Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2011-0178

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

AND IN THE MATTER OF an application by Kingston Hydro Corporation for an order or orders approving or fixing just and reasonable distribution rates and other charges, to be effective May 1, 2012.

BEFORE: Karen Taylor
Presiding Member

Paula Conboy
Member

DECISION AND ORDER

Introduction

Kingston Hydro Corporation ("Kingston Hydro"), a licensed distributor of electricity, filed an application with the Ontario Energy Board (the "Board") on November 30, 2011 under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that Kingston Hydro charges for electricity distribution, to be effective May 1, 2012.

Kingston Hydro is one of 77 electricity distributors in Ontario regulated by the Board. The *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "IR Report"), issued on July 14, 2008, establishes a three year plan term for 3rd generation incentive regulation mechanism ("IRM") (i.e., rebasing plus three years). In its October 27, 2010 letter regarding the development of a Renewed Regulatory Framework for Electricity ("RRFE"), the Board announced that it was extending the 3rd generation IRM plan until such time as the RRFE policy initiatives have been substantially completed. As part of the plan, Kingston Hydro is one of the electricity distributors that will have its rates adjusted for 2012 on the basis of the IRM process, which provides for a mechanistic and formulaic adjustment to distribution rates and charges between cost of service applications.

To streamline the process for the approval of distribution rates and charges for distributors, the Board issued its IR Report, its *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on September 17, 2008 (the "Supplemental Report"), and its *Addendum to the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* on January 28, 2009 (collectively the "Reports"). Among other things, the Reports contain the relevant guidelines for 2012 rate adjustments for distributors applying for distribution rate adjustments pursuant to the IRM process. On June 22, 2011, the Board issued an update to Chapter 3 of the Board's *Filing Requirements for Transmission and Distribution Applications* (the "Filing Requirements"), which outlines the application filing requirements for IRM applications based on the policies in the Reports.

Notice of Kingston Hydro's rate application was given through newspaper publication in Kingston Hydro's service area advising interested parties where the rate application could be viewed and advising how they could intervene in the proceeding or comment on the application. No letters of comment were received. The Notice of Application indicated that intervenors would be eligible for cost awards with respect to Kingston Hydro's proposal for the recovery of incremental capital expenditures, LRAM and the disposition of Account 1562. Schools Energy Coalition ("SEC"), Energy Probe and the Vulnerable Energy Consumers Coalition ("VECC") applied for intervenor status in this proceeding. The Board grants SEC, Energy Probe and VECC intervenor status and eligibility for cost awards in regards to Kingston Hydro's proposal for the recovery of incremental capital expenditures and LRAM. Board staff also participated in the proceeding. The Board proceeded by way of a written hearing.

While the Board has considered the entire record in this proceeding, it has made reference only to such evidence as is necessary to provide context to its findings. The following issues are addressed in this Decision and Order:

- Price Cap Index Adjustment;
- Rural or Remote Electricity Rate Protection;

- Shared Tax Savings Adjustments;
- Retail Transmission Service Rates;
- Review and Disposition of Group 1 Deferral and Variance Account Balances;
- Review and Disposition of Account 1521: Special Purpose Charge;
- Review and Disposition of Account 1562: Deferred Payments In Lieu of Taxes;
- Review and Disposition of Lost Revenue Adjustment Mechanism; and
- Incremental Capital Module.

Price Cap Index Adjustment

As outlined in the Reports, distribution rates under the 3rd Generation IRM are to be adjusted by a price escalator, less a productivity factor (X-factor) of 0.72% and a stretch factor.

On March 13, 2012, the Board announced a price escalator of 2.0% for those distributors under IRM that have a rate year commencing May 1, 2012.

The stretch factors are assigned to distributors based on the results of two benchmarking evaluations to divide the Ontario industry into three efficiency cohorts. In its letter to Licensed Electricity Distributors dated December 1, 2011 the Board assigned to Kingston Hydro efficiency cohort 2 and a cohort specific stretch factor of 0.4%.

On that basis, the resulting price cap index adjustment is 0.88%. The price cap index adjustment applies to distribution rates (fixed and variable charges) uniformly across customer classes that are not eligible for Rural or Remote Electricity Rate Protection.

The price cap index adjustment will not apply to the following components of delivery rates:

- Rate Riders;
- Rate Adders;
- Low Voltage Service Charges;
- Retail Transmission Service Rates;
- Wholesale Market Service Rate;
- Rural or Remote Rate Protection Charge;
- Standard Supply Service – Administrative Charge;
- Transformation and Primary Metering Allowances;

- Loss Factors;
- Specific Service Charges;
- MicroFIT Service Charges; and
- Retail Service Charges.

Rural or Remote Electricity Rate Protection

On December 21, 2011, the Board issued a Decision with Reasons and Rate Order (EB-2011-0405) establishing the Rural or Remote Electricity Rate Protection (“RRRP”) benefit and charge for 2012. The Board amended the RRRP charge to be collected by the Independent Electricity System Operator from the current $0.0013 per kWh to $0.0011 per kWh effective May 1, 2012. The draft Tariff of Rates and Charges flowing from this Decision and Order will reflect the new RRRP charge.

Shared Tax Savings Adjustments

In its Supplemental Report*,* the Board determined that a 50/50 sharing of the impact of currently known legislated tax changes, as applied to the tax level reflected in the Board-approved base rates for a distributor, is appropriate.

The calculated annual tax reduction over the IRM plan term will be allocated to customer rate classes on the basis of the Board-approved base-year distribution revenue. These amounts will be refunded to customers each year of the plan term, over a 12-month period, through a volumetric rate rider using annualized consumption by customer class underlying the Board-approved base rates.

Kingston Hydro’s application identified a total tax savings of $68,149, resulting in a shared amount of $34,075 to be refunded to rate payers.

In its submission, Board staff supported Kingston Hydro’s shared tax savings as filed.

The Board approves shared tax savings of a credit of $34,075, to be disposed of over a one year period, May 1, 2012 to April 30, 2013.

Retail Transmission Service Rates

Electricity distributors are charged the Ontario Uniform Transmission Rates ("UTRs") at the wholesale level and subsequently pass these charges on to their distribution customers through the Retail Transmission Service Rates ("RTSRs"). Variance accounts are used to capture timing differences and differences in the rate that a distributor pays for wholesale transmission service compared to the retail rate that the distributor is authorized to charge when billing its customers (i.e. variance Accounts 1584 and 1586).

On June 22, 2011 the Board issued revision 3.0 of the *Guideline G-2008-0001 - Electricity Distribution Retail Transmission Service Rates* (the "RTSR Guideline"). The RTSR Guideline outlines the information that the Board requires electricity distributors to file to adjust their RTSRs for 2012. The RTSR Guideline requires electricity distributors to adjust their RTSRs based on a comparison of historical transmission costs adjusted for the new UTR levels and the revenues generated under existing RTSRs. The objective of resetting the rates is to minimize the prospective balances in Accounts 1584 and 1586. In order to assist electricity distributors in the calculation of the distributors' specific RTSRs, Board staff provided a filing module.

On December 20, 2011 the Board issued its Rate Order for Hydro One Transmission (EB-2011-0268) which adjusted the UTRs effective January 1, 2012, as shown in the following table:

2012 Uniform Transmission Rates

Network Service Rate	$3.57 per kW
Connection Service Rates	
Line Connection Service Rate	$0.80 per kW
Transformation Connection Service Rate	$1.86 per kW

Board staff submitted that Kingston Hydro's RTSR Workform had been completed appropriately and supported recovery of Kingston Hydro's Retail Transmission Service Rates as updated to incorporate 2012 UTRs.

The Board finds that these 2012 UTRs are to be incorporated into the filing module.

Review and Disposition of Group 1 Deferral and Variance Account Balances

The *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative* (the "EDDVAR Report") provides that, during the IRM plan term, the distributor's Group 1 account balances will be reviewed and disposed if the preset disposition threshold of $0.001 per kWh (debit or credit) is exceeded. The onus is on the distributor to justify why any account balance in excess of the threshold should not be disposed.

Kingston Hydro's 2010 actual year-end total balance for Group 1 Accounts including interest projected to April 30, 2012 is a credit of $107,885. This amount results in a total credit claim of $0.00015 per kWh, which does not exceed the preset disposition threshold. As a result, Kingston Hydro did not request disposition of the Group 1 Accounts.

In its submission, Board staff noted that the principal amounts to be disposed as of December 31, 2010 reconcile with the amounts reported as part of the Reporting and Recordkeeping Requirements ("RRR"). Board staff submitted that Kingston Hydro had completed the necessary Deferral and Variance Account continuity table and threshold calculation to demonstrate that its Group 1 Deferral and Variance Account balances do not meet the threshold test.

The Board notes that the EDDVAR disposition threshold of $0.001/kWh has not been exceeded. No disposition of Group 1 Deferral and Variance Accounts is required at this time.

Review and Disposition of Account 1521: Special Purpose Charge

The Board authorized Account 1521, Special Purpose Charge Assessment ("SPC") Variance Account in accordance with Section 8 of *Ontario Regulation 66/10* (*Assessments for Ministry of Energy and Infrastructure Conservation and Renewable Energy Program Costs*) (the "SPC Regulation"). Accordingly, any difference between (a) the amount remitted to the Minister of Finance for the distributor's SPC assessment and (b) the amounts recovered from customers on account of the assessment were to be recorded in "Sub-account 2010 SPC Assessment Variance" of Account 1521.

In accordance with Section 8 of the SPC Regulation, distributors are required to apply by no later than April 15, 2012 for an order authorizing the disposition of any residual balance in sub-account 2010 SPC Assessment Variance. The Filing Requirements state the Board's expectation that requests for disposition of this account balance would be heard as part of the proceedings to set rates for the 2012 year.

Kingston Hydro's application did not include a request to dispose of the residual balance in Account 1521. In response to interrogatories, Kingston Hydro stated that the balance in this account was a debit of $10,561.02.

Board staff submitted that despite the usual practice, the Board should authorize the disposition of the unaudited balance in Account 1521 as of December 31, 2010, plus the amount recovered from customers in 2011, including carrying charges to April 30, 2012, noting that this was consistent with Board decisions in both the Horizon (EB-2011-0172) and Hydro One Brampton (EB-2011-0174) 2012 IRM proceedings. Board staff requested that Kingston Hydro provide an update to the balance of this account in its reply submission to include actual 2011 recoveries and projected interest to April 30, 2012.

In its reply submission, Kingston Hydro indicated that the balance in Account 1521 remains unchanged at $10,561.02 and requested disposition of this amount.

The Board approves the disposition on a final basis of a debit balance in Account 1521 of $10,561.02, representing principal and interest to April 30, 2012, over a one year period, May 1, 2012 to April 30, 2013. The Board directs Kingston Hydro to close Account 1521 effective May 1, 2012.

For accounting and reporting purposes, the balance of Account 1521 shall be transferred to the applicable principal and interest carrying charge sub-accounts of Account 1595 pursuant to the requirements specified in Article 220, Account Descriptions, of the *Accounting Procedures Handbook for Electricity Distributors*. The date of the journal entry to transfer the approved account balances to the sub-accounts of Account 1595 is the date on which disposition of the balances are effective in rates, which generally is the start of the rate year (e.g. May 1), and this entry should be completed on a timely basis to ensure that these adjustments are included in the June 30, 2012 (3rd Quarter) RRR data reported.

Review and Disposition of Account 1562: Deferred Payments in Lieu of Taxes

In 2001, the Board approved a regulatory payments in lieu of taxes proxy approach for rate applications coupled with a true-up mechanism filed under the RRR to account for changes in tax legislation and rules and to true-up between certain proxy amounts used to set rates and the actual amount of taxes paid. The variances resulting from the true-up were tracked in Account 1562 for the period 2001 through April 30, 2006.

On November 28, 2008, pursuant to sections 78, 19 (4) and 21 (5) of the *Ontario Energy Board Act, 1998*, the Board commenced a Combined Proceeding (EB-2008-0381) on its own motion to determine the accuracy of the final account balances with respect to Account 1562 Deferred Payments in Lieu of Taxes ("Deferred PILs") (for the period October 1, 2001 to April 30, 2006) for certain electricity distributors that filed 2008 and 2009 distribution rate applications.

The Notice in the Combined Proceeding included a statement of the Board's expectation that the decision resulting from the Combined Proceeding would be used to determine the final account balances with respect to Account 1562 Deferred PILs for the remaining distributors. In its decision and order, the Board stated that, "[e]ach remaining distributor will be expected to apply for final disposition of Account 1562 with its next general rates application (either IRM or cost of service)."[1]

Kingston Hydro applied to refund a credit balance of $156,545. Kingston Hydro updated this amount through responses to interrogatories to a credit balance of $404,462, consisting of a credit principal balance of $388,196 and an interest credit of $16,266.

<u>IESO Prudentials</u>

Board staff's submission requested clarification from Kingston Hydro as to whether interest on IESO prudentials is a standby fee for providing, but not drawing on, a line of credit, or whether Kingston Hydro had drawn down the line of credit due to non-payment of commodity invoices. If drawn down, IESO prudentials would be classified as an interest expense relating to debt. Board staff noted that the Board had identified the components of interest expense in the Hydro One Brampton IRM proceeding (EB-2011-0174), although Hydro One Brampton had not disclosed prudential costs in its evidence. Board staff submitted that the components of interest that should be used by Kingston

[1] EB-2008-0381 Account 1562 Deferred PILs Combined Proceeding, Decision and Order, p. 28

Hydro should be interest expense on debt, bank interest and service charges and IESO prudentials. Board staff calculated total interest from 2002 to 2005 to be $132,217 and requested that Kingston Hydro re-submit its 2001-2005 SIMPIL claw-back penalty calculations to reflect this submission.

In its reply submission, Kingston Hydro stated that the IESO had never drawn on its Letter of Guarantee and that IESO prudentials should not be included in interest expense. Kingston Hydro noted that the Hydro One Brampton IRM Decision makes two references to consistency with cost of service applications; therefore this would appear to be a determining factor. Kingston Hydro stated that it has never included this item as a cost of long term debt in its cost of service applications and noted that in its last application it was included in regulatory costs. Kingston Hydro submitted that IESO prudentials are not a line of credit and are not available to fund short or long term capital expenditures. The components of interest expense, in Kingston Hydro's submission, should include interest expense on debt and bank interest and service charges for a total of $928,484.

Income Tax Rates

Board staff's submission noted that Kingston Hydro had used the blended maximum income tax rates identified in the Combined Proceeding (EB-2008-0381), although it was eligible to claim the small business deduction from 2001 to 2005. Board staff submitted that the applicants in the Combined Proceeding were not eligible to claim the small business deduction and were therefore directed to use the maximum rates. Kingston Hydro's eligibility for the small business deduction would, in Board staff's submission, result in tax rates approximately 2% below the maximum. Board staff requested that Kingston Hydro provide this imputed tax calculation in its reply submission.

Kingston Hydro replied that the purpose of SIMPIL models is to address changes in tax legislation, rather than the effects of additions or deductions to taxable income. Kingston Hydro noted that it had used the maximum tax rate to calculate the PILs gross-up in its 2001 cost of service application, reflecting the fact that additional revenue received to recover PILs is taxed at the maximum rate, therefore this rate should be used in the true-up calculations. Kingston Hydro further noted that the Board excludes the tax effect of regulatory assets and liabilities from the true-up calculations, which affect the calculation of effective tax rates. Kingston Hydro stated that it was appropriate to apply the principles of the Combined Proceeding, which contributes to the intended result of handling the balances in this account in an expeditious and largely administrative manner. In Kingston Hydro's submission, the use of the effective tax rate as proposed by Board staff results in a change in methodology from the Decision in the Combined Proceeding and is inconsistent with the PILs proxy models that were used to calculate PILs in rates.

Consistent with the Board's approach in Hydro One Brampton (EB-2011-0174) the Board finds that the components which will comprise interest expense for purposes of the true-up calculations, based on Kingston Hydro's evidence are: interest expense on debt and bank interest and service charges. The Board notes that while Kingston Hydro has confirmed that interest on IESO prudentials is a standby fee paid to a financial institution, Kingston Hydro also confirmed that this cost was not included in "interest" in its last cost of service application. As such, the Board will not consider IESO prudentials to be a component of interest, for the purpose of this application. In general, however the Board does not agree that this cost should be included in "Regulatory Costs" rather than "interest" and is of the view that this issue should be considered in Kingston Hydro's next cost of service application.

The Board does not concur with Kingston Hydro's interpretation of the decision of the Board in the Combined Proceeding (EB-2008-0381) with respect to the income tax rate to be used to calculate the tax amounts that form part of the balance in Account 1562. The Board notes that Kingston Hydro provided evidence that it was eligible to claim the small business deductions during the tax years 2001 to 2005. The distributors whose applications were considered in the Combined Proceeding were not eligible to claim the credit. The Board is therefore of the view that Kingston Hydro's interpretation of the Combined Decision that the maximum taxation rates apply is incorrect. The Board agrees with the submission of Board staff that the imputed taxation rates reflecting the small business deduction should be used to calculate the tax amounts for balances in Account 1562, and that it is appropriate to use a proxy to be applied to the 2001 and 2002 tax years to complete the regulatory PILs calculation in this case. In particular, the Board notes that the average difference between the maximum tax rates and Kingston Hydro's imputed taxation rates is approximately 1.2%. The Board finds that the proxy rate for each of 2001 and 2002 shall be calculated as the maximum rate less 1.2%. The Board directs Kingston Hydro to input the following tax rates into the SIMPIL models for 2001 to 2005.

Blended Federal & Ontario Income Tax Rates					
	2001	**2002**	**2003**	**2004**	**2005**
For the tax impact	39.42%	37.42%	35.70%	33.85%	35.70%
For the tax gross-up	38.30%	36.30%	34.58%	32.73%	34.58%

The Board directs Kingston Hydro to re-file the revised SIMPIL models in active Excel format for 2001 to 2005 that incorporate the findings of the Board in this Decision. Kingston Hydro is also directed to file an updated continuity schedule in active Excel format showing the principal and interest calculations that support the amount to be disposed.

The Board approves the disposition of Account 1562 on a final basis over a one year period, May 1, 2012 to April 30, 2013.

Review and Disposition of Lost Revenue Adjustment Mechanism ("LRAM")

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

Kingston Hydro requested the recovery of an LRAM claim of $175,754, consisting of the effect of CDM programs implemented from 2006 to 2010 for the 2010 year. Kingston Hydro proposed to recover the LRAM claim over a one-year period. In response to interrogatories, Kingston Hydro provided OPA final results for 2010, which showed a small amount of additional savings. Kingston Hydro chose not to update its LRAM claim on the basis of these savings.

Board staff's submission noted that Kingston Hydro had last rebased in 2011, therefore Kingston Hydro had not recovered lost revenues in 2010, including persisting revenues from programs delivered in 2006, 2007, 2008 and 2009. Board staff noted that Kingston Hydro's 2006 forecast was established on a historical basis and did not consider future CDM effects. Board staff submitted that, with the exception of 2006, Kingston Hydro was under IRM for the entire period, and there was no opportunity for Kingston Hydro to recover lost revenues. Board staff supported the approval of Kingston Hydro's 2010 LRAM of $175,754 as submitted.

VECC's submission noted the use of an outdated assumption for CFLs, but stated that the impact on lost revenues was immaterial. VECC supported Kingston Hydro's application as filed, as the savings occurred prior to rebasing, were not included in the approved load forecast and had not been previously claimed.

Energy Probe submitted that the proposed one year recovery period was appropriate and agreed with the submissions of VECC on all remaining issues.

Kingston Hydro noted the approval of other parties in its reply submission and requested approval of the LRAM amount as filed.

The Board approves an LRAM recovery of $175,754, including carrying charges, over a one year period, May 1, 2012 to April 30, 2013. The claim represents new or persisting lost revenues in 2010 associated with CDM programs delivered in 2006, 2007, 2008, 2009 and 2010. The Board notes that, with the exception of 2006, Kingston Hydro was under IRM during this period and has not otherwise received compensation for LRAM in this period. The Board acknowledges that there would have been no opportunity to account for future CDM effects in the 2006 Board-approved load forecast.

Incremental Capital Module ("ICM")

Kingston Hydro's application proposed the recovery of incremental capital expenditures of $3,500,000 associated with four projects:

- 44kV underground Cable Rebuild;
- Transformer Vault TV6 Rebuild;
- Substation #15 Circuit Breaker Retrofit; and
- Transformer Vault TV11 Rebuild

Kingston Hydro's total 2012 capital budget including the incremental projects was $6,025,000. In response to interrogatories, Kingston Hydro indicated that all of its 2012 capital projects were "of equal priority and significance to the operations of the utility". Kingston Hydro's 2011 approved capital budget was $5,433,500 and actual spending in 2011 was $6,023,337. Kingston Hydro calculated a materiality threshold in its application of $2,490,780. This was updated in response to interrogatories to correct the growth rate and include the GDP-IPI rate approved by the Board for January 1, 2012, resulting in a revised materiality threshold of $2,595,875. Kingston Hydro agreed that this threshold would be updated further to incorporate the GDP-IPI applicable for

May 1, 2012 implementation. Kingston Hydro proposed to allocate the resultant revenue requirement on the basis of distribution revenue in accordance with the ICM model. Kingston Hydro proposed to recover the revenue requirement by way of fixed and variable rate riders to remain in effect until its next cost of service application, in order to maintain its current fixed/variable split.

Project Need, Prudence and Materiality

Kingston Hydro provided a detailed description of the individual projects, outlining the impact of the deteriorated assets on public and employee safety, outage frequency and duration and system reliability and performance through its evidence and responses to interrogatories.

Kingston Hydro's evidence regarding the transformer vault rebuilds was supported by a structural engineer's report recommending replacement of these assets due to their level of deterioration. Kingston Hydro stated that its transformer vault rebuilds were planned for 2011 to coordinate with other City of Kingston work in the area.

The Substation 15 Circuit Breaker Retrofit project was proposed by Kingston Hydro to address the obsolescence of the breakers and the unreliability of the mechanical operating mechanism. Kingston Hydro stated that failure of this equipment could result in worker injury and significant utility and customer equipment damage.

Kingston Hydro's evidence and interrogatories outlined the deterioration of the King Street Underground 44kV Cable, and its impact on employee safety, as well as the criticality in supplying power to the downtown core, including critical loads to Kingston General Hospital and Queen's University. Kingston Hydro stated that the rebuild of this cable will be required to serve as reliable backup for the hospital as it begins the rebuilding of Substation 1, scheduled to begin in 2013.

Board staff submitted that Kingston Hydro had justified the need for the 44kV Underground Cable Rebuild, Transformer Vault TV6 Rebuild and Transformer Vault TV11 Rebuild projects. Board staff noted that Kingston Hydro had been aware that the breakers in its Substation #15 have been out of service for some time and that Kingston Hydro had not addressed this issue in past years, including in its 2011 cost of service application. Board staff requested Kingston Hydro to assess the priority of this project and explain the implications of either deferring it to another year or deferring another project to accommodate this work in its reply submission.

Board staff stated that the costs for TV6, TV11 and the 44kV Cable Rebuild appear to be reasonable, based on previous experience with similar capital work. Board staff requested that Kingston Hydro confirm in its reply submission that TV6 is still planned to coincide with the City of Kingston's work and if not, confirm if any cost increases would result from maintaining the 2012 in-service date. It also noted that the Filing Requirements require Kingston Hydro to track the difference between actual and proposed expenditures, and that the Board will carry out a further prudence review of these expenditures at the time of rebasing.

Board staff submitted that the Filing Requirements state an expectation that distributors should manage a capital expenditure level outside of rates up to the materiality level prior to being permitted to apply for incremental capital during the IRM term. The Board-approved capital budget in Kingston Hydro's 2011 cost of service application was $5,433,500; therefore the total 2012 capital budget exceeds the approved level by only $591,500, which, in Board staff's submission, was well below the materiality threshold. Board staff requested that Kingston Hydro provide a detailed explanation in its reply submission of how it determined that the materiality threshold had been met.

VECC's submission noted that 2011 actual spending included amounts not spent in 2010 and that the total 2012 forecast of capital spending could be viewed as non-discretionary. VECC calculated the eligible incremental capital as the difference between total non-discretionary spending and the materiality threshold in accordance with the Filing Requirements. The result is $3,429,125, therefore, in VECC's submission, the materiality threshold had been met.

VECC also submitted that Kingston Hydro had demonstrated that all four incremental projects have met the need criteria, are incremental, non-discretionary and directly related to the claimed drivers, which were, in VECC's submission reasonable. VECC noted that Kingston Hydro stated that the current working alternatives to address the limitations presented by the four projects are no longer viable and that it had presented reasonable and appropriate design responses employing reasonable costs to mitigate future risks. VECC submitted that all four projects had met the prudence criteria and should be eligible for recovery.

SEC generally agreed that the monetary threshold had been met. However, SEC noted that the Board has made it clear that projects that are part of the normal capital spending requirements do not qualify for ICM treatment. SEC submitted that only one of the four projects could be viewed as resulting from unusual circumstances. The 44kV Underground Cable Rebuild, Circuit Breaker Retrofit and TV#11 Rebuild all represent projects to upgrade and/or replace aging or obsolete infrastructure, similar to past projects, which Kingston Hydro should be doing as its normal course of business. SEC submitted that ICM treatment should be denied for all projects with the exception of the TV#6 rebuild, which could be considered unusual in that coordinating with planned work by the city may result in lower costs. SEC noted that Kingston Hydro did not disclose plans for future ICM applications, despite numerous references to projects to occur in 2013 which could indicate that this is the first of a series of incremental capital applications. SEC submitted that the Board should make it clear that such a course of action is not consistent with Board policy.

Energy Probe submitted that all four projects are incremental and non-discretionary and should be eligible for recovery as incremental capital. It noted that Kingston Hydro had miscalculated the growth factor to derive the threshold in the model, and provided a correction in the materiality threshold to $2,723,741 and an incremental capital amount of $3,301,259, noting that its calculations were subject to updates to incorporate the Board's updated price escalator.

Kingston Hydro's reply submission indicated that it did not understand the request to provide an explanation of how it has met the materiality threshold, as this is based on the Board's formula and model. Kingston Hydro submitted that the eligible amount of incremental capital is based not on previous capital spending, but on rate base, depreciation and certain other variables. Kingston Hydro agreed with Energy Probe's calculations.

Kingston Hydro noted that it had elaborated on the unusual and unanticipated circumstances of the projects in response to interrogatories, and also noted the general support among parties for the individual projects. It confirmed that TV6 is still planned to be completed in conjunction with city work. Regarding the Circuit Breaker Retrofit, Kingston Hydro stated that it had been monitoring this situation and employing work-around solutions for some time, and that other competing priorities had taken precedence in 2011. Kingston Hydro submitted that the four projects satisfy the eligibility criteria of materiality, need and prudence, and that the evidence demonstrates that the materiality threshold has been met, the projects have significant influence on the operation of the distributor and are non-discretionary.

Incremental Revenue Requirement Calculation

Kingston Hydro provided the required calculation of the Revenue Requirement resulting from its incremental capital, using a 60/40 capital structure, its cost of capital parameters from its 2011 cost of service proceeding (EB-2010-0136) and a 28.3% tax rate. Kingston Hydro did not employ the half year rule, as it is not scheduled to file a cost of service application until 2014 for 2015 rates. The resulting Incremental Revenue Requirement was $268,458. Kingston Hydro's 2011 cost of service was filed on the basis of CGAAP, therefore Kingston Hydro filed its incremental capital calculations on the basis of CGAAP. In response to interrogatories, Kingston Hydro indicated that the differences between the two methodologies would be minimal.

Board staff's submission supported Kingston Hydro's treatment in not applying the half year rule, consistent with the Supplemental Report and past decisions, its use of a deemed 60/40 capital structure and 2011 approved cost of capital parameters, as well as Kingston Hydro's proposed allocation methodology, which was consistent with the ICM model.

Board staff did not support Kingston Hydro's use of a tax rate of 28.3% and submitted that the model specifies the use of the same tax rate as contained in the Tax Savings Workform. In Kingston Hydro's case, this tax rate is 24.06%.

Board staff also noted that Kingston Hydro had not provided a reconciliation between CGAAP and MIFRS and requested that Kingston Hydro provide this in its reply submission.

Board staff suggested that it would be helpful to provide a comparison and analysis of the impacts of fixed/variable and variable-only recovery, noting that the Board had previously approved variable-only recovery for other distributors. In Board staff's submission, fixed/variable recovery may create additional, unwarranted complexity.

VECC supported Kingston Hydro's proposed fixed/variable recovery.

Energy Probe accepted both Kingston Hydro's proposed allocation and recovery methodologies.

Kingston Hydro submitted that the revenue requirement calculations should be based on the maximum tax rate of 26.25% for 2012. It noted that it had successfully demonstrated in its 2011 cost of service proceeding (EB-2010-0136) that the additional revenue subject to PILs comes in to income at the maximum tax rate as the small business deduction is already fully utilized.

Kingston Hydro provided the requested reconciliation between CGAAP and IFRS, stating that the costs for each of its incremental capital projects would increase under IFRS, resulting from the requirement to include costs for dismantling, removal and restoration. The total cost of the incremental capital program would increase from $3.5 million to $3.995 million.

Kingston Hydro provided a comparison table of variable and fixed/variable rates for recovery however it did not provide an analysis of impacts. Kingston Hydro stated that it had no preference for a recovery methodology.

Board Findings

Need, Prudence and Materiality

Kingston Hydro has applied for ICM treatment for four projects:

1. King Street 44kv Underground Rebuild - $1,860,000;
2. Transformer Vault (TV 6) Rebuild - $565,000;
3. Substation No. 15 Circuit Breakers Retrofit - $560,000; and
4. Transformer Vault 11 (TV11) Rebuild - $515,000.

Kingston Hydro's total 2012 capital budget including incremental capital projects is $6,025,000. The total applied-for ICM associated with four projects is $3,500,000.

As set out in the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, dated July 14, 2008, the incremental capital module was designed to address the treatment of incremental capital needs that may arise during the IRM term and to do so on a modular basis. The *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors,* dated September 17, 2008 ("Supplemental Report"), states that the capital module is intended to be reserved for unusual circumstances that are not captured as a Z-factor and where the distributor has no other options for meeting its capital requirements within the context of its financial capacities underpinned by existing rates.

Both reports set out incremental capital investment eligibility criteria, which are repeated below:

1. Materiality: The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.

2. Need: Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.

3. Prudence: The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

The materiality threshold is based on the premise that revenue generated under the price cap plan automatically generates more revenue for capital investment. The materiality threshold set by the Board in its Supplemental Report established a level of capital expenditure that can be financed by increases in revenues due to the price cap formula and load growth. The Board also set a 20 percent adder, or dead band, to prevent marginal applications.

The Board is of the view that the applied-for projects are consistent with the purpose of the ICM, and that it is appropriate to evaluate the four projects using the incremental capital investment eligibility criteria.

The Board finds that the need and prudence for each of the four applied-for projects, totalling $3.5 million, has been established. As briefly highlighted below for each project, Kingston Hydro has provided sufficient evidence documenting asset failure, condition deterioration, and safety issues to establish need and prudence in the context of this application. The Board is of the view that Kingston Hydro has also adequately demonstrated that its 2012 capital budget of $6,025,000 is non-discretionary.

1. King Street 44kv Underground Rebuild: Kingston Hydro has evaluated risk, liability, health and safety matters relative to its assets and after several years of repair and monitoring Kingston Hydro submits and the Board accepts that this

asset has reached a point of criticality and the applied-for capital expenditures can no longer be delayed.

2. Transformer Vault (TV 6) Rebuild: Kingston Hydro confirmed and the Board accepts that the TV 6 project is planned to coincide with the City of Kingston's work on Princess Street.

3. Substation No. 15 Circuit Breakers Retrofit: In its submission, Kingston Hydro identified this project as a priority with no discretion for further delay. Kingston Hydro stated and the Board accepts that it has monitored this facility and has provided "work around solutions" in order to avoid capital expenditures. Kingston Hydro stated that clips and other parts are dislodging from the switchgear during maintenance and operation presenting a potential safety risk to workers and extended power outages.

4. Transformer Vault 11 (TV11) Rebuild: In accordance with its condition assessments performed on the civil works, worker safety issues and the reliability of the current electrical equipment, Kingston Hydro submits and the Board accepts that this project must be completed this year.

In light of the evidence presented, the Board finds that the revised materiality threshold should be further adjusted to reflect the 2.0% price escalator announced by the Board on March 13, 2012. Using the 2.0% price escalator, the Board has calculated a materiality threshold of $2,851,159. The maximum amount eligible for recovery will be the difference between the total non-discretionary capital expenditures of $6,025,000 and the threshold value of $2,851,159 or $3,173,841. Kingston Hydro has applied for an ICM of $3.5 million, which is in excess of the maximum amount eligible for recovery. The Board therefore approves an incremental capital module of $3,173,841.

Board staff noted in its submission that Kingston Hydro's 2012 non-discretionary capital budget of $6,025,000 is higher than the 2011 Board-approved capital budget of $5.4 million (EB-2010-0136) by approximately $500,000, with the implication being that customers would be paying for new capital expenditures that are already reflected in current rates.

The Board points out that the materiality threshold, as set out in Appendix B: Amended Filing Guidelines of the Supplemental Report of the Board (EB-2007-0673) dated September 17, 2008, calculates the amount of ongoing capital expenditures that can be supported by rates during IRM, including the price cap index adjustment, growth and a 20% dead band. The Board highlights that, in Kingston Hydro's case, the materiality threshold of $2,851,159 is about half of the 2011 Board-approved capital budget. The

Board is of the view that the applied-for incremental capital is outside of the base upon which rates were derived.

Incremental Revenue Requirement Calculation

Half-Year Rule, Capital Structure, Cost of Capital Parameters

The Board finds that the half-year rule will not apply as Kingston Hydro is not scheduled to file a rebasing application until 2014 for 2015 rates. The Board also approves a 60/40 (debt/equity) capital structure and the cost of capital parameters as approved in Kingston Hydro's 2011 cost of service application.

The Board concurs with the submission of Board staff that the appropriate taxation rate is 24.06%, the same rate that issued in the Tax Savings Workform and reflects the small business credit.

Reconciliation between MIFRS and CGAAP

The Board will accept the use of CGAAP for the purposes of this IRM application and notes that there is no material difference between the calculations under IFRS and CGAAP.

Allocation of the Incremental Revenue Requirement

The Board approves the allocation of the revenue requirement associated with the incremental capital on the basis of distribution revenue, consistent with the methodology contained within the Incremental Capital Workform.

Recovery of the Incremental Revenue Requirement

The Board finds that the incremental revenue requirement should be recovered by means of a variable rate rider, as this approach is consistent with the Board's approach in its decisions on Guelph's (EB-2010-0130) and Oakville's (EB-2010-0104) 2011 IRM applications . The Board notes that Kingston Hydro had no issue implementing a variable rate rider to recover the incremental revenue requirement.

IMPLEMENTATION

The Board has made findings in this Decision which change the 2012 distribution rates from those proposed by Kingston Hydro.

The Board expects Kingston Hydro to file detailed supporting material, including all relevant calculations showing the impact of this Decision on Kingston Hydro's determination of the final rates. Supporting documentation shall include, but not be limited to, filing completed versions of the 2012 IRM Rate Generator model, RTSR Workform, updated SIMPIL models and continuity tables in active Excel format to support the claim for disposition of Account 1562 Deferred PILs and a revised Incremental Capital Workform.

A Rate Order will be issued after the steps set out below are completed.

THE BOARD ORDERS THAT:

1. Kingston Hydro shall file with the Board, and shall also forward to intervenors, revised models in Microsoft Excel format attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision by April 26, 2012.

2. Board staff and intervenors shall file any comments on the revised models and proposed rates with the Board and forward to Kingston Hydro within 7 days of the date of filing of the draft Rate Order.

3. Kingston Hydro shall file with the Board and forward to intervenors responses to any comments on its revised models and proposed rates within 4 days of the date of receipt of intervenor comments.

Cost Awards

The Board will issue a separate decision on cost awards once the following steps are completed:

1. Intervenors shall submit their cost claims no later than **7 days** from the date of issuance of the final Rate Order.

2. Kingston Hydro shall file with the Board and forward to intervenors any objections to the claimed costs within **21 days** from the date of issuance of the final Rate Order.

3. Intervenors shall file with the Board and forward to Kingston Hydro any responses to any objections for cost claims within **28 days** from the date of issuance of the final Rate Order.

4. Kingston Hydro shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote file number **EB-2011-0178,** be made through the Board's web portal at, www.errr.ontarioenergyboard.ca and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available parties may email their document to BoardSec@ontarioenergyboard.ca. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 2 paper copies.

DATED at Toronto, April 19, 2012

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary