Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2011- 0271

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 Halton Hills Hydro Inc. for an order approving or fixing just and reasonable rates and other charges for electricity distribution to be effective May 1, 2012.

BEFORE: Paula Conboy
Presiding Member

Cathy Spoel
Member

DECISION AND ORDER
June 14, 2012

BACKGROUND

On August 26, 2011, Halton Hills Hydro Inc. ("HHH") filed an application with the Ontario Energy Board (the "Board") 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 HHH charges for electricity distribution, to be effective May 1, 2012.

In 2006, the Board announced the establishment of a multi-year electricity distribution rate-setting plan. On March 1, 2011, the Board informed HHH that it would be one of the electricity distributors to have its rates rebased for the 2012 rate year. Accordingly, HHH filed a cost of service application based on 2012 as the forward test year. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006.

Chapter 2 of that document, as amended on June 22, 2011, outlines the filing requirements for cost of service rate applications by electricity distributors, based on a forward test year.

In Procedural Order No. 1, dated October 14, 2011, the Board approved intervenor status and cost award eligibility for Energy Probe Research Foundation ("Energy Probe"), the School Energy Coalition ("SEC"), and Vulnerable Energy Consumers Coalition ("VECC"). The Board provided for written interrogatories and responses to these interrogatories from HHH.

In Procedural Order No. 2, dated December 15, 2011, the Board provided for supplementary interrogatories, a potential technical conference, a settlement conference, and the filing of any settlement proposal. In Procedural Order No.3, dated January 30, 2012, the Board confirmed that a technical conference would be required. The technical conference was held on February 1, 2012. Undertakings made by HHH at the Technical Conference were filed by February 6, 2012.

On February 6 and 7, 2012, a settlement conference was held and a partial settlement was reached. On February 16, 2012 HHH requested and was granted an extension of the date that had been set in Procedural Order No. 2 for filing a proposed settlement agreement. On February 28, 2012 the Board granted a further extension for filing a proposed settlement agreement. The parties filed a proposed Partial Settlement Agreement (the "Partial Agreement") on February 28, 2012. The Partial Agreement identified five unsettled issues:

- Issue 2.3: inclusion of Green Energy Initiative in the rate base and related items in the revenue requirement
- Issue 11.1: property, plant and equipment ("PP&E") account amortization period;
- Issues 4.1 – 4.6: operations, maintenance and administration ("OM&A") for test year;
- Issue 5.2: long-term debt rate;
- Issue 9.2: deferral and variance account clearance.

The Partial Agreement noted that HHH would file updated evidence with respect to its PP&E Account, which tracks the amounts, including associated depreciation, attributable to the difference between CGAAP and IFRS calculations of net fixed assets as at the end of 2011.

In Procedural Order No. 4, dated March 5, 2012, the Board provided for updated evidence and an oral hearing on the unsettled issues. HHH filed its updated evidence on PP&E on March 12, 2012 and a further update on March 21, 2012. This second update reflected work that HHH had subsequently done in preparation for its 2011 audit.

An oral hearing was held on March 22, 2012. The Board confirmed its acceptance of the Partial Agreement. A number of undertakings arose from the oral hearing. These were filed by HHH on March 30, 2012. Two corrections to the undertakings were subsequently made and filed on April 3, 2012.

In Procedural Order No. 5 and Interim Rate Order dated March 26, 2012, the Board provided for HHH's argument-in-chief and submissions. It also declared HHH's existing distribution rates interim effective May 1, 2012. HHH filed its argument-in-chief on the unsettled issues on March 30, 2012. The intervenors and Board staff submitted their arguments on April 13, 2012, and HHH submitted its reply argument on April 25, 2012.

GREEN ENERGY INITIATIVE

The Green Energy Initiative ("GEI") put forward by HHH is a proposal to install 1,400 photovoltaic devices on distribution pole-tops, at an installed cost of $1,000 each which would add $1,400,000 to HHH's 2012 rate base. Each device consists of a single 220-280 watt solar panel, a Smart Energy Module with inverter, a two-way wireless smart grid communicator, sensor, digital meters and a pole mounting system. Through the 2nd round of interrogatories, HHH updated its OM&A request to include $11,760 related to its GEI[1]. In addition to OM&A, the implementation of the GEI has consequential impacts on a variety of related areas of revenue requirement calculation, such as depreciation, working capital, and payments in lieu of taxes ("PILs"). HHH estimated the impact on revenue requirement of the GEI to be $91,467.

HHH submitted that while containing a clean generation component, the GEI is more appropriately classified as a distribution project given the broad distribution benefits associated with it. HHH outlined many benefits to its proposed initiative, including those that could be quantified and those that could not. HHH submitted that while very difficult to estimate, the quantified benefits would be $35,496 per annum. These cost savings would be achieved through electricity production, line loss reduction and transmission

[1] VECC Interrogatory 35, Board staff TCQ # 3(a)

and other non-commodity savings. HHH proposed that these cost savings be directly passed on to HHH's customers through the establishment of a deferral/variance account ("DVA").

As part of the distribution system, HHH submitted that the GEI would also provide many benefits that cannot be quantified. In its final argument, HHH highlighted the following non-financial and non-quantifiable benefits:

- Non-Financial Benefits to Ratepayers: Increased reliability, voltage stabilization, improved monitoring of system (i.e., monitoring operation and health of grid, reliability alerts, remote sensing of voltage quality and power flows), platform for future smart grid opportunities, improved public awareness about electricity usage/renewable production, reduced generation emissions, etc.
- Non-Quantifiable, Financial Benefits to Ratepayers: Value of emission reduction credits, value of any improved response times to specific problems as a result of better real-time information, etc.[2]

HHH is of the view that the non-financial benefits far exceed the $55,971 differential between the annual GEI revenue requirement and DVA benefits (i.e., $91,467 - $35,496 = $55,971).

Despite its negative net present value ("NPV") calculation of the project, (calculated without consideration of the unquantifiable benefits) HHH indicated that the GEI is not a pilot project but rather a viable capital project with net benefits to the utility and ratepayers. HHH indicated that it has previously carried out a pilot project of 4 units installed in February 2010. HHH also pointed to deployment in other jurisdictions and two other Ontario distribution utilities to demonstrate the project's viability.

Board staff and intervenors did not support the approval of HHH's GEI. SEC and VECC provided two alternatives discussed below. Several intervenors suggested that the estimated benefits of $35,496 were overstated.

VECC submitted that even under more favourable assumptions the NPV might improve from the negative $661,000 calculated by HHH to approximately negative $501,000. VECC also pointed out that the project is not supported by a proper business plan,

[2] Exhibit 2, Tab 3, Schedule 7 and Undertaking J1.5.

detailed cost-benefit analysis or risk assessment. Energy Probe submitted that with improved tax planning and escalating the cost savings at a higher rate, the estimated NPV could be improved to approximately negative $391,000.

SEC asserted that there is insufficient information to conclude that the non-economic benefits of the initiative outweigh the economic cost to ratepayers. Board staff suggested that based on the evidence provided the GEI is not financially feasible when operated within the regulated distribution business. All parties agreed that the costs of the GEI outweigh the financial benefits of the project. Intervenors disagreed with HHH that, once the non-financial and non-quantifiable benefits were taken into account, the project is feasible and should be approved.

The intervenors commended HHH for its initiative and offered alternatives to the full amount of capital expenditure proposed by HHH. VECC suggested that HHH might collaborate with other distributors in a pilot to demonstrate the costs and benefits of the technology in question. SEC recommended a pilot project at 10% of the scale proposed by HHH, which would provide information to consider at HHH's next cost-of-service application. Energy Probe suggested three alternatives: a smaller-scale pilot similar to that suggested by SEC, a phased-in installation over a long period to reduce the cost and riskiness of the project, and an alternative accounting treatment of the proposal that would isolate HHH's customers from the cost and uncertainties of the GEI.

In its reply argument, HHH argued that there is sufficient experience with the technology, and sufficient evidence on the record in this proceeding, to indicate that the GEI represents a prudent distribution investment. HHH also put forward the argument that there is a presumption on the part of the regulator that a utility's expenditures are reasonable and made in good faith. HHH acknowledged that intervenors can rebut the presumption of management good faith by establishing a *prima facie* case that calls into question the reasonableness of the utility's proposed expenditures.

Board Findings

Costs and Benefits of the Green Energy Initiative

The Board will not approve HHH's GEI as filed. While the Board recognizes that the GEI may provide benefits in terms of cost savings which will ultimately flow through to customers and accepts that there would also be benefits that are difficult to quantify, the Board does not agree with HHH that there is sufficient experience with the technology and sufficient evidence on the record to suggest that the GEI represents a prudent distribution investment. As such the project funded through rates is not justified.

During the oral hearing HHH undertook to file studies with respect to technology being used in other jurisdictions highlighting those that mirror what is being proposed in Ontario. HHH filed one study undertaken in the U.S. The purpose of the study was to provide a description of the potential technical merits of "Distributed Smart Solar technology" and propose a methodology to quantify the economic opportunity of a Smart Solar investment. It was not clear where the study was published and the Board notes that the authors of the study appear to be employed by a solar company involved in the provision of the technology.

Had HHH filed the study earlier in the proceeding, there would have been an opportunity for further discovery. HHH noted in an undertaking that the decision to proceed with the GEI was made based on HHH's pilot project experience (with four panels), as well as HHH's discussions with individuals at other utilities where these units had been installed namely Oakville Hydro, Festival Hydro, and the Public Service Electric and Gas Company (the public utility in New Jersey with 135,000 units installed, with approval of their regulator, the New Jersey Board of Public Utilities). The Board finds that this is not compelling justification for a project of this size. Once again, had this information been provided earlier in the proceeding there would have been an opportunity for appropriate discovery. HHH's GEI represents a significant portion of the company's test year capital project costs, yet the pre-filed evidence provided was less than one page in length. The onus is on HHH to provide compelling evidence and argument for the approval of the GEI yet the Board finds that despite efforts through interrogatories and argument such information was either not forthcoming or was not sufficiently compelling to support the approval sought by HHH.

This is not to say that the GEI does not have potential merits. The Board is encouraged that HHH is investigating methods to improve its distribution system and support green initiatives. However it needs to be done on a measured and prudent basis. The Board recognizes the argument put forward by HHH in its Reply submission with respect to the presumption of prudence. Putting aside the fact that HHH's costs for the GEI initiative are forecast and not historical, once a party challenges on reasonable grounds the sufficiency of an applicant's evidence the presumption of prudence ends, and the onus lies squarely with the applicant to justify the inclusion of the proposed expense in the revenue requirement. The intervenors and Board staff clearly challenged HHH's evidence and noted that it was insufficient to justify the expenditures. The Board agrees.

Ratepayers should not be required to fund projects that provide a questionable return. As such, the Board finds that more research should be undertaken before a mass roll out of the devices across HHH's service area is approved.

The Board does not agree with HHH's assertion that the intervenors failed to acknowledge any potential benefits other than financial ones. In fact, each of the intervenors offered suggestions for a pilot project that would enable HHH to document and quantify the benefits appropriately.

The Board finds that HHH should proceed with an expanded pilot project on a scale of not more than 200 units. The Board approves the inclusion of 1/7 (based on 200 units being installed) of the capital related costs of HHH's GEI as originally proposed. The Board also approves the full amount of the associated OM&A, which is $11,760, which will arguably be approximately the same for a pilot project as for the GEI as submitted. The Board acknowledges that this alternative scale is not found in the record. However, the Board considers that a pilot project of this scale is a reasonable compromise between the financial cost to HHH's customers and the value of improved information.

The Board expects that HHH will prepare documentation of its costs, financial benefits and any non-financial benefits. It expects that the documentation will serve to narrow uncertainties on both cost and benefits. The Board expects that the documentation of the pilot will be filed in support of any application that HHH may make at a future time for approval of additional photovoltaic installations. This way the results can be made publicly available and may be useful to other distributors.

HHH proposed that the Board approve a CCA rate of 8% that is based on classifying the solar assets as distribution assets in Class 49. Energy Probe suggested that the Board consider a CCA rate of 29% as the midpoint of 8% proposed by HHH and 50% intended to provide enhanced tax deductions for various renewable asset properties. Energy Probe offered that this or some other alternative would balance the short and long term cost consequences to ratepayers of the GEI project. As the Board has decided to allow for a smaller scale project and the resulting rate impact will not be material, it will not make a determination on the appropriate CCA rate.

PROPERTY PLANT AND EQUIPMENT ("PP&E")

In its prefiled evidence, HHH filed for approval of its PP&E Deferral Account balance of $1,384,586 owing to ratepayers. The Partial Agreement indicated that no settlement was reached with regard to HHH's PP&E amortization period and that HHH would be filing updated evidence on this issue. Section 11 of the Partial Agreement however did not specifically refer to the amortization period, but in answering the issue "Is the proposed revenue requirement determined using modified IFRS appropriate?" it stated the following:

> With regard to HHH's PP&E Account, which tracks the amounts, including associated depreciation, attributable to the difference between CGAAP and IFRS calculations of net fixed assets as at the end of 2011, no settlement has been reached. HHH will be filing updated evidence on this issue.[3]

<u>PP&E Balance</u>

HHH filed its updated evidence on March 12, 2012 seeking approval of a revised PP&E balance of $1,462,823 owing to ratepayers. On March 21, 2012 the day before the oral hearing, HHH revised its March 12, 2012 update. HHH stated that the revision reflected results of HHH finalizing its 2011 capital expenditures and depreciation during its 2011 year-end audit process with KPMG. The 2011 CGAAP depreciation figures were reduced to $2,115,000 from $2,741,106.[4] The revision reduced the PP&E deferral account balance from $1,462,823 to $836,717 owing to ratepayers.

Intervenors expressed concern over the revised balance of the PP&E deferral account. They submitted that HHH did not provide a complete evidentiary record of the changes in the calculation of rate base for 2011 under CGAAP and IFRS and only indicated that it had corrected an error in the calculation of the depreciation expense under CGAAP. Energy Probe took the position that the Board should not accept the depreciation expense calculation for 2011 under CGAAP. Energy Probe argued that the updated calculation of 2011 depreciation in the CGAAP calculation did not make sense as it does not follow the upward trend from previous years that would be expected, given that gross fixed assets had increased. More specifically, Energy Probe asked HHH to confirm that the depreciation rates used in calculating the 2011 depreciation expense under CGAAP were unchanged from those used in 2008 through 2010.

SEC and VECC supported Energy Probe's submission with regards to the depreciation calculations relating to the 2011 adjustments from CGAAP to MIFRS.

In its reply argument, HHH indicated that it was not HHH's desire or intent to have a late update to its evidence. HHH was in the process of its year-end audit with KPMG and during that process the amount in the account was updated, and the update was material. In response to Energy Probe's submission, HHH noted that it had established a depreciation model to facilitate the implementation to MIFRS. The rates were not

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[3] Halton Hills Hydro Inc., Partial Settlement Agreement, EB 2011-0271, pg. 22
[4] Transcript Undertaking J 1.1, March 30, 2012

changed in the model, but the overall depreciation expense was revealed to be slightly lower under the audit. HHH clarified that the change was a result of finalizing the 2011 fixed assets section of the audit file and the correction of a formulaic error.

PP&E Amortization Period

HHH proposed to amortize its PP&E deferral account balance over a period of 20 years. Intervenors and Board staff supported a shorter amortization period such as four years. HHH, intervenors and Board staff considered factors such as accounting policy changes, impact on rates, impact on cash flow, and intergenerational equity in support of their submissions related to the amortization period of the PP&E deferral account.

PP&E and Accounting Policy Changes

HHH submitted that the Board did not have a prescribed standard amortization period and argued that a 20 year amortization period aligns with the useful lives of the distribution assets. HHH argued that the PP&E deferral account is meant to return to ratepayers increased rates attributable to an accounting change and it seems suitable to amortize the PP&E deferral account over a longer period.

Board staff and intervenors submitted that an appropriate amortization period for the PP&E account is no more than four years. This would result in the amortization to be completed during the IRM period prior to HHH's next cost-of-service proceeding. Board staff noted that the PP&E deferral account was only designed to capture and remove the impact of the accounting policy changes as caused by transition from the legacy CGAAP to MIFRS and therefore a shorter amortization period should be used. SEC submitted that under the new accounting regime, the PP&E deferral account costs represent part over-collection of depreciation from ratepayers which is due to revaluation and should be refunded to customers as soon as possible.

Impact on Rates

HHH stated that amortization of the PP&E deferral account over 20 years will effectively reduce rates by 0.4% per year for 20 years; whereas amortizing the PP&E deferral account over four years will effectively reduce rates by 2% per year. Board staff argued that HHH did not provide any analysis and compelling arguments related to the rate impacts or any requirement for rate mitigation for a 20 year amortization period. Energy Probe provided a calculation showing that volatility in customer bills would be ameliorated, not exacerbated by the shorter amortization period once other rate riders were considered.

In its reply submission, HHH submitted that the rate impact of a longer amortization period is less volatile (i.e. smoother). From a rate impact perspective, there is no need for a shorter amortization period in order to mitigate or offset rate increases associated with this rate application.

Cash Flow

HHH submitted in its reply submission that a shorter amortization period would have a material impact on HHH's cash flow and revenues, Board staff and intervenors stated that HHH should have no problem with its cash flow due to a shorter amortization period. Board staff noted that HHH's five year historical liquidity position was positive and that HHH had not provided any concrete evidence, such as a cash flow analysis on the possible implications of IFRS transition. Furthermore, Board staff noted that HHH is proposing to recover from its customer approximately $612,000 in deferral & variance account balances.

Intergenerational Equity

In its argument in chief, HHH stated that the 20 year amortization period would ensure that HHH customers in 2025 who will still be "paying" for the current transition to MIFRS are also receiving some rate reduction. HHH submitted that the impact of the transition to IFRS will increase rates for a number of years and therefore it would be suitable to ensure that customers who will still be paying for the current transition would receive some rate reduction.

Board staff did not agree with HHH that the principle of intergenerational equity argues in favour of a longer amortization period. PP&E costs are past costs under legacy CGAAP and were allowed to be recovered from customers through rates. The PP&E deferral costs arise from a one time transitional adjustment and should be refunded to current HHH's ratepayers who have been directly impacted by the accounting policy change and not to future customers.

Energy Probe argued that intergenerational inequity means not forcing one generation of customers to cover the costs of another generation of customers and a twenty year period can cover several generations of customers. Both Energy Probe and SEC submitted that many customers today will not be the customers in 20 years. SEC further stated that these customers should receive the full benefit of the balances as soon as possible. VECC was in favour of a two to four year amortization period. HHH submitted in its reply submission that the increase in rates will be sustained well beyond four years. A short amortization period such as four years would not achieve the same intergenerational equity.

Board Findings

Updated Evidence and Quantum of PP&E Deferral Account Balance

The introduction of updated evidence was contemplated by the Partial Agreement and the update provided on March 12, 2012 was relatively minor. What was not contemplated by the parties was the introduction of a further, material update one day prior to the oral hearing. The Board is concerned by this late filing of evidence as parties and Panel members are limited in their ability to test the evidence prior to and during the oral hearing.

The Board understands HHH's dilemma upon discovering the material change to the 2011 fixed assets section of the audit file and the correction of a formulaic error; however, the Board is placed in an awkward position on whether to approve such a material update without appropriate testing.

Despite its concerns, the Board notes that none of the intervenors, or Board staff proposed that the update to the updated evidence filed the day before the hearing should be disallowed. Rather, submissions from the parties related to the amount of the PP&E account and whether or not there was sufficient evidence on the record for the changes in the calculation of depreciation expenses for 2011 under CGAAP and MIFRS.

Energy Probe questioned how the amount could change so significantly from $1,462,823 to $836,717. The Board shares the unease expressed in Energy Probe's argument that, according to HHH's undertaking J1.1 from the oral hearing, the gross book value of HHH's assets increased in 2011 while its CGAAP depreciation apparently decreased substantially relative to the preceding years. This counter intuitive result has not been fully examined or explained.

Due to these concerns, the Board approves on an interim basis the amount of $836,717 as the appropriate PP&E deferral account balance subject to a confirmation by HHH's auditors, KPMG, and verification of the results by the Board's Regulatory Audit and Accounting (the "Regulatory Audit").

The Board directs HHH to file with the Board, under EB-2011-0271, by September 30, 2012 the results of KPMG's audit and its confirmation of all detailed calculations for the derivation of PP&E net book value and depreciations under both CGAAP and MIFRS assumptions. In other words, HHH is directed to file an audited statement of the PP&E balance including detail sufficient to support the amount that is to be amortized, whether it is one of the three balances already submitted or some other amount.

The Board anticipates that the Regulatory Audit group will conduct an audit review which may assist the Board in determining how best to finalize the amount in this account. When Regulatory Audit has concluded its audit review of the account, and depending upon its conclusions, the Board will determine whether it is necessary to revise the account balance for purposes of issuing a final order prior to HHH's next IRM rate application. If necessary, HHH will be required to prepare a final draft order to that effect at that time.

PP&E Amortization Period

The Board notes that the PP&E deferral account is a unique account, which is "cleared" through a one-time adjustment to rate base and is designed to capture PP&E differences arising only as a result of the accounting policy changes caused by the transition from CGAAP to MIFRS. The PP&E deferral account is being treated differently than a traditional deferral account. It addresses the circumstance of a change in accounting standards and provides for the continuity of rate base. The Board had indicated that it would determine the period of time for amortization on a case-by-case basis and would be guided primarily by such considerations as the impact on rates, implications of any other IFRS transition matters and any requirements for rate mitigation.[5]

The Board examined all evidence submitted by HHH, intervenors, and Board staff and considered all factors including the impact of the PP&E deferral account balance on

[5] Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment dated June 13, 2011 (EB-2008-0408)

HHH's customers and HHH's cash flow position, and other matters such as intergenerational equity. The Board does not agree that a longer amortization period of twenty years is warranted given that the resulting rate impact on HHH's distribution rates for a four year amortization period is a 2% rate reduction and hence there is no need for rate mitigation consideration. Furthermore, the Board is not convinced that a four year amortization period would negatively impact HHH's cash flow position and impose a risk to its financial viability. The PP&E deferral account resulting from a one-time transitional accounting adjustment as a result of a change in accounting standards does not support the principle of intergenerational equity in favour of a longer amortization period. The Board agrees with the intervenors and Board staff position that a four year amortization period for HHH's PP&E deferral account is appropriate. Therefore, the Board approves a four-year amortization period for HHH's PP&E deferral account.

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

HHH has requested approval of OM&A in the test year of $6,274,021 (including property tax). The accounting basis is MIFRS. Compared to the initial application, it excludes the forecast cost of the IESO MDM/R at $135,000 and adds the operating cost of the proposed GEI at $11,760.

This amount is a large increase over OM&A expenditures in previous years. HHH's evidence identified four cost drivers that are largely responsible for the increase:

- an increase in wages and benefits
- an increase in tree trimming costs
- an increase in smart meter costs
- an increase related to the transition from CGAAP to MIFRS accounting.

Wages and benefits include the addition of four new positions during the test year, as well as increased benefits and wages as required by HHH's collective agreement.

The increase in tree trimming costs is due to a high rate of growth, disease and die back of mature trees, and underfunding of line clearance over a number of years. HHH submitted that its ratepayers have benefitted from low tree trimming costs in past years that are unsustainable in the future.

The increase in smart meter OM&A costs is beyond HHH's control, in its view, because it is driven by regulatory requirements.

HHH also submitted that the increase due to MIFRS is beyond its control. The amount of this increase is $286,621. No party took issue with the inclusion of costs associated with the conversion from CGAAP to MIFRS.

HHH maintained that while the company was not lacking in any standard utility practices over the IRM period, wages and benefits and tree trimming costs have been underfunded for the past few years.

While Board staff and intervenors all had different submissions on what they considered to be a reasonable approved 2012 OM&A expense, all agreed that the requested budget was too high. Intervenors made arguments that HHH had consistently under spent their 2008 approved OM&A during the IRM term to the benefit of its shareholder. Both SEC and Energy Probe made submissions that the gains directly benefiting the shareholder of the applicant during IRM are not supposed to disappear during rebasing but flow on a prospective basis to ratepayers. VECC noted that theoretically under IRM ratepayers should expect service costs to increase by no more than inflation. Otherwise ratepayers gain nothing from the incentive plan and may in fact be better off with annual cost of service rate reviews.

VECC compared HHH's proposed OM&A budget with the previously-approved amount in 2008, making allowance for some increases in percentage terms (e.g. inflation and customer growth) and some increases in dollar terms (e.g. smart meters and property taxes). VECC calculated an increase over the 2008 approved level of $1,042,810 at the low end of the range to $1,224,510 at the high end of the range.

SEC suggested a percentage adjustment to the actual OM&A expenditures in 2010, paralleling a similar adjustment recently approved for Hydro Ottawa[6]. The result of the adjustment for HHH would be OM&A totaling $5,124,500 for the 2012 test year. While SEC did not specify the accounting treatment, this amount appears to be in CGAAP terms, which in this situation yields a lower amount than MIFRS.

Energy Probe submitted two methods of deriving an OM&A budget. The first resembled that of VECC and SEC, relying primarily on a percentage adjustment to historical amounts plus specific increments. The second was similar to the approach suggested by Board staff which identified possible decrements.

[6] EB-2011-0054, Decision and Order, December 28, 2011 p. 14.

Energy Probe described cost reductions achieved in 2009 compared to the amount approved in the previous re-basing, and submitted that the actual OM&A in 2010 and projected OM&A in 2011 are at similar levels. It submitted that this level is sustainable, based on there being no evidence of deterioration in the service quality metrics and on HHH's testimony that standard practices were maintained.

Energy Probe suggested that the Board might apply a 10% increase to the 2010 actual OM&A expenditure, based on the same reasoning the Board had used in a recent decision for Hydro One Brampton Networks Inc.[7] It noted that a larger percentage increase had been approved by the Board in a recent decision, but that in that case the Board had found that standard utility practice had been lacking during the previous period.

Board staff and intervenors all made comments on the individual cost drivers set out in HHH's evidence as being largely responsible for the OM&A increase , specifically those listed above.

Wages and Benefits

Board staff noted that the customers per employee ratio will decrease in the test year, as the growth in employee complement increases more quickly than the number of customers. Board staff also noted that the cost of benefits per employee is forecast to increase from approximately $38,000 per employee in 2010 to $46,000 in the test year, but did not suggest these elements of the increase not be approved.

VECC argued that there is no inherent reason for ratepayers to be expected to fund wage and benefit costs beyond inflation unless there is an accompanying increase in utility efficiency. VECC submitted that the evidence shows that HHH has been able to operate with fewer employees per customer and therefore compensation costs could reasonably be adjusted to something more than the level of inflation. VECC suggested an adjustment of 2.3%.

SEC submitted that HHH had made productivity gains by reorganizing and reducing OM&A during the IRM period, but would now reverse these gains. In particular, SEC submitted that HHH had not justified the additional position of Engineering Technician. Finally, SEC identified one of the studies to be done by an outside party, calculation of the actuarial cost of post-employment benefits, as a one-time cost that should be spread over the four-year IRM period.

[7] EB-2010-0132, Decision and Order, April 4, 2011, p. 23

Energy Probe submitted that HHH has not justified the increase in staff and that total employee costs for 2012 should be allowed to increase for rate setting purposes at the same rate as they did in 2010 and 2011. This would result in a reduction of $342,000.

Tree Trimming

The basis put forward by HHH for increasing the tree trimming activity and budget was the independent line clearance and tree trimming report of May 2011 prepared by a third party. HHH argued that customers have benefited from low tree trimming costs for years however now there are significant safety and reliability issues associated with encroachment prevalent throughout their system

SEC, VECC and Energy Probe all argued that HHH ratepayers should not be required to pay for the incremental tree trimming costs required to remedy under-spending during the IRM period. SEC submitted that the budget increase had not been justified by the evidence. VECC argued that the significant increase in tree trimming costs were not as a result of changing circumstances, and argument for which HHH might be justified in having the costs passed on to ratepayers and should be borne by HHH's shareholders. Energy Probe submitted that the need for tree trimming is not an activity that should require a significant change from one year to the next.

Board staff did not take issue with the expenditures noting that they were supported by the independent evaluation.

In its reply, HHH argued that a more aggressive tree-trimming program is required given that it had not kept pace with abnormally high tree growth, excessive disease and die back in recent years. HHH noted that the work and costs would be averaged over the next four years and that these are necessary expenses, driven by factors beyond HHH's control. HHH countered the intervenors arguments and stated that there is no indication on the record that HHH "underspent" on tree trimming to the benefit of its shareholder.

Smart Meters

Board staff pointed out that the OM&A requested by HHH allows for an increase in smart meter expenses over and above the increased staff complement associated with smart meters. The allowance for meter reading is higher than actual or projected costs in recent years, which Board staff suggested should be lower in the test year or at least lower by the time of the IRM period following the test year. Between these two items, Board staff submitted that OM&A should be reduced by $175,000, to an amount of $6,099,021 based on MIFRS.

HHH argued that its test year smart meter forecast is well-founded. HHH stated that it is fully implemented on smart meters, and has actual OM&A expenses that it has used to forecast the annual incremental OM&A costs associated with smart meters.

Board Findings

Intervenors have submitted that HHH should be allowed (based on CGAAP valuation) an OM&A figure for the test year in the range of $5,124,500 to $5,309,510, based either on comparisons with other proceedings or taking into account decrements to the 4 main cost drivers. The Board considers the comparisons to other proceedings to be useful to consider as a general approach. However, the Board must base its determinations on the record before it in this proceeding. The Board finds that HHH has provided adequate rationale for most of its spending requirements. However, the Board also notes that HHH's actual OM&A spending in 2008 to 2010 was significantly lower than 2008 Board approved spending. Such a pattern followed by a significant increase in the test year is a potential cause for concern.

The Board will approve OM&A spending using an envelope approach.

The Board accepts that tree trimming has been under funded and notes that HHH will amortize the program and costs over 4 years. The Board accepts the need and the costs that have been validated by a 3rd party whose findings have not been disputed by intervenors. However, the Board agrees with intervenors that ratepayers should not be required to pay for the entire deferred incremental tree trimming costs necessary to remedy the under-funded budget during the IRM term, particularly when overall OM&A spending during the IRM period has been lower than the 2008 Board approved level.

HHH submitted that its wages and benefits have also been under funded for the past few years and must be increased. The Board notes that HHH held off on hiring additional staff however, the evidence indicates that some of the 2008 approved budget could have funded those additions.

Given the adjustments outlined above and accounting for growth in the customer forecast, the Board has determined that the forecast OM&A envelope will be $5.9 M. This is based on a sharing of 2.5% year over year escalation of 2008 approved levels notwithstanding the lower actual expenditures levels during the IRM period. This figure also includes the provision for $286k in MIFRS transition costs which the Board finds is beyond HHH's control and was uncontested.

The Board will not direct specific spending cuts, as these are matters for HHH to manage within the spending envelope approved by the Board. The Board expects that HHH will be able to prioritize its business activities and implement planned spending within the envelope approved.

LONG TERM DEBT RATE

The proportion of long term debt in determining the cost of capital is included in the Partial Agreement, at 56% of total capital. Proportions for short term debt and equity were also settled, at 4% and 40% respectively. The cost of capital parameters are settled for short-term debt and equity at the rates established in the Board's letter to distributors and intervenors dated March 2, 2012.

The parties agreed on the capital structure proposed by HHH with the exception of the long-term debt rate. HHH proposes that its long term debt rate be set at the Board's deemed rate for long-term debt in the same letter, which is 4.41%. Intervenors suggest that the rate should be set at 3.85% and Board Staff suggests the rate be set at 3.96%.

The current amount of debt outstanding under a Promissory Note is $16,141,970 held by its affiliate, the Town of Halton Hills. This is in the form of a five year renewable loan due in 2015. No party disputed the use of the Board's deemed rate of 4.41% with respect to this instrument.

During the proceeding, HHH indicated that it has periodically looked to sources of debt from 3rd party lenders, namely TD Commercial Banking ("TD Bank") and Infrastructure Ontario.

HHH has a one year term loan due in August 2012 with TD Bank with principal at $3.9 million. HHH indicated that given the term and despite that it is being used in part to finance smart meters, a capital asset, this loan is not considered to be long term debt. This loan bears an interest rate of prime plus 1.4%, or 2.13%. HHH expects to renegotiate this loan with TD Bank, for an as-yet unspecified term. HHH has received estimates from TD Bank for a long term (5 years and more) rate in the range of 3.9% to 4.08% depending on the term.

HHH also indicated that it may seek an additional $5 million financing in the test year to be drawn down in tranches to correspond with HHH's capital program. HHH stated that it would consider all possible financing options. HHH stated that it has not yet determined where the financing would be placed, or its associated terms, conditions and rates. HHH submitted that the quantum of the loan amount is based on inclusion of the $1.4 million expenditure on the GEI. HHH identified the current posted rates from Infrastructure Ontario to be from 2.52 % (5 year) to 4.29% (40 year).

HHH indicated its expectation that current interest rates will rise in the short to medium term and argued that the Board's deemed rate represents a prudent level for all its debt.

Board staff and intervenors submit that HHH has overestimated the appropriate long-term debt rate that should be used in the calculation of the revenue requirement.

Board staff proposed that the long term debt rate should be a weighted average of four components of debt outlined by HHH, as follows:

- $16.1 million at deemed rate of 4.41% for a full year
- $2.2 million at actual rate of 2.13% for 2/3 of the year
- $2.2 million at 3.96% for 1/3 of the year
- $5.0 million at 3.96% for ½ of the year.

The dollar weightings are debt held by HHH's affiliate ($16.1 million), existing debt of $3.9 million less $1.7 million to be designated as short-term (or $2.2 million), and prospective new debt contracted during 2012. The rate 2.13% is the rate on existing debt and 3.96% is a rate in the mid-range of several rates that have been quoted to HHH. Board staff proposed the partial year weightings to reflect assumptions about when debt instruments will be renewed or issued, however Board staff argued that this was somewhat unclear in the evidence.

Energy Probe's submissions on long term debt were supported by SEC and VECC. The main argument of intervenors is that consistent with "*The Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*", the onus is on the applicant to forecast the amount and cost of long-term debt in the test year.

Energy Probe agreed that HHH's estimate of the $5 million financing requirements was reasonable given the company's 2012 capital requirements and that this amount should be treated as long term debt. Energy Probe, however did not agree that the rate used should be the Board's long term debt as it does not reflect the most recent evidence provided in the proceeding. Energy Probe also argued that given the $5 million will be drawn down in tranches that the average amount, or $2.5 million, should be included in the calculation of long term debt. This figure matches with the result of the methodology that incorporates the capital expenditures into rate base, being the average of the opening and closing balances. Given that the most recent rate on the record of this proceeding for a 5 year term loan from Infrastructure Ontario is 2.52% and that HHH has confirmed that it can still get a lower rate from TD Commercial Bank, Energy Probe submitted that the rate of 2.52% should be the ceiling on the rate used for this loan in the calculation of the overall long term debt cost.[8]

Energy Probe argued that in absence of evidence from HHH on how it will replace its $3.9 million loan with TD Bank, the simplest approach to setting a rate is to assume that a prime based loan, currently at 3.00% would be continued for the last four months of 2012. Based on the 3.00% for four months and the 2.13% that is in place for the first eight months, the weighted average rate that should be applied to the principal of $3.9 million would be 2.42%. This is comparable to the 2.52% ceiling on what HHH has indicated it can borrow the $5 million from the TD Commercial Bank to finance its 2012 capital expenditures.

Energy Probe also argued that the loan is being used to finance specific long-term assets. Energy Probe stated that the agreement is a multi-year agreement entered into in December 2009 and consists of three types of credit and borrowing options: an operating loan, an interim demand loan and the committed term facility, which was to be used to take out the interim demand loan that was used to finance the smart meter assets. In other words, Energy Probe argues, the one year committed term facility was the last year of a multi-year loan agreement to finance smart meters. Energy Probe argued that the Board should consider at least the replacement loan as long term debt.

Energy Probe proposed a weighted average rate of four components, equal to 3.85%, which was adopted by the other intervenors.

- $16.1 million at deemed rate of 4.41% for the full year
- $3.9 million at 2.42% (based on 2.13% for 2/3 of the year and 3.00% for 1/3 of the year)
- $2.5 million at 2.52% for the full year

HHH suggested in its Reply Argument that it had no good basis for forecasting the term or rate associated with its $5m loan. HHH indicated intervenors' failure to recognize that its borrowing requirements would be decreased in the event that the Board does not approve the GEI proposal. HHH indicated that it does not expect to be in a good position to forecast its test year loan parameters until its audited financials are prepared and the decision in this case is rendered. It will then have a better financial picture of the utility upon which to base financing decisions.

[8] *Argument in Chief* of Halton Hills HydroInc. at para 30

HHH indicated that Energy Probe was incorrect in its argument that the current one year smart meter loan is the last year of a multi year loan agreement but rather a separate one year loan.

Board Findings

There is no dispute that the $16.1 million Promissory Note held by the Town should be calculated at the Board's deemed rate of 4.41%.

The Board accepts that the $3.9 million smart meter loan is the last year of a multi year loan agreement rather than a separate one year loan. As such and despite the fact that the loan was used to finance a capital asset the Board will set the rate at 2.13% until August 2012. The Board will consider the renegotiation of the loan to be at a long term. "*The Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*", is clear that the onus is on the applicant to forecast the amount and cost of long-term debt in the test year. HHH has provided evidence from both TD Bank and Infrastructure Ontario. As noted above, HHH has received estimates from TD Bank for a long term (5 years and more) rate in the range of 3.9% to 4.08% depending on the term and confirmed the current posted rates from Infrastructure Ontario to be from 2.52 % (5 year) to 4.29% (40 year).

In the absence of further refinement of HHH's estimates the Board is of the view that it is appropriate to use 3.96%, the midpoint of the ranges provided, for the refinancing of HHHs smart meter loan.

The Board is also of the view that HHH will likely be able to negotiate its test year loan on similar consideration as the refinancing of its smart meter loan and will set the rate at 3.96% for the purposes of calculating the weighted average rate for long term debt. The Board finds that it is appropriate to apply a weighted average of long term debt rates as proposed by Board Staff, with an adjustment to the new $5 million in debt as this will not be required to finance the GEI project. As it is unclear how much of the new debt will be required, the Board will weight that component at $4 million.

The Board does not accept the argument put forward by Energy Probe that the prime rate of 3.00% should be used. There is no evidence that rate is available for long term debt. The Board accepts the evidence of HHH of the range of rates likely available to it from TD Bank or Infrastructure Ontario, and agrees with Board Staff that a reasonable approach is to take the mid-range.

The Board therefore calculates that the weighted average rate for long-term debt will be approximately 4.21% on the basis of the following calculation:

- $16.1 million at deemed rate of 4.41% for the full year
- $2.2 million at actual rate of 2.13% for 2/3 of the year
- $2.2 million at 3.96% for 1/3 of the year
- $4.0 million at 3.96% for ½ of the year.

DISPOSAL OF GROUP 1 & GROUP 2 DEFERRAL AND VARIANCE ACCOUNT BALANCES ("DVA")

Quantum of DVA Balances

The original total DVA amount requested was a debit of $627,940 (i.e. an amount to be recovered from ratepayers).

HHH requested that Account 1521, Special Purpose Charge Variance Account should be continued, and requested disposition of the account after the balance had been audited. It proposed that it would apply for disposition along with its 2013 IRM application. In its response to Board staff interrogatory # 44 (d), HHH indicated that if the Board will allow disposition of an unaudited balance, it would include the balance of Account 1521 in its request for DVA disposition.

The table below shows the deferral and variance account balances. The balances include the principal as of December 31, 2010 and interest amounts up to April 30, 2012 for Group 1 and Group 2 DVA Accounts.

Account Name	**Account Number**	**Principal Balance** (A)	**Interest Balance** (B)	**Total Claim** C (=A+B)
Group 1 LV Variance Account	1550	($613,274)	($13,534)	($626,808)
RSVA, Wholesale Service Charge	1580	($503,791)	($130,003)	($633,794)
RSVA, Retail Transmission Network Charge	1584	$601,339	($238,494)	$362,845
RSVA, Retail Transmission Connection Charge	1586	$517,827	($186,920)	$330,907

RSVA, Power (Excluding Global Adjustment)	1588	($473,530)	($440,300)	($913,830)
RSVA, sub account Global Adjustment	1588	$2,249,396	$54,258	$2,303,654
Recovery of Regulatory Asset Balances	1590	($48,428)	$116,101	$67,673

Group 2 Other Regulatory Assets-Sub acct. Incremental Capital charges	1508	$147,776	($72,501)	$75,275
Other Regulatory Assets-Sub account Other	1508	$167,838	$15,047	$182,885
Retail Cost Variance Account-Retail	1518	($30,746)	($672)	($31,418)
Miscellaneous Deferred Debits	1525	$13,015	($4,831)	$8,184
Retail Cost Variance Account-STR	1548	$3,788	($1,400)	$2,388
Deferred Payments In Lieu of Taxes	1562	($420,641)	($79,381)	($500,022)
SUB-TOTAL (including Group 1)				$627,940

With clarification of the date of the principal balance and carrying charges, it was established that there is a credit balance of $15,513 in Account 1521. The updated DVA total requested by HHH is therefore a debit of $612,426[9]. The $612,426 was the most updated total DVA balance submitted by HHH prior to the February 29, 2012 Partial Agreement approved by the Board.

[9] Appendix OEB 2-A, IRR Supplemental Board staff #72, January 24, 2012

Account Name	Account Number	Forecasted Principal Balance at December 31, 2011	Forecasted Interest Balance at April 30, 2012	Total Claim
Special Purpose Charge Variance Account	1521	($16,237)	$724	($15,513)
Sub-Total from Group 1 and Group 2				$627,940
TOTAL				$612,426

DVA Rate Riders

HHH proposed that the DVA balance be disposed over two years. The period for disposition of the balances was not included in the Partial Agreement. As a result, the rate riders for the respective classes are also not settled.

Board staff submitted that Board policy is to dispose over one year, unless there is a reason to deviate from this standard. Board staff noted that HHH had proposed a longer period to decrease customer bill impacts. Board staff supported the two-year request.

Energy Probe supported a 2 year recovery if the approved amortization period for the PP&E Deferral Account was to be 4 years. If, however, the Board determines that HHH should be allowed to amortize the PP&E deferral account over 20 years, then Energy Probe argued that the clearance of deferral and variance accounts should be extended to 4 years. This would have the impact of smoothing the amounts to be recovered from ratepayers and reduce rate volatility. Energy Probe concluded that it would also be consistent with the length of recovery associated with the smart and stranded meter costs.

SEC and VECC did not make submissions on this issue.

Board Findings

The Partial Agreement did not specifically include any consideration of disposition of the balance in account 1521, Special Purpose Charge.

The Board will not approve the continuation of Account 1521. The Special Purpose Charge Assessment ("SPC") Variance Account was approved 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 were required to apply no later than April 15, 2012 for an order authorizing the disposition of any residual balance in sub-account 2010 SPC Assessment Variance. The Filing Requirements states 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.

The Board authorizes the disposition of Account 1521 as of December 31, 2010, plus the amounts recovered from customers in 2011, including interest, because the account balance does not require a prudence review, and electricity distributors are required by regulation to apply for disposition of this account. The Board will approve the disposition of a credit balance of $15,514 in Account 1521 on a final basis, representing principal balance plus carrying costs until April 30, 2012. The Board approves a two year disposition period. The Board directs HHH to close Account 1521 effective May 1, 2012.

For accounting and reporting purposes, all account balances approved for disposition in this proceeding 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*. This entry should be completed on a timely basis to ensure that these adjustments are included in the RRR data as soon as possible. .

The Board agrees with HHH that given the rate impacts associated with this rate application, a four-year clearance period is unnecessary. The Board will approve the clearance of HHH's DVA amounts over 24 months.

EFFECTIVE DATE

HHH's existing distribution rates were declared interim, effective May 1, 2012, in Procedural Order No. 5 and Interim Rate Order, issued March 26, 2012. The application received by the Board requested that the effective date for new rates would be May 1, 2012. The effective date of new rates was not identified as an issue in the proceeding and is not listed in the Partial Agreement. No party submitted an argument that the effective date should be other than the requested date.

The Board approves an effective date of May 1, 2012 and an implementation date of July 1, 2012.

IMPLEMENTATION OF RATES

The Board directs HHH to reflect the terms of the approved Partial Agreement and this Decision in its Draft Rate Order. The Board expects HHH to file detailed supporting material, including all relevant calculations showing the impact of the implementation of the approved Partial Agreement and this Decision on its proposed Revenue Requirement, the allocation of the approved Revenue Requirement to the classes, and the determination of the final rates, including bill impacts. The Board expects that HHH will provide rate riders, to be applied over the remaining ten months of the rate year, to compensate for the difference between final rates and the interim rates that will have been charged for two months following the effective date of May 1, 2012. HHH is also expected to provide detailed calculations of any revisions to the rate riders or rate adders reflecting the approved Partial Agreement and this Decision. Supporting documentation shall include, but not be limited to, the filing of a completed version of the Revenue Requirement Work Form excel spreadsheet which can be found on the Board's website.

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

THE BOARD ORDERS THAT:

1. HHH shall file with the Board, and forward to the intervenors, a Draft Rate Order attaching a proposed Tariff of Rates and Charges and other filings reflecting the Board's findings in this Decision and Order on or before June 20, 2012

2. Intervenors and Board staff shall file any comments on the Draft Rate Order with the Board and forward to HHH within three business days of the date on which HHH files the Draft Rate Order.

3. HHH shall file with the Board and forward to intervenors, responses to any comments on its Draft Rate Order on or within two business days of the date on which the comments of intervenors and Board staff are filed.

Cost Awards

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. The Board will determine such cost awards in accordance with its *Practice Direction on Cost Awards*. When determining the amounts of the cost awards, the Board will apply the principles set out in section 5 of the Board's *Practice Direction on Cost Awards*. The maximal hourly rate set out in the Board's Cost Awards Tariff will also be applied.

A cost awards decision will be issued after the following steps have been completed:

1. Intervenors found eligible for cost awards shall file with the Board, and forward to HHH, their respective cost claims within 7 days from the date of the Board's Rate Order.
2. HHH shall file with the Board and forward to intervenors any objections to the claimed costs within 14 days from the date of the Board's Rate Order.
3. Intervenors shall file with the Board and forward to HHH any responses to any objections for cost claims within 21 days of the date of the Board's Rate Order.

HHH shall pay the Board's costs incidental to this proceeding.

All filings to the Board must quote file number **EB-2011-0271,** 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 the address below. 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 7 paper copies.

DATED at Toronto, June 14, 2012

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary