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.

HYDRO OTTAWA LIMITED
REPLY ARGUMENT

1. Introduction

1. The argument in chief of Hydro Ottawa Limited (Hydro Ottawa) in this proceeding was delivered orally on November 10, 2011. Board staff provided its written submission on November 18, 2011 and the following parties have also delivered arguments:

(1) Energy Probe Research Foundation (Energy Probe);

(2) Consumers Council of Canada (CCC);

(3) Vulnerable Energy Consumers Coalition (VECC); and

(4) School Energy Coalition (SEC).

2. There are seven unsettled issues in this case that have been canvassed in argument. Under the headings that follow, Hydro Ottawa will address the unsettled issues starting with OM&A Expenses and then proceeding to Long Term Debt Rate, Working Capital Allowance, Load Forecast; LRAM, Smart Meters and Modified IFRS.

2. OM&A Expenses

3. Hydro Ottawa's OM&A budget, exclusive of municipal taxes, is $63.891 million for 2012 and $61.334 million for 2011.[1] Intervenors have advanced various arguments about an "envelope" approach to OM&A expenses and, in so doing, have put forward numerous amounts and ranges for 2012 OM&A. A few of the many examples of

[1] Ex. D2-1-5, p.3.

different numbers or ranges noted, but not necessarily supported, in intervenor arguments are as follows:

> (1) CCC's argument refers to an approach that yields a 2012 OM&A amount of $59.244 million;[2]
>
> (2) Energy Probe's arguments about OM&A are said to result in a "relatively narrow range" of $58.0 million to $58.7 million;[3] and
>
> (3) one of the approaches discussed by VECC produces "a 2012 OM&A (pre-tax) of between $58.1 and $62.3 million".[4]

4. Of these different approaches, Energy Probe's argument places particular reliance on decisions of the Board with respect to other electricity distributors. Despite its purported reliance on these decisions, however, Energy Probe's effort to bring OM&A outcomes into a "relatively narrow range" requires it to change the approach taken in one of the decisions.

5. As stated by Energy Probe, in the EB-2010-0131 Decision and Order for Horizon Utilities Corporation ("Horizon"), the Board "approved an increase in the 2011 test year OM&A expenses based on an average annual increase of about 3% since the last Board approved budget in 2008".[5] Energy Probe, though, proceeds to make submissions based on the Horizon decision that use 2008 actual OM&A as a starting point, rather than Board-approved 2008 OM&A.[6] In short, Energy Probe purports to rely on the Horizon decision, but does not actually follow the approach taken in that decision.

6. Both in evidence[7] and in argument in chief,[8] Hydro Ottawa has given the reasons why its 2008 actual OM&A expenses are not an appropriate starting point for a determination of a reasonable level of OM&A spending in 2012. As stated in argument in chief, if Hydro Ottawa's 2008 Board-approved OM&A expenses are increased by a factor of 3.5% each year until 2012, the resulting amount is in line with the OM&A budget for 2012.[9]

---

[2] Final Argument of the Consumers Council of Canada ("CCC Argument"), at para. 18.
[3] Argument of Energy Probe Research Foundation ("Energy Probe Argument"), at p. 18.
[4] Final Submissions of the Vulnerable Energy Consumers Coalition ("VECC Argument"), at para. 15.
[5] Energy Probe Argument, p. 16.
[6] Energy Probe Argument, p. 17.
[7] Ex. D2-1-1 and 1Tr.136-138.
[8] 3Tr.8.
[9] 3Tr.8-9.

7. Of course, labour compensation represents a considerable portion (approximately 60%) of Hydro Ottawa's OM&A expenses.[10] VECC submits that, in the current economic environment, it is not unreasonable to expect Hydro Ottawa to operate with an increase in labour compensation of no more than 3%.[11] Unfortunately, VECC does not explain how this level of increase is even achievable, let alone reasonable. The evidence is that, for 2012, the increase for unionized employees under Hydro Ottawa's collective bargaining agreement is 3% and that, on top of this increase, Hydro Ottawa is faced with higher benefits costs, including pension costs, of approximately 1% "across the board".[12]

8. Hydro Ottawa explained in argument in chief its position that 2011 OM&A represents an appropriate starting point for 2012 costs, in that 2011 does not reflect non-recurring items that must be taken into account for other years.[13] The evidence is clear that Hydro Ottawa's actual spending in 2011 has closely tracked the budget amount and that this has continued right up to the time of the hearing.[14] As stated by Mr. Simpson during cross-examination by counsel for VECC:

> ...But either way, within this one, I believe you'll see the numbers are that essentially we're 50 percent spent as at the end of June.
>
> Where we do the comparison to our year-to-date budget, which is somewhat calendarized, as I mentioned yesterday, we were 97 percent spent, so essentially on budget for 2011.
>
> And when I say that has continued, that essentially is the trend that continues through our Q3 reporting, that we are very close on our OM&A spending to the budget expectation.[15]

9. In light of comments made by Board staff about potential savings through reduced hiring of apprentices,[16] it is worthy of note that the 2012 OM&A budget does not include the hiring of any additional apprentices in 2012. All budgeted 2011 hiring of apprentices has occurred[17] and the 2012 budget includes an increment for apprentices only because of the full year effect of 2011 hiring.[18] This illustrates why the 2011 OM&A budget is an important starting point for evaluation of 2012 expenses. Any expectation

[10] 1Tr.121 and 2Tr.32.
[11] VECC Argument, para. 20.
[12] 1Tr.121 and 2Tr.19-20.
[13] 3Tr.6-8.
[14] 1Tr.124 and 2Tr.47-49.
[15] 2Tr.49.
[16] See Board Staff Submission ("Board Staff Argument"), at pp. 12-13.
[17] Ex. K4-1-14, Response to CCC Interrogatory #23 and Technical Conference Transcript, September 26, 2011, pp. 14-15.
[18] 1Tr.121.

that Hydro Ottawa can reduce its hiring of apprentices does not mean simply a change to the 2012 budget to remove new apprentices to be hired in that year (of which there are none); it means the dismissal of apprentices who have just been hired in 2011.

10. The OM&A budget for 2012 represents an increase of 4.2% from 2011 OM&A expenses. Hydro Ottawa has detailed the areas of expense, in addition to labour compensation, that give rise to this increase.[19] The cost drivers described in the evidence include important initiatives such as the customer service strategy. During the hearing, Mr. Quesnelle asked Mr. Simpson to explain evidence about the customer service strategy that refers to "on-call and outage support procedures, schedules and training" and Mr. Simpson replied as follows:

> ...at the high level, it's responsibility for -- I mean, that sentence as a whole, what you've got is the link between our website, our brochures, and in the case of on-call and outage support, the communication efforts that go on between our website, some updates that happen automatically to customers who are city councillors, for example, and other customers who are linked in, and even from a little more of a technological perspective, between our outage management system and our other systems in order to have it linked, working quickly, in real-time almost.
>
> And that's been a lot of what the initiatives we've been into the last couple of years have been improving.[20]

11. Another starting point for determination of 2012 OM&A put forward by intervenors is 2010 actual expenses. The fact is, though, that use of 2010 actual expenses - with recognition for non-recurring savings - as the starting point for the 2012 OM&A budget produces much the same result as use of 2011 as the starting point. Actual OM&A expenses in 2010 were about $53.350 million. Mr. Simpson pointed out in his testimony that this amount was affected by non-recurring savings in specific categories that totaled $4.1 million. Recognition of these non-recurring items takes the 2010 base to about $57.450 million.

12. Mr. Simpson also explained the challenges of "essentially flat" revenue growth[21] and he said that in 2010 there was a need to respond to a $2.1 million underachievement in electricity distribution revenue that had been foreseen early in the year.[22] Conservatively recognizing the expense reductions necessary to respond to the $2.1 million underachievement suggests an adjusted 2010 base of about $58.5 million. Energy Probe's argument refers to possible escalations of 8.2%, 8.8% or 10% from the

---

[19] Ex. D1-1-2 and 1Tr.121.
[20] 2Tr.13-15.
[21] 2Tr.33.
[22] 1Tr.123 and 2Tr.8-9.

2010 base.[23] Applying the 8.8% escalator to a 2010 base of $58.5 million gives a 2012 OM&A budget of approximately $63.650 million. This is very close to both the 2012 budget based on a 4.2% increase from the 2011 base and the 2012 budget based on a 3.5% annual increase from the 2008 Board-approved amount.

13. VECC's argument contains a number of detailed submissions about OM&A expenses that do not appear in the arguments of other parties. Relying on the 2010 budget memorandum, VECC asserts that Hydro Ottawa "explicitly pursued 'flatlining' costs" during the incentive regulation period.[24] VECC's submission on this point misses the words of the budget memorandum to the effect that the 2010 budget was to be "flatlined" to the prior year amount, adjusted for an inflation factor not to exceed revenue increase and that all new initiatives were to require a business case and approval from the President and CEO.[25]

14. In a similar vein, VECC suggests that Hydro Ottawa applies a different budgeting standard in rebasing years than during the term of incentive regulation and, in this regard, VECC relies on an isolated excerpt from the hearing transcript.[26] Missing in this submission by VECC is any reference to the context of the quote from the transcript, which is as follows:

> The 2012 rate application ... The increases that have been built in, as I highlighted yesterday, are inflationary, driven by collective bargaining, and then on top of that there are some new initiatives, some priority initiatives, that do get some funding.
>
> And the priority initiatives, getting funding within any budget year, is ... where there are significant new initiatives that they require approval by the executive before being entered into the budget.
>
> So, in this case, for the 2012 test year, that would pick up the workforce strategy, the customer service strategy, the IT strategy, et cetera.
>
> ...
>
> ...But the concept or the principle of our regular operating expenditures being flatlined from this year's number and adjusted for an inflationary factor, that is the principle that's been used for the 2012 request.

[23] Energy Probe Argument, p. 16.
[24] VECC Argument, para. 9.
[25] See Ex. K4-1-25, Att. 1 and 2Tr.30.
[26] VECC Argument, paras. 11-12.

> To say it's an inflationary factor not to exceed our revenue increase, that principle doesn't apply as directly in a rebasing year, as you can appreciate.[27]

15. VECC's argument challenges Hydro Ottawa's meter maintenance costs.[28] From the point of view of OM&A, Hydro Ottawa's focus has shifted from smart meter deployment (a capital expenditure activity) to verifying, managing and maintaining the meter assets and communications infrastructure (an OM&A expenditure activity). Now that Hydro Ottawa has fully installed the smart meters, it is critical that the meters continue to work and the communications network provides the proper data; thus, maintenance costs will increase to ensure that the new meters and the associated systems will continue to work properly. In addition to regular maintenance scheduling for meters that are now six years old, new requirements include checking of collectors, nodes and orphaned meters and ensuring that data is provided to the MDM/R on a timely and accurate basis.[29]

16. Another OM&A item that has drawn the attention of VECC is overtime. In fact, even though Hydro Ottawa is currently overspending its 2011 budget for overtime[30], the 2012 budget carries forward the 2011 budget amount with no increase.[31]

17. Board staff has also raised certain specific issues about the OM&A budget. These issues, and Hydro Ottawa's response to the points raised by Board staff, are as set out under the following subheadings:

Costs Related to Smart Meters

18. Board staff submits that "one time costs" related to Smart Meters and the time of use roll-out, estimated to be $1.3 million, should be removed from the OM&A budget.[32] In fact, Board staff has improperly characterized the amount of $1.3 million as one-tme costs. The one-time amount of $600,000 for communications costs associated with the time of use roll-out has been removed from the OM&A budget.[33] The balance of the amount referred to by Board staff is the increase in costs associated with operating in the new environment of Time of Use meters.

---

[27] 2Tr.30-31.
[28] VECC Argument, paras. 30-36.
[29] 1Tr.141.
[30] 2Tr.46.
[31] Ex. D3-1-1, Table 2.
[32] Board Staff Argument, p. 9.
[33] Ex. D2-1-5, p. 5 and 1Tr.135.

Regulatory Costs

19. Board staff recommends the removal of legal and intervenor costs from the budget for 2012. However, reducing the 2012 budget for regulatory costs in any such manner would fail to take account of the higher amount for the Board's cost assessment that must be absorbed in 2011 and, on a forecast basis, must be assumed to carry forward to 2012.[34] As well, Board staff's submission does not address the fact that the Board released reports for EB-2010-0378, EB-2010-0377, EB-2011-0004 and EB-2011-0043 on November 8, 2011 with respect to the renewed regulatory framework for electricity distributors and transmitters. The accompanying letter included a list of intervenors eligible for costs and these number between 6 and 16 depending on the particular filing. Hydro Ottawa's 2012 costs for these proceedings will form part of its regulatory expenses in the test year.

Non-union Compensation Costs

20. Board staff's submissions regarding compensation costs for non-unionized employees[35] fail to recognize that the transfer of 17 staff from Hydro Ottawa Holdings to Hydro Ottawa Limited would increase the overall average base wages of management and other non-union staff. The pre-filed evidence states clearly that management staff compensation has been based on a 3% annual adjustment that is in line with the increment for unionized employees.[36] All base wages were adjusted for the 3% average annual increase, so any increase in average yearly base wages above 3% reflects the transfer of employees from Hydro Ottawa Holding whose salaries are higher than the average.

Workforce Planning

21. Board staff submits that it is "costly and inefficient" to hire replacement staff at a rate higher than staff attrition.[37] Hydro Ottawa is concerned that there is a misunderstanding about hiring practices and the need for apprentices that have been hired in 2011. The apprentices hired in 2011 are not replacements for employees currently eligible to retire (over the time period of 2008 to 2011). They are replacements for employees expected to retire in 2016 and 2017. It takes approximately 4 to 5 years for apprentices to be trained and replace existing fully qualified staff. Since employees are not required to declare when they are going to retire and, given the long lead time for training, Hydro Ottawa must plan according to retirement eligibility. It is the responsibility of Hydro Ottawa to plan ahead to ensure that it will have adequate qualified staff when existing employees retire – to do otherwise would put customer service at risk and ultimately could itself prove to be "costly and inefficient".

[34] 2Tr.68.
[35] Board Staff Argument, pp. 10-11.
[36] Ex. D1-1-2, p. 4.
[37] Board Staff Argument, p. 13.

3. Long Term Debt Rate

22. Energy Probe has made a series of arguments with regard to the long term debt issued by Hydro Ottawa, but has not given any indication of the average long term debt rate that would result from acceptance of all of these arguments by the Board. Hydro Ottawa has calculated the cumulative impact on the long term rate of Energy Probe's contentions and has determined that giving effect to all of these arguments would result in an average rate under 4.35%. This clearly would not be a just and reasonable result on the evidence in this case.

23. A striking feature of Energy Probe's argument, then, is that it has grasped at any theory that might tend to support a lower long term debt rate and it has put forward all such theories without regard for whether the end result is just and reasonable. A sense of how far Energy Probe has allowed itself to stray from any possible notion of a just and reasonable result can be gained by reference to the comparators mentioned during Hydro Ottawa's testimony. Opposite the average long term rate of less than 4.35% resulting from Energy Probe's arguments, the comparable average rates for Hydro One Networks, Hydro One Brampton, Horizon Utilities and Toronto Hydro are 5.64%, 6.2%, 5.97% and 5.37%, respectively.[38]

24. Board staff makes a comment to the effect that comparisons to other utilities have no "determinative weight".[39] Hydro Ottawa certainly accepts that these comparisons are not "determinative". However, the ultimate outcome of this case is supposed to be just and reasonable rates and the comparators identified in evidence by Hydro Ottawa actually shed considerable light on whether the ideas brought forward by different parties are likely to move the Board in the direction of a just and reasonable result on the long term debt rate. In point of fact, the comparators bring out starkly how the arguments of parties like Energy Probe diverge from any reasonable conception of an appropriate cost of long term debt.

25. Energy Probe itself is more than willing in other areas, like OM&A expenses[40] and Working Capital Allowance,[41] to make broad-brush and sweeping comparisons among Hydro Ottawa and other utilities, despite the obvious differences in circumstances for each utility. Hydro Ottawa submits that comparisons of average long term debt rates are more useful than the comparisons relied upon by Energy Probe and other intervenors because the average long term debt rate is a reflection of the rates that a utility has been able to obtain, or is deemed to obtain, in the third party debt market. Since the long term debt rates of utilities are intended to be reflective of the

[38] 1Tr.96-97.
[39] Board Staff Argument, p. 22.
[40] Energy Probe Argument, p. 14 (table).
[41] Energy Probe Argument, p. 9.

market, the overall average rates of different utilities does provide a useful basis for comparison.

26. A second striking feature of Energy Probe's argument on the long term debt rate is the extent to which it studiously avoids points made in argument in chief by Hydro Ottawa. Energy Probe simply chooses to ignore the evidence and arguments of Hydro Ottawa that undermine its efforts to cobble together any and all theories that might tend to support a lower long term debt rate.

27. One subject addressed at some length in argument in chief is the unrealistic notion that promissory notes with prepayment rights should be treated as "callable" and should be subject to the current ceiling on the long term debt rate.[42] Energy Probe simply ignores the reasons given by Hydro Ottawa as to why this is not a realistic or appropriate approach to long term debt and doggedly sticks to its arguments about "callable" debt.[43]

28. Moreover, Hydro Ottawa submits that the arguments made by intervenors with respect to debt described by them as "callable" do not reflect a proper interpretation of the Board's Report on the Cost of Capital for Ontario's Regulated Utilities (EB-2009-0084). The Cost of Capital Report contains the following clear and explicit statement about the cost of long term debt:

> **The Board will primarily rely on the embedded or actual cost for existing long-term debt instruments.**[44]
>
> (Bold print in original.)

29. The debt instruments that intervenors describe as "callable" are existing elements of Hydro Ottawa's long term debt financing and, in fact, the 2005 and 2006 issuances have previously been approved by the Board as such. The Cost of Capital Report states plainly that, in respect of these existing long term debt instruments, the Board will primarily rely on the embedded or actual cost of the debt. The comments in the Cost of Capital Report about "callable" long term debt apply in circumstances where a deemed long term debt rate is required; they do not apply in circumstances where the Board's over-riding principle is that it will rely on the embedded or actual cost of debt.[45]

30. Another subject addressed in argument in chief is the benefits that ratepayers receive from Hydro Ottawa's financing arrangements with its parent company.[46] As

---

[42] 3Tr.12-15.
[43] Energy Probe Argument, pp. 20-22.
[44] Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, EB-2009-0084 ("Cost of Capital Report"), p. 53.
[45] Cost of Capital Report, pp. 53-4.
[46] 3Tr.14.

outlined in the evidence,[47] Hydro Ottawa would incur higher costs if it were to try to go to market with relatively small issuances of long term debt. Instead of incurring these higher costs, Hydro Ottawa finances relatively small "tranches" of debt through promissory notes given to the parent company. The parent company is then in a position to go to the debt markets when a sufficiently large amount of long term debt has accumulated. Hydro Ottawa's ratepayers receive 100% of the benefit from these arrangements that avoid the higher costs associated with small debt financings.

31. Hydro Ottawa's methodology is to use calculations of the deemed debt rate on a transitional basis until a sufficient critical mass is reached for an issuance of actual debt into the market by its parent company. When actual debt is raised from the market by the parent company, it is Hydro Ottawa's understanding and expectation that the actual costs of raising that debt will pass through to Hydro Ottawa.

32. If, in line with arguments made by Energy Probe, Hydro Ottawa were required to put a term of 10 to 30 years on relatively small issuances of long term debt that are subject to a deemed debt rate calculation, it is unlikely that the scattered, long-term maturities of the issuances would ever allow these debts to be wrapped up in a sufficiently large issuance for the parent company to achieve the best market rates. In other words, it is unlikely that the small "tranches" of debt would ever be converted to an actual market rate that the parent company could flow through to Hydro Ottawa. The features of the debt arrangements between Hydro Ottawa and its parent company which intervenors say make the debt "callable" actually add flexibility to allow a number of small "tranches" of debt to be rolled over into a larger issue at the same time, thereby capturing the benefit of lower overall debt rates for customers.

33. SEC obviously understood Hydro Ottawa's argument in chief about the long term debt financing methodology and it at least recognizes the benefit that accrues to ratepayers, for SEC "agrees that there may be a premium that would be required for external debt on small issuances".[48] Far from even acknowledging Hydro Ottawa's argument about the benefits to ratepayers of its financing arrangements, Energy Probe ignores the benefits and actually suggests that the Board should apply an interest rate to borrowings under the Grid Promissory Note that treats the borrowings as short term debt.[49] When this suggestion was put forward during cross-examination, the Hydro Ottawa witness pointed out that Energy Probe's approach is not consistent with the Board's Cost of Capital report and Hydro Ottawa's deemed capital structure.[50] Again, this flaw in Energy Probe's position is simply ignored in its argument.

34. Similarly, Energy Probe persists in arguing about lending rates available from Infrastructure Ontario – even to the extent of offering new evidence in its final

[47] 1Tr.115.
[48] SEC Argument, para. 5.3.2.
[49] Energy Probe Argument, pp. 24-26.
[50] 1Tr.111.

argument[51] – despite Hydro Ottawa's evidence that it has looked at financing from Infrastructure Ontario and has determined that "the Infrastructure Ontario program typically is targeted [at] specific assets, which ours is not".[52]

35. Hydro Ottawa therefore submits, with respect to long term debt issued before 2008, that the rates put forward in evidence should be accepted by the Board. As stated by Board staff, these debt instruments have already been reviewed and approved by the Board in previous decisions: "Board staff sees no reason why the previously approved rates should not continue to the maturity of these instruments".[53] Also as stated by Board staff, "these debt instruments are tied to external bond issuances by the parent company to fund the loans, and differ only in terms of some timing differences and a 10 basis point administration charge".[54]

36. With respect to debt issued on December 21, 2009 and April 30, 2010, Board staff accepts Hydro Ottawa's evidence that the rates for these issuances meet the guidelines set out in the Cost of Capital Report.[55] For the reasons given by Board staff, Hydro Ottawa submits that the rates given in evidence for these debt issuances should be accepted by the Board.

37. In respect of the July 5, 2011 debt issuance under the Grid Promissory Note, Board staff disagrees with Hydro Ottawa's methodology for calculation of the deemed long term rate as of the date of issuance.[56] It is important to note, though, that the Cost of Capital Report specifically states that the deemed long-term debt rate <u>at the time of issuance</u> (underlining in original) will be used as a ceiling on the rate allowed for that debt. Hydro Ottawa calculated the deemed rate as of July 2011 in order to follow the guidelines set out in the Cost of Capital Report and, moreover, because this calculation produces a more accurate estimate of the market rate at the time when the debt was issued.[57]

38. Board staff submits that Hydro Ottawa's methodology for calculation of the deemed long term rate for the July 5, 2011 issuance is inconsistent with "its argument for treatment" of the issuances on December 21, 2009 and April 30, 2010.[58] However, Board staff's concern about the methodology has been addressed in evidence by Hydro Ottawa. The evidence indicates that, as of April 30, 2010, Hydro Ottawa had not yet acquired the subscriptions that it requires in order to "emulate" the Board's calculation of

---

[51] Energy Probe Argument, p. 26, second paragraph.
[52] 1Tr.111-112.
[53] Board Staff Argument, p. 14.
[54] Board Staff Argument, p. 14.
[55] Board Staff Argument, p. 16.
[56] Board Staff Argument, pp. 16-18.
[57] 1Tr.94 and 105.
[58] Board Staff Argument, pp. 16-17.

the long term debt rate. By July 5, 2011, Hydro Ottawa had subscribed for these services and was able to perform the debt rate calculation.[59]

39. Specifically in relation to the July 5, 2011 issuance under the Grid Promissory Note, Board staff expresses concern about the issuance costs and administration costs included in Hydro Ottawa's calculation of the rate for this debt.[60] The Cost of Capital Report indicates that electricity distributors should be motivated to make rational decisions for commercial "arms-length" debt arrangements, even with shareholders and affiliates.[61] There are issuance costs and administration costs associated with commercial arms-length debt arrangements. In determining a rate that is representative of a commercial arms-length arrangement in the debt market, it should not matter how the lender obtains its money or what actual issuance costs are incurred by the lender.

40. Regardless of how the lender obtains its money, the issuance costs and administration costs need to be added to a pure debt rate to arrive at an overall debt cost that is comparable to the cost that would have to be paid for a commercial arms-length debt issuance. Hydro Ottawa submits that the administration costs are a direct cost to the utility and recoverable from customers, because, among other things, they cover subscription services, meetings with rating agencies and investment bankers and other information-gathering efforts that Hydro Ottawa relies upon as it applies its methodology to follow the Board's guidelines on the cost of debt.[62]

41. For the forecasted long term debt issuances that have not yet taken place, Hydro Ottawa proposes to continue to apply its methodology of calculating the deemed long term debt rate at the time of issuance, in accordance with the Board's Cost of Capital Report. As Board staff has observed, the Board issued Cost of Capital parameters on November 10, 2011, which, effective January 1, 2012, update the long term debt rate to 5.01%.[63] However, interest rates are in a volatile period and Hydro Ottawa's expectation is that, when it comes time to calculate the deemed long term rate for future issuances, the calculation will not result in a deemed rate of 5.01%. Hydro Ottawa's evidence provided its best forecast of the outcome of the deemed rate calculation for future issuances of debt and Hydro Ottawa submits that its forecast should not be subject to revisions to reflect short-term changes in interest rates that are a function of the current volatility in the market.

4. Working Capital Allowance

42. Hydro Ottawa's proposed 14.2% working capital allowance (WCA) is supported by a lead/lag study that in turn is supported by an acknowledged expert – Navigant

[59] Technical Conference Transcript, September 26, 2011, pp. 103-104.
[60] Board Staff Argument, pp. 17-18.
[61] Cost of Capital Report, p. 53.
[62] 1Tr.106.
[63] Board Staff Argument, p. 21.

Consulting. In general, intervenors and Board Staff did not take issue with the vast majority of the lead/lag study. Issues with respect to service lag, collections lag, the impact of monthly billing and the value and use of comparators have been raised and these will be addressed by Hydro Ottawa under the subheadings below.

Service Lag

43. Hydro Ottawa agrees with Energy Probe that the service lag is the number of days between the time when the customer receives the service and the time when the meter is read. Further, there is no dispute that the point at which the customer is deemed to receive the service is the midpoint of the period over which the service was provided. However, Hydro Ottawa parts company from Energy Probe with respect to customer weighting. Customer weighting is more appropriate for determining service lag than revenue weighting because it more closely reflects the period of time between the service being provided and the reading of the meter. Prior to the meter being read and having a price from the IESO, revenue has not yet entered the calculation.[64]

44. As stated in the response to Undertaking L1.2,[65] in order for service lags to be based upon revenue weighting, as proposed by Energy Probe, then it would be necessary to make the related adjustments to other components on the revenue lags. Therefore, in order to be consistent throughout the analysis, it would be necessary to consider the impact on service, billings, collections and payment processing and to use revenue weighting for those activities as well. While the approach followed in the response to Undertaking L1.2 was not proposed by Hydro Ottawa, but was provided for illustrative purposes only, it shows that using a consistent approach to revenue weighting for the service lags and these other related components results in a WCA of 14.4%.[66]

45. Hydro Ottawa submits that the Horizon decision referred to above (Decision and Order in EB-2010-0131) indicates an expectation that utilities will use a consistent methodology and include all elements, including changes that would reduce WCA, in the calculation of WCA. In the Horizon Decision, the Board specifically noted that:

> The Board is also concerned with the adequacy of the WCA calculation given the testimony of the Navigant consultant, who stated that the lead/lag study did not take into consideration a number of elements that would have reduced the billing lag – most notably the introduction of smart meters and AMI, which represent a significant investment in assets in order to improve billing information.[67]

[64] 1Tr.17
[65] Response to Undertaking L1.2, p. 1, ll. 17-25.
[66] Response to Undertaking L1.2, p. 3, Table 26.
[67] Horizon Decision, p. 16.

46. Energy Probe's reading of the Horizon Decision as an endorsement of revenue weighting of service lag is incorrect. In that decision, the Board approved a 13.5% WCA rather than the 13.0% WCA[68] that would have resulted from using revenue weighting to determine service lag. Thus, Hydro Ottawa submits that its customer weighting approach is proper and has not been rejected by the Board in other proceedings.

Collections Lag

47. As part of its calculation of WCA, Hydro Ottawa used the Days Sales Outstanding (DSO) approach to determine its collections lag. Mr. Subbakrishna, Hydro Ottawa's expert witness, stated that the use of DSO is the industry standard approach to calculating WCA.[69] Indeed, Board Staff accepts Hydro Ottawa's use of DSO to determine the collections lag.[70]

48. Hydro Ottawa disagrees with Energy Probe's proposal to use the dollar-weighted average of DSO by taking the midpoint of each of the DSO buckets because the effect of this is to understate significantly the period. Mr. Subbakrishna indicated that the use of 11.5 as the mid-point for the first bucket, as suggested by Hydro Ottawa is overly conservative and that the use of 16 days, the period prescribed by the Board in the Distribution System Code, would be more appropriate.[71]

49. In this area, Energy Probe's approach once again fixates on one element of the equation and fails to take a consistent principled approach to the entire determination of WCA. Energy Probe argues that customers could pay early and that there is no evidence that customers wait until the 16th day. There are a number of difficulties with this contention by Energy Probe, including the following:

> (1) it is known that some customers will be late and others will never pay - otherwise there would be no bad debt or aged accounts;
>
> (2) Hydro Ottawa's analysis is based upon the premise that customers will generally wait as long as permissible before paying - this is an appropriate assumption as it recognizes that people will generally meet their obligations but not exceed their obligations; and

[68] Horizon Decision, p. 15.
[69] 1Tr.39.
[70] Board Staff Argument, p. 2.
[71] 1Tr.27.

> (3) Hydro Ottawa's approach is consistent with the methodology used in other elements of the WCA – the methodology might assume, for example, that Hydro Ottawa will choose to pay its suppliers early rather than wait for the last possible day, but such a proposition would not be acceptable to intervenors and it is inappropriate to ascribe a different approach to Hydro Ottawa's customers.

50. For all of these reasons Hydro Ottawa's methodology, using the industry standard DSO approach, is appropriate.

Monthly Billing

51. Hydro Ottawa agrees with Board Staff that the switch to monthly billing, which is to occur following the implementation of the new CIS system in late 2013, is "out-of-period"[72] and therefore should not be taken into account in setting the WCA for the present proceeding. Energy Probe also agrees that there should be no change to WCA for this proceeding based upon a future change to monthly billing.[73]

52. Hydro Ottawa confirmed that the switch to monthly billing will be accompanied by increases in OM&A costs, such as printing, postage and employee costs for dealing with exceptions.[74] Energy Probe confirms that additional costs would accompany such a change.[75] Accordingly, the change to monthly billing should not be considered to affect the WCA in this proceeding.

53. Hydro Ottawa intends to file an updated lead/lag study as part of its next cost of service rebasing and such study will be based upon the relevant facts and evidence at that time. While Hydro Ottawa does not agree that a direction from the Board in this regard is necessary or appropriate, any direction provided by the Board with respect to an updated lead/lag study in the next cost of service hearing should not be restricted to a single issue - a switch to monthly billing - as suggested by Energy Probe.[76]

Comparison to Other Utilities

54. Hydro Ottawa reiterates that WCA is utility specific, as the Board recognized in the Horizon decision, wherein it stated:

> The Board does accept Horizon's argument that a lead/lag study is undertaken based on the individual characteristics of

[72] Board Staff Argument, page 4.
[73] Energy Probe Argument, p. 8.
[74] 1Tr. 40.
[75] Energy Probe Argument, p.7.
[76] Energy Probe Argument, p.8.

> the distributor, and therefore comparisons to other distributors may not be appropriate. Nevertheless, the Board must take notice of the results of other study results such as those conducted for and filed by Hydro One Networks Inc. and Toronto Hydro Electric Systems Ltd. to ascertain reasonableness and within a reasonable range of results for other utilities.[77]

55. Hydro Ottawa has serious reservations about the value of comparing its WCA with the WCA calculated by other utilities. For example, the Board recently established a 13.5% WCA in the Horizon decision. In that decision, the Board expressed concern that the WCA calculation had failed to include elements, such as smart meters, that would have reduced the WCA.[78] No such shortcomings have been noted in Hydro Ottawa's evidence. Hydro Ottawa specifically dealt with the fact that smart meters do not reduce billing lag; Ms. Scott testified that smart meters do not impact WCA because the utility must still await IESO pricing.[79] In other words, factors used by the Board to reduce the WCA from Horizon's requested 14.0% to 13.5% are not relevant in the present proceeding and therefore tend to support the reasonableness of the 14.2% requested by Hydro Ottawa.

56. Hydro Ottawa's proposed WCA is well below the default value of 15% established by the Board for electric utilities that do not file a lead/lag study. It is more consistent with the Board-approved WCA for Hydro One Networks Inc. (11.9%), Toronto Hydro (12.9%) and Horizon Utilities (13.5%) than the 11.0% WCA suggested by Energy Probe. Hydro Ottawa is not aware of any approval by the Board for a WCA that approaches the 11.0% contended for by Energy Probe. While Hydro Ottawa has taken a principled approach to the calculation of WCA, Energy Probe's arguments appear to be premised solely on a resolve to drive a smaller WCA, rather than a principled approach.

57. In conclusion on this issue, Hydro Ottawa agrees that the WCA should be re-calculated based on the updated cost of power and approved OM&A. The WCA of 11.0% proposed by intervenors is outside of any range that could be considered to meet a standard of reasonableness and Hydro Ottawa urges the Board to reject this proposal. Intervenors have used a theoretical mathematical approach to reduce two individual elements of the WCA calculation without regard to Hydro Ottawa's circumstances, nor with any regard to the use of a principled, internally consistent approach throughout the entire calculation. In contrast, Hydro Ottawa's calculation of a 14.2% WCA is: (i) based upon Hydro Ottawa's specific and unique circumstances; (ii) consistent with industry practice; and (iii) within a reasonable range for electric utilities in the province of Ontario.

---

[77] Horizon Decision, p. 16.
[78] Horizon Decision, p. 16.
[79] 1Tr.36.

5. Load Forecast

58. In its evidence, Hydro Ottawa has outlined the robust methodology that it has followed in order to develop its load forecast for kWh sales in 2012.[80] This methodology involves the development of a system forecast and the calibration of class-specific sales forecasts to the loss adjusted system forecast. Hydro Ottawa's system energy forecast for 2012 is 7,753 GWh and Board staff has indicated its agreement with this forecast.[81]

59. Certain intervenors, apparently perceiving that the total of the sales class forecasts without calibration produces a higher overall load forecast, have submitted that the 2012 load forecast should be based on the sum of the non-calibrated customer class-specific results.[82] Other intervenors propose that the 2012 load forecast should be based on an average of the system forecast and the non-calibrated class sales forecast.[83]

60. There is apparently a mistaken impression that no evidence on the record of this proceeding addresses the relative accuracy of the system forecast and the non-calibrated class sales forecast.[84] On the contrary, though, the relative accuracy of the system forecast and the non-calibrated class sales forecast was addressed in the response to Undertaking L2.1, which states as follows:

> ...The system forecast is based on calendar month actuals, whereas the individual class forecasts are based on billed month actuals. For example, one month's billed sales can include consumption from that month plus the previous two months. The calibration factor brings the billed month forecast into line with the calendar month system forecast. Hydro Ottawa believes that the calibrated class forecasts are more accurate than the non calibrated class forecasts.[85]

61. VECC notes in its argument that the R^2 values of the class sales forecasts are between 0.718 and 0.961 and says that the class sales forecasts perform "reasonably well".[86] As discussed in the evidence, the R^2 factor is a statistical measure of how well a regression line fits the available data. An R^2 value of 1.0 indicates that the regression

---

[80] Ex. C1-1-1, p. 9 and 1Tr.46.
[81] Board Staff Argument, p. 7.
[82] VECC Argument, para. 52 and CCC Argument, para. 11.
[83] Energy Probe Argument, p. 11 and Final Argument on Behalf of the School Energy Coalition ("SEC Argument"), para. 3.1.1.
[84] Energy Probe Argument, p. 11 and VECC Argument,
[85] Response to Undertaking L2.1, p. 1.
[86] VECC Argument, para. 48.

line perfectly fits the data.[87] The R^2 value of 0.985[88] for the system sales forecast is very close to 1.0 and is higher than the value for the class sales forecasts.

62. VECC also notes that, in many of the 2011 rate applications approved by the Board, electricity distributors used customer class-specific models to forecast billed energy, while a number of other distributors tested class-specific models and found that the results were not satisfactory.[89] Hydro Ottawa submits that these observations do not shed any light on the load forecast issue in this proceeding, particularly in the absence of further information about the nature of the load forecast models used by the different distributors, the extent of monthly or bimonthly billing for each distributor and the rate of growth affecting each distributor.

63. Hydro Ottawa urges the Board to accept the 2012 load forecast of 7,753 GWh produced by a robust methodology for forecasting system load that has been shown to yield accurate and reliable results. Indeed, it is to be expected that, in a case where the system forecast is less than the non-calibrated class sales forecasts, intervenors will have no difficulty accepting the accuracy and reliability of the system forecast. Hydro Ottawa submits that it is not appropriate to make an arbitrary decision to average the system forecast and the non-calibrated class sales forecasts, nor is it appropriate to ignore the evidence that the calibrated class forecasts are more accurate than the non-calibrated class forecasts.

6. LRAM

64. VECC's argument on the LRAM issue poses a question as to whether the Board's Guidelines for Electricity Distributor Conservation and Demand (CDM) Management (EB-2008-0037) allow for "unforecasted CDM results" and "unforecasted lost revenues", which would "effectively" result in a "refund" to ratepayers.[90] In its discussion of this issue, VECC asserts that the Board's "CDM Guidelines" (sic) for Gas Utilities should be applied in the interpretation of the Electricity CDM guidelines.[91]

65. The Board's Demand Side Management (DSM) Guidelines for Natural Gas Utilities explicitly and clearly state that LRAMs for gas utilities are symmetrical and may result in an amount that is refundable to the utility's customers.[92] The words "symmetrical" and "refund" or "refundable" do not appear anywhere in the Conservation and Demand Management Code for Electricity Distributors that was issued on September 16, 2010. Simply put, the express words of the guidelines for DSM by gas utilities and CDM by electricity distributors make it plain that the Board's framework for

[87] Ex. C1-1-1, p. 4.
[88] Ex. C1-1-1, p. 5.
[89] VECC Argument, para 47.
[90] VECC Argument, para 60.
[91] VECC Argument, para. 63.
[92] CCC Argument, para. 35.

CDM is not the same as that for DSM. Given that the two are clearly different, Hydro Ottawa submits that there is no basis to think the framework for gas DSM can be used to "interpret" the Electricity CDM guidelines.

66. Moreover, as Hydro Ottawa stressed in its argument in chief, any effort to change the regulatory framework for electricity CDM by introducing the concept of a "refundable" LRAM should only be considered on a prospective basis. While this was a key point of Hydro Ottawa's argument in chief on the LRAM issue,[93] none of the intervenor arguments have responded in any way to this point. There certainly are comments about "retroactive ratemaking" in the submissions made by intervenors,[94] but Hydro Ottawa's point in argument in chief was that, even in circumstances where "retroactive ratemaking" may be permitted by law, it is an entirely different matter to attempt to change the "rules" or regulatory framework for ratemaking on a retrospective basis. All parties govern themselves according to the rules or regulatory framework in place at any particular time and Hydro Ottawa submits that the Board should categorically reject any notion that the Board can or should "reach back in time" to retrospectively change the regulatory framework that all parties were entitled to assume would constitute the governing rules during a previous period of time.

67. Indeed, CCC says that it is important that "going forward", the Board consider the outcome of circumstances where actual savings are less than the savings embedded in the load forecast.[95] Hydro Ottawa agrees that, if the Board sees fit to re-consider the regulatory framework for LRAMs for electricity distributors, then this should be done on a going forward, or prospective, basis.

68. On the subject of "retroactive ratemaking", Hydro Ottawa is, as VECC has noted, one of the first electricity distributors to make an LRAM claim for program years in respect of which CDM savings have been explicitly incorporated into the load forecast to set rates.[96] As a result, Hydro Ottawa's base rates for 2008 are affected by the CDM adjustment and it is in this context that retroactive ratemaking must be considered.

69. CCC states that "where savings are greater than the savings implicit in the forecast, LDCs are compensated through the LRAM".[97] While Hydro Ottawa cannot speak for other electricity distributors, it has never been Hydro Ottawa's understanding that once a CDM adjustment has been made to a rebased load forecast, it can come back for an additional LRAM if savings turn out to be higher. Hydro Ottawa has always conducted itself in accordance with its understanding that it cannot request an additional LRAM in such circumstances.[98]

[93] 3Tr.38-39.
[94] CCC Argument, para. 38.
[95] CCC Argument, para. 37.
[96] VECC Argument, para. 58.
[97] CCC Argument, para. 37.
[98] 1Tr.68 and I3.1-1-1, p. 3.

70. VECC contends that Hydro Ottawa's 2008 program results were less than forecasted over the period of 2008-2010 and that the revenue impact of actual CDM results is $541,801 less than "what was (implicitly) incorporated into rates for this period".[99] The amount of $541,801 calculated by VECC is based on the difference between the forecasted lost revenue due to the forecasted savings from the 3rd CDM tranche and 2008 OPA CDM programs in 2008-2010 compared to the calculated lost revenue in 2008-2010 due to actual net savings reported for the 2008 OPA programs only.[100] Hydro Ottawa was asked to remove the impact of the 3rd tranche programs from the 2008-2010 calculation and, although Hydro Ottawa does not agree that it is appropriate to remove the impact of these programs, the savings calculated in this manner are 13,933 MWh.[101] Even if, despite all of Hydro Ottawa's arguments to the contrary, the Board is inclined to accept VECC's position regarding the calculation of a retroactive, refundable LRAM not contemplated by the electricity CDM guidelines, the reported savings that should be used in the calculation are 57,529 MWh.[102]

7. Smart Meters

71. Arguments made by intervenors on the issue of smart meter costs advance the proposition that, as stated by CCC, smart meter cost recovery should be based on cost causality to the extent possible.[103] Hydro Ottawa also supports cost causality as the basis for allocation of costs among customer classes, but agrees with SEC that the Board should only apply this proposition when the underlying data is adequate.[104] In order for a class-specific rate to be determined accurately, the allocation of costs must be done correctly. Hydro Ottawa has confirmed that all of its costs related to smart meter implementation cannot be allocated to specific classes with any degree of certainty.[105]

72. VECC surmises that Hydro Ottawa has taken a position with respect to smart meter costs to favour its commercial customers at the expense of residential customers.[106] Hydro Ottawa has no reason to favour its commercial customers in this manner and it has not attempted to do so. Rather, Hydro Ottawa has endeavoured to follow the directions of the Board that were articulated in the PowerStream decision (EB-2010-0209). In that decision, the Board observed that no class by class tracking has been required since the initial implementation plans were filed and the Board said that it would entertain proposals for smart meter disposition riders based on principles of

---

99 VECC Argument, para. 60.
100 Response to Undertaking L1.6.
101 Response to Undertaking LT2.13, Table 1.
102 Response to Undertaking LT2.8.
103 CCC Argument, para. 31.
104 SEC Argument, para. 6.1.1.
105 3Tr.44.
106 VECC Argument, para. 86.

cost causality "where the distributor has the necessary historical and forecasted data".[107]

73. VECC's concluding submission on this issue is that Hydro Ottawa and every other LDC that was required to install smart meters should be directed to come forward with proposals that, if possible, reflect principles of full cost causality, or alternatively, that Hydro Ottawa should be required to implement class-specific riders in accordance with the "proxy" approach developed in the answers to Undertakings LT1.14 and UT1.4.[108] Hydro Ottawa notes that the lack of complete and accurate data for class-specific calculations bears on both of these proposals made by VECC.

74. CCC points out that the Board's Guideline G-2008-0002 allowed for alternative approaches to the collection of smart meter costs.[109] Hydro Ottawa has proposed one of these alternative approaches. Going forward, Hydro Ottawa would have no objection to a generic determination by the Board that electricity distributors should maintain a sufficient level of detailed information to support a class-specific calculation of smart meter costs. Should the Board in fact decide to require distributors to provide class-specific Smart Meter Disposition Riders, Hydro Ottawa agrees with SEC's request that the board provide guidance as to the required level of "data granularity" to support class-specific cost recovery.[110]

8. Modified IFRS

75. Board staff's submissions with respect to the transition to modified IFRS generally support the position of Hydro Ottawa except in relation to the request for establishment of an asset disposals deferral account. The only other party that made specific submissions in response to Hydro Ottawa's evidence with regard to modified IFRS was SEC.

76. A considerable portion of SEC's submissions on modified IFRS are directed towards a question raised by SEC about the nature of the evidence that should be filed by an electricity distributor to establish the appropriate amount of depreciation expense. SEC discusses at some length whether an electricity distributor like Hydro Ottawa should be expected or required to file a depreciation study performed by independent experts with particular expertise "in utility assets".[111]

77. SEC refers to the Accounting Procedures Handbook that applies under Canadian GAAP and focuses on a sentence indicating that "in the absence of an objective study to support changes", utilities will continue to use "methods, lives or rates" consistent

[107] Response to Undertaking LT1.14.
[108] VECC Argument, paras. 89-90.
[109] CCC Argument, para. 31.
[110] SEC Argument, para. 6.1.1.
[111] SEC Argument, paras. 8.2.1 to 8.2.30.

with past practice. SEC's seizes on the word "objective" in this particular sentence, it equates "objective" with "independent", it postulates that the assumed requirement for an "independent" study continues under modified IFRS and then it discusses whether the careful study performed by Hydro Ottawa and confirmed by Hydro Ottawa's auditors meets such a standard.

78. After all of this discussion, however, SEC arrives at the following "Conclusion":

> Some utilities are undoubtedly fully capable of carrying out a rigorous depreciation study, and when they do so the Board may be willing and able to assess if it has been done properly.[112]

This Conclusion emphatically and unequivocally answers SEC's question about whether an electricity distributor should be expected or required to file a depreciation study performed by independent experts. SEC says that "undoubtedly" some utilities are "fully capable" of carrying out a "rigorous" depreciation study.

79. There is no requirement under IFRS for a depreciation study to be prepared by an independent expert with particular expertise in utility assets. On the contrary, IAS 16, paragraph 57 states, in part, that:

> The estimation of the useful life of the asset is a matter of judgment based on the experience of the entity with similar assets.[113]

80. The issue, then, is not whether Hydro Ottawa has filed a depreciation study performed by independent experts. As stated by Board staff:

> In Board's staff's view, whether the depreciation study conducted by Hydro Ottawa is an independent and objective study is less relevant for the Board in setting just and reasonable rates as long as the depreciation study gives due consideration of the Kinectrics Report.[114]

81. As to whether Hydro Ottawa has appropriately taken into account the Kinectrics Report, Board staff's submission goes on as follows:

---

[112] SEC Argument, para. 8.2.31.
[113] Ex. M2.1, p. 13.
[114] Board Staff Argument, p. 32.

> Board staff submits that Hydro Ottawa has given due consideration to the Kinectrics Report and has applied the Kinectrics report to their specific circumstances.[115]

82. The other primary thrust of SEC's submissions about depreciation under modified IFRS is aimed at the basis upon which Hydro Ottawa determined the useful lives of assets for depreciation purposes. In relation to the differences between Canadian GAAP and modified IFRS insofar as depreciation is concerned, SEC points out that "[o]ne of the most important" differences is componentization. With respect to this important element of determining depreciation under modified IFRS, SEC does not take issue with the "correctness" of Hydro Ottawa's results, but, significantly, it also does not take issue with the "thoroughness" of Hydro Ottawa's process.[116]

83. Even though SEC accepts the thoroughness of Hydro Ottawa's process when it comes to componentization, SEC baldly asserts that Hydro Ottawa's approach amounts to a "guess" when it comes to the determination of useful lives. SEC's assertion that Hydro Ottawa made a guess is founded on a single exchange of question and answer between counsel for SEC and a Hydro Ottawa witness at the hearing.[117] The question from counsel for SEC to which the witness responded affirmatively was actually a multi-part question. The question included the following parts:

> ...How long is this stuff going to last? What do we have that tells us the reasons why it would last this length or this length? ...[118]

84. For some unknown reason, SEC has interpreted the affirmative answer to this question to mean that Hydro Ottawa relied on a guess rather than empirical evidence. In fact, when the witness agreed that Hydro Ottawa considered "What do we have that tells us the reasons why it would last this length?", there was nothing in the witness's answer to suggest in any way that Hydro Ottawa did not look at empirical data. On the contrary, given that Hydro Ottawa looked at "How long is this stuff going to last?" and "What do we have that tells us the reasons?", it follows that Hydro Ottawa considered the information available to it, including empirical data on asset lives. As stated by Mr. Simpson:

> ... the service lives related to those components ... were developed through discussions amongst the engineers, based on their experience and professional judgment, as well as reviewing the asset management practices, failed data of some of the components, and the lives were

[115] Board Staff Argument, p. 32.
[116] SEC Argument , para. 8.2.6.
[117] SEC Argument , para. 8.2.22.
[118] 2Tr.156.

> developed with local operating conditions in mind, weather, economic conditions.[119]

85. In its submissions about the empirical data relied on by Hydro Ottawa, SEC embarks upon a discussion of "survivor curves".[120] Of course, this was a subject raised by SEC during cross-examination at the hearing and, in response to an undertaking given during SEC's cross-examination, Hydro Ottawa provided a detailed explanation of data with respect to asset lives, including the use of Weibull Distribution analysis and survivor curves.[121] While Weibull Distribution analysis is used by Hydro Ottawa, there are shortcomings in the amount of data plotted on the curves[122] and the purpose of the curves is to assess the point at which the risk and consequences of failure make it economical to replace assets, rather than to take into account the whole range of factors that will bear on asset retirement decisions.[123] It should be noted here that the Kinectrics report does not contain any survivor curves, not does it provide any reference to survivor curves.

86. During the hearing, SEC's cross-examination brought out that Toronto Hydro has not in all cases used the asset lives determined by its own independent expert.[124] It can be seen from the document referred to in cross-examination that there are a number of instances where Toronto Hydro has used a useful life that varies both from the results of the study commissioned by Toronto Hydro and from the results of the Kinectrics report.[125] This is not an unexpected or unusual outcome, because IAS 16, paragraph 57 makes clear that the estimation of the useful life of an asset is a matter of judgment based on the experience of the entity with similar assets.

87. The response to Undertaking L2.6 summarizes the work performed by Hydro Ottawa to assess the useful lives of assets in the following manner:

> The process for determining Hydro Ottawa's IFRS Useful Lives started late in 2008. The engineers from Assets used existing information regarding asset failure rates to determine technical lives from the 2005 Asset Management Plan (AMP), also considering 2006/2007 asset management analysis and opinion and industry technical reports. The evaluation of technical life span of assets focuses on the failure of assets only, rather than the broader question of

---

119 2Tr.72. See also for example, the evidence of Mr. Bennett at 2Tr.77.
120 SEC Argument, paras. 8.2.23-8.2.26.
121 Response to Undertaking L2.6.
122 Response to Undertaking L2.6, p. 2.
123 Response to Undertaking L2.6, p. 6.
124 2Tr.155.
125 The document referred to at 2Tr.155 is Ex. R2-1-3, Appendix A in EB-2010-0142.

> asset retirement, and as such does not consider assets retired from service for external reasons, such as capacity upgrades, relocations, and vehicle collisions. ... Utilitizing the AMP technical analysis together with their experience and professional judgment, the engineers considered existing and future issues which were pertinent to Hydro Ottawa's asset operational conditions, in order to develop appropriate commercial useful lives.[126]

88. Board staff's submission reviews in some detail the evidence on the depreciation issue, including the evidence comparing the useful lives determined by Hydro Ottawa to those set out in the Kinectrics report.[127] SEC's argument does not reply to, or provide any basis for the Board not to accept, the points made by Board staff. Board staff concluded its submissions on this aspect of the modified IFRS issue with the following:

> ...Board staff submits that the components and useful lives used by Hydro Ottawa in developing its depreciation expense for its 2012 rates are reasonable.[128]

89. In conclusion on the depreciation issue, Hydro Ottawa submits that its study on componentization and useful lives for its utility assets was objective and thorough and fully recognized and considered the Kinectrics study in its results. In this regard, Ernst & Young made the following comments:

> We have performed detailed procedures with respect to the determination of the components as well as the useful lives under IFRS. ... We compared the useful lives as determined by management to the report from Kinectrics and obtained an understanding of the variances between the components and the useful lives determined by HOL to those in the report. ... Based on the procedures performed, the components and the useful lives as determined by management appear to be reasonable.[129]

Hydro Ottawa submits that the results of its study of asset useful lives are reasonable and appropriate for the determination of 2012 rates.

90. SEC's submissions in relation to the transition to modified IFRS also touch on the capitalization of overheads and on contributions and grants. However, the submissions

[126] Response to Undertaking L2.6, p. 6.
[127] Board Staff Argument , pp. 29-33.
[128] Board Staff Argument, p. 33.
[129] Response to Undertaking L2.5, Attachment 1, p. 15.

made by SEC in these two areas do not raise any issue that has an impact on Hydro Ottawa's 2012 revenue requirement or rates.

91. With respect to capitalization of overheads, SEC says that it has "no specific submissions on the overhead expense categories the Applicant is capitalizing or has ceased to capitalize".[130] SEC proposes that the Board "review the detailed overhead capitalization approaches used by the distributors currently filing application, and provide a comprehensive list of the items that the board believes are appropriately capitalized under IFRS in normal circumstances".[131] Hydro Ottawa submits that this generic review of capitalization approaches is not something that can or should be accomplished in the relatively more narrow context of this 2012 rate application by Hydro Ottawa.

92. With respect to contributions and grants. SEC highlights the fact that the change in the capitalization of overheads has a bearing on the calculation of contributions and grants.[132] SEC notes that there are differing views as to whether contributions should be lower due to reduced capitalization of costs or whether the model for calculating contributions should be adjusted so that contributions will not be lower. SEC agrees that either approach can be supported and proposes that the Board make a determination in favour of one approach or the other.[133] Particularly in light of SEC's acknowledgement that either approach can be supported, Hydro Ottawa submits that the record of this proceeding does not provide the Board with a sufficient basis to resolve the generic issue raised by SEC about contributions and grants.

93. SEC's argument with respect to the proposed deferral account to record gains and losses on disposal of pooled assets amounts to nothing more than an assertion that Hydro Ottawa has not complied with the Board's policy, coupled with an expression of agreement with Board staff's position.[134] In argument in chief, Hydro Ottawa addressed why its proposal for the creation of the deferral account is an appropriate one in the context of the policy set out in the Addendum to the Board's report on IFRS.[135] SEC has not responded to the points made by Hydro Ottawa in this regard and, accordingly, they need not be repeated here.[136]

94. The Addendum to the Board's IFRS report addresses submissions about the creation of a generic variance account for utilities that have rebased under modified

[130] SEC Argument, para. 8.3.5.
[131] SEC Argument, para. 8.3.7.
[132] SEC Argument, para. 8.4.1.
[133] SEC Argument , para. 8.4.6.
[134] SEC Argument, para. 8.5.3.
[135] 3Tr.25-26.
[136] See Argument in Chief 3Tr.24-27 for Hydro Ottawa's submissions in this area.

IFRS.[137] In the Addendum, the Board said that it was "not persuaded that a generic account is necessary" and that:

> At the first cost of service application **after** the transition, a utility will be expected to provide a forecast of ... gains and losses from retirements, as part of its application.
>
> (Emphasis added.)

95. Hydro Ottawa accepts the Board's decision not to approve the creation of a generic variance account. However, with respect to the Board's direction regarding information to be provided "after" the transition to modified IFRS, Hydro Ottawa notes that its transition and rebasing are both occurring in the context of the forward test year, 2012. Utilities that will rebase in 2014 or 2015 will have an opportunity to collect data in order to provide an estimate of gains and losses. Hydro Ottawa does not have the same opportunity in relation to its rebasing case in 2012, but it certainly can and will provide a forecast of gains or losses in its first cost of service case after transition. In the meantime, Hydro Ottawa submits that it is only fair and appropriate that any gains and losses be captured in a deferral account.

96. Board staff's position is that the proposed account should not be approved due to "the lack of information on materiality".[138] The problem, of course, is that Hydro Ottawa needs to have a base of information in order to forecast the overall magnitude of gains or losses on disposal of pooled assets. It is the lack of this base of information upon which to develop a forecast that gives rise to the need for a deferral account.

97. Hydro Ottawa submits that it would be neither just nor reasonable if the deferral account were to be denied for the very reason that it is required (*i.e.*, lack of information upon which to forecast the overall magnitude of gains and losses). Board staff alludes to its perception that Hydro Ottawa failed to collect information on pooled asset disposals in the period 2008 to 2011,[139] but the evidence indicates that it has been necessary for Hydro Ottawa to make numerous system changes for the gathering of this information.[140] Hydro Ottawa agrees with Board staff's submission that the granting of the account would likely be a temporary measure that reduces the risk to Hydro Ottawa and to ratepayers until the forecasting of gains or losses improves with experience.[141]

[137] Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, EB-2008-0408 ("Addendum to Board Report"), pp. 22-24.
[138] Board Staff Argument, p. 38.
[139] Board Staff Argument, p. 38.
[140] 2Tr.187.
[141] Board Staff Argument, p. 38.

9. Conclusion and Implementation

98. The highly generalized comparisons to other electricity distributors made in argument by intervenors (in particular, Energy Probe) do not give any consideration to rate impacts. The evidence in this case is that the total bill impact of Hydro Ottawa's 2012 rate application is an increase of slightly less than 0.49%, when the adjustments under the Settlement Proposal are taken into account.[142] For all of the reasons set out above, Hydro Ottawa submits that its application, if accepted by the Board, will result in rates for 2012 that are just and reasonable.

99. The Issues List for this proceeding includes the following issue: "Is the proposal to align the rate year with Hydro Ottawa's fiscal year, and for rates effective January 1, 2012 appropriate".[143] This issue was the subject of a complete settlement by the parties and, in respect of the second part of the issue, the Board-approved Settlement Proposal sets out that: "Further, the Participating Parties agree that rates be effective January 1, 2012". Hydro Ottawa therefore respectfully requests that the Board make an order for 2012 rates that will be effective on January 1, 2012. In the eventuality that the Board's decision in this case is not released with sufficient time for rates to be implemented for the month of January, Hydro Ottawa requests that the Board approve a rate rider to allow recovery of any lost incremental revenue during the period from January 1, 2012 to the implementation date.

All of which is respectfully submitted.

November 29, 2011

Fred D. Cass
Counsel for Hydro Ottawa Limited

[142] 2Tr.69.
[143] Procedural Order No. 2 dated August 11, 2011, Appendix "A", Issue 1.4.