Jay Shepherd
Professional Corporation
2300 Yonge Street,
Suite 806
Toronto, Ontario M4P 1E4

BY RESS and EMAIL

July 5, 2011
Our File No. 20110099

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2011-0099 – E.L.K. Energy 2012 Rates

We are counsel for the School Energy Coalition. We have had the opportunity to review the Board's letter to E.L.K. dated June 17, 2011, and their response dated June 28, 2011. For the reasons set forth below, SEC believes that the Board should not grant the Applicant's request to defer its cost of service application from 2012 to 2013 unless and until further information is provided by the Applicant.

Revenue Sufficiency

The Applicant has calculated its ROE for each of 2009 and 2010 as being 16%. While SEC does not have access to the 2010 data (because the RRR filings have not yet been published in a Yearbook), we do have the ability to review the 2009 data. Our conclusion is that the Applicant is collecting around twice as much in rates as is necessary to cover its cost of capital and related income tax. Overall, rates appear to be about 22% higher than cost of service rates.

Based on an assumed rate base for regulatory purposes of $10 million (similar to the numbers used by the Applicant in their letter), and using the deemed capital structure currently applicable

Tel: (416) 483-3300 Cell: (416) 804-2767 Fax: (416) 483-3305
jay.shepherd@canadianenergylawyers.com
www.canadianenergylawyers.com

to this utility, it appears to us that at the ROE, cost of debt and tax rates embedded in current rates, the Applicant should be collecting about $975,000 per year for those three cost categories.

Doing the same calculation, but using more recent ROE, cost of debt, and tax rates (as would be the case in a 2012 cost of service application), we estimate that the amount included in rates for these three categories would be approximately $800,000.

In 2009, the amount of those three costs was in fact $1,778.473, largely due to the high net income and related PILs. The increase from 2009 to 2010 in net income, as set out in the Applicant's letter, when coupled with the related PILs, would all other things being equal bring that amount collected from ratepayers to something in excess of $1,900,000. In either case, the costs that should be collected for regulatory/cost recovery purposes are 42% to 55% (depending on what assumptions are considered appropriate) of the amounts the Applicant is actually collecting from ratepayers.

These are, of course, only rough estimates. The actual sufficiency for each of 2009 and 2010 can be shown if the Board asks the Applicant to prepare a Revenue Requirement Work Form for each year based on actual revenues and expenses, except ROE, interest, and PILs, which would of course be deemed amounts. We expect, though, that such a calculation would result in a sufficiency, i.e. an over-collection of revenues, of somewhere around $1 million per year. For a distributor with net distribution revenues in 2009 of about $4.6 million, this implies that current rates are about 22% higher than necessary to recover the actual costs of operating the utility. If the reason for this is that management has found ways to run the utility efficiently, as IRM incents them to do, that would be an excellent result, but given the numbers in our view the Board should look at the actual results before assuming that to be the case.

Capital Spending

The Board is aware that, since the Board made available the annual yearbook data in spreadsheet format, SEC and others have been seeking to understand the data through comparisons and averages.

One comparison that is particularly useful for utilities under IRM is the ratio of new capital spending to depreciation. Another is the comparative increase in net fixed assets over time.

On average, in 2009 all LDCs spent 123% of depreciation on capital assets (where new capital is calculated as the net increase in gross fixed assets over the prior year). While this is a particularly inexact metric, and varies widely from one LDC to the next, and from year to year, it is possible with this metric to get an indication (subject to detailed review, of course) of how aggressively any given LDC is keeping its distribution infrastructure renewed and updated.

In the case of this Applicant, their capital spending for 2009 is less than 67% of their depreciation, a very low number relative to their peers. While their 2008 and 2007 spending was much higher relative to depreciation, their 2006 number again was very low.

Overall, their net fixed assets increased 8.04% over the four years from 2005 to 2009, while the increase in net fixed assets for the distribution sector as a whole was 22.15%.

This is a cause for concern on behalf of ratepayers, and suggests that an investigation into the reason for this difference would be beneficial. In our view, if the 2010 ratio was again well below 100% of depreciation, that suggests another reason that a cost of service application for 2012 may be appropriate, perhaps even urgent.

Rationale for Delay

The Applicant offers two reasons for the deferral of their cost of service application. The first is smart meters and time of use rates. This is a common issue for many utilities, and in our view is not persuasive in individual cases.

The second is that their Director of Regulatory Affairs is on maternity leave. Depending on the timing, and the reasons why no-one has been brought in to fill this position during that period, this rationale could have some justification. However, in our view the Board needs further information before assessing whether this justifies deferring cost of service at a time of very high overearnings.

SEC Recommendations

Based on this analysis, SEC asks that the Board consider taking the following three steps before granting approval to defer cost of service:

1. Require the Applicant to file a Revenue Requirement Work Form, based on actuals for all costs except cost of debt, PILs, and net income (which is a result, not an input), for each of 2009 and 2010. In each case, both a calculation of the sufficiency against the embedded cost of capital and PILs parameters, and then against the expected 2012 cost of capital and PILs parameters, should be presented.

2. Require the Applicant to file all Asset Condition Assessments in its possession that were done in the last five years, including any done with respect to M&A or attempted M&A activities. If there is an existing Asset Management Plan, that should also be filed, so that the Board can see the utility's response to the ACA data.

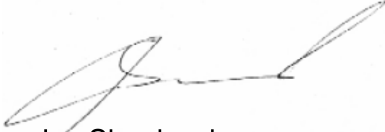
3. Require the Applicant to file further specifics on the timing of the maternity leave for the Director of Regulatory Affairs, and the reason for not providing backup for the position.

In our submission, the information currently provided by the Applicant does not support a deferral of cost of service. With this additional information, the Board will be in a better position to determine whether on balance it is better to defer the application, or require that a cost of service application be filed for 2012 on schedule.

All of which is respectfully submitted.

.

Yours very truly,
JAY SHEPHERD P. C.



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested parties (email)