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Ontario

BY EMAIL

February 14, 2012

Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Kingston Hydro Corporation
2012 IRM3 Distribution Rate Application
Board Staff Submission
Board File No. EB-2011-0178

In accordance with the Notice of Application and Written Hearing, please find attached the Board Staff Submission in the above proceeding. Please forward the following to Kingston Hydro Corporation and to all other registered parties to this proceeding.

In addition, please advise Kingston Hydro Corporation that its Reply Submission is due by February 24, 2012.

Yours truly,

Original Signed By

Martha McOuat
Project Advisor

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2012 ELECTRICITY DISTRIBUTION RATES

Kingston Hydro Corporation

EB-2011-0178

February 14, 2012

Board Staff Submission
Kingston Hydro Corporation
2012 IRM3 Rate Application
EB-2011-0178

Introduction

Kingston Hydro Corporation (“Kingston”) filed a revised application (the “Application”) with the Ontario Energy Board (the “Board”) on November 30, 2011, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that Kingston charges for electricity distribution, to be effective May 1, 2012. The Application is based on the 2012 3rd Generation Incentive Regulation Mechanism.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by Kingston.

In the interrogatory phase, Board staff requested certain clarifications to Kingston’s proposals. Kingston has clarified its 2011 and 2012 tax rates as entered into its Shared Tax Savings Workform. Board staff supports Kingston’s proposal to refund a credit balance of $34,075 to customers.

Board staff submits that Kingston has completed the necessary Deferral and Variance Account continuity tables and threshold calculation to demonstrate that its Group 1 Deferral and Variance Account balances do not meet the threshold test, therefore no disposition is requested. Board staff notes that the 2010 balances entered into the worksheets are consistent with the 2010 RRR balances submitted to the Board by Kingston.

Board staff finds the RTSR model as completed by Kingston to be appropriate. Pursuant to Guideline G-2008-0001, updated on July 8, 2010, Board staff notes that Kingston’s RTSRs will be updated at the time of this Decision based on the January 1, 2012 approved Uniform Transmission Rates.

Board staff makes detailed submissions on the following matters:

- Disposition of Account 1521;
- 2012 Incremental Capital Expenditures

- LRAM; and
- Disposition of Account 1562 (PILs)

Disposition of Account 1521

Chapter 3 of the Filing Requirements states that:

> "In accordance with Section 8 of the SPC Regulation, distributors are required to apply no later than April 15, 2012 for an order authorizing the disposition of any residual balance in sub-account 2010 SPC Assessment Variance.
>
> The Board expects that requests for disposition of the balance in "Sub-account 2010 SPC Assessment Variance" and associated carrying charges will be addressed as part of the proceedings to set rates for the 2012 rate year. Exceptions may apply in cases where this approach would result in non-compliance with the timeline set out in section 8 of the SPC Regulation."[1]

Kingston's application did not contain a proposal to dispose of the remaining balance in Account 1521. In response to a Board staff interrogatory, Kingston stated that it did not apply for disposition of account 1521 as the Applicant could not find anywhere on Worksheet Number 9 of the 2012 IRM Rate Generator Workbook to include the principal collected in 2011 so as to report a correct balance for disposition. Kingston also provided a table in response to the interrogatory which shows the opening balance, amounts collected from customers in 2010 and 2011, the applicable carrying charges forecast to April 30, 2012 and a closing debit balance of $10,561.02. Kingston did not request disposition of this closing balance in its interrogatory response.

Board staff submits that Kingston should dispose of the final balance of Account 1521 as at December 31, 2011, with forecast interest to April 30, 2012 as provided in its interrogatory response, in accordance with the Filing Guidelines. Board staff requests that Kingston provide an update to the balance of this account to include actual principle and interest balances as at December 31, 2011 in its reply submission, and interest to April 30, 2012.

1 Filing Requirements for Transmission and Distribution Applications, Chapter 3, page 19

Board staff notes that the usual practice by the Board is to dispose of audited deferral and variance account balances. The final balance proposed for disposition will be an unaudited balance. Board staff notes that the Board has approved the disposition of unaudited balances in account 1521 in both the Horizon (EB-2011-0172) and Hydro One Brampton (EB-2011-0174) 2012 IRM proceedings.

2012 INCREMENTAL CAPITAL EXPENDITURES

The Request

Kingston proposed to recover, through an Incremental Capital Module (ICM), the incremental capital costs of $3,500,000 associated with the following four capital projects:

Table 1 – Incremental Capital Project Expenditures

2012 Incremental Capital Projects	
King St 44kV Underground Cable Rebuild (M454)[1]	*$ 1,860,000*
Transformer Vault (TV6) Rebuild[1]	*$ 565,000*
Substation No.15 Circuit Breakers Retrofit[1]	*$ 560,000*
Transformer Vault 11 (TV11) Rebuild[1]	*$ 515,000*
Total	**$ 3,500,000**

Kingston proposed to allocate the revenue requirement associated with the incremental capital expenditures eligible for cost recovery on the basis of distribution revenue, in accordance with the methodology contained within the Incremental Capital Workform. Kingston proposed to recover these amounts by means of fixed and variable rate riders that would remain in effect until its next cost of service application (scheduled for the 2015 rate year).

Eligibility Criteria

The *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, issued July 14, 2008 (the "Report") requires that incremental capital expenditures satisfy the eligibility criteria of materiality, need and prudence in order to be considered for recovery prior to rebasing. Applicants must demonstrate that amounts exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor, must be clearly non-discretionary and the amounts must be clearly outside of the base upon which rates were derived.

(i) Materiality

Kingston originally calculated a materiality threshold value of $2,490,780. In response to Energy Probe Interrogatory #1, Kingston provided an update to this calculation to incorporate a correction to the growth rate and an update to the Price Escalator to reflect more recent GDP-IPI information. Both Energy Probe and Kingston acknowledged that this statistic would be further updated with the release of the final Decision in this case. Based on this calculation, Kingston's revised materiality threshold is $2,595,875. Kingston's 2012 capital budget, including its ICM, is $6,025,000.

In Kingston's 2011 cost of service proceeding, the Board approved a total capital budget level of $5,433,500. The Filing Guidelines state an expectation that the distributor should manage a CAPEX level outside of the base upon which rates were derived up to the materiality threshold prior to being permitted to apply for incremental capital during the IRM term. In response to SEC Interrogatory #2, Kingston has provided detail of preliminary actual spending for 2011 of $6,023,337, which is approximately equal to Kingston's total planned spending for 2012. In response to VECC interrogatory #1e), Kingston has indicated that, in the event the Board does not approve the application, all of the identified incremental capital projects will be completed. Given that Kingston's proposed capital expenditures for 2012 are only $591,500 higher than the Board-approved 2011 capital expenditures, Board staff requests that in its reply argument, Kingston provide a detailed explanation of how it views that it has met the materiality threshold.

In the event that the Board accepts that Kingston is eligible for incremental capital spending, Board staff is providing comments below on the need and prudence of Kingston's incremental capital projects *(ii) Project Need and Prudence*

<u>Project Need</u>

<u>a) King Street 44kV Underground Cable Rebuild (M454)</u>

Kingston proposes to replace the current M454 cable, which is a 1.4 km 44kV underground 500MCM Paper Insulated Lead Sheathed Cable ("PILC"), with a modern cross-linked polyethylene ("TR-XLPE") cable. The M454 PILC cable is a single conductor per cable except for the direct buried portions which span about 400 meters. The new TR-XLPE cable will be located in concrete encased ducts to eliminate the combined risk of worker safety in congested electrical manholes, cable failure due to accelerated insulation degradation caused by moisture ingress in the direct buried portions and sustained outages due to failing splices.

Kingston has provided detailed evidence highlighting the risks to employee safety due to the congestion created in various manholes which house the 44kV circuit as well as other 5kV circuits, the poor condition of the existing PILC cable as witnessed through frequent oil leaks and splices and the difficulty in sourcing qualified technicians to carry out splices on the existing PILC cable. Kingston also noted that the project is critical in that it is a sub-transmission feeder which is responsible for supplying power to the downtown core, including critical loads to the Kingston General Hospital and Queen's University. Kingston further stated that the Demand Response 3 program, involving Queen's University, Utilities Kingston and the IESO stipulates that the M454 cable be available in the event that Kingston General Hospital requires backup power, which is to be provided by the Queen's University cogeneration plant. Kingston also noted that the rebuild of the cable is needed to serve as a reliable back up (for the Kingston General Hospital) as it begins the rebuilding of Substation 1 which is scheduled to begin in 2013.

Board staff notes that the frequency of mechanical failures due to leaking joints (weak points such as splices and terminations) has been increasing since the mid-1990s. These failures correspond with the increased load on the 44kV system (Hotel Dieu Hospital added in the late 1980s) and the deteriorating condition of the 44kV PILC joints. Kingston stated that there have been four failures since 2006, with the most recent failure occurring in 2011.

Given the high number of splices on the 44kV cable and that the M454 is a sub-transmission feeder that is responsible for serving the Kingston General Hospital and is also intended to serve as a back up during the rebuild of Substation 1 in Board staff's view the need for this project has been justified.

b) Transformer Vault TV6 Rebuild

TV6 is located on the corner of Princess Street and Bagot Street and supplies 120/208V to local retail businesses. Kingston stated that TV6 had been identified for vault replacement due to significant structural and electrical equipment degradation and unsafe working conditions.

Kingston proposes to rebuild the vault at a nearby location and replace existing oil switches with a Vista Gear switch, which uses modern vacuum and SF6 interrupting technology.

Kingston retained a structural engineer to study the condition of a number of vaults and manholes. The structural engineer's December 2010 report, which was included in the evidence, found significant deterioration in the walls on the north and west sides in TV6. The north wall is of significant concern because it is adjacent to the foundation wall of a customer's building. Kingston stated that if structural failure, i.e. collapse, of the north wall were to occur, the customer's foundation wall would also likely collapse. Kingston submitted that due to vault location and access issues, the most cost effective option is to relocate and rebuild the entire vault on Bagot Street, around the corner just north of TV6's current location.

With respect to concerns with the electrical equipment, Kingston stated that TV6 features a technologically obsolete oil switch, which is inoperable when live, a transformer at end-of-life and several 5kV PILC cable splices. The oil switches are approximately 40 years old and are unsafe to operate under load due to slow-moving deteriorated mechanical contacts in the switch tank, which are prone to arcing. This hazard is further exacerbated by the confined working conditions in the vault. Kingston also noted that repairs often result in lengthy outages for customers.

Further, in response to Board staff interrogatory 5(c), Kingston stated that the TV6 rebuild was intended to coincide with the renovation of Princess Street which is being undertaken by the City of Kingston. Kingston stated that doing the rebuild in conjunction with the renovation work being undertaken by the city, will reduce costs and minimize customer disruption.

Board staff submits that the need for the rebuild has been justified. Staff notes that Kingston has stated that the new vault will be less congested and the new electrical equipment is rated to operate under load thus greatly reducing arc flash risk. Staff accepts that these improvements will significantly improve worker safety, reduce outage duration, and improve system reliability and performance. Board staff also notes that Kingston has experienced vault fires and lengthy forced outages that have occurred in May 3, 2010, May 5, 2010, July 29, 2011 and August 9, 2011.

c) <u>Substation No. 15 (MS#15) Circuit Breaker Retrofit</u>

MS#15 is located on the corner of Esdon Street and Dauphin Avenue in the North East section of Central Kingston and serves primarily residential load including several apartment buildings and a primary school with a total peak load of approximately 2.5MVA. This project involves retrofitting (replacing) 5kV circuit breakers and relocating the battery charger and SCADA equipment to a separate control hut enclosure with improved insulation, ventilation and cooling.

With respect to the electrical equipment, the breaker’s mechanical operating mechanism has been deemed unreliable by the manufacturer. Further, Kingston states that the breakers are obsolete (therefore not replaceable) and not repairable. A failure of this mechanism would cause the entire breaker to fail to operate, and in the worst case, remain closed into an electrical fault, causing worker injury as well as significant utility and customer equipment damage. Kingston also noted that its staff has noticed that clips and other parts have dislodged from the switchgear during maintenance and operation. Kingston further stated properly functioning substation circuit breakers are key to ensuring worker safety, protecting station and customer equipment and maintaining service quality by appropriately detecting and clearing faults. Kingston also stated that the scope of the work to MS#15 is similar to the work on MS#3 that was approved by the Board in Kingston’s recent cost of service application.

With respect to the SCADA equipment, Kingston stated that the non-insulated and poorly ventilated walk-in metalclad enclosure is also prone to overheating during the summer months, which has led to premature failure of the SCADA electronics.

Chapter 3 of the Filing Guidelines requires demonstration that capital work that is proposed as part of an ICM is non-discretionary. While the work proposed in this instance may need to be done at some point in that the equipment is obsolete and cannot be replaced, Board staff is not entirely convinced that the work proposed must be done in 2012. Board staff notes that Kingston was aware that one of the breakers had been out of service since 2007 and another breaker had been out of service since December 2000. Further, in 2010 Kingston was notified by the manufacturer that the breakers were irreplaceable. Given the history of breaker failure, and the fact that Kingston did not address this issue in past years, including in 2011 when it filed a cost of service application, it appears to Board staff that this issue is not a top priority for Kingston and that there is room for discretion in terms of the timing of the work. It is not clear to Board staff that this work must be done in 2012 and that it should be included as an ICM given the other, more pressing projects included in this application.

In Board staff's view, Kingston should assess the priority of this project and in its reply submission explain the implications of deferring this project to a future year or deferring another project that is part of the 2012 capital budget to accommodate the work on MS#15

<u>d) Transformer Vault TV11 Rebuild</u>

TV11 is located at the corner of King Street East and Clarence Street in downtown Kingston and contains an end-of-life 500kVA transformer, an end-of-life oil switch (which is inoperable when live) and a load break centre. The vault is located under the sidewalk with one end towards the intersection and the other extending under the sidewalk along King St. The vault houses several primary (5kV) cables supplying local businesses including two hotels, a marina and a restaurant. Due to concerns with the structural integrity of the vault and condition of the electrical equipment, Kingston proposes to rebuild and replace the electrical equipment in the vault.

Similar to the rebuild of TV6, Kingston proposes to rebuild TV11 at a new location and will convert the existing vault to a manhole to house other primary cables.

Kingston stated that the structural assessment performed in December 2010 found that TV11's roof slabs and beams are significantly deteriorated and require replacement. However, due to electrical worker safety requirements, all the circuits must be de-energized before any structural work can be performed. Therefore Kingston stated that any civil remediation work at this vault will lead to extended outages in the order of a week, resulting in significant financial losses for customers.

With respect to the electrical equipment and similar to the concerns noted in regards to the rebuild of TV6, Kingston proposes to replace the existing oil switch with a Vista Gear switch, the end-of-life transformer as well as primary PILC cable with TR-XLPE cable.

Given the concerns to employee safety arising from the congested nature of the vaults, the structural concerns noted in the structural engineer's report, the recent history of vault fires and repeated equipment failures, Board staff submits that the need for the rebuild of TV11, similar to TV6, is justified.

Nothwithstanding Board staff's support for the 44KV Underground Cable Rebuild and the Rebuild to transformer vaults TV6 and TV11, Board staff does think that Kingston could benefit from more robust capital prioritizing criteria to balance the need and timing of capital work and the regulatory rate setting schedule.

Prudence

Subject to the comment regarding the TV6 vault below, Board staff submits that the costs of the 44KV Underground Cable Rebuild and the Rebuild to transformer vaults TV6 and TV11 appear reasonable. Board staff notes that Kingston has provided a detailed breakdown of the costs of the project by labour, vehicles and materials and contracts in response to VECC interrogatory #3. Kingston has also stated that the cost estimates were developed based on previous experience where Kingston had undertaken similar capital work. Board staff notes that pursuant to Chapter 3 of the Filing Guidelines, Kingston is required to track the difference between actual and proposed capital expenditures and to annually report on the actual capital expenditures. Further, at the time of rebasing, the Board will carry out a prudence review of the actual costs to determine the amounts to be added to rate base.

Board staff requests that in its reply submission, Kingston confirm that the TV6 project is still planned to coincide with the City's work on Princess Street. If not, Kingston should confirm whether any cost increases would result from maintaining a 2012 in-service date for its project.

(iii) The Incremental Revenue Requirement Calculation

The Half Year Rule

Kingston did not apply the half year rule when calculating the incremental revenue requirement associated with the allowable ICM amount. This is consistent with the *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* dated September 17, 2008 ("Supplemental Report") and the Board's Decision and Order in Oakville's 2011 IRM proceeding (EB-2010-0104). Kingston's last cost of service application was for May 1, 2011 rates, and it is not scheduled to file a rebasing application until 2015._Board staff submits that this treatment is appropriate.

Capital Structure

Kingston used a 60% debt and 40% equity deemed capital structure and the cost of capital parameters approved in its 2011 cost of service application when calculating the revenue requirement associated with the incremental capital expenditures. Board staff submits that this calculation is appropriate.

PILs

Kingston has calculated the incremental revenue requirement for its ICM based on a 2012 tax rate of 28.3%.

Chapter 3 of the Filing Guidelines states that:

> "Since currently known legislated tax changes from the level reflected in the Board-approved base rates for a distributor will be reflected in the IRM adjustments, a distributors (sic) filing for an ICM adjustment should apply the current tax rates when calculating the revenue requirement associated with the ICM".2

The model specifies that the value to be used for this calculation is the same as that used in the Z-Factor Tax Changes sheet of the Tax Savings Workform, which is 24.06%. This value incorporates the applicable federal and provincial tax rates, as well as the small business credit.

Board staff submits that the final model supporting the Decision in this case should be adjusted to reflect a 24.06% tax rate in the calculation of incremental revenue requirement and applicable rate riders.

Reconciliation of MIFRS and CGAAP

The *Report of the Board: Transition to International Financial Reporting Standards* ("IFRS") dated July 28, 2009 ("IFRS Report") and the *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment,* dated June 13, 2011 ("Addendum to IFRS Report") set out regulatory policy guidance regarding the transition to IFRS, or modified IFRS ("MIFRS") under both cost of service and incentive rate setting mechanisms. Kingston's IRM application and ICM were prepared under CGAAP, consistent with its 2011 cost of service application. In response to an interrogatory from SEC, Kingston stated that MIFRS was not available therefore no reconciliation between the two standards was possible.

Kingston indicated that it expected that the calculations under CGAAP and MIFRS were likely to be similar, due to the nature of its CGAAP capitalization policy. As an example, Kingston stated that its practice was to only capitalize direct costs specific to capital assets.

Appendix A of the Board's Addendum to the IFRS Report states that:

> "Where the distributor has adopted IFRS for financial reporting but has not yet made an annual RRR reporting under modified IFRS, the financial information mentioned above must be provided in both CGAAP and modified IFRS format, and a reconciliation provided between the two accounting standards."[3]

While Kingston has indicated that the calculations would be "very similar if not identical", Board staff suggests that it would be helpful to parties in this case for Kingston to demonstrate this assertion in its reply argument. Subject to this request, Board staff supports Kingston's use of CGAAP for its ICM application.

2 Chapter 3 of the Filing Requirements for Transmission and Distribution Applications, section 2.2.4, page 12
3 Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, June 13, 2011, Appendix A, Issue 1, Page 31

Allocation of the Incremental Revenue Requirement

Kingston has allocated the revenue requirement associated with the incremental capital on the basis of distribution revenue, consistent with the methodology contained within the Incremental Capital Workform. Board staff submits that this allocation is appropriate.

Recovery of the Incremental Revenue Requirement

Kingston proposed to recover these amounts by means of fixed and variable rate riders that would remain in effect until April 30, 2015. No rationale for this selection was provided in Kingston's application.

In response to Board staff interrogatory 15, Kingston stated that the option of a fixed and variable split was chosen to maintain the fixed-variable split determined in its 2011 cost of service proceeding to the extent possible. Kingston did not provide analysis to demonstrate the impact of either this approach or the variable recovery option on its cost recovery proportions.

Chapter 3 of the Filing Guidelines requires that the distributor must include comprehensive evidence to support the claimed need, including the rationale for the proposed calculation of the rate rider. Board staff suggests that it would be helpful to parties if Kingston would provide in its reply submission an analysis of the impacts of the two methodologies to support the rationale provided.

Board staff notes that the Board previously approved in the case of Guelph Hydro (EB-2010-0130) and Oakville Hydro (EB-2010-0104) the recovery of the incremental annual revenue requirement amount by means of a variable rate rider. While Board staff has no issues with Kingston's proposal, Board staff is of the view that the recovery of the amount by means of fixed and variable rate riders creates additional complexities that may not be warranted.

LOST REVENUE ADJUSTMENT MECHANISM ("LRAM") CLAIM

Background

The Board's *Guidelines for Electricity Distributor Conservation and Demand Management* issued on March 28, 2008 (the "CDM Guidelines") outline the information that is required when filing an application for LRAM or SSM recovery.

In its decision on Horizon's application (EB-2009-0192) for LRAM recovery, the Board noted that distributors should use the most current input assumptions available at the time of the third party review when calculating a LRAM amount.

Kingston originally sought to recover a total LRAM claim of $175,754, including carrying charges, over a one-year period. The lost revenues include the persisting impacts of 2005-2009 CDM programs in 2010 and lost revenues from 2010 CDM programs in 2010.

Submission

2010 Lost Revenues Arising from Persisting Impacts of 2006-2009 Programs and 2010 Programs

Board staff notes that Kingston last rebased in 2011. Therefore, Kingston has not collected the new or persisting lost revenues in 2010 associated with CDM programs delivered in 2006, 2007, 2008, 2009, and 2010. Board staff notes that with the exception of 2006, Kingston was under IRM during this period. In 2006, Kingston rebased on a historical test year basis and there was no opportunity to account for future CDM effects. Board staff supports the approval of the requested 2010 lost revenues, including the persisting lost revenues from 2006, 2007, 2008, and 2009 programs in 2010 as these lost revenues took place during years that Kingston did not have an opportunity to recover these amounts. Board staff notes that this is consistent with what the Board noted in its decisions on applications from Horizon (EB-2011-0172), Hydro One Brampton (EB-2011-0174), and Whitby Hydro (EB-2011-0206).

Disposition of the Balance in Account 1562 Deferred PILs

Background

The PILs evidence filed by Kingston in this proceeding includes tax returns, financial statements, Excel models from prior applications, calculations of amounts recovered from customers, SIMPIL[4] Excel worksheets and continuity schedules that show the principal and interest amounts in the account 1562 deferred PILs balance. In pre-filed evidence Kingston disclosed a zero balance in account 1562 to be disposed in the Rate Generator model[5]. On the same schedule, Kingston reported its RRR debit balance as $498,685. In additional evidence filed on December 13, 2011, Kingston provided an Excel workbook that disclosed a credit principal balance of $213,899 and a debit interest balance of $57,354 for a net total to be refunded of $156,545. After responding to interrogatories, Kingston revised its evidence to disclose a credit principal refund of $388,196 and credit interest of $16,266, for a net total refund of $404,462.[6] Kingston also filed revised SIMPIL models for 2001-2005 in answer to interrogatories that disclose different true-up variances. Kingston stated that "Kingston Hydro does not agree with the attached filings."[7]

Submission

<u>Excess Interest True-up Variance Calculations</u>
When the actual interest expense, as reflected in the financial statements and tax returns, exceeds the maximum deemed interest amount approved by the Board, the excess amount is subject to a claw-back penalty and is shown in the TAXCALC worksheet as an extra deduction in the true-up calculations. This has been a feature of the Board's methodology and was settled in the Combined PILs Proceeding[8] under Issue #13.

In response to interrogatories, Kingston provided the following table that shows the components of its interest expense for the period 2001 through 2005 as well as a series of explanations.[9]

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4 Spreadsheet implementation model for payments-in-lieu of taxes
5 Rate Generator Tab 9. 2012 Cont. Sched. Def_Var.
6 2012_IRM_Rate_Generator_20120131.pdf, pdf page 17.
7 Responses to OEB Board Staff Interrogatories, January 31, 2012, page 53.
8 EB-2008-0381, issued June 24, 2011
9 Responses to OEB Board Staff Interrogatory #22 j), page 58.

Interest Expense Components	**2001**	**2002**	**2003**	**2004**	**2005**
Interest expense on debt	924,752	983,338	1,126,901	950,285	928,484
IESO prudentials			44,152	44,032	44,033
Regulatory assets/ liabilities			51,866	-10,081	
Customer security deposits		7,484	11,060	12,210	
Capitalized interest			-98,330		-128,196
Bank interest & service charges		166	8,945	4,393	
Total	924,752	990,988	1,144,594	1,000,839	844,321

In its Decision with respect to Hydro One Brampton Networks Inc's (HOBNI) IRM application (EB-2011-0174) the Board decided which components of interest expense HOBNI should include in the true-up calculations. HOBNI did not disclose prudential costs in its evidence. The Board stated:

> "The Board finds that the components which will comprise interest expense for purposes of the true-up calculations based on HOBNI's evidence in this case are interest on long-term debt, accounting amortization of deferred debt costs, foreign exchange and interest expense (*other*). After making the changes in HOBNI's SIMPIL models and the continuity schedule to reflect these findings, the Board has determined that the amended credit balance in account 1562 deferred PILs is $3,675,429 to be refunded to customers over one year.
>
> While audited financial statement disclosures may vary among the distributors, the Board is not persuaded that interest income should be netted against interest expense in the SIMPIL true-up calculations since this treatment is not consistent with cost of service filing instructions. In the decision in the Combined Proceeding, the Board accepted the settlement that the impacts of regulatory assets and liabilities should be excluded from the determination of the balance in account 1562 deferred PILs, and the Board agrees with that determination in this case. Interest expense related to customer deposits is not recovered in cost of service applications and therefore should be excluded in the SIMPIL calculations. Capitalized interest and its reversal in the tax calculations nets to zero, and this treatment is consistent with prior guidance issued by the Board."[10]

In the present application Board staff submits that Kingston should clarify if the interest on IESO prudentials is a stand-by fee for providing, but not drawing on, a line of credit.

10 EB-2011-0174, Decision and Order, December 22, 2011, pages 9-10

If Kingston confirms that the IESO has drawn down the line of credit because of non-payment of commodity invoices, then Board staff submits that this interest expense relates to debt and should be included in the interest claw-back variance calculations.

A line of credit is a debt facility and standby charges are similar to interest since the bank calculates a lower percentage rate of the dollar amount of the total undrawn facility as the charge. Board staff submits that interest on the prudential line of credit is an interest charge for not using the credit facility and, therefore, meets the definition to be included in the SIMPIL true-up calculations.

Board staff submits that the components of interest expense that Kingston should use in the interest true-up calculations are interest on debt, bank interest, service charges and IESO prudentials as shown below in the table.

Interest Expense Components	**2001**	**2002**	**2003**	**2004**	**2005**
Interest expense on debt	924,752	983,338	1,126,901	950,285	928,484
Bank interest & service charges		166	8,945	4,393	
IESO prudentials			44,152	44,032	44,033
Total	924,752	983,504	1,179,998	998,710	972,517

Board staff submits that Kingston should change the amount of interest expense used in the 2001-2005 SIMPIL model interest claw-back penalty calculations to reflect Board staff's submissions, and update the PILs 1562 continuity schedule and balance to be refunded to customers. Board staff submits that Kingston should file a schedule of revised interest expense identifying the components in a format similar to that above shown.

Income Tax Rates Used In Calculations of PILs Tax Variances

Kingston has used the blended maximum income tax rates identified in the decision in the combined proceeding.[11] These income tax rates are used in the SIMPIL models to calculate the variances that form part of the entries in the evidence of the balance in account 1562 deferred PILs. However, Kingston was eligible to claim the small business deductions during the tax years 2001-2005.

11 EB-2008-01381, Maximum Income Tax Rates in Percentages, page 17.

Board staff's interrogatory #21 a) asked Kingston to explain why it did not use the blended income tax rate for each year based on its own tax evidence.

Kingston responded as follows:

> "Kingston used the maximum tax rates for each year in accordance with the Decision made on this issue in Proceeding EB-2008-0381. The Board stated in its Decision in EB-2008-0381 that the Proceeding "assisted the Board in achieving its broader objective". This has been evidenced in Kingston's Cost of Service Proceeding EB-2010-0136 whereby one of the issues in that proceeding was decided by the Board to be consistent with EB-2008-0381.
>
> Also in EB-2008-0381, the Board stated that "If the distributor files evidence in accordance with all the various decisions made in the course of this proceeding, including the use of the updated model referenced above and certifies to that effect, the distributor may expect that the determination of the final account balance will be handled expeditiously and in a largely administrative manner." Kingston has complied with this Directive."

Board staff notes that in its cost of service case EB-2010-0136, Kingston used an income tax rate that was less than the maximum..

Board staff's interrogatory #21 b) asked Kingston to update the evidence by inserting the appropriate tax rates in sheet TAXCALC in the SIMPIL models.

Kingston replied as follows:

> "As requested, included with this filing are revised SIMPIL models using the blended tax rates for each tax year which were derived from the tax returns submitted on November 30, 2011. The effective tax rates are as follows:
> 2001 – 36.43%
> 2002 – 12.5% (Ontario only as regulatory assets reduced Federal tax to Nil.)
> 2003 – 35.7%
> 2004 – 33.85%
> 2005 – 35.7%
>
> "Kingston Hydro does not agree with the attached fillings."

Kingston was eligible to claim the Ontario small business deduction in 2002 but did not make the claim. The tax rate would have been lower than 12.5% had the deduction been made.[12]

Based on the tax facts filed in the Combined Proceeding, the three applicants were not eligible to claim the small business deduction. The Board therefore directed the applicants to use the tax rates in the table entitled "Maximum Income Tax Rates in Percentages" as below shown.[13]

Maximum Income Tax Rates in Percentages						
	2001 4th Quarter	**2002**	**2003**	**2004**	**2005**	**2006**
Federal	27.00	25.00	23.00	21.00	21.00	21.00
Federal Surtax	1.12	1.12	1.12	1.12	1.12	1.12
Ontario	12.50	12.50	12.50	14.00	14.00	14.00
Combined Rate	40.62	38.62	36.62	36.12	36.12	36.12
Gross-up Rate	39.50	37.50	35.50	35.00	35.00	35.00

There are many distributors regulated by the Board whose tax facts allow them to use blended income tax rates that are less than the maximum. Board submits that Kinston should use imputed tax rates for each year that are based on the maximum federal tax rate (with surtax) and an Ontario tax rate that reflects the small business deduction. Board staff estimates that this will result in tax rates that are approximately 2% below the maximum rates. Board staff requests that Kingston provide this imputed tax rate calculation its reply submission.

All of which is respectfully submitted

12 2002 CT23 Ontario tax return, pages 4-6.
13 EB-2008-0381, decision dated June 24, 2011, page 17-19.