Kingston Hydro

April 15, 2011

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

Dear Ms. Walli,

**RE: Kingston Hydro Corporation-EB-2010-0136 Cost of Service Rate Application
Reply Submission of the Applicant**

Please find attached the Reply Submission of the Applicant, Kingston Hydro Corporation.

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

Respectfully submitted,

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

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

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ONTARIO ENERGY BOARD

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

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

REPLY SUBMISSION OF THE APPLICANT

Kingston Hydro Corporation

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 has used half-year depreciation for the 2011 test year. This is not being contested. What is being contested is Kingston Hydro's use of the half year rule since last rebasing (for the years 2005 to 2010).

Parties claim that this is not consistent with the Board's policies. Kingston Hydro disagrees.

The Board's Filing Requirements for Transmission and Distribution Applications (the "Filing Requirements") provide:

> "In particular, the Board's general policy for electricity distribution rate setting is that capital additions would normally attract six months (i.e. half-year) of depreciation expense in the year that they enter service. The applicant should identify its historical practice and its proposal for the test year. Variances from this "half-year" rule must be documented with supporting rationale." [Section 2.5.7 bullet point 3]

Kingston Hydro submits that the words above do not support the intervenors' and Board Staff's interpretation that the Board's policy is that half-year depreciation should be used only for the test year. The plain reading of the words is that using half-year depreciation is in fact the general rule. This is Kingston Hydro's interpretation, as has been the interpretation of many other distributors that have filed rebasing applications and in which the Board had to decide or will need to decide on this issue. The fact that many distributors have filed on the same basis as Kingston Hydro suggests, at a minimum, that Kingston Hydro's interpretation is a widely held interpretation. The interpretation by Board Staff and others when they suggest that Kingston Hydro's approach is inconsistent with the Board policy has not been substantiated.

Board staff asserts that section 2.5.7 of the current Filing Requirements dated June 28, 2010 does not allow the half-year rule be applied to past years and that the Filing Requirements have been enhanced from the previous version to accomplish just that. Kingston Hydro notes that the current version of the Filing Requirements, for 2011 applications, in particular bullet point 3 of section 2.5.7 highlighted above, does not differentiate between the method of depreciation for capital additions in the test year versus capital additions that a distributor makes in between cost of service applications. Board Staff's assertion therefore cannot stand.

Particularly, Board Staff asserts that the "enhancement" in the June 28, 2010 version was intended to reflect the Board's decision in the Kitchener-Wilmot Hydro's case. First, the Board has not provided such rationale; this information seems to be esoteric to Board Staff. Second, the issue in the Kitchener-Wilmot Hydro case, relied on by Board Staff, did not deal with the specific issue at hand; the specific issue in that case was only whether the half-year rule should apply to the test year, not to past years. Third, the Kitchener-Wilmot Hydro decision is dated April 7, 2010; since that time the Board dealt with the full depreciation issue in the Renfrew Hydro decision (November 15, 2010) and Ottawa River Power decision (December 14, 2010). In both these decisions the Board approved the half-year rule for prior years as well as for the test year. In fact, in those cases Board Staff relied on interrogatory responses in which both utilities confirmed that <u>for ratemaking purposes</u> they had applied the half-year rule for historical years. In its decision in Renfrew Hydro, the Board stated that "Board staff noted that clarification had been provided on the half-year rule which showed Renfrew had used the half-year rule consistent with Board instructions". Thus, Board Staff stated it had "no issue". In the Ottawa River decision, the Board made a similar statement. Therefore the Board had noted and accepted that argument by Board Staff. For unknown reasons, Board Staff now argues differently.

Board Staff alleges that the company's approach is a "restatement" and Energy Probe claims that the ratepayers are paying twice. Kingston Hydro submits that both parties' positions miss the point entirely. The last rebasing by the company was in 2006, based on 2004 historical financial information. The only assets in rate base prior to this Cost of Service application were those assets in service prior to 2005. Assets purchased from 2005 through 2010 are only now <u>and for the first time</u> included in rate base for rate making purposes as part of this 2011 Cost of Service application. The depreciation charge being recovered in current rates (since May 1, 2006) reflects the depreciation of those pre 2005 assets, not since then. There is therefore no issue of restatement of rate base or ratepayers paying twice.

Energy Probe submitted that it is not appropriate for Kingston Hydro to use a different set of books for regulatory purposes than it has for financial statement RRR reporting purposes. Board Staff also note Kingston Hydro employed full -year depreciation accounting in its financial statement reporting.

Section 2.1.13 of the current (May 1, 2010) edition of the *Electricity Reporting and Record Keeping Requirements* ("RRR") states that information submitted for regulatory accounting purposes can differ from financial statement purposes. In particular, the section requires a distributor to provide Uniform System of Accounts balances reconciled to the audited financial statements. This requirement acknowledges that audited financial statements do in fact differ from those for regulatory accounting purposes. The RRR filing requirements are to support the audited financial statements. They are not to determine rate base for rate making purposes. Section 2.2.3 of the filing requirements requires the utility to file "a detailed reconciliation of the financial results shown in the Annual Reports/Audited Financial Statements with the regulatory financial results filed in the application in order to separate non-utility business <u>and to validate the regulatory</u>

financial results filed in the application." This provision recognizes that regulatory financial information used for rate making purposes can in fact differ from audited financial statements. The addition of bullet point number 3 in section 2.5.7 of the June 28, Filing Requirements explicitly states the Board's policy for "electricity distribution rate setting" is the half-year rule. Kingston Hydro is surprised that these points have been ignored or missed by Energy Probe and by Board Staff.

SEC argues that it is the Board's longstanding requirement that utilities obtain Board approval, either in a rate case or by way of accounting order, for any change in their regulatory accounting methods or policies. Interestingly, SEC is the only party making that assertion. Kingston Hydro submits that there is no such Board requirement, and questions the basis for this position.

If Kingston Hydro is required to take full year depreciation on assets purchased in the period 2005-2010 instead of half year rule depreciation, then Kingston Hydro would never be able to include $433,960 in its rate base, the difference between the full year depreciation and the half year depreciation. This would result in the shareholder paying for these capital assets without an opportunity for recovery under the Board's current regulatory construct. This would be contrary to fair rate making principles, if not confiscatory. Moreover, this would weaken the Board's current regulatory construct of not being able to true-up rate base during the term of IRM.

In summary, Kingston Hydro submits that its calculations of net fixed assets and resulting rate base reflecting depreciation on the half-year is consistent with the Board's policy as currently stated and consistent with recent Board decisions. Kingston Hydro submits that a different finding cannot be supported on the evidence and it would undermine the intent of the Board's current regulatory construct.

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

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

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

Kingston Hydro in its original submission used the cost of power estimates that were issued by the Board on April 15, 2010, as that was the most recent Board approved RPP rates report. This was subsequently updated in response to Interrogatory 13 from Energy Probe to use the RPP calculation from the report issued by the Board on October 18, 2010.

Energy Probe (supported by VECC) and Board Staff suggested that the Board should use the forecast cost of power values that would pertain to the rate year, in this case May 1, 2011 to April 30, 2012. In the alternative, Energy Probe suggested that the prices to be applied be those of the 2011 test/calendar year (January 1, 2011 - December 31, 2011). SEC disagreed with Board staff's and Energy Probe's rate year approach, and argued that it would be appropriate to use the test/calendar year prices. Board staff noted that if the timing of the Rate Order in this proceeding will allow for the Board's new prices in the pending April 2011 report be used for the 2011 rate year.

In its decision with respect to Kitchener-Wilmot Hydro's 2010 rate application (EB-2009-0267-Decision dated April 7, 2010), the Board stated:

> "The Board has reviewed the parties' comments on this matter and concludes that the October 15, 2009 data should be used in determining the RPP and non-RPP prices to determine the commodity cost of power. The Board notes that the record of this application closed on February 10, 2010. The Decision of April 7, 2010 is based on the record as at February 10, 2010. The Board's finding regarding the use of the most accurate data was in response to Board staff's and intervenors' submissions that the most current prices should be used. At the time of the Board's Decision, the most current prices were those based on the October 15, 2009 report. The draft rate order process is a mechanistic exercise intended to implement the Board's findings in a decision. Unless explicitly stipulated in the decision, no new information can be used when determining the final Tariff of Rates and Charges."

Consistent with that Board finding, Kingston Hydro submits that the Board should use the Board's prices that pertain to the November 2010 to October 2011 period arising from the Board's October 2010 report. The evidentiary record in this proceeding was closed on February 28, 2011.

As indicated by Board staff in its submission, Kingston Hydro witness, Ms. Taylor, did agree that the best information available should be used to forecast the costs of power. However, Ms. Taylor went on to say:

> "it strikes me on reading the report of the Board that was issued October 18th, that we don't have all of the information yet in order to forecast beyond April 30th of 2011, specifically because it seems that the other adjustment that needs to get made every six months is on the global adjustment number"[1]

It is the view of the applicant that the absence of a forecast for the Global Adjustment is a significant factor. The Global Adjustment amount typically increases when the Hourly Energy price declines. The forecast in the October 18, 2010 report of the Board is that Hourly energy prices will decline over the six quarters that are forecast resulting in the lowest energy price being forecast for the second quarter of 2012. The Global Adjustment that would offset this lower energy price is not available in the October 2010 report as the report indicates at page 16 that the Global Adjustment forecast is for the period November 1, 2010 to October 31, 2011. The Applicant disagrees with Energy Probe's assertion at page 6 of its submission that adjustments to components that represent in total 38%-40% of the total price are insignificant. It appears to the Applicant that the argument to use a lower hourly energy price in the absence of matching that price with a higher Global Adjustment value is opportunistic.

It is Kingston Hydro's understanding that the RPP calculation that is approved by the Board uses the Hourly energy price forecast for the 12 months from the implementation date of the new RPP rates, that is, typically May 1 and November 1.

Therefore, it is our understanding that the 12 months November 1, 2010 to October 31, 2011 were used in the most recent calculation of RPP and non-RPP pricing. Projections for the six months beyond April 30, 2011 are very likely to be subject to change. At the time of this submission the April 2011 RPP report has not yet been issued.

Therefore Kingston Hydro submits that the most recent in-effect 12 month projections are the appropriate numbers to use in the calculation of the cost of power.

[1] TR February 28, 2011, Page 29

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

Based on its updated evidence, Kingston Hydro is requesting approval for Capital Expenditures during 2011 of $5,433,500.

Board Staff supports Kingston Hydro's 2011 capital budget, and does not propose any reductions. Board Staff acknowledges that 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 is a valid reason for justifying the high percentage increase.

SEC supports Kingston Hydro's top-down budgeting approach. However, SEC joined the other intervenors in suggesting a reduction in the proposed capital budget. Kingston Hydro addresses below the specific issues raised by the intervenors under relevant subject headings.

Comparison of 2011 capital expenditures with 2010 and other years

Energy Probe produced a variance analysis of the capital additions based on Kingston Hydro's Submission in Chief, in which Kingston Hydro normalized the variances to account for Hydro One's inaccurate capital contribution estimate. As explained in the Submission in Chief, because of Hydro One's inaccurate estimate, capital expenditures in 2010 were artificially low. Comparing the artificially low 2010 capital expenditures with capital expenditures in 2011 will of course show a high increase but it is not reasonable to compare the two numbers and make conclusions on a simple arithmetic comparison. As discussed at the oral hearing (transcript page 35, lines 26+), 2010 capital expenditures were at a low level because instead of owing Hydro One $609,000 for the Gardiners TS, Kingston Hydro received a refund of approximately $121,000. Had Hydro One provided Kingston Hydro with the information that it would be receiving a $121,000 refund in 2010, instead of a $609,000 capital contribution cost, Kingston Hydro would have spent the $609,000 budgeted cost and the $121,000 refund in 2010 on other projects. This would have increased the 2010 capital additions from $3,215,000 to $3,945,000. Further, Kingston Hydro explained that it would not have increased its 2011 capital additions by the $609,000 and $121,000 as it did, which would have reduced the $5,433,500 capital additions to $4,703,500. Therefore, the normalized amounts for 2010 and 2011 are $3,945,000 and $4,703,500 respectively.

Energy Probe's variance analysis contemplates the normalized capital addition increase in 2010, but fails to contemplate the corresponding normalized capital addition decrease in 2011. The table at page 12 of Energy Probe's Submission includes a row labelled "modified" (this is the same as what Kingston Hydro refers to above as "normalized"). In this row, Energy Probe included $3,935,000 for 2010 (this number is off by $10,000, but this error is not material), and $5,433,500 for 2011.

References for both of those numbers are in Kingston Hydro's Submission in Chief (footnote #4). However, the normalized 2011 number that Kingston Hydro included in its Submission in Chief was $4,703,500, not $5,433,500. Kingston Hydro submits that any variance analysis conducted by Energy Probe that normalizes 2010 but does not make the corresponding normalization for 2011 is flawed, since Hydro One's inaccurate estimate affected both the 2010 and 2011 capital budgets.

As explained in Kingston Hydro's Submission in Chief, had Hydro One provided Kingston Hydro with the correct information in 2010, Kingston Hydro's variance in capital additions from 2010 to 2011 would have been approximately $778,000, or 20% (as opposed to 38.1% as suggested by Energy Probe). Kingston Hydro submits that this 20% variance is the appropriate variance for consideration by the Board, if indeed the Board's deliberations were to be driven by simply a year over year comparison, which the Applicant suggests would be too simplistic of an approach given the unique circumstances in this case.

With respect to the 2011 level compared to previous years, again this must be placed in the right context. At Exhibit 2, Tab 1, Schedule 1 and throughout the oral hearing, a historical context was provided on how past emphasis on keeping rates low has resulted in years of underfunding of capital reinvestment in the distribution system. This historic underfunding has resulted in lower rates, but has also taken a toll on the operational integrity of the distribution system.

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

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

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

<u>Top-down approach and 2011 capital expenditures</u>

According to Energy Probe (at page 13), Kingston Hydro should not spend whatever it can in 2011, but should spend on whatever it needs to spend in 2011. To that end, Energy Probe opposes the inclusion of the Substation No. 3 project, which was added to the original 2011 capital addition forecast as a result of the inaccurate Hydro One estimate discussed above. The SEC supports Kingston Hydro's top-down budgeting approach. However, SEC stated, "when money is saved, the appropriate response is not to look for ways to spend the savings as soon as possible." Kingston

Hydro respectfully submits that SEC's position is contradictory. The basis for the top-down approach is that the re-investment that is needed is greater than the funds available to spend. If more funds become available, then under the top-down approach the incremental funds should be spent on needed projects.

As Kingston Hydro explained [for example, Transcript Page 12] the utility's approach on capital projects is a top-down approach, in that projects are selected on the basis of the availability of funds. Now that more funds have become available as a result of Hydro One's inaccurate estimate, Kingston Hydro submits that it is appropriate to undertake this project now, as this would be consistent with the utility's changed philosophy to be proactive rather than reactive in order to restore its distribution system to an acceptable operational level.

Substation No.3

The essence of the arguments by VECC, Energy Probe and SEC is that the Board should approve a capital budget that would exclude the addition of the Substation No. 3 project.

To be clear, the Substation No.3 project did not come out of the blue. It was identified in Board Staff Interrogatory #31 in which Kingston Hydro was asked what project would be undertaken if more funds were available. The Substation No. 3 project was identified at that point. Further, just because the Substation No. 3 project was originally deferred due to lack of funding does not mean that it is not needed in 2011. As explained in the oral hearing (Transcript Page 123, Lines 10-13), just because a project is delayed does not mean that it is not urgent.

Specifically, a budgeted 2010 capital expense (i.e. the Hydro One capital contribution) did not materialize. This circumstance freed up capital to be spent on the much needed Substation No. 3 project. From an operational perspective, it would make no sense for Kingston Hydro to ignore this incremental financial capacity and refrain from repairing Substation No. 3. If Kingston Hydro were to ignore the incremental financial capacity, as suggested, and Substation No. 3 were to fail in 2011, Kingston Hydro's 1170 customers (including Police Headquarters, the Kingston Fire Station and Ambulance Station) would likely not appreciate the fact that Kingston Hydro had the funds and resources to replace obsolete breakers and relays in the substation in 2011, but deferred the repair to 2012.

Kingston Hydro submits that the intervenors' position fails to recognize that the Substation No. 3 project is needed in the 2011 Test Year, despite the fact that it was originally not proposed for the 2011 Test Year. As explained by Kingston Hydro, it did not have the funds to pursue the Substation No. 3 project in the Test Year, but would have pursued the project had the funds been available. The need for and importance of this project was described in the February 4, 2011 evidence update:

> "This capital project involves retrofitting replacement breakers at Substation No.3 and improving the insulation/ventilation/cooling of the metalclad walk-in enclosure. Kingston Hydro was advised in Fall 2010 that the 5kV breakers at this substation were obsolete and not repairable.
>
> This breaker assessment was made by the manufacturer more than 1 year after a 5kV breaker was sent out for repair. The mechanical operating mechanism has been deemed unreliable and difficult to calibrate both in the field and at the factory. The uninsulated and poorly ventilated walk-in metalclad enclosure suffers from excessive heat gain during the summer months which has led to premature failure of the SCADA electronics located inside.
>
> Substation switchgear is considered to have significant impact on reliability and operability, and with this 5kV switchgear being obsolete and not repairable, Kingston Hydro considers that this would be a prudent project to undertake.
>
> Substation No.3 normally serves approximately 1170 customers with a peak demand of 5.5MW. Customers include the Kingston Police Headquarters, City Public Works, Kingston Fire Station & Ambulance Station, as well as two Schools. The feeders from this substation serve as backup to Substations No.8, No.10, No.17, No.14 and No.13. This project would involve the replacement of all 11 circuit breakers; two main breakers supplying each transformer bus, eight feeder breakers and one tie breaker. It would also involve insulation, ventilation and cooling upgrades to the walk-in metalclad enclosure."

As set out in the response to Energy Probe's interrogatory #52, in September 2010, maintenance activities undertaken at Substation No.3 uncovered that 8 out of a total of 11 circuit breakers would fail to operate properly during a fault occurrence. Clearly, the Substation No. 3 project is needed. Kingston Hydro submits that any benefit of the rate reduction associated with deferring this project does not outweigh the potential reliability and operability detriments associated with deferring this project. As a result of the information obtained in the September, 2010 maintenance activities, if this project is delayed, system reliability in the area would be in serious jeopardy.

<u>Rate Stability</u>

Energy Probe argued for a decrease to the proposed 2011 capital expenditures based on the importance of stable capital expenditures that would ensure rate stability. As set out in the Submission in Chief, Kingston Hydro agrees that rate smoothing should be a consideration in rate setting. However, there are many considerations that enter the rate making process. Rate smoothing is only one consideration. Its relative weight should be determined by the other considerations that also come in play. Rate smoothing should not jeopardize the operational integrity of Kingston Hydro's distribution system and the health and safety risks for its customers and employees. Moreover, the impact of capital additions in the determination of revenue requirement and rates is only fractional. A one dollar increase in capital expenditures translates to an increase of approximately seven cents in this case to the revenue requirement. This is not to say that the level of capital expenditures should not matter. Rather, it is submitted that, again, the rate smoothing considerations arising from capital expenditures must be placed in the proper context regarding rate impact.

Energy Probe relied on a quote from the Decision and Order from the Burlington Hydro proceeding (EB-2009-0259) that addressed rate smoothing. The following excerpt from the quote in the decision provided by Energy Probe illustrates in fact that Kingston Hydro's circumstances differ from Burlington Hydro's:

> "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."

Kingston Hydro submits that the Burlington decision does not apply to Kingston Hydro's circumstances, since Kingston Hydro's proposed increase in capital expenditures in the 2011 Test Year pertains to one project - the Substation No. 3 project. As stated above, this project is needed, but was originally deferred to 2012 because of underfunding. With the additional funding that arose as a result of Hydro One's inaccurate estimate, Kingston Hydro can now proceed with this important project.

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

As set out in Appendix B of Kingston Hydro's February 4, 2011 updated evidence, Kingston Hydro has proposed, as a revenue offset, an amount of $75,321 that it projects to earn on funds that are held on deposit, in the City of Kingston's bank account. This amount is based on an estimated Prime Interest Rate of 3.00%, less 1.65%, and a projected 2011 average balance of $5,579,323. The Applicant has an arrangement with the City of Kingston whereby funds are held by the City of Kingston to be used to pay for Kingston Hydro's needs. Consequently, Kingston Hydro is paid interest on those funds at the same preferential rate of interest as the City of Kingston earns from its bank. The City earns the same rate of Prime minus 1.65%.

Parties raised two matters with respect to this issue. The first is the reasonableness of the projected Prime Rate of 3.0%. The second is the view by parties, except Board staff, that the funds projected to be held are in excess of what Kingston Hydro needs and that such excess should be used to pay down long-term debt owing to the City of Kingston. Kingston Hydro deals with each of these matters in turn.

1) Projected Prime Rate

Parties argued that the projected prime interest rate of 3.0% used by Kingston Hydro in the updated application is too low and should be increased to 3.375% to reflect a projected prime interest rate of 3.5% for the 3rd Quarter of 2011 and 4.0% for the 4th Quarter of 2011.

Kingston Hydro believes that the most appropriate prime interest rate to utilize is the prime interest rate currently in effect and that has been in effect since the 3rd quarter of 2010. Previous forecasts for higher interest rates for the balance of 2011 from current levels are increasingly doubtful, given the recent catastrophe in Japan, the political unrest in other parts of the world, and the continuing debt challenges faced by countries in Europe. In addition, the upcoming Federal election here in Canada creates more uncertainty, particularly around monetary and fiscal policy decisions by a new administration. As a result, the Prime Rate not only could be maintained at its current 3.0% level but could in fact decrease in the 2nd, 3rd and 4th quarters of 2011. Kingston Hydro submits that the Board should find that on balance of probabilities the current 3.0% Prime Rate reflected in the application is an acceptable forecast for purposes of setting rates.

2) Amount of funds held in the bank versus long term debt

Energy Probe, SEC and VECC advanced that Kingston Hydro holds excess funds and that this excess should be used to pay down a portion of the long-term debt payable to the Shareholder. Board Staff did not take this position.

Kingston Hydro is surprised that intervenors have interpreted the issue as a license to link the amount projected to be held in the bank account with the level of long-term debt owing to the City of Kingston. Kingston Hydro urges the Board to find that the intervenors have erred in their interpretation of the unsettled issue.

The Board's regulatory construct is to deem the level of long-term debt for electricity distributors for ratemaking purposes. The issue is not how the utility's deemed debt compares to the actual debt, and neither the Board nor the intervenors have made this an issue. Therefore the issue should not be how to reduce the actual level of debt from the deemed amount by linking it to bank cash balances. The costs of the utility's long-term debt should stand on its own, which is an issue that is addressed elsewhere in this reply submission.

However, if the Board decides that the link made by intervenors is a matter that needs to be decided by the Board, Kingston Hydro makes the following submissions.

Kingston Hydro in fact requires the full amounts in the bank account to pay Kingston Hydro's next month's expenses. As noted in the Oral Hearing [Transcript Page 43], Kingston Hydro's December, 2010 IESO bill due January, 17, 2011 was $6.2 million. In addition, approximately $500,000 of operating expenses are due in January, 2011. With approximately $6.7 million of invoices due in mid-January, $5.5 million is a reasonable amount of funds to have on hand to meet that commitment. If 50% or approximately $2 million of the estimated $4 million of accounts receivable is turned over in the 15 days leading up to when the IESO payment is due, then that would leave Kingston Hydro with only approximately $800,000 in the bank account to pay for other requirements, such as routine capital expenditures and operating expenses, some of which may not be consistent from month to month. Therefore $800,000 is an insufficient balance to address Kingston Hydro's needs.

SEC went further by claiming that Kingston Hydro should be using an un-tested cash model that SEC developed. Kingston Hydro submits that the model submitted by SEC not be allowed into evidence at this stage of the proceeding. Kingston Hydro is surprised that SEC, an experienced intervenor that knows or should know the Board's rules and practices, has actually done this. It is evidence that has not been put to Kingston Hydro during the hearing, and Kingston Hydro has not had the opportunity to pose interrogatories on this evidence. Kingston Hydro submits that the Board should dismiss this filing and related argument.

Intervenors argue that Kingston Hydro should be lowering their bank account, repaying long term debt that is owed to the City of Kingston, and then utilizing a line of credit to pay their normal recurring operating expenses. SEC also indicates that funds in the bank should be used to pay down long-term debt. Kingston Hydro submits that it is beyond the scope of the issues in the proceeding, and is not the intervenor's place to be determining how a utility should be managing its cash balances. This is a business management matter that should be left to the utility.

This debt has been outstanding since incorporation and Kingston Hydro is not required to pay down any principal on this debt. In a period where Kingston Hydro will be investing significant sums of money in its capital infrastructure and needing maximum long-term debt and borrowing, Kingston Hydro would be foolish to think about paying down shareholder debt that does not require principal repayments and that it can never re-borrow from its shareholder due to limitations in the Eligible Investments Regulation under the *Municipal Act*.

SEC argues that, by doing what it suggests, there would be no net cost to the Applicant. Kingston Hydro strongly disagrees. SEC's proposal does not consider future requirements of the utility with respect to long term financial borrowing or the risk to the utility. There will be a definite net cost to the utility which could have adverse long-term negative effects on the utility.

Energy Probe submits that Kingston Hydro paid down the loan before and should not have any issue with paying down the loan again. As noted by Mr. Murphy in the oral hearing, (Tr. Page 184) Kingston Hydro did in fact make a one-time payment of the loan in 2004, however that payment was made solely as part of a restructuring of the ownership of the different corporate entities. No payment has been made since and no payment is contemplated in the future.

As stated by Mr. Murphy at the hearing (Transcript page 65), Kingston Hydro follows certain financial principles. Those principles are that long-term debt is used to finance capital assets and short-term funds, such as cash on deposit with the City of Kingston, is used to pay the following month's expenses. Kingston Hydro submits that each particular utility should have the ability to determine its own comfort level with respect to cash in its bank account. Kingston Hydro submits that each utility's management and Board of Directors should make that determination based on utility specific needs, and each utility's individual appetite for risk.

The scope of this issue is limited to whether the proposed interest income earned on funds held in the City of Kingston's bank account is appropriate, as proposed by Kingston Hydro.

It is not within the scope of this issue to determine the mix between levels of long-term debt and short-term funds held in a bank account. That determination is for each utility's management and board of directors to determine, guided by the cost implications in the Board's determination on the deemed capitalization of rate base, which includes the level of long-term debt.

Moreover, it is Kingston Hydro's submission that this matter should not be a part of a particular utility's rates proceeding, but rather the Board should convene a generic hearing, project or study on the appropriate mix of short term cash, capital assets, short-term debt and long-term debt. Then the Board itself could issue a regulatory cash flow/debt model for all utilities to utilize in their rates proceeding so that all rate making decision are consistent and determined using the same methodology. To be clear, Kingston Hydro does not advocate such an approach as, in its view, this would get the Board into micromanaging utilities, something that the Board has resisted over the years.

VECC indicated that the issue in this proceeding is similar to the issue in Decision EB-2010-0018 (Natural Resources Gas Ltd., or NRG) whereby the utility in that proceeding specifically borrowed money to invest as a condition of its financing. The facts in this proceeding are entirely different. The money borrowed by Kingston Hydro has been outstanding since incorporation and was not borrowed to invest. The notes payable to the City of Kingston were issued on incorporation in exchange for capital assets transferred in to Kingston Hydro. Kingston Hydro submits that the argument made by VECC is not on point. The circumstances therefore are very different between NRG and Kingston Hydro. Moreover, the electricity sector has a different history of regulation and a different regulatory construct than NRG, which, in fact, has a unique history in respect of financial/regulatory matters as the Board is aware.

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

General Submission

Kingston Hydro has had historically low OM&A expenditures. As pointed out in the hearing (Transcript page 161, line 21) by Mr. Keech:

> "…our strong belief, is that our OM&A expenses have been significantly lower than what they should be to keep the system in the condition that it needs to be…"

Kingston Hydro submits that the Board-approved OM&A level should be based on the evidence adduced in support of the requested level. In this regard, a parallel context can be drawn to that made regarding capital. Low rates and underfunding have impacted these areas as well, also impacting system reliability and safety. Similar to capital, this cost of service rate application is an appropriate mechanism to correct a historical deficit in the reasonable manner proposed by the Applicant.

The proposed increases in OM&A expenses are linked to capital expenditures, and they are largely driven by the need to hire workers. This need is driven by a combination of:

- preparing for upcoming retirements,
- returning staffing levels in the technical trades to the proper level,
- striving to be proactive in Kingston Hydro's operating and maintenance practices, and
- addressing the requirements of all regulatory bodies impacting the industry to a level beyond that which has been historically the case.

Kingston Hydro's growth in staff levels are mainly in the technical service areas, not what may be considered as "soft" areas. Kingston Hydro's operating and maintenance practices have, historically, primarily been reactive. Though this practice has kept rates quite low, as Mr. Keech stated in the oral hearing (Transcript, page 14, line 9),

> "Our own analysis indicates that our rates are 76th lowest of 83 LDCs".

The past prime objective for lower rates introduced higher levels of risks and problems, as was recently demonstrated in September 2010, when maintenance activities undertaken at Substation No.3 uncovered that 8 out of a total of 11 circuit breakers would fail to operate properly during a fault occurrence, (response to Energy Probe Interrogatory #52). That failure could have led to public and worker injury, and should have been identified well before it got to such a critical condition. Best practices indicate that planned, proactive maintenance is necessary to achieve a viable, safe and reliable distribution system. To do so requires an adequate number of experienced, knowledgeable, well trained staff.

Trades and technical staff require an overlap to facilitate a reasonable transfer of knowledge and skills, and years to gain their proficiencies. With the requirement to bring the staffing levels in the trades area to a more appropriate level to perform the required maintenance, and with the large number of trade staff retirements that are anticipated to occur over the next few years, Kingston Hydro cannot risk having those hires delayed any further. Proficient staff is necessary to allow the much needed capital and maintenance work to be undertaken, and to ensure that emergency operational needs are met.

Failure to appreciate the importance of ensuring that there are adequate levels of proficient staff would risk the safety of both employees and the public. Kingston Hydro cannot overemphasize that the additional staff in these technical areas are both necessary and prudent for implementing and maintaining the much needed renewal, not just today but over the next four years before the Applicant has its next opportunity for rebasing.

The increased obligations that all regulatory bodies are having on Kingston Hydro's operations is reflective of that same recognition, and the Applicant is wholly cognizant of its responsibilities to satisfy the new standards, codes and expectations.

Kingston Hydro addresses below general and specific areas raised by parties by relevant headings.

<u>Benchmarking</u>

According to SEC, because Kingston Hydro is a virtual utility, absent a detailed review of all of the business activities of the affiliate, there is insufficient information on the record to assess the proposed OM&A costs. Specifically, SEC wrote:

> 7.1.2 ...The lack of transparency of this arrangement made it difficult for the intervenors and the Board to get a clear picture of this substantial expansion of personnel.
>
> 7.1.5 In our view, the primary impact of this structure is that it is not possible, on the evidence before the Board, to have a complete picture of the costs of operating the utility. The deeply interrelated activities within Utilities Kingston mean that, absent a detailed review of all of the business activities of that entity, a clear view of the standalone electricity distribution business is not possible.

Kingston Hydro submits that it prepared comprehensive evidence and interrogatory responses, resulting in fulsome record that will allow the Board to make an informed decision on Kingston Hydro's 2011 OM&A costs. In fact, a transfer pricing study (submitted in response to Board Staff interrogatory #28), by a third-party expert was voluntarily commissioned and Kingston Hydro expects to implement all of the suggestions contained in that study. As well, Kingston Hydro voluntarily provided financial statements for its affiliate, Utilities Kingston (Exhibit 1 Tab 2 Schedule 3 Attachment 5). To suggest that the OM&A costs proposed in this case are not transparent has no factual basis in the evidence submitted in this application. We note that neither Board Staff, VECC nor Energy Probe raised the issue of non-transparency; only SEC did.

Based on its non-transparency argument, SEC proposed that the 2011 OM&A budget be set by benchmarking. SEC proposed that Kingston Hydro's 2011 OM&A budget should be based on the average OM&A cost per customer for its cohort. Kingston Hydro strongly objects to its rates being set based on benchmarking. To adopt this approach would mean that all the evidence provided on OM&A was wasted. The Board's filing requirements do not provide that virtual utilities only need to file benchmarking information. If rates for virtual utilities are going to be set differently from all other distributors, the Board should convene a generic proceeding to address this approach.

Kingston Hydro is unaware of the Board ever setting rates based on benchmarking in a cost of service application, as proposed by SEC. Further, given that Kingston Hydro's OM&A costs are transparent, there is no need for the Board to adopt such a novel method for setting rates at rebasing. As explained by Kingston Hydro at Exhibit 4, Tab 1, Schedule 1, Page 4, in 2011 its OM&A cost per customer will rank 5th out of 15, however during the IRM period, that ranking will change as the members of its cohort file cost of service applications:

> "Based on the above analysis, Kingston Hydro's 2011 operating costs per customer are expected to rank 5th out of 15 (with no. 1 being the highest) in its cohort group. The Applicant believes that this ranking is reasonable. Furthermore, as the Applicant files 3rd Generation Incentive Regulation Mechanism applications during 2012 to 2014, most of the other distributors in its cohort listing will be filing Cost of Service Applications. Consequently, Kingston Hydro's OM&A per customer ranking will likely move closer to15th as opposed to staying at 5th highest."

For these reasons, Kingston Hydro submits that SEC's benchmarking proposal be rejected.

Overall Level of OM&A

At the outset, Kingston Hydro wishes to comment on the table produced by Energy Probe at page 19 of its Submission. The total OM&A expense for 2010 listed in the table is $6,012,417. However, in the second last paragraph on page 20, Energy Probe recognized that this number has changed, "As indicated in the response to Undertaking J1.3, actual OM&A expenses in the bridge year were $5,976,724." Kingston Hydro therefore submits that the Board should take note that Energy Probe's associated trend analyses based on the table are incorrect.

Based on the table on page 19, Energy Probe pointed out that Kingston Hydro's average annual increase in OM&A costs from 2006 through 2011 is 4.7 times the of the average annual increase in inflation over the same period. As discussed below, comparing OM&A increases to increases in inflation is not determinative of the reasonableness of OM&A expenses for the year.

Energy Probe also emphasized the trend of Kingston Hydro's OM&A costs. Kingston Hydro submits that OM&A disallowances should not be based on trend analyses, and requests that any disallowances by the Board are based on the specific costs proposed by Kingston Hydro. Kingston Hydro put a great deal of effort into its application and interrogatory responses, and it submits that the record is more than sufficient for the Board to assess the utility’s proposed OM&A costs on a specific basis. Kingston Hydro's request is consistent with the Board's Decision with Reasons in the Hydro One 2009 and 2010 transmission rate application (EB-2008-0272) (at Page 17):

> The Board does not believe that a disallowance based on trend projections is appropriate is this case. While trend projections are useful as a potential trigger for an examination of changing circumstances, they cannot be used alone to justify a particular level of spending. In this case there is sufficient evidence for the Board to assess matters on a more specific basis.

Energy Probe quoted the Burlington Hydro Decision in EB-2009-0259 as authority that an overall two-year increase (i.e. 2009 to 2011 in this case) in OM&A typically should not exceed 10%. Kingston Hydro submits that the Burlington Decision does not stand for this proposition. To apply a two-year 10% rule of thumb generically to all cases would convert cost of service proceedings into quasi-IRM proceedings. Rather, the Board should review the specific costs proposed by the applicant, just as it did in the Burlington Decision where it found a number of instances of excessive spending in reaching the conclusion that a two year OM&A increase of 10% would be reasonable in that case:

> "With respect to some of the specific cost items, the Board also finds that the spending is excessive for the following reasons:

- The claim for Board of Directors fees results from there being two layers of oversight for Burlington, which is not justified in the circumstances.
- Regulatory costs are over-stated as there was no oral hearing. The fees are also excessive in comparison to 2009 levels of other distributors. The Board acknowledges that some additional work might have been required to consider the impacts of the Green Energy Act, but not to the extent claimed by Burlington.
- Bad debt expense may be overstated in light of more recent economic circumstances.
- The impacts of the HST have not been reflected in the forecast.
- The additional costs associated with LEAP are not justified as this matter has been placed on hold. If programs are later introduced, appropriate cost recovery will be addressed at that time.
- The wage forecast is overstated in relation to the increases actually negotiated. In addition, there is no adequate justification to increase non-union wages by any greater amount than that for the unionized staff. A recommendation that non-union wage increases be kept to 3% is explicitly identified in the materials presented to the Board of Directors on October 20, 2009.
- About half of the incentive pay is directly related to shareholder value and should therefore be funded directly by the shareholder." [at page 15]

Circumstances such as these do not exist in Kingston Hydro's case. As such, Kingston Hydro submits that a two year 10% OM&A rule of thumb should not be applied in this case as a basis for arriving at a prudent OM&A budget. In fact, Energy Probe did not recommend such an approach in this case, since it would bring the 2011 OM&A budget below the 2010 OM&A budget. Instead, Energy Probe proposed a 5% increase in OM&A from 2010 to 2011, stating 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." Kingston Hydro submits that Energy Probe's approach is arbitrary. What kind of analysis has been produced to demonstrate that a 5% increase over 2010 "should be more than sufficient"? The costs approved in this proceeding will be the basis for rates over the next four years. Kingston Hydro submits that a more serious rationale should be provided to justify reductions in its proposed costs, with which it has to operate over the next four years.

Inflation

According to Board staff, historical increases for OM&A have been in excess of inflation by a “meaningful” amount. Kingston Hydro submits that comparing OM&A increases to increases in inflation is not determinative of the reasonableness of OM&A expenses. Kingston Hydro is not aware of any Board Policy or Decisions on cost of service reviews where the inflation rate was used as the determinative factor for OM&A. This would resemble an IRM review. Theoretically, if OM&A costs were only permitted to increase at the same rate as inflation, no new OM&A costs could ever be implemented. Kingston Hydro submits that the Board approved OM&A level should be based on the evidence adduced in support of the requested level.

Links to Capital Spending

Board staff acknowledged 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, Board staff submitted that in this instance the proposed increases in OM&A are in excess of those justified by additional capital investment. Kingston Hydro's interpretation of Board staff's concern is that Board staff believes that Kingston Hydro has justified its proposed OM&A increase exclusively on the basis of capital expenditures. As set out above, Kingston Hydro's OM&A budget is "linked" to capital investment, however the proposed OM&A is driven by a combination of factors set out at Exhibit 4, Tab 1, Schedule 1, page 2:

- Required general increase in the level preventative maintenance programs that currently exist from vegetation control to substation maintenance;
- Required introduction of new, proactive, preventative maintenance programs to ensure capital investments achieve maximum life expectancies;
- Required increase of engineering support for field crew activities;
- Required hiring of additional staff to train for imminent retirements, especially in trades areas;
- Required hiring of additional staffing to handle the additional mandatory regulatory requirements including but not limited to Electrical Safety Authority, Ontario Energy Board, Ministry of Energy and Infrastructure, Ministry of Labour, Ministry of the Environment, Independent Electricity System Operator, as well as archaeological, heritage and accessibility requirements;
- Required increase in the level of proactive communications to a customer base that is demanding more information in many formats; and
- Required increased focus on CDM initiatives, and green energy alternatives.

Specific Cost Reductions

Below, Kingston Hydro addresses the specific cost reductions proposed by parties. In doing so, Kingston Hydro felt that it was important to repeat parts of its evidence to correct Board staff's understanding or interpretation of the evidence on certain matters.

Journeyperson Powerline Technicians

Board Staff submitted that the Board should approve only 3 of the 5 proposed Journeyperson Powerline Technician positions. The basis for Board Staff's position is that the response to its interrogatory #15 shows when the current 14 Journeyperson Powerline Technicians are eligible to retire and that historically employees retire 3.4 months after their earliest possible retirement eligibility. Because only 3 will achieve retirement eligibility without penalty in the next 5 years, according to Board Staff only 3 Journeyperson Powerline Technician positions should be approved. Kingston Hydro submits that the issue is more complex than perceived by Board Staff, as the need for the additional 5 Journeyperson Powerline Technician positions is driven by more than just the pending retirements.

It is Kingston Hydro's intention to introduce proactive preventative maintenance programs to ensure that capital investments achieve maximum life expectancies. This will require the achievement of an increased complement of Journeyperson Powerline Technicians. As set out at Exhibit 4, Tab 2, Schedule 3, Page 17, since 2005, Kingston Hydro's Powerline crew complement has decreased from 17 Journeyperson Powerline Technicians to 14. In the same period, the capital program that these personnel are involved in has more than doubled. Put another way, the supply of Journeyperson Powerline Technicians has decreased, while the demand for their services has increased.

Added to this strain on resources are the forecasted retirements of Journeyperson Powerline Technicians. The average age of these employees is 49 years with the median being the same – none of the staff are younger than 40 years. While it is true that 3 Journeyperson Powerline Technicians will achieve retirement eligibility without penalty in the next 5 years, replacing only these 3 employees will not address the decrease in Journeyperson Powerline Technicians from 17 to 14 since 2005, the more than doubling of the capital program, and the implementation of proactive preventative maintenance programs. Kingston Hydro also notes that it could lose more Journeyperson Powerline Technicians to retirement in the next 5 years (i.e. those who retire with penalty), or to illness or injury or another employer as competition for these resources increases. Since it takes four years for new journeypersons to become certified as Powerline Technicians, Kingston Hydro firmly believes that it is imperative that the hiring of the 5 Journeyperson Powerline Technician positions occurs as planned to ensure that there are sufficient resources to operate and maintain the distribution system in the near future.

Journeyperson Substation Electricians

Kingston Hydro has proposed that 2 Journeyperson Substation Electricians be hired in the Test Year. Board Staff took the position that only one of the 2 positions should be approved. Although Board

Staff recognized that 2 Journeyperson Substation Electricians are eligible to retire without penalty within the next 5 years, Board Staff argued that only one Journeyperson Substation Electrician should be approved because, "As shown in response to VECC IR # 30, Kingston Hydro does not expect that this level of positions will be maintained going forward." Kingston Hydro submits that Board Staff has misinterpreted its response to VECC interrogatory #30, which is set out below:

Interrogatory #30
Reference: Exhibit 4/Tab 2/Schedule 5, page 2

a) The table indicates 2011 FTEs of 60.91. Does Kingston expect to maintain this level going forward, e.g., after expected future retirements?

No, Kingston Hydro does not expect to maintain this level going forward. For those employees hired for succession planning prior to retirements as incumbents retire, not all will be replaced. Decisions to be made based on the circumstances/work load at the time.

This interrogatory pertained to the total level of FTEs going forward, not the complement of Journeyperson Substation Electricians going forward. While it is true that going forward, Kingston Hydro does not expect to maintain 60.91 FTEs, the assumption cannot be made from this response that going forward Kingston Hydro plans to reduce the level of Journeyperson Substation Electricians. Kingston Hydro has no intention to reduce its complement of Journeyperson Substation Electricians going forward, as evidenced by the proposal to add 2 Journeyperson Substation Electricians to replace 2 Journeyperson Substation Electricians that are eligible to retire without penalty in the next 5 years.

Board Staff also stated that only one Journeyperson Substation Electrician be funded “again to handle additional workload and as a transition to possible retirements”. As noted on pages 14-15 of Exhibit 2, Tab 2, Schedule 3, Kingston Hydro “determined that two full-time equivalents would be required on an annual basis to complete the tasks outlined by the Substation Maintenance Program”, and was evidenced by the fact that in 2009, “Kingston Hydro was not able to complete the preventive maintenance activities on the electrical equipment and appurtenances at Kingston Hydro’s seventeen substations”. The Applicant submits that the new Substation Maintenance Program is critical to ensuring that these assets are maintained in a condition consistent with accepted standards to ensure public and worker safety and integrity of the electrical system. Notwithstanding that the 2 positions are needed to replace the 2 pending retirements and further that it takes four years for new journeypersons to become certified as Substation Electricians, this additional substation maintenance workload substantiates the requirement for these 2 positions.

CDM Advisor Position

As set out in the response to Board Staff interrogatory #11, Kingston Hydro currently has a .23 FTE allocated towards CDM activities. This .23 FTE position is funded through OPA fixed and variable conservation program funding. This .23 FTE is overextended with current requirements for OPA program administration, inspection, strategic planning, conservation consulting with customers, and community initiatives. Planning activities for the initiatives designed to achieve the regulatory targets are such that additional resources in the form of .77 additional FTE are required to enable success in meeting Kingston Hydro's 2011-2014 CDM targets. Current resources are simply not sufficient to provide for general public education programming, dealing with general customer inquiries about rising electricity prices, or strategic and innovative CDM activities within or outside of the OPA program portfolio.

At the time of filing, comprehensive information on the regulatory and funding structure for CDM during the 2011-2014 Conservation Target period had not been released or finalized. To date, Kingston Hydro's 2011-2014 CDM strategy has not been approved by the OEB, and funding assumptions made have not been confirmed by the OPA.

Board staff submitted 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." Kingston Hydro does not know the basis for Board Staff's assertion that funding for this position is available through the Global Adjustment. Board Staff has not pointed to evidence or public authoritative reports to support this assertion. As such, Kingston Hydro submits that it would be prudent to fund the proposed FTE from rates until such time as sufficient funding from the OPA or OEB approved programs can be guaranteed for an additional full-time conservation specialist.

Community Relations Professional

Kingston has proposed a full time professional for community relations at a cost of $82,000 per year. As set out at Exhibit 4, Tab 2, Schedule 3, Page 20, 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 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.

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

Board staff questioned whether a distributor the size of Kingston Hydro is justified in adding a full FTE position for these matters. According to Board Staff, a full time position for community relations is not justified and should be reduced to a half-time position.

Kingston Hydro questions how Board Staff came to the conclusion that a full time position is not required, primarily on the basis of Kingston Hydro's size, without consideration of the community relations demands faced by Kingston Hydro. The growing demand for community relations should be recognized by the Board, as it forms an important part of the Board's own 2011-2014 Business Plan, in which new media communications tools are specifically addressed:

> "New Media communications, particularly the Board's Industry and Consumer websites will be an increasingly important tool for the Board as it aims to provide timely and relevant information to diverse groups. Recent work that the Board will build upon includes improved search capabilities (Google site searching) and online bill calculators for both consumers and small businesses. The Board's continuing efforts will include improved website organization and a content review to ensure the public and stakeholders can find the information they need more easily." [2011-2014 Business Plan, Communications Plan, Page 2]

In light of the ever increasing customer demands related to CDM programs, smart metering, FIT and Micro Fit, ongoing changes to customer bills, green energy alternatives and smart grid initiatives, and the need for clear communications using new media tools requires Kingston Hydro to hire a full time community relations professional.

The last paragraph in Board Staff's submission under Community Relations section provides:

> "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." [emphasis added]

This paragraph seems to suggest that an <u>additional</u> $97,000 for community relations is being requested by Kingston Hydro, and Board Staff has proposed that in addition to cutting the full time community relations position in half, the community relations budget should be reduced by an additional $50,000. To clarify, the $97,000 added to the Community Relations budget in the Test Year is not incremental, as suggested by Board Staff. It is comprised of $82,000 for the full-time community relations professional, plus approximately $15,000 for low income consumers mandated by the Board, as explained at Exhibit 4, Tab 2, Schedule 3, Page 20. Therefore, Board Staff is counting the same number twice. If the Board were to follow Board Staff's recommendation, it would reduce the $82,000 cost for the full time community relations professional by 50% or $41,000, and reduce the overall budget by another $50,000.This would result in a total reduction of $91,000, which is almost the entire $97,000 addition to the community relations budget. As such, the additional $50,000 decrease proposed by Board Staff is erroneous.

<u>Administration and General</u>

Board Staff submitted that in response to Board Staff IR #25, Kingston Hydro provided additional detail on the two additional Administration and General FTEs it is seeking for the test year at an additional cost of $160,000 in the test year. Staff noted that, "these positions contribute to an overall large increase in the Administration and General category" and 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."

Kingston Hydro submits that it did not propose two additional positions. It proposed seven partial positions that once summed, total approximately 2 FTEs. Further, Kingston Hydro would hardly describe its evidence in support of these seven partial positions as "largely unspecified". With the exception of one of the seven partial positions, none of the individual FTEs exceeded materiality. In light of the small amounts for each individual partial position, the information provided by Kingston Hydro for each was appropriate. The information provided by Kingston Hydro in response to Board Staff interrogatory #25 was as follows:

> **0.25 FTE .... $16,000 .... SCADA Network Technician allocation increase**
> Installation of the existing SCADA system commenced in 1994 and is now reaching end of life. Replacements are planned with upgrades to municipal substations to commence in 2011. We have determined that maintenance requirements on the legacy system will require an increase of staffing in this area.

0.24 FTE .... $20,000 .... Systems Analysts allocation increase
In 2010, the Systems Analysts allocation was reduced (by 0.69 FTE) in recognition that work would shift to the implementation of Utilities Kingston's Enterprise Asset Management System. In 2011, the allocation was increased by 0.24 FTE representing the shift back to work primarily associated with the Customer Information System and continuing to improve that system and ensure that any electricity regulatory requirements are met.

0.23 FTE .... $13,000 .... Administrative Secretary allocation increase
There isn't currently any support staff to assist management with administrative functions. This allocation will assist management staff with functions such as the preparation of correspondence, filing, etc.

0.60 FTE .... $66,000 .... Regulatory Analyst allocation increase
This change represents a re-allocation based on the amount of time the Regulatory Analyst devotes to regulatory matters concerning the electric utility.

0.38 FTE .... $17,000 .... Administrative Clerk allocation increase
This is to provide clerical support to the Manager, Supervisor and Work Planning staff for Electric and Operational Services. Currently, clerical support is absent but is required, and the staff mentioned are performing some of these clerical duties whereas they should be able to focus wholly on their core tasks.

0.23 FTE .... $19,000 .... Financial Analyst allocation increase
This increase is to address responsibilities associated with accounting for and reporting of Kingston Hydro's electric assets under the new International Financial Reporting Standards (IFRS) as established by the International Accounting Standards Board (IASB).

0.10 FTE .... $9,000 .... Supervisor allocation increase
This is not additional staffing; rather the Supervisor charges time to both operating and capital accounts. The increase here is based on the fact that slightly more time will be chargeable to operating accounts, and it therefore has a corresponding decrease on the capital allocation.

Kingston Hydro submits that Board Staff has arbitrarily proposed a reduction of $50,000 to the sum of these partial positions, without a specific explanation as to which costs are unreasonable. Board Staff likely proposed the $50,000 figure to reduce the envelope of 2011 OM&A to approximately

10% over 2010 actual. Kingston Hydro submits that Board Staff's approach is based on convenience and should be rejected by the Board.

For all of the reasons set out above, Kingston Hydro submits that Board Staff's proposed OM&A reduction of $300,000 should be rejected.

Below Kingston Hydro addresses the submissions made by Energy Probe on specific items.

Increase in FTEs

Energy Probe pointed out that the average annual decline in the number of customers per FTE in the 2006 through 2010 period was 3.6%, versus 24.2% from 2010 to 2011. According to Energy Probe, "...there has been no justification for this significant and precipitous drop." Mathematically, the drop in customers per FTE can be attributed to an increase in FTEs in the 2011 Test Year. Kingston Hydro rejects the statement that there has been "no justification" for the proposed drop in customers per FTE, since a great deal of evidence and testimony has been provided by Kingston Hydro in support of its need for additional FTEs in the 2011 Test Year.

As stated above, Kingston Hydro's proposed increase in OM&A is largely driven by the need to hire workers. This need is driven by a combination of preparing for upcoming retirements, returning staffing levels in the technical trades to what existed, striving to be proactive in Kingston Hydro's operating and maintenance practices, and addressing the requirements of other regulatory bodies impacting the industry to a level beyond that which has been historically the case. In addition to these current demands for additional FTEs, as explained by Mr. Keech during the oral hearing [Transcript, Page 10], Kingston Hydro has been operating with an artificially low complement of FTEs since its amalgamation:

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

> the year of our initial unbundling, the year that we initially set our rates as a corporation, our operating expenses were the lowest level that they had been since 1990, and this was an artificially low operating expense."

Kingston Hydro requests that the Board consider the decrease in customers per FTE in the context of its need for additional FTEs in light of the historic circumstances that led to an artificially low FTE complement. While customers per FTE can be an informative metric, it should not be determinative of an FTE budget for the 2011 Test Year.

Non-Union Wage Increases

Energy Probe proposed a $29,228 reduction in 2011 OM&A on the basis that the non-union proposed wage increase of 4% being higher than the union wage increase of 2.5%. Kingston Hydro has the following comments on Energy Probe's analysis. First, Kingston Hydro does not understand Energy Probe's calculation of (($3,887 + $10,784) x 2). These numbers do not correspond to the numbers in the response to Energy Probe interrogatory 21c, and the "x2" is a mystery. Second, Energy Probe's proposed reduction is below the materiality threshold. Energy Probe has proposed this non-material reduction, despite the fact that it argued the non-materiality of intervenor costs in its Submission (at Page 32):

> "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)."

Third, there is no requirement that non-union wage increases need to match (or as suggested by Energy Probe, be lower than) union wage increases. As set out in Kingston Hydro's response to Energy Probe interrogatory 21b, there are no automatic inflationary or general increases for non-union and management employees. All increases are performance based and combine inflationary and progression increases. Unlike some utilities, employees are not eligible for bonuses. As Mr. Keech noted in the hearing (Transcript page 171, line 4):

> “For the non-union staff, we work on a -- I'm going to call it a pay-for-performance system, but it is not a bonus system. I have to be very clear about that. None of us can get bonuses.”

Comprehensive evidence has been provided that describes and supports Kingston Hydro's progression increases at Exhibit 4, Tab 4, Schedule 3. The intervenor should not dismiss that evidence and support so conveniently.

Audit Fees Related to IFRS

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

Energy Probe submitted that Kingston Hydro's proposed amortization should not be accepted because Kingston Hydro is "trying to recover a potential 2012 cost in the 2011 test year." Kingston Hydro submits that the $17,500 represents the amortized portion of the additional IFRS cost over the IRM period. The rates that are being set in this proceeding will serve as the basis for rates for the next four years. It would be reasonable for the Board to recognize this increased expense as it will persist for four years until next rebasing. Kingston Hydro further submits that the amount raised by Energy Probe is below the Materiality Threshold. Kingston Hydro has included this cost in its 2011 Cost of Service Application as it is unclear to the Applicant whether this cost would be captured in the IFRS deferral account. Should the Board still be inclined to make this reduction, Kingston Hydro requests guidance as to whether the increased audit fees would be eligible for inclusion in the deferral account. Otherwise this cost would never be recovered; this would not be reasonable.

Utilities Kingston Board of Directors

Energy Probe disputed the amount of $2,286 associated with Board of Director costs of Kingston Hydro's affiliate Utilities Kingston, an amount well below the Materiality Threshold. Upon further consideration, Kingston Hydro agrees that affiliate Board of Director costs should not be recoverable from ratepayers.

Below Kingston Hydro addresses the specific issues raised by VECC.

Retirement Eligibility

VECC proposed a $100,000 reduction in regard to one employee that achieved retirement eligibility in 2009. According to VECC:

> "Based on KH's forecasting methodology it is extremely probable that that employee will retire in the test year, representing approximately $100,000 in costs the company will have included in rates but not actually pay once that employee retires." (at Paragraph #35)

Kingston Hydro submits that this reduction should be rejected by the Board. Notwithstanding the fact that part of the $100,000 would be capitalized, Kingston Hydro does not agree that it is "extremely likely" that this particular employee will retire during the Test Year. Kingston Hydro does not know when this employee will retire. Predicting retirements is not a science. Kingston Hydro needs to hire technical personnel now in order to prepare itself for potential retirements, in light of its increasing demand for technical expertise and the long lead time to train new employees. Retirement assumptions are made, and the potential for overlap exists. This is the nature of the business. Likewise, sometimes employees retire and there is a period of time before a replacement is hired. As such, to propose a $100,000 reduction to the OM&A budget (which translates to a $400,000 reduction over the IRM period) that is based on a precise prediction by VECC of the retirement of one employee would be unreasonable.

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

Kingston Hydro has included in its revenue requirement a net amount of $114,220 related to the tax effects of reserves for employee future benefit liabilities. This amount is the result of adding back the ending balance of its future benefit liability of $1,544,435 and subtracting the beginning balance of its future benefit liability of $1,254,336 when calculating its taxable income.

The Applicant wishes to clarify for the Board the information outlined in Table 1 on page 19 of Board Staff's submission. The $114,220 is the net impact on revenue requirement and not the net impact on the PILs expenses. That is, the impact shown on Table 1 has already factored in the required gross up for inclusion in revenue requirement.

Intervenors opposed the applicant's request on the prime ground that the employees are not employees of Kingston Hydro and that there is no specific wording in the service agreement between Utilities Kingston and Kingston Hydro pertaining to future benefits.

It is not clear to Kingston Hydro what Board staff's final position is on this issue. They state on page 23 that "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". They end their argument with "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". Kingston Hydro agrees completely with this last statement. To not allow this PILs Schedule 1 adjustment would mean that the Board would be treating Kingston Hydro differently and that Kingston Hydro would be discriminated against because of its structure. As discussed at the hearing, Kingston Hydro believes that its virtual utility model is more cost efficient than Kingston Hydro providing services on its own (transcript pages 169 and 170). Kingston Hydro submits that it should not be penalized for operating under a cost effective virtual utility model where personnel who provide services to the utility are employed by an affiliate.

Board Staff raise the EB-2008-0381 Settlement Agreement (the "PILs Settlement Agreement") which dealt with the nature of the matter at hand. As stated in Kingston Hydro's response to Board Staff Update IR#4, none of the parties to the PILs Settlement Agreement were virtual utilities, so the interests of virtual utilities in regard to issue no. 7 in the PILs case were not canvassed. The PILs Settlement Agreement states:

> "Barrie and Halton Hills did not pay for personnel services provided by an affiliated service company during the period 2001 to 2005. The OPEB liability on the balance sheets of Barrie and Halton Hills relate to the people who were directly employed by

> these distributors. EnWin directly employed the staff to which the OPEB liability relates."

Further, the PILs Settlement Agreement with respect to its issue no. 7 does not appear to adversely impact any of the parties involved in the settlement. As such, while the PILs Settlement Agreement on its issue no. 7 may be the general rule regarding post-employment benefit liabilities, an exception should be recognized by the Board for virtual utilities. The PILs Settlement Agreement notes:

> "The Parties further agree that this Agreement does not purport to be binding or enforceable with respect to any person, whether regulated entity or otherwise, that is not a party hereto, including without limitation any member of the Coalition of Large Distributors or the Electrical Distributors Association."

The PILs Settlement Agreement also states:

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

In its Decision in EB-2008-0381, the Board itself stated that the PILs Settlement Agreement filed in that proceeding is not binding on any party but the parties to the PILs Settlement Agreement.

The PILs Settlement Agreement also states:

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

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

The actual expenses for this liability ultimately end up as expenses of Kingston Hydro and the tax effect of these expenses, in our view, and our tax advisor's view, should correspond to the Corporation that is incurring the expenses, which is Kingston Hydro.

Also, as stated in the response to Board Staff Update IR#4, the following statement was also made in the PILs Settlement Agreement:

> "The general principle that was part of the Board's methodology at the relevant times was that tax liabilities included in the distributor's return should be included in the PILs calculation."

Kingston Hydro maintains that its Schedule 1 adjustment for future benefit liabilities increases its tax liability and the resultant full actual liability should be recognized in its PILs calculation. In the Applicant's view, any deviation from the above methodology would be inconsistent with the principles of ratemaking and the Board's methodology. The Board did in fact recognize in its filing instructions for final recovery of regulatory assets for the May 1, 2006 electricity distribution rate adjustments issued June 16, 2005, the Board confirmed that there is "utility specific variability in the calculation of PILs." Kingston Hydro is a distributor that does in fact have utility specific variability in calculating its PILs liability. Kingston Hydro requests the Board give weight to this finding in making a decision on this issue in this case.

In the "Reasons for Agreement" in the PILs Settlement Agreement, it is noted:

> "The general principle that was part of the Board's methodology at the relevant times was that tax liabilities included in the distributor's return should be included in the PILs calculation."

Kingston Hydro agrees with this regulatory tax principles and requests that this principle be appropriately applied in its proceeding.

Intervenors argue that the issue is whether or not Kingston Hydro should be able to recover the PILS impact associated with future benefit liabilities for employees of its affiliate, Utilities Kingston. Kingston Hydro disagrees. The issue as framed by the parties in this proceeding is, "Is the PILs Schedule 1 adjustment for future benefit liabilities as proposed by Kingston Hydro in the application appropriate?"

Intervenors assert that, in the absence of a written agreement that specifically deals with these costs and their associated tax implications, there is no reason to allow these costs to be borne by ratepayers. Board Staff on the other hand state that it is not clear that these costs are truly the responsibility of Kingston Hydro. These liabilities are in fact liabilities of Kingston Hydro as they are responsible for these expenses and liabilities in accordance with the Service Level Agreement provided at Exhibit 1, Tab 2, Schedule 3 Attachment 3. These annual expenses and resulting liabilities have been recorded in the audited financial statements for years. This agreement is the basis for all charges from Utilities Kingston to Kingston Hydro and the expenses recorded on Kingston Hydro's books of account, which have been audited and to which the Company has always received clean audit opinions. Kingston Hydro submits that the charges to Kingston Hydro are indeed valid and for anyone to imply otherwise would call into question the validity, of not only these particular charges, but of the entire set of financial statements and the clean audit opinions provided to Kingston Hydro every year.

SEC submits that Kingston Hydro does not have any tax impacts of such costs. Kingston Hydro strongly disagrees, and so does Kingston Hydro's tax advisor, KPMG LLP, as illustrated by KPMG's opinion at Appendix E of Kingston Hydro's February 4, 2011 evidence update. KPMG wrote that Kingston Hydro is required to adjust its taxable income for the effect of the change in its liability in accordance with a specific provision of the *Income Tax Act* (Canada). Therefore, Kingston Hydro's actual PILs liability is affected by this required adjustment. The adjustment is made because these liabilities are only deductible for tax purposes when actually paid and not when accrued as required by Generally Accepted Accounting Principles. KPMG has confirmed this tax treatment and has instructed the Applicant that these liabilities are not deductible.

Further, Page 58 of the 2006 Electricity Distribution Rate Handbook states:

> "The tax amount included in rates reflects taxes payable as a result of operating the distribution-only business, rather than taxes calculated for accounting purposes."

Kingston Hydro's calculation of PILs has been done to reflect taxes payable pursuant to this provision of the 2006 Electricity Distribution Rate Handbook. Parties' arguments want to ignore this rate making principle and to rather reflect taxes calculated for accounting purposes. As the Board knows, these are two different things.

Energy Probe states that if the Board does find these costs to be recoverable, there should be a deduction for apprentice tax and co-op tax credits. As noted by Mr. Murphy in the oral hearing (Tr. Page 55) neither Kingston Hydro nor Utilities Kingston has received any such tax credits.

Finally, SEC states that disallowing Kingston Hydro's request is "consistent with many past Board decisions". SEC does not name any such decisions. Kingston Hydro cannot respond to such a generic and unsupported statement. The one decision that has been raised by Board staff has been commented on. Kingston Hydro also commented on other Board documents pertaining to the issue.

For all of the above, Kingston Hydro submits that its request to include the requested adjustment in the calculation of its PILs liability is 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?

Kingston Hydro has in its current rates and in its 2011 cost of service application, embedded shareholder debt of $10,880,619 at a rate of 7.25%. This rate has been in effect since 2000, the time of issuance.

Intervenors argued that the Board should not accept the requested 7.25% rate as in their view the debt is callable on demand. VECC and Energy Probe suggested that the current Board rate of 5.32% should apply. SEC suggested the Board could find a rate of 5.87%, the Board's rate that applied on July 6, 2010 when the shareholder's resolution was passed. Board Staff acknowledged at page 26 of its Reply Submission that "Kingston Hydro has demonstrated that the debt instrument in question is not callable in the test year" but then argued that the Board's current long-term deemed debt rate of 5.32% should nevertheless apply.

On page 54 of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities* (the "Report"), issued December 11, 2009, the Board wrote:

> "For debt that is callable on demand (within the test year period), the deemed long-term debt rate will be a ceiling for the rate allowed for that debt. Debt that is callable, but not within the period to the end of the test year, will have its debt cost considered as if it is not callable."

Kingston Hydro has provided a copy of its 2011 resolution at Exhibit 5, Tab 1, Schedule 1, Attachment 4 that confirms that this debt is not callable during the Test Year.

Intervenors argue that there was no formal resolution. However, the evidence shows that the Corporate Secretary provided a copy of what was resolved at the Shareholder meeting. VECC asserts that the resolution tried to circumvent Board's policy and Energy Probe asserts that this resolution was an obvious attempt to protect revenue and that there were strategic adjustments attempted by the Applicant. Kingston Hydro submits that it did not attempt any "strategic adjustments" for the purposes of this rate application. As illustrated by Kingston Hydro's financial statements, this shareholder debt has been historically classified as "long-term" debt. The reason for this classification is that Kingston Hydro's shareholder has historically passed resolutions similar to the one passed July 6, 2010. Had such resolutions not been passed, Kingston Hydro's auditors would have classified the debt as "short-term" instead of "long-term", and that classification would have been indicated in Kingston Hydro's financial statements.

Energy Probe and SEC suggest that Kingston Hydro should be looking at refinancing this debt. What these parties are missing is that this debt does not require repayments of principal. Kingston Hydro is not aware of any arm's length lenders that would allow for no principal to be repaid. As stated in the Hearing, and well known to the Board, Kingston Hydro would not be able to re-borrow due to limitations in the Eligible Investments Regulation of the Municipal Act. Also, it is a most common practice in the electricity distribution sector in the Province that the shareholder is the prime lender if not the only lender. In a time when Kingston Hydro will be spending over $23 million over the next 5 years, the last thing it would want is to forego $10.9 million of financing which does not require principal repayments.

Further, the Board has rejected intervenor arguments that affiliate debt should be refinanced by third-party debt:

> "SEC submitted that in light of the Board's 2009 Report it would be prudent for Burlington to obtain third party financing. SEC submitted that the weighted average long-term debt rate should be recalculated with the cost of the note set at 5.14%, reflecting the market rate for prudent debt issuances, and $11 million of long-term debt at 4.55%...The Board does not interpret the provisions of the 2009 Report to be that Burlington is obligated to seek third party financing at this point." [Burlington Hydro Decision, EB-2009-0259, at Page 25]

> "SEC did suggest that the Board should direct the Applicant to seek alternate debt financing arrangements at market rates in time for its next rebasing application. CCC agreed with SEC...The Board agrees with Greater Sudbury's submission that issues raised by SEC relating to its actual capital structure are of a generic nature and are outside the scope of this proceeding." [Greater Sudbury Utilities Decision, EB-2008-0230, at Pages 31 and 32]

Board staff raised the Board's decision in Erie Thames (EB2007-0928), suggesting that the circumstances are the same in that case as in this case. Board staff only mentioned the Erie Thames case but they did not demonstrate how that case is the same as this case. In fact, at page 23 of its decision in the Erie Thames case the Board stated:

> "The shareholder debt instrument is subject to rate renegotiation as to the applicable rate at the instance of the debt holder, and has no fixed rate for a fixed term. In the Board's view, this qualifies this instrument as a variable rate loan, subject to the deeming provision of the Report"

In the case of Kingston Hydro's debt, there is a fixed rate and a term that is fixed, beyond the test year period. The two cases are not the same. They are in fact different.

For the reasons set out above, Kingston Hydro urges the Board to find that the existing interest rate of 7.25% for the long-term debt instrument held by the City of Kingston is appropriate.

Should the Board not be persuaded to find so, Kingston Hydro submits that VECC's suggestion of a 5.87% rate rather than a 5.32% rate should apply. The 5.87% rate is also a rate that is acceptable to SEC.

OTHER

1) Intervenor Costs

Kingston Hydro requested the Board to direct the intervenors to provide an estimate of their costs, so it could be determined whether Kingston Hydro's forecasted amount of $25,000 per intervenor was reasonable. All of the intervenors provided estimates in their Reply Submissions, and those estimates were in-line with Kingston Hydro's forecast. We thank the intervenors for their assistance on this matter.

2) Effective Date

It appears from SEC's Reply Submission that it agrees that, based on the Settlement Agreement, the effective date for Kingston Hydro's 2011 rates is May 1, 2011. The effective date was not one of the seven unsettled issues, and with the exception of the seven unsettled issues, everything else in the Application was settled, which would include an effective date of May 1, 2011. Kingston Hydro notes that it has not yet received an order from the Board making its current rates interim on May 1, 2011, as it requested in its Application at section 5 (c) of Exhibit 1, Tab 1, Schedule 2. Because the new rates will certainly not be implemented by May 1, 2011, we request that the Board issue such an order as soon as possible.

All of which is respectfully submitted. April 15, 2011

Andrew Taylor