EB-2007-0696

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

AND IN THE MATTER OF an Application by Halton Hills Hydro Inc. for an Order or Orders approving or fixing just and reasonable rates and other charges for the distribution of electricity commencing May 1, 2008.

SUBMISSIONS
OF THE
SCHOOL ENERGY COALITION

These are the Submissions of the School Energy Coalition ("SEC") in the application by Halton Hills Hydro Inc. ("Halton Hills") for just and reasonable distribution rates commencing May 1, 2008.

Overall Comments

SEC has done its best to provide useful submissions to the Board on the evidence provided. Upon review of the record, however, it appears to SEC that there are a number of issues that would benefit from oral examination. In particular, there are unexplained issues with respect to OM&A, load forecast, and line losses that would benefit from cross-examination. With these remarks in mind, SEC provides the following submissions:

Operations and Maintenance

Halton Hills' OM&A increases by $1,395,555 between 2006 Board approved and 2008 forecast. Of this amount, approximately 58% is driven by increases in compensation costs. [Board Staff Submissions, pg. 3]

The total increase in labour costs in 2008 over 2007 is 5.2%. It appears the 11.7% increase in *OM&A* labour results from the fact that a lower proportion of Halton Hills' total labour costs is being capitalized in 2008 versus 2007. It is not clear to SEC the reason for this lower level of capitalization given the increases in Halton Hills' capital program overall.

Nonetheless, the increases in total compensation appears to be excessive. Even accepting the fact that the 2006 Board approved compensation was based on 2004 historical data, the increases amount to an average annual increase in total compensation of approximately 7%[1]

Even if one discounts the cost of the three added staff members ($159,000), the increase still amounts to an average annual increase of just over 6% since 2004.

Most of the increase in compensation appears in 2006 actual over 2006 Board approved, as is seen from the following table:

2008 vs. 2006 Board approved		$1,142,651
2006 actual vs. 2006 Board approved		$618,851 (17% increase)[2]

[1] Assuming total compensation of $3.621 million for Board approved 2006 represents the 2004 historical value, the difference between that amount and 2008 represents an annual increase of 7%.

[2] 2006 actual total compensation = $4.258,267 versus 2006 Board approved of $3,639,416 [Exhibit 4, Tab 2, Schedule 6] Note: as is explained in the note below, the total compensation for

Consisting of:		
Increased base comp.	$447,405[3] (14% increase)	
Increased pension and benefit costs	$109,781 (21% increase)	
Incentive pay	$61,665	
Total		$618,851

In SEC interrogatory #6, we sought clarification of the large increases in compensation from 2006 Board approved to 2006 actual. Halton Hills' response was that the increase was due to:

i.) increase in wage rates of 2.75% for 2005 and 3.25% for 2006;
ii.) increase in overtime- 13.2% over 2006 Board approved;
iii.) position step-up on wage grid- certain employees stepped up on the wage grid for 2006 Actual compared to 2006 Board approved;
iv.) benefits costs- actual increase in benefits costs were 12.8% over 2006 Board approved.

SEC has used the information provided to update the 2006 Board Approved total base compensation to provide a comparable number to 2006 actual. Because we do not know the precise dollar amounts of the increase in over-time or the impact of employees moving up on the wage grid, we have included only the increase in base pay:

Salaries & Wages

	2006 Board Approved ($)	***2006 Actual ($)***
# FTE mgmt	9	9
# FTE Unionized	34	34
Total Salaries & Wages ($)		

2006 Board approved should be $3,639,416, not $3,621,416 as appears at pg. 4 of Board Staff's submissions.

[3] Note: there appears to be an error in the 2006 Board approved compensation that appears in the table at pg. 4 of Board Staff's submissions. The correct figure should be $903,051 (Management) plus $2,217,075 (unionized) for a total of $3,120,126, not $3,102,126 as stated in Board Staff's submissions.

Mgmt	903,051	1,015,579
Unionized	2,217,075	2,551,952
Total Base Salary	3,120,126	3,567,531
<u>2006 Board Approved inflated by wage increase of:</u>		
2.75%- 2005	3,205,929	
3.25%- 2006[4]	3,310,122	3,567,531
Difference from 2006 actual		$257,409

Adapted from: Exhibit 4, Tab 2, Schedule 6

As can be seen the result of inflating total base compensation by 2.75% in 2005 and 3.25% in 2006 results in a total base compensation of $3,310,122 for 2006. This is $257,409 less than the 2006 actual.

It is possible that the increases in over-time and increases caused by movement up the salary grid account for the remaining $257,409. If so, it would mean that over-time and salary grid increases amount to 8.2% of the 2006 Board approved total compensation ($257,409 divided by $3,120,126). Even so, there is no explanation as to why the increases in over-time costs would be replicated in 2007 and 2008.

In SEC's submission, the increase in total compensation from 2006 Board approved to 2006 actual has not been fully supported by the evidence. SEC discusses the recommended reduction to 2008 OM&A below.

<u>Incentive Compensation Plan</u>

As is seen in the response to SEC interrogatory #6(g), a portion of the incentive compensation plan paid to the President, Vice-President and Chief Financial Officer on the basis of the performance of Halton Hills' non-regulated affiliates. It appears that, based on the percentages given, the amount represents 44% of the incentive paid to the three executives listed, and that the three executives represent approximately one third of the total incentive compensation. Therefore, SEC recommends a reduction to

[4] As provided in SEC Interrogatory #6.

incentive compensation of $10,391 (equals the $70,923 forecast for 2008 incentive compensation times 44% times 33%). [Exhibit 4, Tab 2, Schedule 6]

Therefore, SEC suggests decreasing the 2008 OM&A amount as follows:

- $126,355 to account for the unexplained variances from 2006 Board approved OM&A to 2008;
- $150,000 to account for the large increase in compensation from 2006 Board approved to 2006 actual. This number is derived from SEC's consideration of the increase in base compensation, but additional consideration should also be given to the large increase in benefits costs during this period;
- $10,391 to account for the portion of the incentive plan

Total reduction: $286,746

In addition, SEC points out that the large increase in capital expenditures should produce savings in OM&A. For example, in response to SEC interrogatory #3(b)(v), Halton Hills explains that upgrading to a new computer server will "provide significantly lower software and hardware maintenance costs."

The resulting 2008 OM&A would equal $5,032,254. This is still a 5.7% increase over 2007 ($4,759,000) and a 9.8% increase over 2006 actual.

Rate Base

SEC believes the capital expenditures proposed by the applicant are generally well-supported by the evidence.

SEC agrees with Board Staff that an asset management plan is necessary in order to have a more transparent understanding of how Halton Hills plans its work and expenditures. However, SEC is not convinced that an independent asset condition assessment is required. The third party report by IRC Building Sciences Group Inc. produced in response to Board Staff interrogatory #11 (Phase II) [and found at Appendix E to the Phase II Board Staff responses] is particularly helpful in confirming the problem and recommended action. However, it appears that that report was commissioned by the company after identifying the problem internally.

SEC suggests that in a relatively small utility such as Halton Hills that kind of process is ideal as it avoids unnecessary third party costs.

Load Forecast

Growth-oriented Load Increases

In SEC interrogatory #4(g), SEC pointed out that much of Halton Hills' capital expenditures appear to be designed to meet anticipated growth in the Halton Hills' service area. One example used was new Municipal 230KV to 27.6KV TS that is said to be driven by "significant prestige industrial growth along Steeles Ave." SEC asked in the interrogatory whether this growth had been incorporated into Halton Hills' load forecast.

Halton Hills' response was that the type of load referred to "comes from the customer class General Service 1,000 to 4,999kW" and that the evidence shows an increase from 2006 of 257,481kW for this class to 306,000kW in 2007 and 316,000kW in 2008. These increases, however, appear to be driven by an increase in use among existing customers. Halton Hills has not forecast any new customers in that rate class for 2008.

In addition, SEC agrees with Board Staff's submissions that the customer growth forecasts are not consistent with the historic period. [Board Staff submissions, pg. 13] Residential customers, for example, increase by 3.9% in 2005 over 2004, a further 2.9% in 2006. The increase from 2006 to 2008, however, is just 3.8%, or approximately 1.9% per year [Board Staff Interrogatory #29, Table 18] Similarly, the GS>50 rate class had increases of 12% and 3% in 2005 and 2006, but the increase from 2006 to 2008 is projected to be just 1.1%, or about half a per cent per year.

Weather Normalization

Halton Hills states [at Exhibit 3/Tab 2/Schedule 2, pg. 1] that using weather normalized consumption for its 2008 load forecast would result in consumption being "grossly overstated, therefore causing an under stated and under collected volumetric charge."

Halton Hills' rationale is that normalized results for 2006 were 8.1% greater than actual. Halton Hills did not adequately explain why it did not attempt to develop a better weather normalization methodology.

In SEC's submission, the purpose of using weather-normalized data is to avoid having single year changes in weather influence the load forecast. Therefore, the fact that normalized results are greater or lower than actual in a given year is not a sufficient justification for not using weather-normalized consumption to forecast load. SEC submits that Halton Hills' load forecast should be weather normalized as is the case for all other utilities in Ontario.

Given the submissions above, SEC shares the concerns of Board staff that there is insufficient evidence to support Halton Hills' load forecast. This is an area where the Board would, in SEC's submission, benefit from cross-examination of the company's witnesses.

Cost of Capital

SEC believes Halton Hills has complied with the Board Guidelines with respect to cost of capital.

There appears, however, to be an inconsistency in the evidence with respect to short-term debt, as follows:

- At Exhibit 6, Tab 1, Schedule 2, short-term debt for 2008, or "deposits" is listed as $500,000.
- At Exhibit 6, Tab 1, Schedule 3, the amount is $250,000.
- In response to SEC Interrogatory #9, pg. 3, the amount is listed at $621,888.

SEC asks that the company reconcile these amounts.

Cost Allocation and Rate Design

At Exhibit 8, Tab 1, Schedule 2, Halton Hills proposes to increase the fixed charge for the GS<50 rate class and decrease the fixed charge for the GS>50 rate class.

SEC believes that these changes are appropriate.

In response to SEC interrogatory #11, Halton Hills provided the revenue to cost ratios that would result if the new proposed fixed charges were implemented:

Rate Classification	Revenue to Cost Ratio - Existing	Revenue to Cost Ratio - Proposed
Residential	88.37%	94.60%
General Service less than 50 kW	81.87%	94.44%
General Service 50 to 999 kW	156.93%	134.81%
General Service 1,000 to 4,999 kW	164.17%	131.92%
Street Lights	15.14%	24.27%
Sentinel Lights	36.74%	53.43%
Un-metered Scattered Load	106.77%	103.37%

As can be seen from the above table, the new revenue to cost ratios are a marked improvement over the existing ratios. All rate classes move in the proper direction- those that are under-contributing move up and those that are (and remain) over-contributing move down.

SEC believes, however, that the revenue to cost ratios are still too high for the GS>50 and GS 1,000 to 4,999kW rate classes. Although these classes are within the range set out in the Report of the Board in the Application of Cost Allocation for Electricity Distributors (the "Board Report"), they still represent a significant over-contribution for those two rate classes. At the very least, the proposed changes to the fixed charge should be implemented.

In addition, the Streetlighting class is still far below the minimum level set out in the Board Report. In SEC's submission, the floor of 70% for Streetlighting was chosen to reflect the concerns "in respect to the allocation of costs [to Streetlighting class] and the model sensitivity to changes in assumptions." [EB-2007-0667, Report of the Board, pg. 11] There is, therefore, no justification for a revenue to cost ratio below that level.

Furthermore, the Streetlighting ratepayer is an affiliate of Halton Hills. Halton Hills is, therefore, providing a service to an affiliate at a cost well below the actual cost of providing the service. In SEC's submission, there is no justification for providing service to the Streetlighting ratepayer at a level below 100% revenue to cost ratio.

LRAM and SSM

In its interrogatory #'s 12 and 13, SEC expressed concerns over whether Halton Hills' requested LRAM and SSM recovery was in compliance with the Board's decision in EB-2007-0096 (an application by Toronto Hydro Electric System Limited). In Board Staff Interrogatory #41 and 42, Halton Hills explained that it filed its application prior to the release of the decision in EB-2007-0096. Halton Hills has now updated its evidence to comply with EB-2007-0096 and SEC is satisfied with Halton Hills' response.

PILS

SEC believes Halton Hills' distribution rates should reflect the most current tax legislation. That would mean an adjustment to the PILS calculation to account for the change in federal corporate income tax rate, the provincial capital tax, and the federal capital cost allowance rates.

With respect to actual versus deemed interest expense, it appears that Halton Hills has credited ratepayers with its deemed interest expense rather than its actual expense. The result is a $61,684 impact on ratepayers, calculated as follows:

Addition to Income to add back actual interest expense:	$1,266,740
Deduction for deemed interest expense:	($1,087,945)
Adjustment to Income:	$178,795
Corporate Income Tax Rate	34.5%
Impact on Ratepayers ($178,795 times 34.5%)	**$61,684**

The difference in actual versus deemed interest appears to result from the difference between its deemed and actual capital structure. Halton Hills' actual capital structure consists of 55% debt [December 31, 2006 Audited Financial Statements, pg. 2 of 16, Appendix B to Pre-Filed Evidence] versus a deemed debt component, for 2006 Board approved[5], of 51% [Exhibit 6, Tab 1, Schedule 2, pg. 1]

In SEC's submission, the reason the actual interest is greater than deemed is because the company is, in effect, over-leveraging itself. The utility already enjoys a benefit by doing so, since it earns a rate of return on the deemed equity component of its capital structure and not its actual equity. To also allow the company to enjoy the tax advantage of doing so would, in SEC's submission, provide too great an incentive to utilities to have actual debt components in excess of that determined by the Board to be an appropriate capital structure.

In SEC's submission, the proposed adjustment to interest expense should be denied.

Line Losses

Halton Hills seeks an increase in its distribution loss factor from 1.368 to 1.499. Halton Hills' rationale is that its line losses for 2006 and 2007 were incorrectly determined and that "an increase in the discover of un-metered power has resulted in historical loss factors being under calculated. Also, additional staff training was instituted to ensure consistency across all customer accounts." [SEC

[5] 2006 Board approved is chosen to be consistent with the last available audited financial statements.

Interrogatory #8(a)] VECC had a similar interrogatory and the company gave a similarly-worded response [VECC interrogatory #14]

In SEC's submission, Halton Hills has not provided sufficient evidence to demonstrate why the past line loss estimates were incorrect or that the un-metered power issues will significantly increase Halton Hills' distribution line losses.

Furthermore, the proposed line losses, if approved, would be quite high.

Again, this is an area where SEC believes further evidence in cross-examination would be beneficial to the Board. If the new line losses are approved, the Board may want to hear evidence as to how the company plans on reducing its line losses to a reasonable level.

Smart Meters

Halton Hills has proposed a rate adder of $1.18 per customer per month for Smart Meter expenditures. Halton Hills has said, however, that it has incurred $40,000 in smart meter costs thus far [Board Staff interrogatory #46], its Smart Meter Investment Plan has not been approved by the Board, and a previous Board panel already considered and rejected Halton Hills' proposal for a rate adder of $1.18 and instead awarded a rate adder of $0.28 per customer.

In VECC interrogatory #2(d), Halton Hills was asked to provide its forecast spending on Smart Meters for 2008. In response, Halton Hills provided its Smart Meter Investment Plan dated December 15, 2006 [Appendix "A" to VECC interrogatories]. That same plan was submitted before the panel in EB-2007-0536, which awarded the $0.28 rate adder, which is set to expire on April 30, 2008.

The Smart Meter Investment Plan submitted in Appendix "A" to VECC interrogatories contains no detailed information. It is based purely on an assumed number of meters and an assumed cost per meter. The Request for Proposal that is included with the document will, once the process is completed, provide more accurate information as to Halton Hills' actual smart meter costs.

Until then, SEC submits that the proposed rate adder of $1.18 per customer should be rejected. Halton Hills' request should be considered when it comes forward with a more detailed investment plan, including a response to its Request for Proposal.

All of which is respectfully submitted this 23rd day of January, 2008.

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