, 2010.

Kingston Hydro indicated that if the application was approved as filed, residential customers consuming 800 kWh per month would experience an increase of approximately 26.5% in their delivery charges with an increase of $7.17 per month on their total bill. General Service customers consuming 2,000 kWh per month and having a monthly demand of less than 50 kW would experience an increase of approximately 16.5% in their delivery charges with an increase of $9.78 per month on their total bill.

This was revised in Appendix C, page 9 of the evidence update of February 4, 2011, where the residential impact for a customer using 800 kWh showed an increase of 31.7% in their delivery charges with an increase of $9.14 per month on their total bill. General Service customers consuming 2,000 kWh per month and having a monthly demand of less than 50 kW would experience an increase of 17.4% in their delivery charges with an increase of $9.90 per month on their total bill.

Procedural Order #1 in this proceeding was issued on October 12, 2010 and set the dates for two rounds of interrogatories, as well as a settlement conference that was held on December 15 and 16, 2010.

Partial settlement was achieved, and Kingston Hydro filed the Partial Settlement Agreement with the Board on January 12, 2011. In the Partial Settlement Agreement, Kingston Hydro indicated it would file a short evidence update.

Procedural Order #2 was issued on January 18, 2011, accepting the partial settlement and setting dates for the evidence update, interrogatories on this update and setting the dates for the oral hearing.

The evidence update was filed on February 4, 2010; Board staff and intervenors filed interrogatories on February 11, 2011 and responses from Kingston were received on

February 18, 2011. A one day oral hearing took place on February 28, 2011. Kingston Hydro submitted its Argument-in-Chief on March 10, 2011.

At the start of the oral hearing, Kingston Hydro requested that the intervenors provide an updated estimate of the intervention costs they expected to submit for recovery from the applicant.[1] It was generally agreed by the intervenors that the most accurate estimate of costs would be available after final submissions were complete. To address this issue, the Board requested that submissions also be made on the appropriateness of the request to update these costs.[2]

Board Staff Submission on Intervenor Costs

Board staff's position on this issue was set out at the oral hearing.[3] Staff recognizes the desirability of accurate costing information in rates cases, however, staff also recognizes the problems arising when intervenors submit revised, close-to-actual costs and having these costs become part of the proposed rate order. This can result in an applicant having no reason to argue against the cost claims (as the claims are already embedded in the proposed rates) and leaving these costs for ratepayers to cover. On page 14 of its Argument-in-Chief, Kingston Hydro submitted 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. "

Staff is not in favour of adding an additional variance account to address the issue of intervenor costs, usually a relatively minor component of a cost of service application. Staff points out that the Board has an existing Practice Direction on Cost Awards and is concerned about changing this process within the ambit of an individual application, as only a limited number of parties can be involved. Accordingly, staff submits that the existing method used to estimate intervenor costs be maintained.

Remaining Issues

The seven remaining issues that were not settled are listed in the Partial Settlement Agreement and are also set out in Procedural Order #2. These issues are:

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)?

[1] TR February 28, 2011, page 5
[2] TR February 28, 2011, page 7
[3] TR February 28, 2011, pages 90 - 92

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?

Board Staff Submissions on Remaining Issues

Issue #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’s pre-filed evidence stated that for financial statement purposes, it uses full year amortization in the year of acquisition in accordance with Canadian Generally Accepted Accounting Principles (CGAAP). In addition, Kingston Hydro stated that in order to comply with regulatory accounting for ratemaking purposes, the amortization expense calculated in the year of acquisition should follow the half-year rule. Accordingly, Kingston Hydro adjusted the amortization expense for the historical years 2005 through to 2009 to reflect the half-year amortization rule.[4]

Kingston Hydro’s response to Energy Probe Interrogatory #2 established that amortization expense for assets added in 2004 was based on a full-year methodology and that amortization expense related to additions in 2004 included in the 2006 revenue requirement was calculated based on the full-year methodology.

In the response to Energy Probe IR #5 Kingston Hydro reiterated that

> “Amortization expense for 2006 that was included in the 2006 revenue requirement was calculated based on the full year methodology. Amortization expense related to additions in the 2004 that was included in the 2006 revenue requirement was calculated based on the full year methodology.”

Under cross examination by Mr. Aiken of Energy Probe, Kingston Hydro witness Mr. Murphy indicated that Kingston Hydro had followed the Board’s filing requirements,

[4] Exhibit 1/Tab 4/Sch 3/page 2

issued June 28th, 2010, specifically Section 2.5.7 as shown on page 2 of the Energy Probe Compendium (Exhibit K1.1) that,

> "…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." [5]

Cross-examination also confirmed that Kingston Hydro's RRR filing with the Board was based on full year depreciation as permitted by financial statement reporting.[6]

Section c) of the response to Energy Prove IR # 5, provided a table that showed the rate base without the adjustment to the half year rule in the years 2005 to 2010 (but using the half year rule for 2011). This interrogatory response was updated in Undertaking J1.1 to include the settled 2010 capital amount showing that without the adjustment, the 2011 Rate Base was $41,983,853, compared to the post-settlement evidence update (including the half-year adjustments) of $42,417,813.[7]

Under cross examination, Mr. Murphy also confirmed that since 2006 Kingston Hydro's rates were adjusted using a price cap mechanism and that these rates from 2006 through 2010 include impacts of the full-year depreciation methodology used for 2004. However, Mr. Murphy also testified that Kingston Hydro had invested at much higher levels than the depreciation expense over that period and as such the majority of the capital additions were not included in rate base.[8]

When Mr. Aiken asked whether Kingston Hydro had done a similar analysis on OM&A, taxes, capital expenditures and all the factors built into existing rates, Mr. Murphy replied, "not with respect to this issue."[9]

In the oral hearing and also cited on page 3 of the Kingston Hydro Argument-in-Chief, Kingston Hydro quoted the Board's Filing Requirements for Transmission and Distribution Applications (the "Filing Requirements"), under Section 2.5.7:

> "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. "

Kingston Hydro submitted that the half-year rule was appropriately applied for the years 2005-2011 for rate making purposes in accordance with these Board instructions.

Mr. Murphy also cited two previous Board decisions, Ottawa River Power (EB-2010-0165) and Renfrew Hydro (EB-2010-0146) and stated:

[5] TR February 28, 2011, page 19
[6] TR February 28, 2011, page 21
[7] Evidence Update, February 4, 2011, Appendix C
[8] TR February 28, 2011, page 22-23
[9] TR February 28, 2011, page 22

> "…in both of those decisions, Board Staff indicated that Ottawa River and Renfrew Hydro had followed the guidelines and they had no issue with what those applicants had done. As well, in both of those decisions, the Board ruled that the half-year rule was appropriately applied for ratemaking purposes, as opposed to financial statement purposes, which is what we have done. The issues are identical."[10]

<u>Board Staff Issue #1 Submission:</u>

Board staff submits that the Board should not permit Kingston Hydro to restate its historical rate base by making adjustments to reflect the half-year rule retroactively.

Board staff submits that rates in Ontario should be set on a consistent basis over time. Staff notes that Kingston Hydro employed full-year depreciation in their financial statement reporting for the intervening years, 2006 to 2010. Kingston Hydro's distribution rates from 2006 through 2010 include the impact of the full-year depreciation methodology used for 2004. It is not appropriate to retroactively adjust rate-determining inputs to set future rates. In Kingston Hydro's case, this adjustment results in overstating the test year opening rate base.

The current Filing Requirements (particularly section 2.5.7), updated and issued on June 29, 2010, are forward looking and indicate that the half-year rule applies to the test year and not that the half-year rule be applied to past years. This was an enhancement of the Filing Requirements. In Board staff's view, the changes to the Filing Requirements for the 2011 applications were, in part, intended to reflect the Board's decision in Kitchener-Wilmot Hydro's 2010 distribution rates application (EB-2009-0267).

In that application, Kitchener-Wilmot Hydro noted that it had used full-year depreciation for capital additions in each year historically and proposed to continue its practice. In its Decision and Order, the Board noted:

> "The only matter under this issue is whether the ½ year rule should be applied for calculating the depreciation expense of capital assets in the year that these assets enter service. As documented in Board staff's submission, the Board has articulated the ½ year rule in the past. In cost of service applications for 2008 and 2009 distribution rates, most distributors have documented compliance with ½ year rule.
>
> The Board finds that KW Hydro should use the ½ year rule for calculating depreciation expense for 2010 capital additions. This is the general policy that the Board has used previously. As has been noted by KW Hydro, the Board has allowed deviations from this policy in specific circumstances where warranted.
>
> …
>
> It is the Board's view that its policy for calculating depreciation expense, which includes allowing a ½ year's depreciation on capital additions in the test year, is appropriate.

[10] TR February 28, 2011, page 23

> The Board directs KW Hydro to recalculate its 2010 depreciation expense using the ½ year rule for new additions in that year, subject to any further revisions which are required as a result of the Board's findings elsewhere on this Decision with respect to KW Hydro's 2010 rate base and capital expenditures and additions."[11]

Board staff observes that the half-year rule was applied to capital additions only in the test year, and was not applied to restate depreciation expense and rate base in the bridge and historical years.

Board staff observes that Kingston Hydro has appropriately applied the half-year rule to its test year capital additions.

As for the two past Board decisions that were cited by Kingston Hydro: Renfrew Hydro Inc. (EB-2009-0146) and Ottawa River Power (EB-2009-0165), in the case of Renfrew Hydro, the Decision stated:

> "The Board will accept Renfrew's calculations for the purpose of determining its 2010 rates, given the amount is not material. The Board directs Renfrew to adhere in the future to the Board's policy on the half year rule."[12]

The Board indicated that, in Renfrew's case, the amount was not material, while in this case the difference in Rate Base using the two variations is $434,000, which, in Board staff's submission is a material amount for this application.

In the Ottawa River Power case, Board staff notes that the Board did not make a specific finding on this issue[13], only noting that the half-year rule was applied retrospectively. In addition, the Board noted that a Board staff interrogatory response indicated Ottawa River had showed it had used the half-year rule consistent with Board instructions for the 2010 test year.

Further, both of these cases, for 2010 rates, were dealt with under the previous version of the Filing Requirements, where adherence to the half-year rule on a going forward basis was not articulated. Kingston Hydro's application is for 2011 rates and for which the current version of the Filing Requirements are applicable.

Therefore, Board staff submits that these two decisions should not be determinative in the decision on Kingston Hydro's request to restate its Rate Base in this application. Rather, Board staff submits that the referenced Kitchener-Wilmot Hydro's 2010 rates application, where conversion to the half-year rule prospectively beginning with capital additions in the forward test year, is more relevant and consistent with the current version of the Filing Requirements.

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[11] EB-2009-0267 Decision and Order, April 7, 2010, pages 23-24
[12] EB-2009-0146 Decision, November 25, 2010, page 27
[13] EB-2009-0165 Decision, December 15, 2010, page 19

Issue #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 in the Application, or the most current projected values (May, 2011 to April, 2012)?

Kingston Hydro's pre-filed application shows that Kingston Hydro has based their application on the Board's April 15, 2010 Regulated Price Plan ("RPP") Report. This yields an average commodity price of $0.06679/kWh.[14] Kingston Hydro updated its cost of power forecast with the Board's October 18, 2010 RPP report.

This specific issue was discussed at length in the oral hearing with cross examination from Mr. Aiken. Kingston Hydro witness, Ms. Taylor agreed with Mr. Aiken that the best information available should be used to forecast the cost of power and that the rate year is defined as the period from May 1, 2011 to April of the following year.[15]

In its Argument-in-Chief, on page 4, Kingston Hydro maintained:

> "… 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. "

This indicates that Kingston Hydro continues to view that the most current estimates should be used to forecast the cost of power.

<u>Board Staff Issue #2 Submission:</u>

Board staff submits that the most recently available commodity price forecasts be used in the calculation of commodity prices used in any distribution rates application. This would include use of the October 18, 2010 RPP Report with prices that should apply to the months for the rate year in question, ie, from May 1, 2011 to April 30, 2012.

The Board may wish, if the timing of the Rate Order in this proceeding permits, to decide whether Kingston Hydro should use the Board's updated RPP forecast, commonly released in April of each year to set the Working Capital Allowance as accurately as possible for the Kingston Hydro rate year.

[14] Exhibit 3/Tab1/Sch 3
[15] TR February 28, 2011, pages 28 - 29

Issue #3 Are the 2011 capital expenditures proposed by Kingston in the Application appropriate?

Kingston Hydro's historical and proposed Capital Expenditures are shown in the table below:

Year	Capital Expenditures
2008 Actual	$3,757,159
2009 Actual	$3,637,113
2010 Settlement	**$3,215,025**
2011 Update	**$5,433,500**

Board staff notes that the pre-filed evidence included capital expenditures of $4,446,000 for 2010, which was revised through the course of the proceeding to $4,318,177 and eventually settled at the level of $3,215,025.

For 2011, in the pre-filed evidence, the original capital expenditure amount was $4,513,000 which was subsequently updated to $5,433,500 after the 2010 amount was settled. This change was described in the cover letter to the Settlement Agreement and also in response to supplemental Energy Probe IR #36,

> "Kingston Hydro contacted Hydro One again and received confirmation from Hydro One late December 6, 2010 that the final costing for this project will result in a refund of $121,000 as opposed to another payment of $609,000. Hydro One indicated that the reason for the change in the amount was due to a change in project costing methodology. Because of the short time frame, Kingston Hydro has not had an opportunity to analyze the effects. With the additional funds now available, Kingston Hydro expects to increase its capital spending in 2011 by the amount of the difference."

In its pre-filed evidence, in Exhibit 2, Kingston Hydro provided significant information on the historical state of its assets and included a number of asset condition studies. Kingston Hydro witness Mr. Keech testified that Kingston Hydro has historically had priorities of keeping rates low and a run-to-the-end-of-life, or run-to-failure approach to system investment. This has resulted in historical under-investment in Kingston Hydro's service infrastructure and the need to increase investment to renew the system.[16]

Kingston Hydro witnesses also testified to the use of a top-down approach to capital budgeting with projects selected on the basis of need and the availability of funds. As funds became available due to lower capital needs in 2010, the Substation #3 project ($968,000) was added to the 2011 capital plan.[17] This project had already been previously identified as the next most likely project that Kingston Hydro would add in the test year if more capital funding was available.[18]

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[16] TR February 28, 2011, pages 11 - 17
[17] TR February 28, 2011, page 38
[18] Board staff IR #31

The list of the major projects and costs that are included in the 2011 plan are listed in Appendix A of the February 4, 2011 evidence update as well as in the Kingston Hydro Argument-in-Chief.

Board Staff Issue #3 Submission:

Board staff submits that the Capital budget proposed by Kingston Hydro for 2011 is appropriate, subject to the OM&A implications noted below.

Board staff initially had some concerns with the evidence filed on the 2011 capital plan in the evidence update with regard to the impact of the settlement of 2010 bridge year capital, on the plans for 2011. However, through the responses to Board staff Update IR #1 and responses by the Kingston Hydro witnesses on this issue during the oral hearing,[19] Board staff is satisfied with the 2011 plan as proposed.

Board staff also had some concerns with the evidence filed on the state of Substation M1 and the fire that occurred in this station in 2009. The concern was primarily related to the belief that Kingston Hydro was not acting quickly enough to rebuild this station, acknowledged as a critical asset, until 2013. However, through the response to Board staff IR #29 and follow-up questions for the Kingston Hydro witness panel[20], Board staff is satisfied that Kingston Hydro's plans for the rebuild of this station were well considered and supports the plan to rebuild the M1 substation in 2013.

Board staff acknowledges the high percentage increase in capital spending from the Bridge to the Test year, but also accepts Kingston Hydro's argument that the late 2010 change in capital contribution to Hydro One was unforeseeable and views this as a valid reason justifying the high percentage increase. While Board staff does not believe that just because additional moneys become available, it should be spent; Board staff in this case is of the view that the additional spending on the substation due to available funds has been justified in the evidence.

It is Board staff's submission that Kingston Hydro has presented sufficient evidence on the history of its capital base and has filed appropriate asset condition evidence.

In accepting the Capital Expenditure forecast, Board staff notes that the capital expenditure forecast may be affected by the submission on OM&A below. Staff has recommended a reduction in Kingston Hydro's requested staffing increase which contributes to the OM&A total spending for the test year. However, as shown in Undertaking J1.6, there is also an allocated capital cost to the affected positions. For these positions, $20,000 for each of the Powerline Technicians and $11,000 for the Substation Electricians, a related reduction in capital of $51,000 in the test year should be made. If Board staff arguments are accepted, these impacts should be reflected in the Capital Budgets granted by the Board for the test year.

[19] TR February 28, 2011, pages 153 - 154
[20] TR February 28, 2011, pages 155 - 156

Issue #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?

Kingston Hydro's application includes a revenue offset which is revenue earned on funds held in a City of Kingston bank account. The original amount reported for this income was $17,050 but this was corrected in the evidence update of February 4, 2011, to $75,321.

The average amount of Kingston Hydro funds in the City's bank account for 2011 is $5,579,323.[21] Response to Energy Probe IR #53 on the Evidence Update indicates that the amount planned to be in the bank account plus the amount of accounts receivable that is collected in a month, is needed to pay for the following month's IESO invoice plus current expenditures coming due.

Based on the $5,579,323 amount, Kingston Hydro expects to earn $75,321 or 1.35% (Prime Rate of 3.00 % less 1.65%). Response to SEC IR 2b) indicates that the actual interest paid by the City of Kingston to Kingston Hydro is calculated at a rate consistent with the rate the Toronto Dominion Bank pays on the City's general bank account.

Response to SEC IR #2b) also shows that the average balance held by the City of Kingston has grown from $2,524,256 in 2009, to $3,640,693 in 2010 (+ 44%), to $5,579,323 in 2011 (+ 53%). Under cross examination from Board staff, Kingston Hydro explained why the average balances appeared to have grown so significantly from 2009 to 2010, primarily due to the fact that an additional amount of $1.85 million was not included in the 2009 amount.[22]

In addition, the Kingston Hydro witness, Mr. Murphy, indicted that it is Kingston Hydro's practice to keep this level of funds in its bank account to pay Kingston Hydro's next month's expenses. Mr. Murphy used as an example, Kingston Hydro's December, 2010 IESO bill due January, 17, 2011 which was $6.2 million. In addition, approximately $500,000 of operating expenses were due in January, 2011. With approximately $6.7 million of invoices due in mid-January, Kingston Hydro believes that the $5.5 million amount cited for this account was appropriate.[23]

Under cross examination from Mr. Aiken, Kingston Hydro indicated that it had forecast the prime rate for the first two quarters of 2011 to be 3% and for the third and fourth quarters at 3.5 and 4 percent respectively.[24]

[21] Exhibit 1/Tab 4/Sch 6/Attachment 1
[22] TR February 28, 2011, page 160
[23] TR February 28, 2011, page 43
[24] TR February 28, 2011, page 42

Board Staff Issue #4 Submission:

Board staff has one concern with this issue regarding the prime rate forecast used for this revenue offset amount. As noted above, the Kingston Hydro witnesses indicated that its own forecast of the prime rate for the third and fourth quarters of 2011 was 3.5 and 4 percent respectively. Therefore, in Board staff's submission, using a 3 percent forecast for the entire year is not appropriate.

Board staff submits that Kingston Hydro should use an average of these quarterly forecasts to restate the revenue offset. For example, an average prime rate forecast of 3.375 percent would yield an effective interest rate of 1.725% (3.375 – 1.65) which would increase the revenue offset to $96,243 for the test year.

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

The historical Operations, Maintenance and Administration (OM&A) expense for Kingston Hydro from 2006 to the test year are shown in the table below which includes the percentage change from year to year.

Operations, Maintenance & Administration Expenses
Kingston Hydro
2006 to 2011, in dollars

	2006	2007	2008	2009	2010 Bridge	2011 Test
Operations	978,901	1,237,794	1,857,541	2,284,260	2,502,904	2,627,053
		26.4%	50.1%	23.0%	9.6%	5.0%
Maintenance	898,832	991,615	850,416	776,254	930,012	1,093,763
		10.3%	-14.2%	-8.7%	19.8%	17.6%
Billing and Collections	831,733	729,219	666,337	434,268	622,503	643,543
		-12.3%	-8.6%	-34.8%	43.3%	3.4%
Community Relations	159,120	261,138	156,184	200,686	240,014	413,492
		64.1%	-40.2%	28.5%	19.6%	72.3%
Admin & General	1,750,166	1,576,034	1,669,824	1,579,504	1,716,984	2,149,653
		-9.9%	6.0%	-5.4%	8.7%	25.1%
TOTAL	**4,618,752**	**4,795,800**	**5,200,302**	**5,274,972**	**6,012,417**	**6,927,504**
		3.8%	8.4%	1.4%	14.0%	15.2%

The information in the table is found at Exhibit 4/Tab2/Sch2/page 2 in Kingston Hydro's pre-filed evidence and includes the changes that were provided in the evidence update, (Outside Services Employed, Property Insurance and Employee Pensions and Benefits). In addition, the table includes the reduction of Administration and General costs to reflect the removal of the Late Payment Penalty amount of $26,138 as a result of the EB-2010-0295 Decision.[25]

In his opening remarks, Kingston Hydro witness Mr. Keech indicated that much of the increase in OM&A costs is linked to increases in staff, increasing complexity of the industry and linked to capital expenditures and the need for renewal of infrastructure at Kingston Hydro.[26]

[25] TR February 28, 2011, page 2
[26] TR February 28, 2011, page 15 - 16

As is shown in the table, OM&A costs increase by 14% in the bridge year and by over 15% in the test year, greatly in excess of inflation which is seen to be in the range of 2% in both years.[27]

In its Argument-in-Chief, Kingston Hydro pointed out that their analysis of the increase in OM&A over the 2006 to 2010 period is 6.9% and not 8.5% as claimed in the Energy Probe compendium (Exhibit K1.1), page 19. Kingston Hydro also argued that Energy Probe's inflation rate in the compendium was too low, 1.7% vs Kingston Hydro's calculation of 1.75%. Board staff would point out that even if one used Kingston Hydro's figures, Kingston Hydro OM&A costs have increased significantly over inflation in this period. Moreover, these numbers do not include the test year increase of 15% with an inflation forecast at 2%.

In terms of customers per employee FTEs, page 19 of Exhibit K1.1 shows a steady drop in these numbers from 675 in 2006 to 443 in 2011. This is a 34% decrease over this period.

During the oral hearing, Board staff noted that the OM&A cost per customer for the test year is $254, compared to an OM&A per customer value of $197 in 2009. Staff pointed out that this would negatively impact the Kingston Hydro OM&A per customer value changing it from 10th highest in its Ontario distributor cohort to 5th highest (using the data shown at response to Energy Probe IR #19). Kingston Hydro's response to this was to say that,

> "…our OM&A expenses were significantly lower than they should be to keep the system in the condition that it needs to be for a number of years. And we view this as an opportunity to catch up."[28]

Kingston Hydro argued that its OM&A per customer was significantly lower than its cohort companions since 2006, saying its expense was $24 to $37 lower than the average of its cohorts. For 2009, Kingston Hydro is 11% lower than the average of their cohort distributors at $221 per customer. Staff would point out that at the proposed OM&A level of $254 per customer, Kingston Hydro suddenly jumps to 15% above the 2009 cohort average, a significant increase by any measure.

A significant portion of the increase in OM&A is the test year increase in staffing to 61 FTEs, an increase of 13 positions from 2010. In addition, in 2010, four positions were added from 2009.

In its Argument-in-Chief, Kingston Hydro argued that the proposed OM&A increases are driven largely by the need to hire workers which are also linked to capital expenditures.

> "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

[27] Exhibit 4/Tab 1/Sch 1/page 5
[28] TR February 28, 2011, page 161

> regulatory bodies impacting our industry to a level beyond that which has been historically the case."[29]

Board Staff Issue #5 Submission:

While Board staff accepts some of Kingston Hydro's evidence and arguments regarding the historical low costs, under-investment and resulting low staffing levels, staff submits that the increase in OM&A requested in this application is too high and has not been fully justified.

As noted above, historical increases for OM&A have been in excess of inflation by a meaningful amount, even as acknowledged by Kingston Hydro in its Argument-in-Chief. In terms of OM&A cost per customer, the evidence shows that Kingston Hydro was not at the bottom of its distributor cohort from 2006 to 2009, but between the middle and bottom third. For the test year Kingston Hydro proposes to increase this from $197 per customer to $254 per customer, an increase of 29%.

Board staff has already indicated that it supports Kingston Hydro's proposal for capital spending in the test year. Board staff acknowledges that there is a relationship between ramping up capital spending and ramping up OM&A spending, since the costs of staff increases may also be capitalized. However, staff submits that in this instance the proposed increases in OM&A are in excess of those justified by additional capital investment.

Board staff also accepts some of the argument that new and better forms of customer communications are necessary, but again submits that the increase sought by Kingston Hydro is excessive.

Staffing Increases
Board staff agrees that the major contributor to the OM&A increase is the increase in staffing of 13 FTE positions for the test year. Specifically, Board staff has concerns with the following positions and related costs:

Kingston Hydro is requesting an additional 5 Journeyperson Powerline Technician positions for the test year. The primary justification is that these positions are needed to replace employees who are able to retire in the next few years. Response to Board Staff IR#15 shows when the current 14 employees are eligible to retire and that historically employees retire 3.4 months after their earliest possible retirement eligibility. Only 3 will achieve this level in the next 5 years. Board staff notes that this is within the time frame of Kingston Hydro's next cost-of-service application.

The situation is similar with the requested 2 Journeyperson Substation Electricians. Response to Board staff IR #15 shows only 2 of 4 of these employees are eligible to retire in the next 5 years.

[29] Kingston Hydro Argument-in-Chief, page 10

Board staff takes the position that it is important to remember that these 7 requested positions are additional, on top of current positions, not just replacements. As shown in response to VECC IR # 30, Kingston Hydro does not expect that this level of positions will be maintained going forward. This appears to show that the Applicant wants to have these additional positions funded by ratepayers into the future, but acknowledges it will not maintain these levels after retirements occur.

Board staff submits that the Board should approve only 3 of the Journeyperson Powerline Technician positions, to cover both planned OM&A and Capital projects and to cover for the potential skill transfer needed in case these retirements materialize. As for the requested 2 Journeyperson Substation Electricians, staff submits it is reasonable for only one to be funded by ratepayers, again to handle additional workload and as a transition to possible retirements.

Board staff also points out that Kingston Hydro has also requested two additional staff (Engineering Technologists) for asset planning and maintenance work. After reviewing response to Board Staff IR#16, Board staff submits that these positions are justified to meet additional workloads as Kingston Hydro implements its infrastructure renewal.

Kingston Hydro has also requested an additional CDM advisor position to augment the current .23 FTE person in place that is funded by the OPA as indicated in response to Board Staff IR #11. In that response Kingston Hydro indicated that it has not pursued OPA funding for this expanded position. This was reiterated by Kingston Hydro witness Mr. Keech, when he said:

> “We have had conversations with the OPA in regards to the funding for the different programs that we will get, but as far as funding of these positions directly, I would say not. I think with, with what's going on with this portfolio at the moment, I think the OPA is fairly busy and I am not sure that we could get someone who could give this type of a question the attention right now.”[30]

Board staff submits that the funding for this position is available through the Global Adjustment (either through the OPA or Tier 2 & 3 CDM programs) and as such, ratepayers should not be made responsible for the funding of this position. Board staff submits that Kingston Hydro should expand their efforts to obtain such funding.

Community Relations

Board staff notes that the Community Relations budget for the test year is 72% higher than the bridge year, with the bridge year up 20% from the year before.

Board staff acknowledges that the aforementioned CDM position is included in this total, however, Kingston has also requested a full time professional for community relations at a cost of $82,000 per year. This position would,

> “…have the responsibility for ensuring new legislated programs, are appropriately communicated to our customers. This would include but not be limited to CDM

[30] TR February 28, 2011, page 168

> programs, smart metering, FIT and Micro Fit, and ongoing changes to customer bills. It is anticipated that such programs and need for clear communications will increase with an ever-growing focus on green energy alternatives and smart grid initiatives. In addition, this person will work with external agencies to help communicate our policies to customers to ensure the public understands the role of Kingston Hydro. This person will also be available to answer questions the public may have regarding outages and be the point of contact for infrastructure renewal projects."[31]

Board staff questions whether a distributor the size of Kingston Hydro is justified in adding a full FTE position for these matters. It appears to Board staff that considering the other additions to staff in this application, a full time position for community relations is not justified and should be reduced to a half-time position.

This conclusion takes into account the fact that the 'miscellaneous' component of the Community Relations budget increases by 11% in the test year, to over $200,000. In addition, a "sundry" component of $97,000 is added to the Community Relations budget in the test year. This brings the increase to over 15% increase in the test year. Board staff feels that on the basis of this large increase alone and its impact on the growth of the OM&A per customer measure, that these largely unspecified costs be reduced by an additional $50,000.

<u>Administration and General</u>

Board staff notes that the Administration and General budget for the test year has increased by 25% after increasing 9% in the bridge year. For the test year this is an increase of $433,000.

In response to Board Staff IR #25, Kingston Hydro provides additional detail on the two additional Administration and General positions it is seeking for the test year at an additional cost of $160,000 in the test year.

Staff notes that these positions contribute to an overall large increase in the Administration and General category.

Again, as with Community Relations, Board staff submits that on the basis of this large increase alone and its impact on the growth of the OM&A per customer measure, that these largely unspecified costs be reduced by $50,000. Board staff notes that Undertaking J1.11 shows that Kingston Hydro did not spend its 2010 budget for Administration and General, by over $135,000. This makes for a 36% requested increase for the test year or $568,000. Board staff also notes that in three categories of Administration and General expenses alone: Management and General Administration Salaries, Outside Services and Miscellaneous, the increase in the test year exceeds $338,000 (based on the pre-filed/amended budget).

Board staff submits that the evidence in this case does not justify such a significant increase over the course of one year and that savings/efficiencies can be achieved to reduce the Administration and General total by $50,000.

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[31] Exhibit 4/Tab 2/Sch 3/page 20

OM&A Summary
According to Undertaking J1.6, the OM&A impact of the reduction in the two Powerline Technicians and the one Substation Electrician is $110,000 in the test year. ($42,000+$34,000+$34,000). The recommended reduction for the CDM position is $55,000 and the half time reduction for the Community Relations position in the test year is $41,000.

When the additional recommended reductions of $50,000 in Community Relations and $50,000 in Administration and General are added to this total, the 2011 OM&A budget is reduced by a total of $306,000 to $6,621,504.

This brings the total 2011 increase in OM&A to a more reasonable 10.1% over 2010 pre-filed/amended levels, or 10.8% over the 2010 actual. In total dollar terms, this is $644,780 over 2010 actual. Board staff again points out that inflation for the test year is still in the 2% range.

This will bring the overall OM&A per customer from $254 to $243, a reduction of 4.3% from the original amounts.

As for customers/FTE, the reduction of 5 proposed positions is estimated to reduce the impact of this measure. In 2006 this was 675 customers/employee. The original application reduced this measure by 34% to 443. Board staff submissions yield a figure of 487, 38% less than in 2006.

Issue #6 Is the PILs Schedule 1 adjustment for future benefit liabilities as proposed by KH in the Application appropriate?

Background

In its original application, the amount of PILs included in Kingston Hydro's 2011 revenue requirement was $692,764[32].

Included in the calculation of the PILs provision for the test year were adjustments to taxable income regarding future post-employment benefit liabilities.

a) $1,544,435[33] was included as an addition to taxable income representing end of year liability.
b) $1,254,336[34] was included as a deduction to taxable income representing beginning of year liability.
c) The difference between these two liability amounts represents a net increase to 2011 taxable income of $290,099.

As a result of the evidence update and the accepted partial Settlement Agreement, the updated 2011 PILs provision was $691,812[35]. There were no changes[36] to the amounts of future post-employment benefit liabilities included in the calculation of the updated 2011 PILs provision.

Kingston Hydro provided a calculation of the test year PILs expense excluding the addition and deduction of book to tax adjustments related to future post-employment benefit liabilities[37]. Excluding these adjustments the PILs expense for the test year was calculated to be $578,544.

The net impact on the 2011 PILs expense of excluding the book to tax adjustments of these liabilities is a decrease of approximately $114,000 as set out in Table 1 below.

Table 1
Impact on PILs Expense of Excluding Book to Tax Adjustments of Post-Employment Benefit Liabilities

Original application PILs expense[38]	$692,764
Adjusted PILs expense[39]	$578,544
Net impact on PILs expense	$114,220

[32] Exhibit 4/Tab 8/Schedule 1/Page 1
[33] PILs or Income Taxes Work Form, Sheet O. Taxable Income Test Year
[34] PILs or Income Taxes Work Form, Sheet O. Taxable Income Test Year
[35] February 4, 2011 Evidence Update, Appendix D, Updated PILs Model
[36] February 4, 2011 Evidence Update, Appendix D, Updated PILs Model
[37] Response to Board Staff Second Round IR #9 d)
[38] Updated evidence PILs provision of $691,812 was not used in Table 1 as the difference between the updated evidence amount and the original application PILs provision is immaterial – approximately $1,000 difference.
[39] Excluding book to tax adjustments of reserves for post-employment benefit liabilities

The amounts of the addition and deduction of post-employment benefit liabilities were further examined by counsel for SEC during the oral hearing. More specifically, Kingston Hydro was asked whether it had recorded an expense related to the future post-employment benefits of $290,000, representing a change in the reserves[40] or liabilities.

Kingston Hydro confirmed that there was an expense in 2011 OM&A representing this amount, but only approximately one-quarter of the amount was added to test year expenses.[41] Kingston Hydro further confirmed $62,525 was included in 2011 OM&A, which represented:

a. The $290,000 amount stated above, less the $40,000 annual amortization expense – generating a difference of $250,000[42]
b. The $250,000 was divided by four years to generate an amount included in 2011 OM&A of $62,525.[43]

Mr. Shepherd inquired why a similar treatment was not done for the amount included in the PILs provision calculation[44], so that the regulatory tax calculation would be adjusted the same way as post-employment benefit expense was included in 2011 OM&A. Mr. Shepherd confirmed that instead of adding back the $250,000, one-quarter of it would be added back, to align the amount included in the PILs provision calculation with the amount included in OM&A expense.

Mr. Murphy agreed to Undertaking J.10 in order to provide an updated PILs calculation to reflect this treatment. In order to align the amount included in the 2011 PILs provision calculation with the amount included in 2011 OM&A expense, Kingston Hydro provided a response to Undertaking J.10. The response to Undertaking J.10 reflected an updated 2011 PILs provision of $617,959.[45]

The net impact on 2011 PILs expense of reducing the amount of book to tax adjustments of future post-employment benefit liabilities is a decrease of approximately $74,805 – see Table 2 below.

[40] TR February 28, 2011, page 144 line 27-28, page 145 line 1
[41] TR February 28, 2011, page 145 line 2-6
[42] TR February 28, 2011, page 146 line 12-14
[43] TR February 28, 2011, page 146 line 15-17
[44] TR February 28, 2011, page 150 Line 12-13
[45] March 3, 2011, Undertaking J.10

Table 2
Impact on PILs Expense of Reducing Book to Tax Adjustments of Post-Employment Benefit Liabilities

Original application PILs expense[46]	$692,764
Adjusted PILs expense[47]	$617,959
Net impact on PILs expense	$ 74,805

Board Staff Issue #6 Submission:

Staff submits that the book to tax adjustments of future post-employment benefit liabilities should be excluded from the calculation of the 2011 regulatory PILs provision.

The impact of including these liabilities in the calculation of Kingston Hydro's 2011 PILs expense is material – the inclusion generates an increase of approximately $114,000 in Kingston Hydro's PILs expense and revenue requirement.

Board staff's submissions on the PILs issue are set out below and deal with the following:

a. The PILs Schedule 1 adjustment for future benefit liabilities as proposed by Kingston Hydro in the application is not appropriate. The change in future post-employment benefit liabilities should be excluded from the regulatory PILs provision calculation.

b. If the Board chooses to exclude the change in future post-employment benefit liabilities, no amount should be included in the PILs expense calculation and this should be reflected in an updated PILs expense calculation, which may be reflected above in Table 1, "Adjusted PILs Expense".

c. If the Board chooses to include the change in future post-employment benefit liabilities, the amount included in the regulatory PILs calculation should be decreased, as reflected above in Table 2, "Adjusted PILs Expense".

Deferred PILs Proceeding Settlement Agreement Principles (EB-2008-0381)

The issue of future post-employment benefit liabilities and obligations and their impact on PILs has arisen in the Deferred PILs proceeding [EB-2008-0381]. In the EB-2008-0381 Settlement Agreement, Issue #7[48] was accepted by the Board and parties agreed that the post employment benefit liabilities and obligations should be shown in the records of the company that directly employs the people. Complete settlement was

[46] Updated evidence PILs provision of $691,812 was not used in Table 2 as the difference between the updated evidence amount and the original application PILs provision is immaterial – approximately $1,000 difference.
[47] Undertaking J.10
[48] Exhibit No. K1.4 EB-2008-0381, Settlement Agreement, Issue #7

reached on this issue. Paragraph 1 of Issue 7 of the EB-2008-0381 Settlement Agreement is quoted 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."[49]

It is Board staff's position that the regulatory tax principles arising from EB-2008-0381 Settlement Agreement are:[50]

a. The liability for post-employment benefits should be recorded in the regulatory books of the company that directly employs the people and issues the T4s.
b. The movement in this liability 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.
c. Any post-employment benefit liabilities for staff employed by service companies, or other affiliated or associated non-regulated companies, should not be used in the distributor's calculation of the PILs provision.

Kingston Hydro has agreed that the regulated utility does not directly employ any people and does not have any employees for which Kingston Hydro issued the federal government T4s in 2009[51] and 2010[52].

The EB-2008-0381 Settlement Agreement established appropriate principles that the Board may choose to consider in this proceeding. Staff notes that the regulatory tax principles arising from the EB-2008-0381 proceeding are relevant to establishing PILs balances for the three Applicants in the EB-2008-0381 proceeding. Staff submits that these principles are appropriate for use in determining the PILs expense in the Kingston Hydro proceeding. The Board's PILs guidance issued since 2002 EDR has been followed with respect to Deferred PILs Account 1562, 2006 EDR, 2008 EDR, and beyond.

Board staff submits that the liability for post-employment benefits belongs in the regulatory books of the company that directly employs the people. Therefore, the change in future post-employment benefit liabilities should be excluded from the calculation of Kingston Hydro's taxable income and the 2011 PILs expense as Kingston Hydro does not directly employ any people.

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[49] Exhibit No. K1.4 EB-2008-0381, Settlement Agreement, Issue #7
[50] Board Staff Supplemental IR on Evidence Update #4 a)
[51] Board Staff Second Round Interrogatory #9 a)
[52] Board Staff Supplemental IR on Evidence Update #4 b)

Virtual Utility – No Exception

Kingston Hydro asserted that "while the settlement on issue no. 7 [of EB-2008-0381] may be the general rule regarding post-employment benefit liabilities, an exception should be recognized by the Board for virtual utilities."[53] Upon examination by Board counsel in the oral hearing, Mr. Murphy confirmed that an exception should be granted based on the fact that Kingston Hydro is a virtual entity.[54]

Further, Mr. Murphy was asked if the only reason given by Kingston Hydro for being granted an exception to the application of this principle with respect to post-employment benefits is because Kingston Hydro is a virtual utility.[55] Mr. Murphy agreed by saying "that, and when we went to prepare the application, there was no specific guidance for PILs calculations that I could find. There was general guidance, plus the model itself."[56]

Mr. Murphy then quoted page 58 of the 2006 Electricity Distribution Rate Handbook, paragraph 3 and stated that "so if we don't add these back appropriately for Kingston Hydro, we are in fact calculating taxes for accounting purposes as opposed to our real taxes payable."[57]

In response to the above statement, Ms. Helt enquired how any taxes could be payable if Kingston Hydro didn't have any employees.[58] Board staff is concerned with the increased impact on taxable income of including the book-to-tax adjustments of the change in future post-employment benefit liabilities, as Kingston Hydro does not have any employees.

Mr. Murphy answered that there is an amount payable through the service agreement.[59] However, upon further inquiry he stated that this is not specifically set out in the service agreement, rather it is an overarching principle that they operate on.[60]

Further, "there is no specific part of the agreement that says that Kingston Hydro is specifically responsible for the charges" [61], as articulated in the oral hearing by Mr. Murphy upon examination by Mr. Aiken.

Staff submits that it is not clear that these costs are truly the responsibility of Kingston Hydro, particularly since Kingston Hydro does not employ any people.

Further, as per the response to a Board Staff Interrogatory, "the burden rate charged by Utilities Kingston to Kingston Hydro does not include a component for post employment

[53] Board Staff Supplemental IR on Evidence Update #4 a)
[54] TR February 28, 2011, page 179 Line 11-15
[55] TR February 28, 2011, page 180 Line 14-17
[56] TR February 28, 2011, page 180 Line 18-21
[57] TR February 28, 2011, page 181 Line 1-3
[58] TR February 28, 2011, page 181 Line 5-6
[59] TR February 28, 2011, page 181 Line 7-8
[60] TR February 28, 2011, page 181 Line 14-15
[61] TR February 28, 2011, page 54 Line 23-28

benefits"[62], so the post-employment benefit cost is not included in the billed cost of labour.

Staff submits 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. Rather, it would be part of the burden rate in the price for the labour billed to Kingston Hydro. If no liability or future obligation for post employment benefits was accrued, this would mean that the impact of the change in these liabilities would not be included in Kingston Hydro's PILs provision.

Board staff submits that even though Kingston Hydro is a virtual utility, Kingston Hydro should not be treated any differently than a utility that employs people directly.

[62] Board Staff Second Round IR #9 f)

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

Kingston Hydro provided its evidence on its capital structure and cost of capital at Exhibit 5 of its pre-filed evidence. The following table found at Exhibit 5/Tab1/Schedule1/ Attachment 2, provides a summary of this evidence:

Weighted Average Cost of Debt

DEBT OUTSTANDING IN 2011

Description	Amount	Issue Date	Term Date	Interest Rate	Annual Cost
City of Kingston	10,880,619	1-Jan-00		7.25%	788,845
TD Cap. Loan	2,452,652	20-May-09	20-May-19	3.25%	79,711
TD Smart Meters	6,000,000	1-Dec-10	31-Dec-20	4.50%	270,000
TD 2009 Cap. Loan	2,213,216	1-Dec-10	1-Dec-30	4.84%	107,120
TD 2010 Cap. Loan	2,557,493	1-Dec-10	1-Dec-30	4.84%	123,783
TD 2011 Cap. Loan	2,167,550	30-Jun-11	30-Jun-31	5.00%	108,378
	26,271,530			**5.65%**	

In the partial settlement agreement, it was agreed that the TD Bank 2009 Capital Loan and the TD Bank 2010 Capital Loan would be set at 4.64% and that the TD Bank 2011 Capital Loan would be set at 4.78%.[63]

This issue is primarily one of the long term debt instrument issued to Kingston Hydro by its affiliate, the City of Kingston and the applicable interest rate of 7.25%.

Initially, on January 1, 2000 the principal amount of this loan was $12,380,619 as noted in Attachment 3 of the same exhibit.

At December 31, 2004, Kingston Hydro received repayment of $3,000,000 of its loan to an affiliate, Utilities Kingston. The proceeds of this repayment were used to repay debt of $1,500,000 in a loan to its shareholder, the City of Kingston and the other $1,500,000 was used as a dividend payment to the City of Kingston, the only dividend payment made from 2000 through 2006.

This resulted in the original affiliate loan payable to be reduced from $12,380,619 to $10,880,619, which remained outstanding at December 31, 2009, will remain outstanding until at least 2012, and likely to remain in effect well beyond 2012.

The interest rate remains at 7.25%, the originally issued interest rate. Attachment 4 of the same exhibit is the current Resolution of the Shareholder stating that the debt will remain in place until at least 2012.

During the oral hearing, Board staff entered into evidence Exhibit K1.5, the Decision and Order for Erie Thames Powerlines Corporation, EB-2007-0928, dated October 27, 2008.

[63] Partial Settlement Agreement, January 12, 2011, page 11 of 17

In this decision, the Board found that the Board's deemed long term debt rate at that time, 6.1% should apply to the shareholder debt, not 7.25%.

In response to Board staff cross examination on this issue, Mr. Murphy, the Kingston Hydro witness, indicated that Kingston had used the instructions provided in the Board's most current cost of capital report:

> "However, when we looked at the cost-of-capital report of the Board, December 11th, 2009, in preparing our application, page 54 of the second bullet point was followed by Kingston Hydro, in that:
>
> > "For debt that is callable on demand, the deemed long-term debt rate will be a ceiling on the rate that is allowed."
>
> And it goes on to say that:
>
> > "Debt that is callable but not within the period to the end of the test year will have its debt considered as if it is not callable."
>
> So our debt is not callable in the test year, so we proceeded with the original embedded debt rate of 7.25 percent."[64]

Under cross examination by Mr. Shepherd, Mr. Murphy indicated that there was nothing stopping Kingston Hydro from repaying this city note and that they could repay it at any time. It addition, Mr. Murphy also indicated that Kingston Hydro did not consider whether a lower rate could be renegotiated and did not consider paying the note off and borrowing the money elsewhere.[65]

Board Staff Issue #7 Submission

Board staff submits that the appropriate interest rate that should apply to %Kingston Hydro's affiliate debt is the Board's current deemed long term debt rate of 5.32% for rates effective May 1, 2011, as documented in the Board's letter of March 3, 2011.

Despite the fact that Kingston Hydro has demonstrated that the debt instrument in question is not callable in the test year but one year later in 2012, it is quite clear that this debt does not have a fixed rate for a finite term, it does not appear to have been re-paid according to a finite schedule and it also appears that it is convertible. It is clear that this debt instrument is renewed on a regular basis, but what is not renewed is the interest rate of 7.25%. If Kingston was seeking the lowest cost debt for its ratepayers, it would commit to lowering its cost of debt as demonstrated in its 20 year TD Bank debt at much lower rates.

Board staff notes page 54 of the Board's December 11, 2009 Cost of Capital report, which reads:

> "A Board panel will determine the debt treatment, including the rate allowed based on the record before it and considering the Board's policy (these Guidelines) and practice. The onus will be on the utility to establish the need for and prudence of its actual and forecasted debt, including the cost of such debt."

[64] TR February 28, 2011, page 187
[65] TR February 28, 2011, page 139-140

And, on page 59 of that report,

> "For new affiliated debt, the deemed long-term debt rate will be a ceiling on the allowed rate. The onus will be on the utility to demonstrate that the applied for rate and terms are prudent and comparable to a market-based agreement and rate on arms-length commercial terms."

It is Board staff's submission that Kingston Hydro has not established that the cost of this affiliated debt is prudent or comparable to a market based agreement and rate on arms-length commercial terms.

And therefore, consistent with the EB-2007-0928 Erie Thames Decision and consistent with the Board's December 11, 2010, Cost of Capital Report, the City of Kingston debt should carry the Board's deemed long term debt rate of 5.32%.

- All of which is respectfully submitted -