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BY E-MAIL

April 13, 2012

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St. 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Board Staff Submission
Halton Hills Hydro Inc.
Board File Number EB-2011-0271

Please find the attached Board staff submission in the above proceeding. Please forward the following to Halton Hills Hydro Inc. and all other parties to this proceeding.

Sincerely,

Original Signed By

Neil Mather
Project Advisor, Applications & Regulatory Audit

Attachment

BOARD STAFF SUBMISSION

2012 ELECTRICITY DISTRIBUTION RATES

Halton Hills Hydro Inc.

EB-2011-0271

April 13, 2012

INTRODUCTION

Halton Hills Hydro Inc. (“HHH“) filed an application on August 26, 2011, requesting new distribution rates and other changes effective May 1, 2012. The Application was based on a future test year cost of service methodology.

The Vulnerable Energy Consumers Coalition (“VECC”), the School Energy Coalition (“SEC”), and Energy Probe Research Foundation (“Energy Probe”) were granted intervenor status. No letters of comment were received.

A Settlement Conference was convened on February 16-17, 2012. A partial settlement was reached between HHH and VECC, SEC and Energy Probe, and the proposed agreement was filed with the Board on February 29, 2012. Five unsettled issues were identified.

An oral hearing was held on March 22, 2012, at which the Board announced its acceptance of the Partial Settlement Proposal, (the “Partial Settlement Agreement”) and the unsettled issues were examined. HHH filed transcript undertakings and submitted its Argument-in-Chief (“AIC”) on March 30, 2012.

The unsettled issues are:

- Inclusion of HHH’s proposed Green Energy Initiative;
- Amortization period for the adjustment to Property Plant & Equipment (“PP&E”) with implementation of International Financial Reporting Standards (“IFRS”);
- OM&A expenditures;
- Long-term debt rate; and
- Disposition period for deferral and variance account balances.

This submission on the unsettled matters reflects observations and concerns which arise from Board staff’s review of the case record including the oral hearing and AIC, and is intended to assist the Board in evaluating HHH’s application and in setting just and reasonable rates.

GREEN ENERGY INITIATIVE

HHH is requesting that its proposed Green Energy Initiative be included in its approved capital expenditures in 2012, with an initial cost of $1.4 million. The proposed project comprises 1400 solar panels attached to existing distribution system poles, at an estimated cost of $1000 per solar panel including installation. The effect on HHH's revenue requirement would be the return on the investment together with depreciation, and a forecast operating cost of $11,760.

Background

The solar panels would produce up to 280 watts (or 0.78 kWh per day) of electricity that would be injected into the distribution line at the pole. The devices include components that would measure the electricity produced and would record line voltage and other information at intervals, and would communicate periodically through a separate wireless system so that the output and status could be recorded in a database.

HHH indicated that it has operated a pilot project of four units for about one year and that several other distributors also have experience with the same units. HHH undertook to provide available studies of the solar panel units.[1]. One article was provided.

In addition, HHH provided an estimate of the revenue requirement impact of the Green Energy Initiative, which amounts to an increase of approximately $104,000 in the test year[2]. Cost savings would be recorded in a deferral account for future disposition. HHH estimated that the net present value of the initiative is $(661,102)[3].

Discussion and Submission

HHH indicated that it does not intend to sell the electricity at a premium rate that might be available for renewable generation. Rather, HHH submitted that the economic benefit associated with the solar panels would be in the form of reduced wholesale purchases of electricity and upstream delivery costs, and reduced line losses due to being located closer to customer loads. In addition, HHH stated that the data collected on line parameters would be used for distribution system planning.

[1] Transcript Undertaking J 1.3
[2] IRR EP # 55(a), updated to include additional operating costs of $11,760
[3] Transcript Undertaking J 1.5

In response to undertaking J 1.3[4], HHH filed a report on distributed smart solar systems. In Board staff's view, the report filed by HHH provides a checklist of benefits and costs, but does not provide a comprehensive quantification of benefits where solar panels have actually operated. On the cost side, the report cites capital cost of $5.50 per kW for "smart distributed solar", which casts doubt on HHH's estimated cost of $1000 per unit of up to 280 Watts. On the benefit side, the report includes a discussion of improved system monitoring and control, and outlines how data could enable improved distribution system specifications. Board staff notes that the information from system monitoring would be valuable if available in real time (which the report appears to assume), but is less valuable if available only after the fact. Board staff also notes that some of the benefits listed, such as outage management and theft detection, are redundant with the benefits that could be achieved from the comprehensive deployment of smart meters.

Board staff does not support the inclusion of this Green Energy Initiative. Board staff submits that this project is not financially feasible, as illustrated by its net present value of $(661,102). Board staff also submits that, even if there are certain Green Energy Initiative benefits that cannot be quantified, they would still result in a considerable net cost to HHH's ratepayers. Also, while HHH argues that the data gathered from the solar panel units may provide information to assure that system upgrades will be well planned and prioritized, there is no evidence that there are serious deficiencies with the information that is currently being collected. While this project may be attractive from a green energy standpoint, Board staff is of the view that the timing of this initiative is inopportune in light of the significant increase in OM&A proposed by HHH.

Furthermore, HHH is permitted under Section 71(3) of the Ontario Energy Board Act to own and operate a renewable energy generation facility that does not exceed 10 megawatts. HHH could seek a contract with the OPA for the supply of electricity from these solar panels and operate these panels separate from the distribution business. There is no need for electricity distribution customers to incur the cost for these solar panels.[5]

[4] "The Economic Opportunity of Distributed Smart Solar Systems", Hisham A. Othman and Ruba A. Amarin, unidentified trade journal.

[5] OEB, G-2009-0300, "Guidelines: Regulatory and Accounting Treatments for Distributor-Owned Generation Facilities", September 15, 2009, section 2.2

AMORTIZATION PERIOD OF PROPERTY, PLANT AND EQUIPMENT ("PP&E") DEFERRAL ACCOUNT

HHH proposes a twenty year amortization period with a rate of return on rate base of 6.20%.

Background

On March 21, 2012, HHH updated the credit balance (refund to customers) in the PP&E deferral account. This amount reflects the difference as a result of the accounting policy changes caused by the transition from CGAAP to MIFRS for the closing net PP&E balance of 2011. The revised difference for the net PP&E balance is $836,717, which is considerably lower than HHH's initial calculation and an earlier update[6].

HHH has proposed to amortize the PP&E deferral account balance over a period of 20 years. HHH indicated that this amortization period closely matches the average remaining useful life of the underlying assets. HHH also indicated that a shorter period would cause a significant cash flow impact on HHH. In its argument-in-chief, HHH stated that a shorter amortization period such as four years would not achieve the same intergenerational equity. If a four year period is used to amortize the PP&E deferral account balance, only HHH's customers in the next four years would receive rate mitigation.

HHH proposed to calculate the return on rate base on a modified declining balance, adjusted every four years to coincide with each rate rebasing period. Board staff notes that HHH used a 6.20% rate of return on rate base over the 20 year proposed recovery period in its updated evidence, which Board staff understands to be the weighted average of cost of capital based on the Board's updated parameters[7].

Discussion and Submission

Board staff has reviewed HHH's evidence and will discuss the following issues related to the disposition of the PP&E deferral account:

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[6] The initial credit amount of $1,384,586 was supported in IRR Board staff # 48, Table OEB-1-22. Per Section 11.1 of the Settlement Agreement HHH filed its updated evidence on March 12, 2012 with the new credit amount of $1,462,823 for the difference between the 2011 CGAAP and MIFRS closing net PP&E balance.

[7] Board letter to distributors and others, "Cost of Capital Parameter Updates for 2012 Cost of Service Applications for Rates Effective May 1, 2012", March 2, 2012.

1. Need for one time transitional adjustment due to accounting policy changes;
2. Impacts on rates and requirements for rate mitigation;
3. Cash flow impact on HHH and implications of any other IFRS transition matters; and
4. Concern with intergenerational equity.

Need for One Time Transitional Adjustment Due to Accounting Policy Changes

On June 13, 2011, the Board established the PP&E deferral account and set out how it will operate in the Addendum to the Board Report on IFRS (the "Addendum"). At page 11 of the Addendum, the Board stated:

> "The Board therefore authorizes a generic deferral account to **capture PP&E differences arising only as a result of the accounting policy changes caused by the transition from CGAAP to MIFRS**. It is for use by utilities to record PP&E differences arising during the period since their last rebasing under CGAAP up to their first rebasing under MIFRS, including utilities using IRM rate-setting methodology" [emphasis added].

It is Board staff's view that the PP&E deferral account was only designed to capture the impact of the accounting policy changes caused by the transition from CGAAP to MIFRS as adopted by HHH as at January 1, 2012. Board staff submits that the difference in the CGAAP closing net PP&E and the MIFRS closing net PP&E is a one time transitional adjustment, as outlined in the Addendum. Board staff is of the view that HHH's proposed 20 year amortization period is too long and does not reflect the transitional nature of the accounting policy changes as a result of HHH's transitioning from CGAAP to IFRS. As such, Board staff does not support the 20 year amortization period proposed by HHH as this is a one-time adjustment and should, in Board staff's view be dealt with over a shorter period of time.

It is Board staff's observation that to date, a four year amortization period has been consistently used by electricity distributors who filed cost of service rate applications for the 2012 rate year. Board staff also notes that the four year amortization aligns with the planned frequency of distributor rebasing. For consistency, Board staff submits that a four year amortization period would be appropriate for HHH.

Impacts on Rates and Requirements for Rate Mitigation

Board staff notes that on page 32 of Appendix A to the Addendum, the Board stated:

> "The Board will determine the period of time for amortization 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"** [emphasis added].

During the IFRS consultation process, Board staff recommended that the average remaining useful life of underlying assets generally be used as an upper limit to the choice of amortization period for three considerations: (1) impacts on rates, (2) implications of any other IFRS transition matters, and (3) any requirements for rate mitigation. In this section, Board staff examines if evidence provided by HHH for a choice of a 20 year amortization period would satisfy any of the considerations for (1) and (3). Consideration 2 will be discussed in the next section under cash flow impact on HHH.

Board staff notes that HHH has not provided any analysis related to the impacts on rates or any requirements for rate mitigation for a four year amortization period. In fact in its AIC, HHH stated that amortizing the PP&E deferral account over 20 years would effectively reduce rates by 0.4% per year for 20 years; whereas amortizing the PP&E deferral account over four years would effectively reduce rates by 2% per year for four years. If the PP&E deferral account is disposed over a period of 4 years, this would lead to a refund of approximately $210,000 to customers over the four years. As such, there is no negative material rate impact on HHH's customers as a result of accounting policy changes and therefore there is no requirement for HHH to take any actions related to rate mitigation. Board staff is of the view that HHH has not provided any compelling arguments related to impacts on rates or any requirements for rate mitigation to justify the use of 20 years as an upper limit for choice of amortization period. As such, Board staff submits that the rate impact of 2% of distribution rates is reasonable as a result of PP&E deferral account to be amortized over a four year period.

Cash flow Impact on HHH

In its argument in chief, HHH noted its concerns with the cash flow impact of a shorter amortization period e.g. four years versus a longer amortization period. Board staff reviewed the 5 year historical data from 2006 to 2010 from HHH's audited financial statements under its RRR filings and the pro forma financial data for 2011 and 2012 provided in its 2012 COS rate application. Except for 2009, the current ratios were sufficient to cover the current liabilities. For 2009, Note 11 to the audited financial statement, stated that HHH had a note payable to the Town of HHH that was due December 31, 2010. The amount reflected in the current liabilities was $16,141,970 in 2009 and nil in 2008. This amount ($16M) was classified as a current liability at December 31, 2009. Without the $16M of current liability, HHH's total current liability would have been less and its 2009 current ratio would have been positive. HHH has not provided any concrete evidence, such as a cash flow analysis, regarding other possible implications of IFRS transition matters. Board staff submits that HHH has not shown that a refund of approximately $210,000 to customers over a four year period for the amortization of PP&E deferral account would negatively and materially impact HHH's financial position. HHH has not provided any evidence that the approximate refund of $210,000 to customers would lead to any risks in HHH's financial viability either on a short-term or a long-term basis. Further, Board staff notes that HHH is proposing to recover the Deferral and Varince Account balances, a net amount of approximately $630,000 over two years, which will improve its cash flow position during those years.[8] As such, Board staff does not agree with HHH's concern over cash flow impact as a reason to justify a longer amortization period.

Concern with Intergenerational Equity

In its argument in chief, HHH stated at paragraph 23:

> "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."

In HHH's view, a shorter amortization period such as four years would not achieve the same intergenerational equity as compared to a longer period such as 20 years. HHH stated that only its customers in the next four years would receive rate mitigation should the Board approve a four year amortization period. Board staff does not agree with HHH that the principle of intergenerational equity argues in favour of a longer amortization period.

First, Board staff notes that the PP&E deferral account is related to the Property, Plant and Equipment components of rate base, including the rate base related intangible assets (referred to collectively hereafter as "PP&E"). The PP&E items were acquired

[8] AIC, paragraph 24

and made operational by HHH in the past under HHH's CGAAP where their costs were allowed to be recovered by HHH from its customers through the rates. Board staff questions if HHH's customers in the future, for example customers in year 2025, should be paying or be refunded for a one-time transitional adjustment due to the changes in accounting policy that HHH has implemented as at January 1, 2012 by adopting IFRS.

Second, the mechanism for recovery or refund for a PP&E deferral account addresses the changes in costs for PP&E items through a one time transitional adjustment and establishes the appropriate rate base under the MIFRS regime. As such, Board staff submits that the credit amount of $836,717 to reflect the changes in HHH's PP&E costs difference should be refundable to current HHH's ratepayers, who have been directly impacted by the accounting policy changes, and not to its future customers.

In summary, Board staff submits that the choice of a four year amortization period for the PP&E deferral account is appropriate for HHH.

On a related issue, Board staff submits that the rate of return used to determine the amount of return should be the average cost of capital, which would depend on the Board's decision on the unsettled issue of HHH's cost of long-term debt within the weighted cost-of-capital formula. If Board staff's submission on the cost of long-term debt is accepted by the Board, the rate of return would be decreased from the rate of 6.20% used by HHH in its calculation.

OPERATIONS, MAINTENANCE AND ADMINISTRATION ("OM&A")

HHH's proposed test year OM&A is $6,274,021, inclusive of property taxes, on the basis of MIFRS. On a comparable year-over-year basis, the request is 31.5% higher than the projected cost in the bridge year, which in turn is 9.5% higher than 2010 actual costs.

Background

The details of OM&A bridge/test year costs by major cost category were presented by HHH at Exh 4 / 1 / 1 / p. 2. The exhibit was further updated in response to Energy Probe Interrogatory # 35 and further clarified in Technical Conference Undertaking JT 1.10.

The following table illustrates the cost drivers for changes in OM&A costs, starting from 2008. Changes agreed to by the parties since this table was prepared are not shown, but are listed in Technical Conference Undertaking JT 1.4, "Tracking Sheet (Table JT-

12)". The main difference would be the removal of forecast MDM/R cost at $135,000, which is approximately one-half of the increase due to "Smart Meter Expenses".

Table 1 (abridged from Application, Exh 4 / 2 / 3 / p. 2)

OM&A	2008 Actual	2009 Actual	2010 Actual	2011 Bridge Year	2012 Test Year
Opening Balance	$ 5,111,058	$ 5,111,058	$ 4,436,426	$ 4,386,371	$ 4,804,910
Change in Salaries and Wages (Note 1)		-$ 368,359	$ 181,248	$ 209,767	$ 300,743
Change in Benefit Costs		$ 69,067	$ 53,430	$ 54,806	$ 254,671
Smart Meter Labour Costs (Note 2)				$ -	$ 191,195
Smart Meter Expenses (Note 2)				$ -	$ 271,515
Tree trimming (Note 3)				$ 20,000	$ 230,000
Reduction in Contract Services Cost		-$ 130,000	-$ 40,601		
Reduction in Charitable Donation		-$ 20,905			
Reduction in Maintenance of General Plant			-$ 143,210		
Additional OM&A resulting from Modified IFRS				$ 206,419	$ 286,621
Other OM&A costs (Note 4)		-$ 224,435	-$ 100,922	-$ 72,453	-$ 18,994
Closing Balance	**$ 5,111,058**	**$ 4,436,426**	**$ 4,386,371**	**$ 4,804,910**	**$ 6,320,661**

(1) 2009 reduction relates to the impact of staffing changes and severances paid in 2008
(2) Smart Meter OM&A including incremental Labour costs
(3) Incremental increase in Tree Trimming costs
(4) Variances relating to changes in allocation methodologies and cost drivers in 2009 and 2010

OM&A costs expressed in per-customer and per-employee terms are shown in the following table.

Table 2 (Application Exh 4 / 2 / 3 / p. 9)

	2008 Board Approved	2008 Actual	2009 Actual	2010 Actual	2011 Bridge Year	2012 Test Year
Number of Customers	20,391	20,670	20,869	21,117	21,581	22,061
Total OM&A from Appendix 2-G	$5,124,000	$5,104,194	$4,434,394	$4,386,371	$4,804,910	$ 6,320,661
OM&A cost per customer	**$ 251**	**$ 247**	**$ 212**	**$ 208**	**$ 223**	**$ 287**
Number of FTEEs	46	46	44	44	47	51
Customers/FTEEs	**443.28**	**449.35**	**474.30**	**479.93**	**459.17**	**432.57**
OM&A Cost per FTEE	**$ 111,391**	**$ 110,961**	**$ 100,782**	**$ 99,690**	**$ 102,232**	**$ 123,935**

These two tables are referred to in the following staff discussion.

Discussion

There was a decrease in OM&A per customer from $247 per customer in 2008 to $208 in 2010, shown in Table 2. In HHH's Application there would be an increase to $287 in the test year, or 38% over two years.

Cost Comparison 2007 - 2010

HHH reports its O&M costs annually for the Board's Statistical Yearbook, most recently for 2010. In 2007, the Board established peer groups based on a study by Pacific Economics Group ("PEG")[9]. HHH is included in the cohort of Mid-Size GTA Medium-High Undergrounding, along with twelve other distributors. In 2010, HHH had per-customer costs third from highest in the group, and above the cohort average.

In this Application, HHH presented a similar comparison based on a peer group that it considers more valid than the PEG grouping, by virtue of having a larger proportion of rural customers. In this alternative grouping, HHH's costs in 2010 stand fourth from best amongst eleven distributors.[10]

Board staff notes that neither comparison of 2010 data would inform the Board on where HHH would stand after the substantial cost increases that are being proposed in this Application.

Cost Drivers

1. Staff Complement

Board staff notes that from the narrative description in Exh 4 / 2 / 6, it is evident that HHH did considerable re-organizing and staff building during the period 2008 – 2010. HHH indicated that some of the staff building can be attributed to the requirements of Smart Meters.

The information in Table 1 above shows that the staff complement and wages and salaries in 2011 were approximately on a par with 2008. The cost of staff additions up to 2011 is offset partially by a decrease in contract services. The number of customers

[9] Pacific Economics Group, "Comparison of Ontario Distributors Costs" (EB-2006-0268).
[10] Board staff TCQ # 4

had grown together with the staff complement, as indicated by the statistic “customers / FTE” in Table 2, until 2011.

HHH is proposing to add in the 2012 test year a staff complement of 4 full-time equivalent employees over the bridge year. Table 1 shows that the increased salaries and wages, including the new staff, and related labour costs, and costs of Smart Meter implementation, amounts to an increase of approximately $500,000 over the bridge year. Consistent with this staff growth, Table 2 shows a decrease in the statistic “customers / FTE”, from 459 in 2011 to 433 in 2012.

Board staff notes that one of the new hires is in anticipation of a retirement[11] It is unclear to Board staff whether an overlap exists in 2012 that would not be sustained during HHH’s upcoming IRM plan term. Board staff suggests that HHH should address in its reply submission whether certain costs expected in the test year will be sustained throughout the IRM period, or alternatively whether some of them might be unusual development or catch-up items whose costs should be averaged over more than one year. The items that would benefit from further justification in the test year include the cost of engineering work (hearing transcript p. 71), and actuarial costs for post-employment benefit calculations, contract negotiations, and a risk management program (all references to the hearing transcript p. 76).

2. Staff Benefits

Table 1 shows an increase in benefit costs of $254,671 over the bridge year. The cost of employee benefits per employee increases from $37,582 in 2010 to $45,664 in the test year, according to Table 4-16 (Exhibit 4 / 2 / 6 / p. 2). The partial explanation provided by HHH is that there is a 1% per year increase in OMERS premiums, $81,000 per Table 4-17, Exhibit 4 / 2 / 6 / p. 6), plus an overall increase in the allowance for “accrued benefit liability” ($25,000, per Table 4-18, same page). Board staff understands that the proposed increase in the number of FTEs would account for most of the remaining $150,000.

[11] Exhibit 4 / 2 / 6 / p. 5 (item # 2)

3. Smart Meter Expenses

Board staff has no comment on the increased cost of labour associated with Smart meters, beyond the earlier question about possible overlap of incoming and retiring staff. However, Table 1 shows an increase in Smart meter expenses, other than labour cost, of $271,515. Even after removal of $135,000 for future MDMR expenses agreed in the settlement proposal, Board staff suggests that there is a wide safety margin in the HHH budget related to Smart meters and should issues arise related to the Smart meter program, Board staff submits that these issues would be expected to ease during the IRM period. Board staff also observes that forecast meter reading expenses for 2012 ($206,840) are higher than 2010 actual and bridge year by about $75,000 and $190,000 respectively, which is counter-intuitive to the expected outcome resulting from the deployment of smart meters. Board staff therefore submits that the Board should consider allowing the recovery of $136,515 (i.e. $271,515 less $135,000) over a four year period and consider a further reduction of OM&A by about $75,000 in order to cap meter reading costs at the average of actual levels in the 2008-2010 period of $133,325. These reductions would reduce the OM&A costs for 2012 by about $175,000.

4. Tree Trimming

Board staff notes that the actual annual expenditures in 2008-2010 were at approximately the level approved in the previous re-basing, and the proposed expenditure level going forward is significantly higher[12]. As the proposed amount of $230,000 per year is supported by an independent evaluation of the matter Board staff does not take issue with the proposed expenditure for maintenance of right-of-way (tree-trimming), and accepts that it is necessary during the test year and during the IRM period thereafter.

5. Transition to IFRS**:**

The apparent increase in OM&A due to the transition to IFRS is not within the control of HHH management. Board staff submits that HHH has made the required changes in OM&A.

[12] Approved expenditure $99,000, Exhibit 4 / 1 / 1 / Table 4-2. Requested approval $393,464 (CGAAP, Table EP 1-32 in IRR EP # 35) or $421,666 (IFRS, Table EP 1-30, same IRR)

LONG-TERM DEBT RATE

The parties agreed on the capital structure proposed by HHH with the exception of the 4.41 % long-term debt rate proposed by HHH.

Background

The agreed proportions of the capital structure are a deemed short-term debt of $1.7 million and deemed long-term debt of $24.1 million[13]. HHH's actual debt consists of a Promissory Note to the Town of Halton Hills[14] with a principal equal to $16.1 million and a line of credit with TD Commercial Banking[15] with principal at $3.9 million at the beginning of the test year.

The Promissory Note with the applicant's affiliate carries a variable rate and is not callable. HHH proposes to use the Board's parameter, which has been updated in the Board's letter to distributors and other stakeholders on March 2, 2012, as confirmed in its response to an interrogatory from Energy Probe[16] and in the AIC.

The purpose of the credit facility from TD Commercial Banking was to provide HHH with working capital and to cover costs incurred for Smart meters[17]. As noted in the executed agreement filed, there are both short-term and longer-term components. The credit facility was arranged on December 23, 2009, and has a maximum term of 15 years and a rate at prime plus 1% for bankers acceptance funds. The actual amount of the loan at December 31, 2011 was $3.9 million, at a rate of 2.13% with a term of 1 year[18]. The terms were considered to be more favourable than funding from Infrastructure Ontario[19].

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[13] Partial Settlement Agreement, Appendix G, and Appendix K "RRWF, Capitalization/Cost of Capital"
[14] IRR Board staff # 35 and Appendix OEB 1-B.
[15] IRR SEC # 13 and Appendix SEC 1-C. Board staff notes that HHH did not reveal this third-party debt in the original Application, but it came to light through interrogatories. See Tr. Vol. 1, page 36, ll. 5-19. HHH should have documented this in its initial Application in compliance of Chapter 2 of the *Filing Requirements for Transmission and Distribition Applications*, updated June 22, 2011.
[16] IRR Energy Probe # 42.
[17] IRR SEC 13
[18] TCQ EP #6
[19] IRR SEC # 27.

Discussion and Submission

The Board is required to determine whether it will allow the standard rate of 4.41% on all to apply to the long-term debt with TD Commercial Banking. The Board's report deals with the rate on long-term debt with non-affiliated lenders as follows:

> In general, the Board is of the view that the onus is on the electricity distribution utility to forecast the amount and cost of new or renewed long-term debt. ….Third-party debt with a fixed rate will normally be afforded the actual or forecasted rate, which is presumed to be a "market rate".[20]

Board staff submits that the proposed rate on affiliate debt is compliant with the guidelines in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* issued December 11, 2009. HHH has recognized in its AIC (paragraph 27) that the updated rate is 4.41%.

Board staff submits that the rate of the affiliate note should bear the largest weight, but not the entire weight, in determining a weighted average cost of long-term debt. Board staff submits that by the end of the test year HHH will have three debt instruments that should be considered as long-term debt: the promissory note at $16.1 million, new debt at $5.0 million, and a portion of the existing debt at $2.2 million, i.e. the actual amount of the existing loan less the amount of deemed short-term debt.

Board staff submits that the rate of 2.13% should be assumed for the long-term debt portion of the actual debt, i.e.. HHH has pointed out that this amount is maturing in August, 2012. Board staff submits that, in the absence of more specific information, it is reasonable to assume that this is weighted as 7.5 months, in other words from January to mid-August of the test year.

HHH has considered an additional loan from a third party such as TD Commercial Banking, in the amount of $5 million. Board staff submits that the term to maturity would make any such loan fall into the category of long-term debt. The expected rate for a 5 year term loan is a range from 3.20% up to 4.08% depending on the details. Information on the terms available from TD Commercial Banking, including two alternative terms to maturity and two alternative amortization rates, were provided by HHH as Transcript Undertaking J 1.2.

If HHH proceeds as it has indicated, the amount of third party debt by the end of the test year would be an additional $5 million. Board staff suggests that the fixed rate of

[20] *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities,* December 11, 2009, p. 53

3.96%, quoted for a 10-year term 15-year amortization period, would be a suitable rate to use in calculating an average cost of long term debt. In the absence of further information, Board staff submits that it would be reasonable to assume that the incremental $5 million be in place for half of the 2012 test year.

Board staff also suggests that the same rate could be applied to the replacement of the residual amount of $2.2 million for smart meter financing, discussed above, from mid-August to December 31, 2012.

Board staff notes that the term of third-party loans would likely be shorter than the lifetime of the assets, and HHH would bear the risk of what the rate will be when the loans must be re-financed. The future rate would be considered at the time of the next rebasing, which would be at or following maturation, and does not affect the rate in this proceeding..

DISPOSITION OF DEFERRAL AND VARIANCE ACCOUNT BALANCES

HHH proposes to recover the balance of certain deferral and variance accounts over two years.

Background

The Partial Settlement Proposal noted that the balances of all accounts and the allocation of the balances to the rate classes were agreed to by the parties. The disposition period is the only aspect of this issue that is not settled, and as a result the rate riders are unsettled as well. The balance for disposition for the Global Adjustment sub-account of account 1588 is a debit of $2,303,654, recoverable from non-RPP customers only. The balance for all other deferral and variance accounts is a credit of $1,675,714, to be refunded to all customers.

HHH's purpose in proposing disposition over two years was to lessen the financial burden on non-RPP customers. The proposed rate riders are shown at Exhibit 9 / 3 / 2, in Table 9-12 and 9-13 as follows.

Table 9-12: 2012 Deferral and Variance Account Rate Rider by Class

Class	Residential	General Service less than 50 kW	General Service 50 to 999 kW	General Service 1,000 to 4,999 kW	Sentinel Lighting	Street Lighting	Unmetered Scattered Load
Deferral and Variance Account Rate Riders, Variable	$ (0.0016)	$ (0.0017)	$ (0.6508)	$ (0.6811)	$ (0.7926)	$ (0.0812)	$ (0.0015)
Billing Determinants	kWh	kWh	kW	kW	kW	kW	kWh
Rate Rider for all Customer Class	*$ (0.0016)*	*$ (0.0017)*	*$ (0.6508)*	*$ (0.6811)*	*$ (0.7926)*	*$ (0.0812)*	*$ (0.0015)*

Table 9-13: 2012 Non-RPP Global Adjustment Rate Rider by Class

Class	Residential	General Service less than 50 kW	General Service 50 to 999 kW	General Service 1,000 to 4,999 kW	Sentinel Lighting	Street Lighting	Unmetered Scattered Load
Deferral and Variance Account Rate Riders, Variable - Non RPP Customers	$ 0.0011	$ 0.0002	$ 1.4835	$ 1.8205	$ 2.3236	$ 1.7575	$ 0.0049
Billing Determinants	kWh	kWh	kW	kW	kW	kW	kWh
Rate Rider for for Non -RPP Customers (GA)	*$ 0.0011*	*$ 0.0002*	*$ 1.4835*	*$ 1.8205*	*$ 2.3236*	*$ 1.7575*	*$ 0.0049*

Based on the tables above, the rate rider applicable to a non-RPP customer in the GS 1000 – 4999 kW class for two years would be $1.1394 per kW, which is based on the amount of the Global Adjustment sub-account rate rider and the rate rider that applies to all customers for the other deferral and variance accounts. Board staff notes that by comparison, the volumetric distribution rate for the same customer is $3.4850 per kW[21]. Using a one-year disposition period, the size of the rate riders would double, to a net debit amount of $2.2788 per kW[22].

Discussion and Submission

Board staff notes that HHH's request for a two year disposition period is not consistent with the guidelines outlined in the EDDVAR Report with respect to the default disposition period for Group 1 accounts (i.e. one year). However, Board staff notes that the Board has made previous decisions which deviate from the EDDVAR Report if it deems it in the public interest to do so.

Board staff is of the view that the Board should strike a balance between reducing intergenerational inequities and mitigating rate volatility. Consequently, Board staff

[21] IRR Board staff # 60
[22] IRR Board staff # 46(c)

supports HHH's request to dispose of its deferral and variance account balances over a two-year disposition period in order to reduce rate volatility for HHH customers and smooth the impact for non RPP customers.

- All of which is respectfully submitted -