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April 1, 2011

BY EMAIL AND COURIER

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge St, Suite 2701  
Toronto ON M4P 1E4

Dear Ms. Walli:

**Board File No. EB-2010-0136**  
**Kingston Hydro Corporation – 2011 Cost of Service Application**  
**Energy Probe – Argument**

Pursuant to Direction provided by the Board in the Oral Hearing on February 28, 2011, please find attached the Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2010-0136 proceeding for consideration by the Board.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

*Original signed by*

David S. MacIntosh  
Case Manager

cc: Randy Murphy, Kingston Hydro (By email)  
Nancy Taylor, Utilities Kingston (By email)  
Andrew Taylor, Energy Law (By email)  
Randy Aiken, Aiken & Associates (By email)  
Interested Parties (By email)

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**Ontario Energy Board**

**IN THE MATTER OF** the *Ontario Energy Board Act, 1998*,  
S.O. 1998, c. 15, (Schedule B);

**AND IN THE MATTER OF** an application by Kingston Hydro  
Corporation for an order approving just and reasonable rates and  
other charges for electricity distribution to be effective May 1,  
2011.

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**ENERGY PROBE RESEARCH FOUNDATION  
("ENERGY PROBE")**

**ARGUMENT**

**April 1, 2011**

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**KINGSTON HYDRO CORPORATION  
2011 RATES**

**EB-2010-0136**

**ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION**

**A - INTRODUCTION**

This is the Argument of the Energy Probe Research Foundation (“Energy Probe”) related to the setting of 2011 rates for Kingston Hydro Corporation. (“Kingston Hydro”) effective May 1, 2011.

Energy Probe was an active participant in all phases of this proceeding, including participating in the Settlement Conference. The Settlement Agreement (dated January 12, 2011) represented a full settlement on all matters with the exception of seven unsettled issues that were identified in the Agreement.

This Argument has been structured to reflect the seven unsettled issues identified in the Settlement Agreement. Submissions related to the discussion of 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 have also been provided.

Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of Kingston Hydro. However, in order to minimize intervenor time and costs, a comprehensive impact analysis has not been undertaken. If the Board accepts any or all of the Energy Probe submissions, it is assumed that the direct and indirect impacts will be determined by Kingston Hydro and reviewed by intervenors and Board Staff through the associated draft rate order.

An example of a comprehensive impact analysis would include the direct impact on rate base of a reduction of \$100,000 in capital expenditures. Depreciation expense would also be directly impacted by the capital expenditure change. The indirect impacts would include the change in total cost of capital and taxes. A further example would be the direct impact on the revenue requirement of a reduction in OM&A expenses, while the indirect impact would be the associated change in the working capital allowance.

Kingston Hydro is forecasting a significant deficiency. As shown in the Revenue Sufficiency/Deficiency sheet in the Revenue Requirement Work Form attached as Appendix C to the February 4, 2011 letter to the Board that included a number of updates to the evidence, the gross revenue deficiency is \$2,641,449 on forecasted total revenues (assuming no rate changes) of \$10,234,371. The deficiency represents an increase of more than 25% in total revenue and nearly 28% in distribution revenue. As shown in the Residential sheet of the Work Form, the increase in distribution costs for a typical residential customer consuming 800 kWh per month is 43.38%.

The total bill impact for this residential customer is shown as 8.71%. However, this figure includes an energy charge of \$0.065 per kWh. If this figure is replaced by the figure of \$0.06838 per kWh, which is the Average Supply Cost for RPP Customers from the October 18, 2010 Regulated Price Plan Price Report, the energy charge increases from \$53.79 to \$56.59. This results in an increase in the total bill impact for a typical residential customer from 8.43% to 11.73%. Energy Probe submits that this increase is excessive.

## **B - UNSETTLED ISSUES**

In this section, Energy Probe provides its submissions with respect to each of the seven unsettled issues.

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

For financial statement purposes, Kingston Hydro applies the full year of amortization expense in the year of acquisition (Exhibit 1, Tab 4, Schedule 3). The evidence then goes on to indicate that for regulatory purposes, Kingston Hydro has reflected the half year amortization rule for 2005 through 2009. This has been done by restating the net book value of assets in each of 2005 through 2009 (and the 2010 bridge year) to reflect a different amortization policy from that used for financial statement purposes and which is different from that used for RRR filing purposes (Tr. Vol. 1, page 21).

Energy Probe submits that it is not appropriate for Kingston Hydro to use a different set of books for regulatory purposes than it has for financial statement and RRR reporting purposes.

Even more fundamentally important is that Kingston Hydro's proposal has the net result of ratepayers paying twice for the same assets. This can be seen based on the response to Energy Probe Interrogatories #2 and #5. The responses to these questions make it clear that the amortization of assets added in 2004 was based on the full year methodology and that it was the 2004 results that was included in the 2006 revenue requirement calculation. Specifically the amortization expense for 2006 that was included in the 2006 revenue requirement was calculated based on the full year methodology (Energy Probe Interrogatory #5b).

Kingston Hydro indicates that it did not believe that its retroactive change in the application of the half year methodology was a form of double counting (Tr. Vol. 1, pp. 22-23). Energy Probe strongly disagrees.

Rates for 2006 through 2010 include full year amortization that was built into the 2006 base rates that were subsequently adjusted under IRM for 2007, 2008, 2009 and 2010. There is no disagreement on this point (Tr. Vol. 1, page 22). In simple terms, had the half year rule for amortization been used to set 2006 rates, rates in that and the subsequent four years would have been lower than they were.

There also is no disagreement on the impact of the retroactive change in accounting policy has had in this application. Kingston Hydro is forecasting a test year rate base of \$42,417,813 (Rate Base sheet in Updated Revenue Requirement Work Form attached as Appendix C to the February 4, 2011 Update Letter). As shown in the response to Undertaking J1.1, application of the full year methodology used in setting 2006 rates to the 2006 through 2010 historical and bridge years results in a total rate base of \$41,983,853. This would reduce rate base by almost \$434,000 or more than 1.0% of the figure proposed by Kingston Hydro.

Energy Probe submits it is not appropriate for ratepayers to pay rates based on one depreciation methodology (full year) and then to pay rates that include a return on capital on a rate base that has been increased because of a retroactive change to the calculation of depreciation that was made only for regulatory accounting purposes and not for financial statement or RRR purposes.

Based on the before tax return on capital requested, Energy Probe submits that the impact on the 2011 revenue requirement is approximately \$42,000. This represents approximately 1.6% of the gross revenue deficiency claimed by Kingston Hydro, of \$2,641,449. Energy Probe submits that this amount is material. This is different than in the EB-2009-0148 Decision for Renfrew Hydro referenced by Kingston Hydro in their Submission In Chief, where the Board allowed the retroactive use of the half year rule.

In that Decision the Board stated: *"The Board will accept Renfrew's calculations for the purpose of determining its 2010 rates, given the amount is not material"* (page 27). The Board then went on to direct Renfrew to adhere in the future to the Board's policy on the half year rule. Energy Probe submits the same is true for the other Decision referenced by Kingston Hydro. The amount would not have been material for Ottawa River Power (EB-2009-0165).

Kingston Hydro quotes from the latest Filing Requirements that indicates 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. Based on this, Kingston Hydro appears to believe they are free to restate history. Energy Probe does not support this interpretation. Energy Probe believes the intent of this policy is to determine the depreciation expense for the test year and not to require (or allow) distributors to go back in time and restate their historical schedule of assets, resulting in the need for separate sets of books for regulatory purposes and financial accounting purposes. The Board is opposed to this for IFRS purposes, so it can only be assumed that the Board did not intend for this to occur for depreciation purposes.

If in the future, the Board changes its general policy and determines that capital additions in the year they enter service should attract a full year of depreciation and rates had been set based on the half year rule, then the question would be whether or not distributors would have to go back and calculate rate base based on the full year of depreciation, would ultimately reduce their net book value. These distributors would likely complain that they are effectively losing a return on capital on the difference in the net book value since their rates would not have reflected recovery of the full year methodology on depreciation expenses and then these amounts are being removed from rate base. This is the parallel impact that the Kingston Hydro approach is having on ratepayers. They have paid for depreciation in rates through the full year methodology and are now being asked to pay a return on assets that are being added back into rate base. Energy Probe submits that both results do not result in just and reasonable rates. Any change or refinement in

Board policy should not have a retroactive impact on rate base when a different policy was being used.

**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)?**

In the current application, the cost of the commodity, based on the RPP Price Report of October 18, 2010, is \$48,695,874 (Undertaking J1.2). Using the 15% factor, this translates into a rate base of approximately \$7.3 million, or more than 17% of the total applied for rate base of \$42.4 million. Kingston Hydro indicated that the cost of power represents a significant portion of rate base (Tr. Vol. 1, page 28).

Given that the cost of power represents a significant portion of the overall rate base, Energy Probe submits that the best information available to forecast the cost of power should be used. Kingston Hydro agreed with this statement (Tr. Vol. 1, pp. 28-29).

Energy Probe and Kingston Hydro disagree, however, as to what is the best information available to forecast the cost of power. In the response to Energy Probe Interrogatory #13e, Kingston Hydro states that the November, 2010 through October 2011 prices are the most suitable reflection of the 2011 test year, which serves as the basis for rates for the 2011 rate year. Ms. Taylor clarified that the rate year commences May 1, 2011 (Tr. Vol. 1, page 29).

Energy Probe disagrees that the November, 2010 through October 31, 2011 price forecasts is the best information available for the May 1, 2011 through April 30, 2012 rate year.

The non-RPP price derived from the October 18, 2010 RPP Price Report is \$65.61/MWh and is composed of the HOEP of \$39.23/MWh and the Global Adjustment of \$26.38/MWh. These figures are shown in Table 2 of the response to part (d) of Energy



Probe Interrogatory #13. The RPP price of \$68.38/MWh is composed of a Load-Weighted Price for RPP Consumers of \$42.16/MWh, the Global Adjustment of \$26.38/MWh and two other adjustments that result in a reduction in the price of \$0.16/MWh. These figures are shown in Table ES-1 of the Regulated Price Plan Price Report dated October 18, 2010 and reproduced below for ease of reference.

<b>Table ES-1: Average RPP Supply Cost Summary (for the 12 months from November 1, 2010)</b>		
<b><i>RPP Supply Cost Summary</i></b>		
for the period from November 1, 2010 through October 31, 2011		
Forecast Wholesale Electricity Price		\$39.23
Load-Weighted Price for RPP Consumers (\$ / MWh)		\$42.16
Impact of the Global Adjustment (\$ / MWh)	+	\$26.38
Total Contract Cost		\$72.67
Market Value		(\$46.29)
Adjustment to Address Bias Towards Unfavourable Variance (\$ / MWh)	+	\$1.00
Adjustment to Clear Existing Variance (\$ / MWh)	+	(\$1.16)
Average Supply Cost for RPP Consumers (\$ / MWh)	=	<b>\$68.38</b>

The load-weighted price for RPP consumers is an adjustment to the HOEP (or the forecast wholesale electricity price) shown immediately above it to reflect the usage patterns of RPP consumers. These patterns do not change materially from year to year. The ratio of the load-weighted price to the wholesale price is 1.0746877. This figure is shown in the calculations provided at page 14 of 42 of the Energy Probe Compendium (Exhibit K1.1). For comparison purposes, based on the April 15, 2010 RPP Price report, this ratio was 1.0777414, a difference of less than 0.3% from the October ratio.

In summary, the RPP prices are dependent on four main components: the forecast wholesale electricity price or HOEP, the load-weighted price for RPP consumers, the Global Adjustment and the net impact of the two other adjustments shown in the table above. This last component is quite small in comparison to the other three components.

Ms. Taylor acknowledged that the forecast wholesale electricity price (or HOEP) was the starting point, or the foundation, for the calculation of both the RPP and non-RPP prices and that the October 18, 2010 RPP Price Report provided a forecast for this rate through April 2012 (Tr. Vol. 1, page 30). Specifically, this forecast was from Table 1 of the RPP Price Report, which is summarized below for ease of reference.

**Summary of Table 1: Ontario Electricity Market Price Forecast (\$ per MWh)**

Quarter	Calendar Period	Average
Q1	Nov 10 - Jan 11	\$43.59
Q2	Feb 11 - Apr 11	\$40.59
Q3	May 11 - Jul 11	\$35.20
Q4	Aug 11 - Oct 11	\$37.57
Q1	Nov 11 - Jan 12	\$37.87
Q2	Feb 12 - Apr 12	\$33.85

As noted earlier, Energy Probe submits that the best information available should be used to forecast the cost of power. Kingston Hydro is using November 2010 through October, 2011 prices and applying this to the rate year, which is, May, 2011 through April 2012. There is only a six month overlap between the year the prices are based on and the rate year (i.e. May, 2011 through October, 2011). Energy Probe submits that the forecast that should be used is the same as the rate year, or May 2011 through April 2012. This information is available in the same RPP Price Report as used by Kingston Hydro, with an exception noted below. In particular, the forecast wholesale electricity price forecast is available through to April 2012. By extension, given the stable relationship between this variable and the load-weighted priced for RPP consumers, this component of the price forecast is also available through to April 2012.

The exception noted above is related to the adjustments, and in particular, the Global Adjustment. Ms. Taylor noted (Tr. Vol. 1, page 29) that the October, 2010 RPP Price Report did not have a forecast for the Global Adjustment beyond October, 2011. Energy Probe agrees that there is no Global Adjustment forecast beyond October 2011. Similarly, there is no forecast for other two minor adjustments noted above beyond April

2011. This means that part of the RPP and non-RPP price forecasts may not match the part of the rate year (in particular, the November, 2011 through April, 2012 six month period). However, these adjustments represent only about 38% of the RPP price and 40% of the non-RPP price.

Energy Probe submits that its proposal, while not perfect, reflects the use of better information that matches the cost of power with the rate year. Under the Energy Probe proposal, the forecast wholesale electricity price (HOEP) and the load-weighted price for RPP consumers use the latest information available and for the correct period. While the adjustments, including the Global Adjustment, do not have a forecast for the November, 2011 through April 2012 period, the use of the forecast from the October, 2010 RPP Price Report based on the period November, 2010 through October, 2011 period is exactly the same as used by Kingston Hydro. In other words, there is no change to the Global Adjustment forecast in the Energy Probe methodology from that already used by Kingston Hydro.

As Ms. Taylor noted (Tr. Vol. 1, page 29, lines 23-27), this adjustment needs to be made every six months and it is not forecast as to whether it is going to be higher or lower. The Kingston Hydro forecast uses the November 2010 through October 2011 forecast and applies it to the rate year (May, 2011 through April, 2012). The Energy Probe methodology uses the exact same forecast. The Energy Probe methodology simply uses the most recent forecast information available for the rate year to determine the HOEP and load-weighted price for RPP consumers. The Kingston Hydro approach does not.

Energy Probe had calculated the impact on the cost of power calculation at page 14 of the Energy Probe Compendium (Exhibit K1.1) if the May 2011 through April, 2012 rate year information was used. This calculation is attached as Appendix A to this Argument, but has been updated to reflect the updated volume of kWh's as shown in the response to Undertaking J1.2. The impact is a reduction in the commodity cost of power of more than \$2.3 million with a corresponding reduction in rate base of approximately \$350,000.

If the Board determines that the best information should be used to forecast the cost of power, but does not agree that the rate year period of May 1, 2011 through April 2012 should be used, then Energy Probe submits that the calendar year period should be used as the forecast period for the RPP and non-RPP prices. Use of the calendar year period in place of the rate year, would be similar to what is done for the calculation of PILs. PILs are calculated on the basis of the calendar year, even though tax changes that may take place on July 1 of a year would have a greater impact if measured on a rate year basis. Appendix B shows the calculations and the impact of using the calendar year calculations. These calculations are the same as shown on page 14 of Exhibit K1.1 with the exception of the update related to the volumes shown in Undertaking J1.2. The impact is a reduction in the commodity cost of power of more than \$0.7 million with a corresponding reduction in rate base of approximately \$107,000.

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

Kingston Hydro uses a top-down approach (Tr. Vol. 1, page 38) and the projects are selected on the basis of the availability of funds. Mr. Joyce also indicated that Kingston Hydro was *"trying to provide a bit of smoothing out of our capital expenditures over the next few years"*.

A review of the 2012 and 2013 summary forecast of 2012 and 2013 capital expenditures provided in Exhibit 2, Tab 4, Schedule 8, Attachment 1 shows estimated totals of \$4.7 million for 2012 and \$12.65 million for 2013. However, both of these figures include amounts described by Mr. Joyce as "abnormal" (Tr. Vol. 1, page 40). In particular, amounts of \$1.5 million in 2012 and \$9.45 million in 2013 are associated with a rebuild of substation number 1. Energy Probe acknowledges that the amounts associated with the rebuilt of a substation is beyond the regular level of activity. Removing these costs from the total estimates yields capital expenditures of \$3.2 million in both 2012 and 2013 for the regular capital additions. This level of capital expenditures is almost dead on the average expenditures recorded in 2005 through 2010. As shown in the table below, the average level of expenditures over this period was \$3.295 million.

The following Capital Additions table provides a summary of the evidence as filed, the adjustment to reflect 2010 actual capital additions (\$3,215,025), and the adjustment to 2010 actuals as described in the Submission In Chief of Kingston Hydro (\$3,935,000). This latter adjustment increases the actual 2010 capital expenditures by \$720,000, the amount that Kingston Hydro indicates that it would have increased its 2010 capital spending by if it had the correct information from Hydro One on the capital contribution cost.

<b><u>CAPITAL ADDITIONS</u></b>									
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>% Change</u>	<u>Source</u>
As Filed	2,202,712	2,673,516	4,513,916	2,519,141	4,648,288	3,215,025	4,513,000		(1), (2)
Updated	2,202,712	2,673,516	4,513,916	2,519,141	4,648,288	3,215,025	5,433,500		(3)
Modified	2,202,712	2,673,516	4,513,916	2,519,141	4,648,288	3,935,000	5,433,500		(3), (4)
	Increase over 2010 Actual					3,215,025	5,433,500	69.0%	
	Increase over 2010 Actual (Modified 2010)					3,935,000	5,433,500	38.1%	
	Average of 2007 - 2010 Actual					3,724,093	5,433,500	45.9%	
	Average of 2007 -2010 Actual (Modified 2010)					3,904,086	5,433,500	39.2%	
	Average of 3 Highest Years					4,125,743	5,433,500	31.7%	
	Average of 3 Highest Years (Modified 2010)					4,365,735	5,433,500	24.5%	
	Sources:								
	(1) Exhibit 2, Tab 4, Schedule 1, Attachment 1								
	(2) Settlement Agreement dated January 12, 2011								
	(3) Updated evidence letter dated February 4, 2011								
	(4) Submission In Chief dated March 11, 2011								

As the above table illustrates, no matter how you measure it, the updated proposed capital expenditure of \$5,433,500 represents a significant increase over recent capital expenditures. The forecast represents an increase of 69% over the 2010 actual additions (or 38.1% over the modified actual additions). As compared to the 2007 through 2010 average (which is significantly above 2005 and 2006 actuals), the increase proposed for

2010 is 45.9%, or 39.2% on a modified basis. Based on the highest three years (2007, 2009 and 2010) the increase is still a significant 31.7%, or 24.5% on a modified basis.

As noted above, Kingston Hydro proposes to spend whatever it can in 2011. Energy Probe submits that this is not appropriate. It should be spending whatever it needs to spend in 2011 and that this spending should be part of a longer term plan that includes relatively stable additions, recognizing that that some projects may be required periodically at significant cost, such as distribution stations. There are no such large projects included in the 2011 forecast.

Kingston Hydro appears to support stable capital expenditures over time to ensure rate stability and that if an overall increase in the level of capital expenditures is required, then it should be planned for on a staged basis in order to smooth the impact on rates. Mr. Joyce agreed with both of these statements (Tr. Vol. 1, page 39).

Energy Probe recognizes that the modified 2010 capital expenditure figure of \$3,935,000 is a better starting point for comparison purposes than the actual level of capital expenditures recorded in 2010. However, it is submitted that an increase of 24.5% over the highest three years (2007, 2009 and modified 2010) from the average of \$4,365,735 to the updated forecast of \$5,433,500 with capital expenditures projected at \$3.2 million in both 2012 and 2013 for regular additions does not represent stable capital expenditures or stable staged basis that would ensure rate stability.

In the EB-2009-0259 Decision and Order dated March 1, 2010 for Burlington Hydro Inc., the Board dealt with a similar request for approval of a significant increase in the 2010 test year capital expenditures. The following paragraph is taken from page 19 of that Decision and Order:

*"With respect to the 2010 capital budget, a number of intervenors argued for reductions on the basis that projects should be deferred. The 2010 budget is 13% higher than 2009 and significantly higher than 2007 although lower than 2008. The Board is of the view that capital programs should generally be stable over time to ensure overall rate stability, and that if an overall increase is required then that should be planned for on*

*a staged basis in a way which smoothes the rate effects. The Board also recognizes that periodically a distributor will undertake capital projects at significant cost which are beyond the regular level of activity. Burlington's capital program has varied over the period 2006 to 2009, but the level forecast for 2010 is significantly higher than the average, even taking into account inflation. The evidence indicates that the 2010 increase is due to growth in the total number of projects and associated expenditures, and not due to a particular project which would substantiate the need for a significant increase from the average over the period 2007 to 2009. The Board finds that the 2010 capital budget, for rate base determination purposes, will be limited to \$8.6 million, which approximates the average over the period 2007 through 2009 (thereby excluding the low expenditures in 2006) and incorporates an additional amount to represent inflation and overall growth in expenditures. The 2010 capital budget is therefore reduced by \$586,000, although further adjustments arise from the Board's findings below."*

Energy Probe submits that the Board should adopt a similar finding in this proceeding. In particular, Energy Probe recommends that the 2011 capital expenditures be limited to the original as filed forecast of \$4,513,000. This level is approximately 3.4% higher than the average of \$4,365,735 for the three highest years (2007, 2009 and modified 2010) and represents an increase of 14.7% over the modified actual expenditure level of 2010.

This proposed increase approximates the level of capital expenditures in the 2007 through 2010 period (excluding the low level of expenditures in 2008), with an additional amount to reflect inflation and overall growth in expenditures and is consistent with the approach taken by the Board in the EB-2009-0259 Decision and Order noted above.

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

Energy Probe submits that there are two issues that need to be determined by the Board as part of this issue. The first is the issue of whether the interest income forecast is appropriate. The second relates to the determination of excess funds held in the City of Kingston bank account and how this excess should be used to reduce the revenue requirement.

In Appendix B to the February 4, 2011 letter to the Board in which a number of updates to its evidence were provided, Kingston Hydro proposed to increase the amount of interest income on the average balance of the funds held in the City of Kingston's bank account from \$17,050 to \$75,321. This latter figure was based on an average balance to be held in the City's bank account of \$5,579,323 and on an interest rate of 1.35%. It was explained that this interest rate was based on a prime rate forecast of 3.0% for the year, less 165 basis points. These figures were confirmed by Mr. Murphy (Tr. Vol. 1, page 41). Mr. Murphy further confirmed that there were no administrative charges or fees charged by the city related to the bank balances.

As noted above, the first issue relates to whether or not the interest income forecast of \$75,321 is appropriate. Energy Probe submits that Kingston Hydro has underestimated the prime interest rate. As noted above, Kingston Hydro has assumed a 3.0% prime rate forecast for the entire 2011 year in its calculation of the \$75,321. However, Mr. Murphy revealed that this figure of 3.0% was the forecast for the first and second quarters of 2011 only and that the forecast for the third and fourth quarters of the year were 3.5% and 4.0%, respectively (Tr. Vol. 1, page 42).

Energy Probe submits that based on the forecast information that Kingston Hydro had, the prime rate forecast for 2011 should be revised from 3.0% to 3.375%, being the average of 3.0% in the first two quarters of the year, 3.5% in the third quarter and 4.0% in the fourth quarter. This would result in an interest rate payable on the bank balance of 1.725% (3.375% less the 165 basis points) in place of the 1.35% used by Kingston Hydro. The resulting interest income would increase from \$75,321 to \$96,243, an increase of more than \$20,000 or 27.8%.



With regard to the second issue, Energy Probe submits that Kingston Hydro has an excess of funds that it maintains in the City of Kingston bank account. In the response to part (c) of Energy Probe Interrogatory #53 Kingston Hydro claimed 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 in a month". Mr. Murphy provided an example of the average IESO and operating expenses that were payable each month, totally approximately \$6.8 million. At the same time the average accounts receivable at the end of a month was estimated to be \$4.0 million (Tr. Vol. 1, pp. 43-44).

Based on the above figures, and the average bank balance of \$5.5 million, Energy Probe submits that the level of excess funds held the City's bank account is \$2.7 million. This is based on the \$5.5 million bank balance plus the \$4.0 million in accounts receivable, that total \$9.5 million. Subtracting the \$6.8 million in IESO invoice and current expenditures leaves an average excess in funds of \$2.7 million.

Energy Probe further notes that Kingston Hydro has their own short term line of credit facility with a limit of \$5 million at a rate of prime (Tr. Vol. 1, page 44). Energy Probe further notes that Kingston Hydro has forecast that it will not be utilizing this line of credit in the 2010 test year (Exhibit 5, Tab 1, Schedule 1, Attachment 5, Table 6). As a result, Energy Probe submits that Kingston Hydro has more than enough capability to reduce the funds in the bank account by \$2.7 million and utilize its short term credit facility when, and if, it requires more cash than it currently has in the bank account.

If the Board agrees that Kingston Hydro has excess funds in the bank account of the City then the issue is how these excess funds should be treated for regulatory purposes.

Energy Probe submits that these funds should be used to reduce the amount of the long term debt held by an affiliate, the City of Kingston. This debt instrument, described on page 2 of Exhibit 5, Tab 1, Schedule 1, is for an amount of \$10,880,619 in the test year at a proposed rate of 7.25%.

The reduction in the amount of the long term debt held by the affiliate by \$2.7 million reduces the weighted average cost of long term debt from 5.60% as a result of the Settlement Agreement (Tr. Vol. 1, page 47) to 5.41% as shown in the following table.

			Average	Effective	Interest
			<u>Balance</u>	<u>Rate</u>	<u>Cost</u>
City of Kingston			8,180,619	7.25%	593,095
TD Bank Capital Loan			2,452,652	3.25%	79,711
TD Bank Smart Meters			6,000,000	4.50%	270,000
TD Bank 2009 Capital Loan			2,213,216	4.64%	102,693
TD Bank 2010 Capital Loan			2,557,493	4.64%	118,668
TD Bank 2011 Capital Loan			<u>1,098,621</u>	<u>4.78%</u>	<u>52,514</u>
Total			22,502,601	5.41%	1,216,681

The reduction in the weighted average long term debt rate from 5.60% to 5.41% results in a reduction to the long term debt interest costs shown in the Capitalization/Cost of Capital sheet in the Updated Revenue Requirement Work Form shown in Appendix C to the February 4, 2011 letter from Kingston Hydro by approximately \$46,000.

Energy Probe submits that this reduction of approximately \$46,000 is appropriate because it represents a prudent use of the excess funds that Kingston Hydro has forecast for 2011. Kingston Hydro has made payments on its affiliate debt to reduce the amount of the outstanding principle in the past and there are no restrictions to stop this now.

Energy Probe notes that its submission with respect to the rate used to forecast the interest income would increase the interest income to about \$96,000. If the \$2.7 million is deemed to be used to pay down the long term debt owed to the affiliate, this interest income would be reduced to about \$49,000 to reflect that only \$2.8 million of the \$5.5 million would be in the bank account earning interest. The net reduction in costs would be about \$95,000 (\$46,000 in long term debt costs and \$49,000 in interest income), in place of the \$75,000 in interest income only forecast by Kingston Hydro. This reduction in the revenue requirement is similar to that resulting from the increase in the interest rate noted earlier in these submissions.

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

### **a) Overall Level of OM&A**

Energy Probe wishes to clarify the figures discussed with respect to the increase in OM&A expenditures. Kingston Hydro addresses this issue on page 9 of the Argument in Chief. Mr. Aiken misspoke with respect to the period associated with an 8.5% increase (Tr. Vol. 1, page 49, lines 10-14). The 8.5% increase per year was not for the 2006 through 2010 period as stated, but was for the period 2006 through 2011.

In addition, Kingston Hydro has indicated in its Argument in Chief that some of the Ontario inflation rates used in the table (which is recreated below with the changes to the Ontario inflation rates suggested by Kingston Hydro) were inaccurate. Energy Probe notes that the Ontario inflation rates used in its calculations were taken directly from the Kingston Hydro evidence at Exhibit 4, Tab 2, Schedule 1, Tables 2 through 6.

Based on the inflation rates of 2.3%, 0.4% and 2.5% for 2008 through 2010 provided by Kingston Hydro in their Argument in Chief, along with a rate of 1.8% for 2007 and the forecast of 2.0% for 2011, the average annual increase in the Ontario inflation rate over the 2006 through 2011 period is 1.8%. In other words, the increase in OM&A costs over this five year period is projected to be approximately 4.7 times that of the Ontario inflation rate.

OPERATING, MAINTENANCE AND ADMINISTRATIVE EXPENSES								
								Average
		Actual	Actual	Actual	Actual	Bridge	Test	Annual
		2006	2007	2008	2009	2010	2011	Variance
Operations		978,901	1,237,794	1,857,541	2,284,260	2,502,904	2,627,053	21.8%
Maintenance		898,832	991,615	850,416	776,254	930,012	1,093,763	4.0%
Billing and Collecting		831,733	729,219	666,337	434,268	622,503	643,543	-5.0%
Community Relations		159,120	261,138	156,184	200,686	240,014	413,492	21.0%
Admin and General		<u>1,750,166</u>	<u>1,576,034</u>	<u>1,669,824</u>	<u>1,579,504</u>	<u>1,716,984</u>	2,073,056	3.4%
Updated Evidence							<u>102,734</u>	
Total OM&A Expenses		4,618,752	4,795,800	5,200,302	5,274,972	6,012,417	6,953,641	8.5%
% Change			3.8%	8.4%	1.4%	14.0%	15.7%	
Inflation Rate - Ontario			1.8%	2.3%	0.4%	2.5%	2.0%	1.8%
Sources:								
(1) Exhibit 4, Tab 2, Schedule 1, Tables 2-6								
(2) Updated evidence letter dated February 4, 2011								
(3) Kingston Hydro Argument In Chief								

More startling than the 8.5% average annual increase from 2006 through 2011 in the total OM&A costs is the increase projected between the last year of actual data, 2009 and the 2011 test year. This increase is 31.8%.

In comparison to the Burlington Hydro case noted earlier, Energy Probe notes that Burlington's 2010 test year requested OM&A costs represented an average annual increase from 2006 through 2010 of 5.19% (page 8 of the EB-2009-0259 Decision and Order dated March 1, 2010). The increase from the last year of actual data (2008) to the 2010 test year was 13.4%.

In the EB-2009-0259 Decision and Order the Board concluded that:

*"...the total level of OM&A for 2010 is excessive. At an overall level, the Board finds that the increase of 13.4% in total controllable OM&A from 2008 actual is excessive in light of prevailing conditions, updated expectations for 2009, and reasonable expectations regarding cost control."*

The Board's Decision went on to list a number of specific cost items where it felt adjustments were warranted and then concluded as follows:

*"The Board estimates that a reduction of at least \$375,000 is warranted for the specific items listed above. However, the Board also finds that Burlington has not adequately controlled its overall costs and the rate at which those costs are increasing over the period and will therefore reduce the OM&A by a total of \$450,000. The resulting level of controllable OM&A of \$14.347 million represents an almost 10% increase over 2008 actual. The Board concludes that it is reasonable to expect Burlington to operate within this level of increased expenditure."*

Energy Probe submits that at an overall level an increase of 31.8% in OM&A from 2009 actual is excessive in light of the prevailing conditions and reasonable expectations regarding cost control. These prevailing conditions and reasonable expectations are, in the view of Energy Probe, unchanged from those when the Burlington Hydro Decision was issued.

If the Board allowed a 10% increase over the 2009 actual expenditures for Kingston Hydro in the same manner as was done for Burlington Hydro, the 2011 OM&A expense would be reduced to \$5,802,469 ( $\$5,274,972 \times 1.10$ ). However, Energy Probe does not believe this would be appropriate, given the actual level of expenses recorded by Kingston Hydro in 2010. As indicated in the response to Undertaking J1.3, actual OM&A expenses in the bridge year were \$5,976,724. This amount is already more than 10% over the 2009 level of expenses. The increase is 13.3%.

Energy Probe believes that in light of the substantial increase in 2010 costs, there should be a reasonable expectation of cost control for 2011. The 2011 forecast of \$6,953,641 represents an increase in OM&A costs of \$976,917, or 16.3% over the 2010 actual expense of \$5,976,724. Energy Probe submits that this is excessively and that the increase should be limited to 5%, resulting in an OM&A expense of \$6,275,560, a reduction of approximately \$678,000. Energy Probe submits that an increase of 5% in 2011, following an increase of more than 13% in 2010 should be more than sufficient to allow the distributor to operate within the resulting level of increased expenditures.

## **b) Specific Reductions**

### **i) Increase in FTEs**

As noted above, the projected increase in 2011 OM&A expenses is nearly \$1 million over the 2010 actual expense. This increase is driven almost entirely by the increase in FTE's.

As shown in the response to Undertaking J1.4, the total compensation charged to OM&A is forecast to increase from \$3,900,767 on an actual basis for the 2010 bridge year to \$4,938,635 in the test year. This is an increase of more than \$1.0 million. A further review of the information provided in Undertaking J1.4 reveals that there is no significant increase forecast for 2011 in the average yearly base wages, average yearly overtime or average yearly benefits per employee in either of the Non-Union or Union categories shown. In fact, in some instances the 2011 forecast average compensation in these areas is lower than the 2010 actual figures. What is driving the overall increase in compensation is the significant increase in the number of FTE's in 2011 as compared to 2010 and previous years.

As the following table shows, the growth in the number of customers has been relatively steady over the 2006 through 2011 period, as has the increase in the number of FTEs over the 2006 through 2010 period. The increase in the number of FTEs from 45.94 in 2010 to 60.91 in 2011, an increase of 14.97 positions or 32.6%, is the abnormality that is driving the significant increase in compensation costs and in overall OM&A costs.

<u>CUSTOMERS PER FTE</u>					
					Average
					Annual
	<u>2006</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Variance</u>
Customers	26,166	26,724	26,845	26,977	
% change (annualized)		0.7%	0.5%	0.5%	0.6%
FTEs	38.74	43.79	45.94	60.91	
% change (annualized)		4.2%	4.9%	32.6%	9.5%
Customers/FTE	675	610	584	443	
% change (annualized)		-3.3%	-4.2%	-24.2%	-8.1%
					-3.6%
					-3.3%
Sources:					
(1) Exhibit 3, Tab 1, Schedule 1, Attachment 1 (excludes USL and street lighting)					
(2) Exhibit 4, Tab 4, Schedule 1, Table 1					
(3) Undertaking J1.4					

As the above table illustrates, the significant increase in FTEs in 2011 results in a significant decrease in the number of customers per FTE from that recorded in previous years. Of more significance is the accelerated decrease in this figure in 2011. Over the 2006 through 2010 period, the average annual decline in the number of customers per FTE was about 3.6%. The 2011 decline is more than 24%.

Energy Probe submits that there has been no justification provided for this significant and precipitous drop. If a further decline of 5% were factored in for 2011, the customer per FTE in 2011 would be approximately 555, and based on the forecasted number of customers, this would result in an FTE figure for the test year of 48.61, a decline of 12.3 FTEs from that forecast by Kingston Hydro. As shown in the response to Undertaking J1.6, the OM&A Impact of the 12.1 FTEs added in 2011 is forecast to be \$613,000. This is close to the \$678,000 reduction in OM&A expenses recommended by Energy Probe above.

It should be noted that the number of FTEs in the response provided to Undertaking J1.4 of 45.94 for the actual 2010 year was 2.23 FTEs or nearly 5% below the forecast level for the bridge year shown in Exhibit 4, Tab 4, Schedule 1, Table 1.

## ii) Non-Union Wage Increases

As shown in the response to Energy Probe Interrogatory #21, union wage increases were 3.0% in each of 2007 and 2008, 2.5% in 2009 and are forecast to be 2.75% in 2010 and 2.50% in 2011. Energy Probe accepts these increases as appropriate.

Non-union staff had increases of 4.8% in 2007, 5.3% in 2008 and 4.1% in 2009. The actual increase for non-union staff in 2010 was 3.8% and the forecast for the 2011 test year 4.0%. These figures are substantially higher than the union increases. Energy Probe submits that in the light of prevailing conditions and reasonable expectations regarding cost control, the non-union increase should be decreased by half from 3.8% to 1.9% in 2010 and from 4.0% to 2.0% for revenue requirement purposes. Based on the figures provided in the response to part (c) of the Energy Probe Interrogatory for management and non-union employees, this would reduce the OM&A cost by about \$29,228 ( $(\$3,887 + \$10.784) \times 2$ ).

## iii) Audit Fees Related to IFRS

Kingston Hydro has originally included \$58,000 for an increase in audit fees related to its first IFRS year (Board Staff Interrogatory #17). Kingston Hydro indicated in that same interrogatory response that since the adoption of IFRS has been delayed to 2012, it was reducing this incremental cost to \$17,500. This amount was on the average of the total expected audit fees for 2011, 2012, 2013 and 2014.

Energy Probe submits that this amortization should not be allowed by the Board to increase the revenue requirement for the 2011 test year. Kingston Hydro is attempting to recover a potential 2012 cost in the 2011 test year. The \$17,500 in amortized 2012 costs should be removed.



iv) Late Payment Penalty Litigation Costs

Kingston Hydro has included \$104,600 in late payment penalty litigation costs in operating expenses associated with other resources allocated to regulatory matters (Energy Probe Interrogatory #46 (c)). This cost was amortized over 4 years, with \$26,138 included in the 2011 revenue requirement.

Kingston Hydro indicated that this amount would be removed from the revenue requirement at the beginning of the oral hearing (Tr. Vol. 1, page 2). Energy Probe submits that this is appropriate since the late payment penalty litigation cost will be recovered through a separate mechanism.

v) Utilities Kingston Board of Directors

Kingston Hydro has included an amount of \$2,286 associated with Board of Director costs of its affiliate Utilities Kingston. Energy Probe submits that these costs should not be recovered from ratepayers. The Board has indicated in several Decisions that the costs associated with the Board of Directors of affiliate or parent companies are not recoverable from ratepayers.

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

Energy Probe submits that Kingston Hydro has not provided any evidence to suggest that the PILs Schedule 1 adjustment for future benefit liabilities is appropriate.

While there was some confusion around this issue as illustrated in the cross-examination of Mr. Shepherd (Tr. Vol. 1, pp. 141-151), two facts are clear. First, Kingston Hydro has no employees and all of the FTEs utilized by Kingston Hydro are employees of Utilities Kingston (Energy Probe Interrogatory #25a). Second Kingston Hydro has included a net amount of about \$250,000 related to reserves for employee future benefit liabilities (Tr. Vol. 1, page 146).

The issue, as Energy Probe sees it, is whether or not Kingston Hydro should be allowed to recover the PILs impact associated with future benefit liabilities for employees of its affiliate, Utilities Kingston.

Energy Probe submits that Kingston Hydro should not be allowed to recover the PILs component associated with the additions and deletions to the taxable income of the future benefits. This is because Kingston Hydro has failed to provide any evidence that it has to pay Utilities Kingston for these liabilities.

In the response to part (c) of Board Staff Second Round Interrogatory #9, Kingston Hydro indicated that it was responsible for the future benefit liability reserve charges in accordance with the Utilities Kingston/Kingston Hydro agreement included in the application at Exhibit 1, Tab 2, Schedule 3, Attachment 3. However, when asked to identify the specific wording in the agreement that says that Kingston Hydro is responsible for these charges, Mr. Murphy indicated that there was no specific part of the agreement that said that Kingston Hydro was specifically responsible for these charges (Tr. Vol. 1, pp. 54-55). Mr. Murphy further agreed that it was true that the responsibility of Kingston Hydro for these charges is based on an assumption that these costs include any tax-related impacts of the Utilities Kingston employees.

The responses provided to Mr. Shepherd (Tr. Vol. 1, pp. 141-142) and to Ms. Helt (Tr. Vol. 1, page 181) were consistent in that Kingston Hydro does not have specific wording in an agreement that indicates it is responsible for these costs. Rather, Kingston Hydro indicated that it was their "understanding and interpretation of the services agreement" that has resulted in them including this cost in the revenue requirement. Energy Probe submits that in the absence of a written agreement that specifically deals with these costs and their associated tax implications, there is no reason, in the view of Energy Probe, for the Board to allow these costs to be borne by ratepayers.

If the Board does allow some or all of these employee related costs to be recovered from ratepayers, then Energy Probe submits that an adjustment to the \$250,000 figure should be made. First, the amount should be amortized over 4 years and the impact on taxes reduced as shown in the response to Undertaking J1.10. Second, because this amount is determined by the number of employee additions, any reductions in the number of employees should be reflected in a reduction in the associated benefit liabilities. Finally, Energy Probe submits that Kingston Hydro should be directed to account for any tax credits associated with the Co-op Education Tax Credit, the Apprenticeship Training Tax Credit and the Federal Tax Credit in its tax calculations.

Mr. Murphy indicated that Kingston Hydro has not received any of those tax credits from Utilities Kingston (Tr. Vol.1, page 55). Under re-examination from Mr. Taylor, Mr. Murphy indicated that Utilities Kingston has never received any of these tax credits and that they do not feel that they have ever had the qualifications to qualify for these tax credits. Energy Probe submits that if Utilities Kingston has hired or plans on hiring any apprentices that would be eligible for these tax credits, then these credits should be allocated to Kingston Hydro for the regulatory tax calculation. It would not be fair to expect Kingston Hydro ratepayers to pay the tax liability associated with employees of its affiliates while at the same time denying them the credit associated with the tax credits for hiring apprentices. Kingston Hydro has recognized the need to hire new journeypersons (Exhibit 4, Tab 2, Schedule 3, page 17) so there is no reason to expect that such credits would not be available.

**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?**

Energy Probe submits that the interest rate applicable to the affiliate long term debt should be reduced from 7.25% to deemed rate of 5.32% as provided in the Board's letter of March 3, 2011 re Cost of Capital Parameter Updates for 2011 Cost of Service Applications for Rates Effective May 1, 2011.

Kingston Hydro has affiliate debt in the amount of approximately \$10.9 million for the 2011 test year (Exhibit 5, Tab 1, Schedule 3, page 2 & Exhibit 5, Tab 1, Schedule 1, Attachment 2, page 1). This debt is held by the City of Kingston and is at a fixed rate of 7.25%. As shown in Attachment 3 of Exhibit 5, Tab 1, Schedule 1, this debt is a Note Payable with no fixed terms of repayment. In other words, this loan is callable upon demand by the City of Kingston. The issue is whether or not this loan is callable within the test year and whether ratepayers should be expected to shoulder the costs associated with the 7.25% that was put in place in 2000.

In the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities* dated December 11, 2009, (the "Report") the Board indicated that for affiliated debt with a fixed rate, the deemed long term debt rate at the time of issuance would be used as a ceiling on the rate allowed for that debt.

The Board also indicated that that for debt that was callable on demand within the test year period, the deemed long term debt rate would be a ceiling for the rate allowed for that debt. Debt that was callable, but not within the period to the end of the test year, would have its cost considered as if it was not callable.

Kingston Hydro is relying on a City of Kingston resolution dated July 7, 2010 (Attachment 4 of Exhibit 5, Tab 1, Schedule 1) to confirm that this debt is not callable within the test year and, as a result, the rate of 7.25% should be applied.

Energy Probe submits that the Board should ignore the City of Kingston resolution upon which Kingston Hydro relies to support its position. This submission is based on the following four considerations.

First, the resolution did not change the actual debt instrument. That debt instrument remains as a Note Payable with no fixed terms of repayment and there is no restriction imposed on the notice required for repayment.

Second, the resolution can be overturned by the City of Kingston municipal council. As indicated by Mr. Keech (Tr. Vol. 1, pp. 56-57), the City of Kingston has the ability to overturn or reverse a resolution. Mr. Keech provided his understanding of the requirements for a two-thirds majority to agree to table the resolution before it can be voted on again. Mr. Keech also indicated that this two-thirds majority was needed to overturn a resolution within the year. Energy Probe notes that the resolution was passed in July 2010. As a result, much of the 2011 test year is beyond this one year limitation, so a simple majority could rescind or replace the resolution with another resolution that could revert to the original debt repayment terms and requirement payment within the test year. In either case, it is clear, in the submission of Energy Probe, that the debt can still be called within the test year by the City of Kingston.

Third, Kingston Hydro has demonstrated that it has the capability to obtain significant amounts of third party financing at competitive rates. This can be seen by reviewing the loans from the TD Bank shown in Attachment 2 of Exhibit 5, Tab 1, Schedule 1. There are a total of 5 loans from the TD Bank shown, totalling more than \$14.3 million with 10 and 20 year terms. As shown in the Settlement Agreement, the rates applicable to these loans range from 3.25% to 4.78%.

Kingston Hydro has also indicated that it has had discussions with Infrastructure Ontario about obtaining long term funding (Energy Probe Interrogatory #30). Energy Probe notes that as of March 15, 2011, the rate on a 10 year term amortizer loan from Infrastructure Ontario is 3.98% while the rate for a 20 year term is 4.72%. These rates are in line with the rates paid on the five loans to the TD Bank noted above.

In the response to part (c) of Energy Probe Interrogatory #31, Kingston Hydro has indicated that it has not investigated the possibility of refinancing its affiliate debt because of restrictions in the Eligible Expenditures regulation under the Municipal Act and the City's desire for the debt instrument to continue.

On the first rationale provided for not refinancing the affiliate debt related to the restrictions under the Municipal Act, Energy Probe submits that this is a non-issue. It is Energy Probe's understanding of these restrictions is that the City of Kingston would not be able to loan any money to Kingston Hydro if the existing loan was repaid to the City (Tr. Vol. 1, page 185). As described above, Kingston Hydro has a proven track record in obtaining significant amounts of debt at market rates from third parties. There is no indication that Kingston Hydro cannot obtain financing from anyone other than an affiliate. The restrictions under the Municipal Act are not relevant when the utility can obtain third party financing and not require any affiliate debt.

With respect to the second rationale provided, Energy Probe understands why the City would want to continue the debt instrument, since the rate received on the callable loan is significantly above market rates that would be available to it. As noted above, the market rates from the TD Bank and Infrastructure Ontario for 10 and 20 year terms are currently in the 4% to 5% range. Rates for money that is callable are less. However, Energy Probe submits that what the City wants should be irrelevant from a regulatory point of view. The only issue is what ratepayers should be expected to pay. The issue here is: Has Kingston Hydro done what is best for its ratepayers?

As indicated in the Report, the Board indicated that it was *"of the view that the onus is on the electricity distribution utility to forecast the amount and cost of new or renewed long-term debt. The electricity distribution utility also bears the burden of establishing the need for and prudence of the amount and cost of long-term debt, both embedded and new"*. The Board also indicated that it was of *"the view that electricity distribution utilities should be motivated to make rational decisions for commercial "arms-length" debt arrangements, even with shareholders or affiliates."*

Energy Probe submits that Kingston Hydro has failed to justify the continuation of the embedded affiliate debt at a rate of 7.25% when replacement funds are available at significantly lower costs that would benefit its ratepayers not only in the test year, but also over the next 10 to 20 years.

Fourth, and finally, Energy Probe submits that the original debt instrument meets the criteria established by the Board in the Report related to debt that is callable on demand within the test year. The resolution passed by the City of Kingston is an obvious attempt to protect its revenue from a rate that is well above market rates available from third party lenders.

Energy Probe notes that the resolution passed by the City of Kingston tries to bypass the Board's requirement that debt that is callable within the test year have a rate that is capped by the Board's deemed long term debt. At the same time the resolution re-affirms a rate of 7.25%, which is clearly not a market based rate.

It is not clear if Kingston Hydro agreed to these terms. If it did, it was not acting in the best interest of its ratepayers. If it did not agree to these terms, then Energy Probe submits that the loan agreement was fundamentally changed by the lender and the resulting loan (terms of repayment and rates) should be considered as a new loan arrangement and that the continuation of a rate of 7.25% is not appropriate and should be subject to the ceiling of the deemed long term rate as determined by the Board.

Energy Probe submits that the Board should not accept the strategic adjustments contained in the resolution of the City of Kingston. Energy Probe notes that the Board has already dealt with a similar circumstance in the EB-2007-0928 Decision and Order dated October 27, 2008 for Erie Thames Powerlines Corporation. In that Decision the Board found that the Section 2.2.1 of the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (Board Report) was "*designed to ensure that interest costs for variable rate debt is deemed at a rate that*

*is reasonable, and not subject to strategic adjustments according to the circumstances of the parties, especially where the interest rate applied is high."* (page 23)

Energy Probe submits that Section 4.4.1 of the current Report is designed to ensure the same result as the Board Report. In particular, the Report ensures that interest costs for callable debt is deemed at a rate that is reasonable and not subject to strategic adjustments (i.e. a resolution that adjusts the loan agreement to change the time when it is callable, while at the same time does not change the rate to reflect market realities) that provide a benefit to the debt holder at the expense of ratepayers.

As shown in the following table, use of the Board's deemed long term debt rate of 5.32% for the affiliate debt reduces the weighted average long term rate from 5.60% to 4.77%.

			Average	Effective	Interest
			<u>Balance</u>	<u>Rate</u>	<u>Cost</u>
City of Kingston			10,880,619	5.32%	578,849
TD Bank Capital Loan			2,452,652	3.25%	79,711
TD Bank Smart Meters			6,000,000	4.50%	270,000
TD Bank 2009 Capital Loan			2,213,216	4.64%	102,693
TD Bank 2010 Capital Loan			2,557,493	4.64%	118,668
TD Bank 2011 Capital Loan			<u>1,098,621</u>	<u>4.78%</u>	<u>52,514</u>
Total			25,202,601	4.77%	1,202,435

The reduction in the weighted average long term debt rate from 5.60% to 4.77% results in a reduction to the long term debt interest costs shown in the Capitalization/Cost of Capital sheet in the Updated Revenue Requirement Work Form shown in Appendix C to the February 4, 2011 letter from Kingston Hydro by approximately \$198,000.

Energy Probe further notes that if the Board accepts the deemed reduction in the amount of the affiliate debt by \$2.7 million as submitted under Issue 4 above, the weighted average long term debt rate would decline further, to 4.71%, and result in a reduction to the revenue requirement of more than \$212,000.



## **C - OTHER - INTERVENOR COSTS**

Kingston Hydro has requested that intervenors provide their actual costs so they can be incorporated into the revenue requirement. If the distributor then objects to any of these costs and Board reduces the intervenor costs, a variance account would be used to ensure that this reduction in costs would flow to ratepayers. This would effectively be an asymmetric variance account since the intervenor costs could not be higher than their actual costs.

Energy Probe submits that the Board should reject the approach to intervenor costs proposed by Kingston Hydro for a number of reasons.

First, Energy Probe notes that Kingston Hydro has forecast intervenor costs of \$75,000 (Exhibit 4, Tab 2, Schedule 4). These costs are then amortized over four years, resulting in the inclusion of \$18,750 in the test year revenue requirement.

Energy Probe further notes that the Materiality Threshold used by Kingston Hydro is \$50,000 (Exhibit 1, Tab 4, Schedule 8) and that this same threshold has been used for OM&A expenditures (Exhibit 4, Tab 1, Schedule 1, page 5).

In other words, the cost included in the 2011 revenue requirement (\$18,750) is significantly below the materiality threshold (\$50,000). In fact, intervenor costs would have to be nearly triple that forecast by Kingston Hydro before they would approach the materiality threshold. Energy Probe assures the Board that this is not likely to occur. Energy Probe's preliminary estimate of its costs is in the range of \$30,000 to \$33,000 for this proceeding.

Second, Kingston Hydro indicates that its request would protect ratepayers. Energy Probe notes that this would only be the case if the Board makes a separate finding with respect to regulatory costs as part of the OM&A expenditures. If the Board were to approve a level of total OM&A expenses that included regulatory costs, it is actually the shareholder that benefits from intervenors providing actual costs to be included in the

OM&A figure approved by the Board. If the Board requires intervenors to provide their actual costs (or their best estimate of these costs at a point in time), then the shareholder has reduced their risk of under forecasting this particular expense and is able to pass on any actual costs in excess of those forecast to the ratepayers. The asymmetric variance account proposed by Kingston Hydro (asymmetric because intervenor costs would not be higher than their actual costs) would return any costs disallowed by the Board to ratepayers that would otherwise accrue to the shareholder, but if the approved costs were higher than the forecast, this difference would still be passed on to the ratepayers.

Energy Probe submits that if the Board is inclined to remove the risk of under forecasting for the shareholder related to the cost of intervenors for this proceeding, then ratepayers deserve a similar arrangement with respect to the other costs associated with this proceeding.

In particular, Energy Probe submits the following. Asymmetric variance accounts should be established around each of the legal and consulting costs associated with this application. The first variance account would be around the legal costs of \$100,000. If the actual legal costs associated with this proceeding are less than this amount, the difference should be returned to ratepayers. Similarly, the second variance account would be around the consultant costs of \$125,000 and if these costs are less than this amount, the difference would also be returned to ratepayers. These figures are provided on page 1 of Exhibit 4, Tab 2, Schedule 4. Energy Probe notes that in aggregate these legal and consulting costs total \$225,000, three times the amount of the forecasted intervenor costs.

Finally, counsel for Kingston Hydro indicated that he believed that there was an obligation of intervenors to inform the applicant during the evidentiary portion of the proceeding if their forecast is off (Tr. Vol. 1, page 92). Energy Probe submits that if the Board accepts this principle, then it should also be observed by the applicant. There should be an obligation of the applicant to provide intervenors and the Board with information if their legal and/or consulting costs associated with this application are off.

This obligation would not stop there. For example, should the applicant be required to provide information based on any actual costs that the utility has where the forecast may be off? This could include the OEB Annual Assessment or the fees paid to the Electrical Safety Authority, both of which are included in the regulatory costs. On a larger front, should the utility be obligated to provide any differences in wages and benefits paid in the first few months of the test year to reflect actual vacancies as compared to those forecast. As noted elsewhere in this submission, the number of filled positions was significantly lower than the number of positions forecast for the 2010 bridge year, which could have a carryover impact to the first few months of the test year.

The problem with this approach, of course, is where and when does it end?

## **D - COSTS**

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Recognizing the size of Kingston Hydro, Energy Probe has attempted to minimize its time on this application, while at the same time ensuring a thorough review on behalf of ratepayers. This was accomplished through co-operation with other intervenors to ensure no duplication of effort wherever possible, including cross-examination. As a further example, Energy Probe regularly circulates its draft interrogatories and/or technical conference questions to other intervenors when it has prepared these questions in advance of the filing dates.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

**April 1, 2011**

**Randy Aiken**

**Consultant to Energy Probe**

## **Appendix A to Energy Probe Argument**

May, 2011 - April, 2012

	Months	Price
May-Jul	3	35.20
Aug-Oct	3	37.57
Nov-Jan	3	37.87
Feb-Apr	3	33.85
Weighted Average		36.12
Global Adjustment		<u>26.38</u>
Non-RPP Price		62.50

Load Weighted Price for RPP Consumers	42.16
Forecast Wholesale Electricity Price	39.23
Ratio	1.07468774
May-Apr Weighted Average	36.12
May-Apr Load Weighted Price for RPP Consumers	38.82
Global Adjustment	26.38
Adjustment to Address Bias	1.00
Adjustment to Clear Existing Variance	<u>-1.16</u>
RPP Price	65.04
Weighted Average (51.84% non-RPP, 48.16% RPP)	63.72
Difference in Average Rate from 66.94	-3.22
Difference in Commodity Costs (727,411,417 kWh)	-2,342,265

## **Appendix B to Energy Probe Argument**

January, 2011 - December, 2011

	Months	Price
Jan	1	43.59
Feb-Apr	3	40.59
May-Jul	3	35.20
Aug-Oct	3	37.57
Nov-Dec	2	37.87
Weighted Average		38.28
Global Adjustment		<u>26.38</u>
Non-RPP Price		64.66
Load Weighted Price for RPP Consumers		42.16
Forecast Wholesale Electricity Price		39.23
Ratio		1.07468774
Jan-Dec Weighted Average		38.28
Jan-Dec Load Weighted Price for RPP Consumers		41.14
Global Adjustment		26.38
Adjustment to Address Bias		1.00
Adjustment to Clear Existing Variance		<u>-1.16</u>
RPP Price		67.36
Weighted Average		65.96
(51.84% non-RPP, 48.16% RPP)		
Difference in Average Rate from 66.94		-0.98
Difference in Commodity Costs (727,411,417 kWh)		-712,863