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March 30, 2012

Filed on RESS
Sent By Courier

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Dear Ms. Walli:

Halton Hills Hydro Inc. ("HHH")
Distribution Rates 2012 (EB-2011-0271)

On behalf of HHH, please find enclosed its Argument-in-Chief in the above-noted matter.

Yours very truly,

Original signed by

Richard King

/mnm

Enclosure

Cop(y/ies) to: All Intervenors in EB-2011-0271
Art Skidmore (HHH)
David Smelsky (HHH)

DOCSTOR: 2392737\1

EB-2011-0271

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application by Halton Hills Hydro Inc. for an Order or Orders approving or fixing just and reasonable rates and other charges for the distribution of electricity as of May 1, 2012.

HALTON HILLS HYDRO INC.
ARGUMENT-IN-CHIEF

March 30, 2012

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A. INTRODUCTION

1. This Argument-in-Chief sets out the position and arguments of Halton Hills Hydro Inc. ("HHH") in respect of the five unsettled issues in HHH's 2012 distribution rate application. These issues are:

- inclusion of one capital project – the Green Energy Initiative ("GEI") – in capital expenditures for the test year (and the consequent impacts on depreciation, cost of capital, etc.);
- the appropriate amortization period for HHH's property, plant and equipment ("PPE") account;
- the clearance of HHH's deferral and variance account ("DVA") amounts;
- the long-term debt rate to be utilized in calculating HHH's cost of capital; and,
- the appropriate operations, maintenance and administration ("OM&A") expenses to be included in HHH's test year.

2. All other issues associated with HHH's 2012 distribution rate application have been settled by way of the Partial Settlement Agreement filed on February 28, 2012, which was accepted by the Board at the commencement of the oral hearing on March 22, 2012.

B. CONTEXT FOR UNRESOLVED ISSUES

3. The Board has broad jurisdiction when it comes to settling electricity distribution rates – it must only ensure that such rates are just and reasonable (subsection 78(3), *Ontario Energy Board Act, 1998*). In the context of this application, the Board's role is to ensure that the determination of the five unsettled issues, in

conjunction with the Partial Settlement Agreement, results in distribution rates that are just and reasonable.

4. With the revenue requirement adjustments agreed to by HHH and intervenors during the interrogatory and settlement process, HHH's revenue deficiency stood at $209,474 at the time of filing of the Partial Settlement Agreement. This deficiency was calculated utilizing the Board's cost of capital parameters in existence at the time.

5. Since then, the cost of capital parameters have been updated by the Board, with the return on equity ("ROE") reduced from 9.42% to 9.12%, and the deemed long-term debt rate reduced from 5.01% to 4.41%. The Partial Settlement Agreement dictates that HHH's cost of capital incorporated into distribution rates be adjusted for the Board's updated cost of capital parameters. As a result, HHH's test year revenue deficiency now stands at $79,360.

6. It is important to note that this very small deficiency is based on HHH's being fully successful on the unresolved issues – in other words, the Board approving:

- HHH utilizing the Board deemed long-term debt rate;
- the inclusion of the full $6,274,021 OM&A costs in HHH's test year;
- the inclusion of the Green Energy Initiative in HHH's test year capital expenditures;
- a 20-year amortization period for HHH's PPE account; and,
- the clearance of the DVAs over 24 months.

7. If the Board denies or reduces any of these five items, HHH's revenue deficiency would be further reduced.

8. The bottom line is that what HHH is asking for in relation to the unresolved issues is a very modest – almost negligible – increase in rates. That is the context for the disposition of the unresolved issues. At most, we are talking about basically the status quo in terms of rates. Further, HHH's rates are currently at the low end of the spectrum when compared to rates of other distributors proximal to HHH, and other predominantly rural utilities.

9. Each of the five unresolved issues is addressed more specifically below. Obviously, HHH has refrained from anticipating the submissions and arguments of Board Staff and intervenors, which will be dealt with in reply. However, we do deal with the PPE and DVA issues jointly below, based on the assumption that the intervenor arguments on the PPE amortization period and clearance of DVA accounts will go to the same point (short-term rate impacts). We do, however, reserve our rights to respond in reply to whatever issues are raised in respect of all outstanding issues in this proceeding.

C. GREEN ENERGY INITIATIVE

10. HHH is requesting the inclusion of its Green Energy Initiative capital project in its test year capital expenditures. The proposed project consists of 1,400 units installed on 1,400 hydro poles in HHH's service area. Each unit consists of a single 220 – 280 watt solar panel, a Smart Energy Module with inverter, a two-way wireless smart grid communicator, sensors, digital meter, and a pole mounting system (Exhibit 2, Tab 3, Schedule 7). The benefits of the units are numerous: (a) reduced non-commodity charges (e.g., transmission, global adjustment); (b) power system voltage stabilization (VAR) which is of particular importance on long lines in rural areas, and in urban areas with aged infrastructure; (c) capacity to provide fault location for trouble-shooting problems on the distribution network; (d) power production directly to HHH's secondary voltage lines, reducing upstream demand; (e) the potential to generate tradeable

emission credits; and (f) reduced line losses (Exhibit 2, Tab 3, Schedule 7 and Undertaking J1.5).

11. HHH is proposing that any power production, line loss reduction and transmission and other non-commodity savings from the Green Energy Initiative be directly passed on to HHH's customers through a DVA. Although very difficult to estimate, HHH anticipates that the annual direct financial benefits to ratepayers would be about $35,496 (not including the value of any tradeable emission credits), which would be returned to ratepayers by way of the DVA. The annual revenue requirement associated with the Green Energy Initiative is $91,467 (EProbe IR#19).

12. In addition to immediate, direct financial benefits, there are numerous non-financial benefits associated with the Green Energy Initiative, including increased grid reliability and efficiency, grid connectivity (i.e., monitoring operation and health of grid, reliability alerts, remote sensing of voltage quality and power flows, platform for other grid applications), reduced carbon footprint, demonstrable commitment to provincial objectives of renewable technology, etc.). HHH is of the view that these non-financial benefits far exceed the $55,971 differential between the annual Green Energy Initiative revenue requirement and DVA benefits (i.e., $91,467 - $35,496 = $55,971).

13. There are three further points to make in respect of the Green Energy Initiative. First, the Green Energy Initiative, while containing a clean generation component, is more appropriately classified as a distribution project given the broad distribution benefits associated with the project. Renewable generation projects are aimed first and foremost at maximizing and being compensated for generation output, with any other benefits of connecting such projects being unintentional and merely incidental. The Green Energy Initiative is quite different in that it is a multi-purpose project that uses the generation component to provide other, far more material operational benefits to the distributor.

14. Second, HHH is proposing the Green Energy Initiative not as a pilot project but a viable capital project with net benefits to the utility and its ratepayers. It is, on its own, a sound distribution project. As noted in Undertaking J1.5, the NPV of the Green Energy Initiative is -$661,102. Given the deployment of the technology by distributors in other jurisdictions – in particular, the deployment of 135,000 units by Public Service Electric and Gas Company ("PSE&G", the public utility in New Jersey) which was approved by the New Jersey Board of Public Utilities in 2009, HHH submits that this type of technology is not "experimental" or best-suited to a pilot project. HHH has already carried out a pilot project at its own cost, via four units installed in February 2010. Two other Ontario distribution utilities have also had units installed (Festival Hydro and Oakville Hydro) (Technical Conference, p.31).

15. Finally, HHH is aware of the distribution utilities having brought forward green energy projects that have been rejected by the Board as appropriate for inclusion in rate base (e.g., recent proposals for electric vehicle programs). HHH submits that these are very different types of projects. Most importantly, HHH considers these other projects (unlike HHH's Green Energy Initiative) more remote from the distributor's business of electricity distribution. The Green Energy Initiative, on the other hand, is operationally in line with HHH's function of electricity distribution.

D. PPE AND DVA ACCOUNTS

16. Subject to intervenor arguments, it does not appear that intervenors are contesting the amounts in the PPE deferral account or other DVAs. What appears to be at issue is the amortization period for the PPE and disposition periods for the DVA.

17. HHH is proposing to amortize its PPE deferral account over a period of 20 years, as noted in its March 12, 2012 evidentiary update (further modified on March 21

to take into account recent preparatory work for HHH's audit). This approach would result in annual reductions in HHH's revenue requirement over the next twenty years in the following amounts:

- $92,415 in Years 1 through 4;
- $82,040 in Years 5 through 8;
- $71,665 in Years 9 through 12;
- $61,290 in Years 13 through 16; and
- $50,914 in Years 17 through 20.

18. A shorter amortization period would increase the PPE deferral amounts refunded to customers (albeit over a shorter time period).

19. The Board has no prescribed, "standard" or "default" amortization period that distributors must utilize. Rather, the Board has stated that it "will determine the period of time for amortization [of the PPE deferral account] on a case-by-case basis and will be guided primarily by such considerations as the **impact on rates**, **implications of any other IFRS transition matters** and any **requirements for rate mitigation**" (see *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment*, EB-2008-0408, June 13, 2011, p. 32) (emphasis added).

20. Amortizing the PPE deferral account over 20 years would have an effective reduction in rates of 0.4% (for 20 years) whereas amortizing the PPE deferral account over four years would effectively reduce rates by 2% per year (for four years).

21. In the context of this rate application, where only a very modest rate increase is being sought, there is no need for a shorter amortization period to mitigate any rate increase. If the likely outcome of this re-basing proceeding was a significant distribution rate increase, the Board would quite rightly consider the amortization period of the PPE account as a mechanism to mitigate the rate increase. But that is not the case here. There is absolutely no need for rate mitigation in the context of this rate application.

22. From HHH's perspective, however, the amortization period does have a material impact on revenues. This impact is moderated or "smoothed" if a longer amortization period is utilized. In HHH's view, an accounting change should not have any material impact on either utility revenue or customer rates. Consequently, HHH's submission is that a longer amortization period for the PPE account is more appropriate for both utilities and ratepayers.

23. Further, HHH believes that the principle of intergenerational equity also argues in favour of a longer amortization period. Intergenerational equity, as a ratemaking principle, suggests that one generation of customers should not be forced to cover the costs of another generation of customers. The PPE deferral account amounts arise because an accounting change (i.e., transition to MIFRS) will increase HHH's rates (above what they would have been under CGAAP) for a number of years. The PPE deferral account is meant to return to ratepayers the increased amounts attributable to the accounting change. This increase in rates will be sustained well beyond four years. Given this, it seems suitable to amortize the PPE deferral account over a longer period. A 20 year amortization period would ensure that HHH customers in, for example, 2025 who will still be "paying" for the current transition to MIFRS are also receiving some rate reduction. A shorter amortization period such as four years would not achieve the same intergenerational equity – only HHH's customers in the next four years

would receive rate mitigation. In addition, the 20 year amortization aligns with the useful lives of the distribution assets.

24. In terms of the other DVA accounts, very little discussion about the DVA took place at the oral proceeding. The amounts that HHH is seeking to have cleared are set out below (Exhibit 9, Tab 3, Schedule 1, page 2, Table 9-7).

Account Description	Account Number	Total Claim
LV Variance Account	1550	$(626,808)
RSVA – Wholesale Market Service Charge	1580	$(633,794)
RSVA – Retail Transmission Network Charge	1584	$362,845
RSVA – Retail Transmission Connection Charge	1586	$330,907
RSVA – Power (excluding Global Adjustment)	1588	$(913,830)
RSVA – Power - Sub-Account – Globa Adjustment	1588	$2,303,654
Recovery of Regulatory Asset Balances	1590	$67,673
Other Regulatory Assets- Sub-Account – Incremental Capital Charges	1508	$75,275
Other Regulatory Assets – Sub-Account – Other	1508	$182,885
Retail Cost Variance Account – Retail	1518	$(31,418)
Misc. Deferred Debits	1525	$8,184
Retail Cost Variance Account – STR	1548	$2,388
Deferred Payments in Lieu of Taxes	1562	$(500,022)
		$627,940

25. HHH would recover this $627,940 over two years (i.e., $313,970 annually), which HHH submits is reasonable.

E. LONG-TERM DEBT

26. All of HHH's corporate long-term debt is in the form of a Promissory Note that is held by the Town of Halton Hills. The terms of the Promissory Note are flexible:

- the rate of interest is at the discretion of the Town (prescribed by the Town Treasurer from time to time); and,

- to provide protection to the utility and its ratepayers from the Town's discretion, HHH has the ability to prepay the Promissory Note in full at any time without notice or penalty.

27. Traditionally, the debt rate on the Promissory Note has closely followed the Board's deemed rate. This is not an unusual form of financing arrangement for Ontario distributors, in part because having the shareholder as the main corporate debt holder offers the utility some flexibility than might be the case with a third party lender (as well as avoidance of transaction and administrative costs). For 2012, the debt rate on the note will be set at 4.41%. The current amount of debt outstanding under the Promissory Note is $16,141,970.

28. Notwithstanding the debt arrangement with the Town, HHH has periodically looked to sources of debt from third party lenders. This practice is consistent with the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (EB-2009-0084) dated December 11, 2009. As the record in this proceeding shows, HHH has periodically made inquiries with both Infrastructure Ontario and commercial banks (primarily Toronto-Dominion ("TD") Bank). From HHH's inquiries, it is clear that Infrastructure Ontario is interested in new projects or asset purchases rather than general corporate debt.

29. To that end, HHH financed its smart meter capital expenditures by way of a TD Commercial Bank loan. The amount of that loan as of December 31, 2011 is $3,943,430. The loan has a one-year term (expiring this August 2012) and an interest rate of prime plus 1.4%. Given the term, HHH does not consider it long-term debt.

30. During the test year, HHH anticipates seeking $5,000,000 in financing (to be drawn down in tranches to correspond with HHH's capital program). HHH will consider all possible financing options. It is unclear at this point, where the financing will be placed, and the associated terms, conditions and rates.

Infrastructure Ontario's current posted rates vary from 2.52% (five year) to 4.29% (forty year) (utilizing the link provided in EProbe IR #62(c)).

31. Very recent inquiries with TD Bank about replacing the corporate long-term debt resulted in a quote of 5.16% (Hearing Transcript, p. 45, line 21).

32. It is HHH's expectation that current interest rates will rise in the short- to medium-term. Consequently, HHH is proposing that for the purposes of rates, the Board's deemed rate represents a prudent level. It is currently 75 basis points lower than the replacement third-party debt rate recently quoted to HHH. Moreover, it is consistent with most provincial distribution utilities, and matches the rate of the Promissory Note.

F. OM&A

33. HHH is requesting the Board approve OM&A expenditures of $5,987,400 (CGAAP) or $6,274,021 (MIFRS) (inclusive of property taxes). At HHH's last re-basing in 2008, the Board approved an OM&A expenditure of $5,124,000 (CGAAP, inclusive of property taxes). Actual and estimated OM&A expenditures since 2008 dropped slightly and remained fairly flat:

- $5,167,120 (2008 actual CGAAP)
- $4,515,477 (2009 actual CGAAP)
- $4,475,435 (2010 actual CGAAP)
- $4,646,940 (2011 estimated CGAAP)

34. The test year OM&A being applied for is a material increase over recent years, but that increase is attributable entirely to four discrete items. These four cost drivers are:

- an increase in wages and benefits;
- an increase in tree trimming costs;
- an increase in smart meter costs; and,
- an increase relating to the transition to MIFRS.

35. The first two items have been underfunded for the past few years and must be increased. The costs of the latter two items result from regulatory/accounting changes beyond HHH's control.

36. None of the increases in these four categories are extraordinary or unreasonable.

37. With respect to wages and benefits, Mr. Skidmore testified that during the past few years under IRM, HHH has held off hiring additional staff (Hearing Transcript, p. 68, lines 26 to 28). This is reflected in HHH's evidence, which shows 46 employees at HHH in 2008 (both actual and Board approved), before falling to 44 employees for 2009 and 2010 (Exhibit 4, Tab 2, Schedule 6). As Mr. Skidmore noted in his testimony, the drop in employee numbers and costs were due to significant organizational changes at HHH during 2009 and 2010.

38. Over the course of 2011 and 2012, HHH will add additional employees to bring the total number of employees to 51 by the end of 2012. In the test year specifically, HHH is planning to add one management position and three unionized positions – a senior engineering technician, and advanced metering infrastructure (AMI) coordinator, and an apprentice metering technician (Hearing Transcript, p. 68, lines 1 through 16). In addition, HHH's collective agreement with its unionized workforce mandates a 3 percent annual wage increase.

39. HHH submits that the net addition of five new employees over the four-year period from 2008 to 2012 is not unreasonable, particularly in light of HHH's

significant growth (customer growth of 5% in that time period), and increased operational burdens related to provincial initiatives in the areas of conservation, smart meters and renewable generation connection (Settlement Agreement, Appendix D).

40. With respect to tree trimming, HHH is proposing to significantly increase its tree trimming activities in the test year, and continue that level of expenditure over the subsequent three years (i.e., the IRM period). The basis for increasing the tree trimming activity and budget was the independent line clearance and tree trimming report of May 2011 prepared by Brian Lang, a certified arborist at Horizon Contracts Management Company Inc. In a nutshell, there are two reasons for the significant increase in the tree trimming budget:

- the high tree growth rate, along with excessive disease and die back of mature trees in recent years; and,
- the underfunding of HHH's line clearance program for a number of years.

41. The first of these two factors is beyond the control of HHH. The second factor demonstrates that ratepayers have, for a number of years, benefitted from very low line clearance and tree trimming expenses being included in HHH's distribution rates. As with wages and benefits, HHH has been able to hold OM&A expenses flat for the past four years because of underfunding in this area. But also as with wages and benefits, continuing to underfund tree trimming is not sustainable.

42. Separate and apart from the rate impacts associated with the tree trimming costs to be included in rates, the issue is ultimately one of good utility practice and reliability/safety of the distribution system. On this point, Mr. Lang's report is clear that a significantly increased tree trimming program is required in the next four years.

43. With respect to smart meter OM&A costs and costs associated with the transition to IFRS, both sets of costs were driven by regulatory changes beyond HHH's control. No party to this proceeding, to HHH's knowledge, has suggested that these costs are unreasonable or out of line with costs incurred by other Ontario distributors.

44. Consequently, although the increase in OM&A proposed by HHH for 2012 is significant when compared to the past few years, the increase can be explained on the basis of these four items.

45. The reasonableness of the increase can be illustrated in a number of different ways. Table 1 starts with the 2008 Board approved OM&A (in CGAAP), assumes an annual increase in OM&A of 3%, and then adds the cost increases for tree trimming and MIFRS transition. The result is a revenue requirement of $6,303,728, which is comparable to the OM&A being applied for by HHH.

Table 1			
			Reference
2008 Board Approved OM&A		5,124,000	Table 4-1 Exhibit 4/Tab1/Schedule 1, page 2
3 percent annual increase			
2009 – 3%	153,720	5,277,720	
2010 – 3%	158,332	5,436,052	
2011 – 3%	163,082	5,599,133	
2012 – 3%	167,974	5,767,107	
<u>Additional requirement - 2012</u>			
Tree trimming	250,000	6,017,107	
Transitioning to MIFRS	286,621	6,303,728	EProbe IR #35
	1,386,147		
		$6,303,728	

46. Another approach shown in Table 2 below would be to take the average of the actual and estimated OM&A expenses for 2008 through 2011 ($4,684,691 CGAAP), and then add the costs associated with the four cost drivers (increased wages and benefits, increased tree trimming, smart metering costs, and MIFRS

transition costs). The result is an OM&A in the test year of $6,034,022, which is comparable to HHH's requested OM&A.

Table 2		
		Reference
Average of 2008-2011 Actual		
2008	5,111,058	Table 4-1 Exhibit 4/Tab1/Schedule 1 page 2
2009	4,436,426	Table 4-1 Exhibit 4/Tab1/Schedule 1 page 2
2010	4,386,371	Table 4-1 Exhibit 4/Tab1/Schedule 1 page 2
2011	4,804,910	Table 4-1 Exhibit 4/Tab1/Schedule 1 page 2
Average	4,684,691	
Tree trimming	250,000	
IFRS	286,621	EProbe IR #35
Smart metering	327,710	$462,710 less $135,000MDMR
Increase Staffing	200,000	
2012 Union Increase/Benefit increase	285,000	
(120,000+80,000 (OMERS)+25,000+60,000 (health))		
	$6,034,022	

47. A variation on Table 2 would be to utilize as a starting point the 2011 estimated bridge year OM&A instead of the four year average. This approach (shown in Table 3 below) would produce a similar result.

Table 3		
2011 Bridge	4,804,910	Table 4-1 Exhibit 4/Tab1/Schedule 1 page 2
Tree trimming	250,000	
IFRS	286,621	2012 only - refer to EP IR#33(b) - Nov16,2011
Smart metering	327,710	$462,710 less $135,000MDMR
Increase Staffing	200,000	
2012 Union Increase/Benefit increase	285,000	
(120,000+80,000 (omers)+25,000+60,000 (health))		
	$6,154,241	

48. Finally, HHH's historic OM&A has been at the low end of the spectrum when compared to other utilities that have a large percentage of their service area as rural (see VECC IR #34(b)).

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49. For all of these reasons, HHH requests that the Board approve:

- the inclusion of the Green Energy Initiative ("GEI") in capital expenditures for the test year;
- a 20-year amortization period for HHH's property, plant and equipment ("PPE") account;
- the clearance of HHH's deferral and variance account ("DVA") amounts over 24 months;
- the use of the Board's long-term debt rate in calculating HHH's cost of capital; and,

- the inclusion of $6,274,021 in OM&A expenses in HHH's test year revenue requirement.

All of which is respectfully submitted this 30th day of March, 2012.

HALTON HILLS HYDRO INC.

Original signed by

By its Counsel, Norton Rose Canada LLP
Per: Richard J. King