EB-2011-0054

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application by Hydro Ottawa Limited for an order approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2012.

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

1. By Application dated June 17, 2011, Hydro Ottawa Limited ("Hydro Ottawa") applied to the Ontario Energy Board ("Board")for approval of distribution rates effective January 1, 2012. Hydro Ottawa filed an update to its application on September 14, 2011, which reflected the fact that there would be a delay with respect to the implementation of its new Customer Information System.

2. On October 13 and 14, 2011, a Settlement Conference was convened. Many of the issues were settled as reflected in the Proposed Settlement Agreement dated November 1, 2011, and approved by the Board on November 4, 2011. A Supplementary Settlement Agreement was presented to the Board on November 4, 2011 at the commencement of the oral hearing and also accepted by the Board.

3. Hydro Ottawa's rates were last rebased in 2008. In the 2009-2011 period Hydro Ottawa's rates were determined through the Board's 3rd Generation Incentive Regulation Mechanism ("3rdGIRM").

4. This is the final argument of the Consumers Council of Canada ("Council"). The Council will be addressing the following unsettled issues:

- Working Capital Allowance - Issue 2.2
- Load Forecast - Issue 3.1
- Operating, Maintenance and Administration Costs - Issue 4.1
- Long-Term Debt Costs - Issue 5.2
- Smart Meter Costs - Issue 6.1
- Lost Revenue Adjustment Mechanism - Issue 10.1
- Modified International Financial Reporting Standards - Issue 11.1
- Modified International Financial Reporting Standards Deferral Accounts - Issue 11.2

ISSUE 2.2 - WORKING CAPTIAL ALLOWANCE:

5. Working capital is the amount of money required to fund the day to day operations of the utility. Hydro Ottawa has forecast a Working Capital Allowance (``WCA``) for 2012 of $105,971,000 (Ex. B4/T1/S1). This has been derived using Hydro Ottawa's new lead-lag study based on 2009 and 2010 data and adjusted for any material changes for the 2012 test year. The study resulted in a WCA percentage of 14.2%. That study was done internally by Hydro Ottawa and reviewed by Navigant Consulting. In Hydro Ottawa's last rebasing proceeding it agreed to a WCA percentage of 12.5%.

6. Navigant concluded that Hydro Ottawa's study was complete in terms of the revenue and expense items considered. In addition, Navigant concluded that the Hydro Ottawa analysis was generally consistent in terms of method s used with other studies that have been presented to the Board by Horizon Utilities ("Horizon"), Hydro One Networks Inc. ("HON") and Toronto Hydro Electric System Limited (``THESL``). They concluded that the 14.2% was reasonable because it represented a working capital requirement as evidenced by the Company’s 2009-2010 operations and it was based on a study that is comparable in terms of approach with those supporting other such requests that have been historically accepted by the Board (Ex. B4/T2/S1/Attachment U).

7. From the Council's perspective it is important that the WCA reflect, to the extent possible, the needs of the utility to fund its day to day operations. If the WCA is overstated the utility will recover more from its ratepayers than is required. The Council has reviewed the analysis provided by Energy Probe in its final argument and supports that analysis. Energy Probe has identified the following weaknesses in the approach advanced by Hydro Ottawa:

1. Hydro Ottawa, in calculating the service lag (the number of days between when the service is provided to a customer and when the customer's meter is read), uses a weighting based on the number of customers/connections that are billed monthly and bimonthly. The use of customer weighting over-estimates the average service lag. The more appropriate weighting to be used to calculate the service lag is sales revenue. The Board accepted this approach in the most recent Horizon Utilities Corporation application.

2. Hydro Ottawa calculated a collection lag (the number of days between when a customer is billed and when that payment is received from the customer) of 25.47 days in 2009 and 25.36 days in 2010. The age of the receivables, however, has not been taken into account. The age of the receivables, based on the midpoint of the bucket data available from Hydro Ottawa's customer information system to provide a weighted average age of the receivables on a month by month basis should be used.

3. Hydro Ottawa advanced a new approach regarding its revenue lag (the number of days between the date that Hydro Ottawa provides a service to its customer and the date that payment is received and funds are available to the Company) in an undertaking response. In that new approach Hydro Ottawa is proposing that all components of the revenue lag are un-weighted. This is a new and untested approach, is not consistent with its own evidence and is not consistent with the methodology approved in the Horizon case. (Final Argument of Energy Probe Research Foundation, pp. 3-10)

8. The Council supports approval of WCA of 11% as advanced by Energy Probe. This would result in a reduction to the test year rate base of approximately $24 million.

ISSUE 3.1 - LOAD FORECAST

9. Hydro Ottawa's load forecast was developed using a series of regression models developed through a contract with the Load Forecasting Group at Itron Inc. The models were produced using a statistical analysis software program called MetrixMD. Two main forecasts were developed for rate-making purposes; a system forecast of energy and demand, and a class sales forecast. In addition, a forecast of peak demand was developed for system planning purposes based on more extreme weather conditions (Ex. C1/T1/S1/pp. 2-3). The increase over 2010 actual billed load for 2012 is 1.44% (Ex. LT2.6).

10. After preparing the two forecasts Hydro Ottawa calibrates the forecasts by rate class so that the sum equals the loss adjusted system forecast (Ex. C1/T1/S1/p. 9). Hydro Ottawa undertakes this final calibration in order to translate billed monthly data into calendar month. This is because they have some customers billed bi-monthly and others billed monthly (Tr. Vol. 1, p. 46).

11. The Council supports the approach which sums the customer class specific results and agrees that the calibration step is unnecessary. This is consistent with the approach used by many other utilities and to date, Ottawa's customer class-specific model has, in recent years, proven accurate.

ISSUE 4.1 - OPERATING, MAINTENANCE AND ADMINISTRATION COSTS

12. Hydro Ottawa is seeking approval of an overall Operating, Maintenance and Administration (OM&A) budget of $63,891,431 for 2012. This represents an increase of more than 15.4% over the last Board approved amount in 2008 and a 23.2% increase over what Hydro Ottawa actually spent in 2008 (Ex. K4/Issue 4.1/1) The Council submits that Hydro Ottawa has not justified this level of increased expenditures, and for a number of reasons, the Board should reject the proposed budget.

13. Exhibit K4/Issue 4.1/1 illustrates Hydro Ottawa's OM&A spending since its last rebasing case, 2008. During that time Ottawa Hydro was operating under the Board's 3rd GIRM framework. As the Board well knows the intent of the IRM model is to set the base rates, and allow for annual increases that factor in both inflation and productivity. The model is intended

to promote sustainable productivity gains through the plan term with the benefits flowing the utility shareholders. Upon rebasing those benefits should flow to the ratepayers. Hydro Ottawa agreed that this was a policy objective of incentive regulation (Tr. Vol. 1, p. 130). The level of spending during the IRM plan term relative to the proposed level for 2012 does not allow for Hydro Ottawa's ratepayers to benefit from IRM in the way the Board intended.

14. Hydro Ottawa was able to earn returns above the Board approved levels throughout the IRM term. In 2008 the actual return on equity ("ROE") was 9.5%, in 2009 it was 10.3%, and in 2010 it was 8.8% (Tr. Vol. 1, p. 129) In fact, in 2008 Hydro Ottawa's forecast for OM&A was $55.328 million and its actual expenditure level was $51.628 million, all to the benefit of its shareholder. During the term of the plan the utility operated its business in a way that ensured that it shareholder was guaranteed the allowed return. It is Hydro Ottawa's position that any of the savings achieved during the plan were not recurring or not sustainable (Tr. Vol. 1, p. 130)

15. The Council submits that it is up to the utility to manage its business efficiently and effectively within a reasonable envelope. It is not up to the Board or intervenors to attempt to micro-manage Hydro Ottawa's business by critiquing every component of the OM&A budget. Hydro Ottawa made decisions during the IRM plan to reduce costs in various areas in order to ensure that its shareholder earned a reasonable return. It has demonstrated it has the ability to prioritize its expenditures and find savings in order to secure those returns. The same should be expected going forward.

16. The Council notes that the Board has in recent years approved OM&A levels based on prior years spending levels, accounting for a level of inflation while also considering customer growth. The Board has, in a number of decisions pointed for the need for utilities to control costs, and based its decisions on a desire to minimize rate impacts on utility customers.

17. In the Horizon case the Board approved OM&A based on Horizon's 2008 Board approved amount, which was very similar to the amount Horizon spent in 2008. In the most recent Hydro One Brampton Decision the Board approved a level of spending for 2011 over 2009 which assumed a customer growth factor and a slight increase over inflation.

18. Hydro Ottawa's customer growth has averaged 1.5% (Tr. Vol. 1, p. 127). Assuming an inflation rate of 2%, the Council submits that a reasonable year over year increase from 2008 for Hydro Ottawa should be 3.5%. The appropriate starting point should be 2008 actuals as that is the level of OM&A actually required by Hydro Ottawa in that year. Starting with the $51.628 million and escalating that each year by 3.5% results in an OM&A amount for 2012 of $59.244 million.

ISSUE 5.2 - LONG-TERM DEBT COSTS

19. All of the cost of capital issues were settled except for the cost of long-term debt. The parties did agree that the relevant cost of capital parameters issued by the Board, effective January 1, 2012 for all 2012 rebasers should be applied.

20. With respect to Hydro Ottawa's overall long-term debt costs there was no agreement. Although the Council was not supportive of the Board's "Report of the Board on the Cost of Capital for Ontario's Regulated Utilities" dated December 11, 2009, the Council accepts this report is now the basis for setting the cost of capital parameters each year for Ontario's electric LDCs. From the Council's perspective Hydro Ottawa's overall cost of debt should be consistent with this Board approved policy.

21. Hydro Ottawa has, embedded in it overall cost of debt forecast, 9 debt issuances. All of Hydro Ottawa's debt is owed to its parent corporation, Hydro Ottawa Holding Inc. ("Hydro Ottawa Holding"). Board Staff, in its Staff Submission dated November 18, 2011, provided a chart setting out each of the debt instruments and their associated costs. Hydro Ottawa's forecast of its average long-term debt rate is 5.39% (Tr. Vol. 3, p. 11)

22. The first three debt issues were issued in 2005 and 2006. These are all demand promissory notes and are callable on demand to Hydro Ottawa Holding. This was confirmed by Hydro Ottawa at the oral hearing:

> **MR. AIKEN**: Am I correct that the first three promissory notes listed here - and those are the ones with rates 5.14 percent, 5.9 percent, and 5.318 percent - are demand promissory notes and are callable?
>
> **MR. GRUE:** Yes, they are. (**Tr. Vol. 1, p. 97**)

23. In the Board Cost of Capital Report the Board refers to how debt callable on demand should be costed, "For debt that is callable on demand (within the test year period), the deemed long-term debt rate will be a ceiling on the rate allowed for that debt." (Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, pp. 53-54)

24. It is Hydro Ottawa's position that although they are clearly demand promissory notes from the holder and that they can be prepaid for the issuer they were intended to bring some flexibility within the organization and that the practice has not been to call them (Tr. Vol. 1, pp. 98-100) Having said that the Council submits that that they are demand promissory notes callable on demand and should be subject to the Board's Guidelines for that type of instrument. In its Cost of Capital Parameters Update for 2012, dated November 2011, the Board set the deemed rate at 5.01%. This rate should apply to the first three debt issuances in 2005 and 2006.

25. With respect to the debt issued in 2009 and 2010, the Council submits that the rates should be set in compliance with the Board's Report. The Board's Report indicates for affiliate debt (all of Hydro Ottawa's debt is affiliate debt) the deemed long-term debt at the time of issuance will be used as a ceiling on the rate allowed for that debt (Report of the Board, p. 53).

26. For the issue on December 21, 2009, Hydro Ottawa has a rate of 5.85%, which represents a base rate of 5.75% and .10% for administrative costs. For the issue on April 30, 2010 Hydro Ottawa has a rate of 5.97% which represents a rate of 5.87% plus .10% for administrative costs (Ex. K5/T2/S1, E1/T1/S1) The Board's deemed rate at the time was 7.62%. The issue for the Board to determine with respect to these components of Hydro Ottawa's debt is the extent to which the Board's ceiling is inclusive or exclusive of any administration costs. The Council submits that given the fact the debt is all with Hydro Ottawa's affiliate, Hydro Ottawa did not incur any administrative costs with respect to this debt. Having said that it is for the Board to determine whether to include Hydro Ottawa's administrative costs in the debt rates is compliant with its Guidelines.

27. On July 5, 2011, Hydro Ottawa issued further debt and has proposed a rate for approval of 5.65% which again includes a base rate of 5.45% plus .10% for issuance costs and .10% for administration costs. At the time the debt was issued, the Board's deemed long-term debt rate was 5.32%. The Council submits that this rate should apply subject to the Board's

determination regarding the inclusion of administrative costs. With respect to issuance costs, the evidence is clear that neither Ottawa Hydro nor its parent incurred issuance costs as the debt was not raised by going to the market. Instead it was funded by the parent through the sale of Hydro Ottawa Telecom Inc. (TC Tr. Vol. 1, p. 69, pp96-97).

28. For the three forecast issues Hydro Ottawa is proposing a rate of 5.75% inclusive of administrative costs and issuance costs (Ex. E1/T1/S1/p. 3). The Council submits that the Board ceiling deemed rate set out in the November 10, Cost of Capital Parameters should be applied. Therefore, a rate of 5.01% should be the approved ceiling and used to calculate Hydro Ottawa's overall long-term debt costs.

29. The Council has reviewed the submissions of Energy Probe regarding long-term debt. Energy Probe raises an important issue for the Board to consider. Hydro Ottawa's grid promissory note which is forecast to total $90 million in the test year and has a payment date of February 9, 2015 (Ex. K5, Issue 5.2/3). The question for the Board to consider is whether this is truly long-term debt as the terms range from 2.5 years to just over 5 years. The Board must consider whether Hydro Ottawa's arrangements are long-term debt and should be costed on that basis, or if they should be subject to rates reflective of shorter terms. From the Council's perspective the arguments advanced by Energy probe are persuasive and should be adopted by the Board, namely that the three forecast issues should be costed at a rate of 2.2%.

ISSUE 6.1 - SMART METER COSTS

30. In the Settlement Agreement parties agreed to the elimination of the smart meter adder and the inclusion of smart meter costs in the 2012 revenue requirement. In addition, the parties agreed that the current Smart Meter adder of $1.42/metered customer/month will end on December 31, 2011, to be replaced by a Smart Meter Disposition Rider ("SMDR") to collect $1,511,586. This represents the deferred revenue requirement from 2006 to December 31, 2011, for smart meters installed and associated operating costs, offset by the revenue collected from the smart meter adder. No agreement was reached with respect to the following issue: a) whether the disposition rider should be collected, as proposed by Hydro Ottawa on a per meter basis or b) on a rate class specific basis, based on the smart meter capital costs incurred on behalf of each

rate class, such that some classes would be entitled to a refund, while others would be subject to a charge.

31. Under the Board's Guideline G-2008-0002, issued on October 22, 2008, the Board has allowed for alternative approaches to collecting smart meter costs. The Council submits that to the extent possible smart meter cost recovery should be based on cost causality. Although Hydro Ottawa is proposing to collect the disposition rate rider on a per meter basis, the evidence demonstrates that Hydro Ottawa has over-collected smart meter costs from the residential class and under-collected from the other rate classes (L1.4). In addition, the evidence demonstrates that per unit meter costs vary from class to class and the revenue requirement on a per unit basis will be higher for a higher cost capital meter (Tr. Vol. 1, pp84-86).

32. Hydro Ottawa does not support recovery on based on class specific meter rates primarily because it does not have the data to undertake a proper cost allocation study (Tr. Vol. 3, p. 44). Although it produced an analysis setting out the over and under collection of the smart meter revenue requirement by rate class it is Hydro Ottawa's position that that analysis should not be used to set class specific riders (Tr. Vol. 3, p. 44).

33. The Council supports introduction of a class specific SMDR. The analysis provided by Hydro Ottawa, though not a full cost allocation study, demonstrates that the residential customers have significantly over-contributed relative to the costs of serving that class. To use a class specific SMDR would be a way with which to correct this cross-subsidy. The over-contribution, as set out in the evidence is significant in this case amounting to \$2.63 million (LT1.14). Although a full cost allocation study has not been performed the analysis provided by Hydro Ottawa is, from the Council's perspective, a sufficient proxy that can, and should be used to determine the class specific SMDR.

ISSUE 10.1 - LOST REVENUE ADJUSTMENT MECHANISM

34. Hydro Ottawa has request a Lost Revenue Adjustment Mechanism ("LRAM") related to lost revenue during the period 2009-2011 arising from the implementation of Ontario Power Authority ("OPA") programs in 2009 and 2010. The amount Hydro Ottawa is seeking to recover is \$859,789 (Tr. Vol. 1, p. 44). Although Hydro Ottawa provided an update to the

amount based on actual 2010 results, it is not seeking to recover that higher amount (Tr. Vol. 2, p. 4).

35. LRAMs have been used for many years across North America to eliminate any disincentives for utilities to pursue cost-effective demand side management (``DSM``) and conservation and demand management programs. The intent is to keep both the utility and its customers whole with respect to DSM and CDM savings. The Ontario natural gas utilities, Enbridge Gas Distribution and Union Gas Limited have had LRAMs in place for over 10 years. As set out in the Board's ``Demand Side Management Guidelines for Natural Gas Utilities``, LRAMs are meant to be symmetrical. The Guidelines specifically state:

> `Accordingly, the LRAM amount is a retrospective adjustment and may be an amount refundable to or receivable from the utility's customers, depending respectively on whether the actual natural gas savings resulting from the natural gas utility's DSM activities are less than or greater than what was included in the forecast for rate-setting purposes. (Demand Side Management Guidelines for Natural Gas Utilities, dated June 30, 2011, p. 33).

36. In its 2008 rebased rates Hydro Ottawa made an adjustment to it load forecast to reflect its projected 2008 CDM savings. That adjustment was maintained in the 2009 and 2010 rates. As it turned out the actual savings were less than what was included in the forecast (LT2.8). Given the fact that the savings were less, the revenue requirement impact for the period 2008-2010 is $541,801 less than what was incorporated into the 2008 rates (L1.6) Without some adjustment to reflect the fact that the actual results were lower, Hydro Ottawa is clearly being compensated for savings that did not actually occur. From the Council's perspective this is simply unfair to ratepayers and contrary to the spirit of how an LRAM should operate.

37. Hydro Ottawa is applying for an LRAM for 2009 and 2010. This is one of the first applications by an LDC for a 2009 and 2010 LRAM where there was a 2008 CDM adjustment implicit in the load forecast. It is important, that going forward, the Board consider the fact that if the actual savings are less than the savings embedded in the load forecast the LDC is being compensated for unrealized savings and unrealized ``lost revenue``. This is simply unfair to ratepayers. If the opposite is true, where savings are greater than the savings implicit in the forecast, LDCs are compensated through the LRAM. The Council submits that in order to

appropriately balance the interests of an LDCs shareholders and its ratepayers the LRAM must be symmetrical. This is consistent with the long-standing LRAM practice in the natural gas sector.

38. With respect to the issue of retroactive rate-making the Council submits that the Board has consistently approved positive LRAMs (where money is recovered from customers retroactively to reflect lost revenue) for the past several years. It is puzzling why a symmetrical LRAM would now constitute "retroactive rate-making". The Council urges the Board to reject Hydro Ottawa's contention that any adjustment to the 2009 and 2010 LRAM amounts to reflect the 2008 actual savings would constitute retroactive rate-making. The Council supports a reduction to the 2009 and 2010 LRAM amounts to reflect the 2008 actual savings.

ISSUE 11.1 - MODIFIED INTERNATIONAL FINANCIAL REPORTING STANDARDS

39. The Council has reviewed the submission of the School Energy Coalition ("SEC") on the issues dealing with capitalization and depreciation and supports the arguments advanced by SEC.

ISSUE 11.2 - MIFRS DEFERRAL AND VARIANCE ACCOUNTS

40. The Council has reviewed the submissions of the SEC regarding the proposed deferral account to capture gains and losses on pooled assets and supports the arguments advanced by SEC.

COSTS

41. The Council asks that it be awarded 100% of its reasonably incurred costs for its participation in this proceeding.