

ONTARIO ENERGY BOARD

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| FILE NO.: | EB‑2013-0116 |  |
| VOLUME:  DATE:  BEFORE: | 2  April 30, 2014  Christine Long  Cathy Spoel | Presiding Member  Member |

EB-2013-0116

THE ONTARIO ENERGY BOARD

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

**AND IN THE MATTER OF** an Application by Cambridge and North Dumfries Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2014.

Hearing held at 2300 Yonge Street,

25th Floor, Toronto, Ontario,

on Wednesday, April 30th, 2014,

commencing at 9:37 a.m.

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VOLUME 2

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BEFORE:

CHRISTINE LONG Presiding Member

CATHY SPOEL Member

MAUREEN HELT Board Counsel

CHRISTIE CLARK Board Staff

JOHN VELLONE Cambridge and North Dumfries Hydro

BRUCE BACON Inc.

JAMES LITTLE

RANDY AIKEN Energy Probe Research Foundation

DAVID MacINTOSH

JAY SHEPHERD School Energy Coalition (SEC)

MICHAEL JANIGAN Vulnerable Energy Consumers' Coalition (VECC)

ALSO PRESENT:

JANE HALE McDONALD Cambridge and North Dumfries Hydro Inc.

[--- On commencing at 9:37 a.m. 1](#_Toc386622464)

[Preliminary Matters 1](#_Toc386622465)

[Final Argument by Mr. Vellone 2](#_Toc386622466)

[1. Context 3](#_Toc386622467)

[Customer Focus 8](#_Toc386622468)

[Operational Effectiveness 10](#_Toc386622469)

[Public Policy Responsiveness 15](#_Toc386622470)

[Financial Performance 16](#_Toc386622471)

[2. Long Term Debt Cost 19](#_Toc386622472)

[3. Other Income - Interest Components 22](#_Toc386622473)

[4. Rate Design G5750 Class 24](#_Toc386622474)

[5. Removal Costs 28](#_Toc386622475)

[--- Whereupon the hearing concluded at 10:30 a.m. 34](#_Toc386622476)

NO EXHIBITS WERE FILED IN THIS PROCEEDING.

NO UNDERTAKINGS WERE FILED IN THIS PROCEEDING.

Wednesday, April 30, 2014

### --- On commencing at 9:37 a.m.

MS. LONG: Good morning, everyone. Good morning, Mr. Vellone, witness panel. Nice to see you're here again today. Ms. Helt.

# Preliminary Matters:

Mr. Vellone, a preliminary matter. I'm wondering if you're able to advise the Board as to when we can expect answers to undertakings that were given yesterday.

MR. VELLONE: Absolutely. So I've had an opportunity to confer with my client, and can confirm that they are going to provide all of the undertaking responses by this Friday; that is, May 2.

I would note that Undertaking J1.8 is being provided on a best-efforts basis, and so that's the one caveat I would put out there.

MS. LONG: Okay. Then given that, our schedule will stand as it is, that you will file those undertakings by Friday, May the 2nd. Board Staff's argument will be due on the 8th of May, with intervenors' argument due the 12th of May, and Mr. Vellone, your reply will be due on May the 26th.

MR. VELLONE: Thank you.

MS. LONG: Are there any other preliminary matters that you have this morning?

MR. VELLONE: No, I do not.

MS. LONG: Okay. Then we'll ask you to proceed with your argument.

# Final Argument by Mr. Vellone:

MR. VELLONE: Thank you, Madam Chair, Panel members. Good morning.

Before I begin my argument-in-chief I do want to say -- just give a thank-you to our articling student, James Little, who I think has been doing an excellent job navigating us through the digital evidence in this proceeding.

MS. LONG: Yes, Mr. Little, we appreciate all your assistance yesterday. Thank you.

MR. VELLONE: Thank you, James.

On behalf of Cambridge and North Dumfries Hydro, which I may refer to alternatively as the applicant, CND, or Cambridge through my submissions, I'm pleased to present this oral argument-in-chief in respect of an application filed by CND under section 78 of the Ontario Energy Board Act, seeking approval for changes to the rates that CND charges for electricity distribution to be effective May 1, 2014.

Yes, application was assigned Board file number EB-2013-0116, and I think there may actually be a typo in the transcript from yesterday at page 1, line 11 which we might want to correct, and on April 2nd, 2014 CND filed with this Board a settlement proposal which represented a partial settlement of the issues in this proceeding.

At the commencement of the oral hearing I had an opportunity to walk you through that settlement and answer questions that you had, and after the break I understand that the Panel has accepted the partial settlement in respect of all the completely settled and partially settled issues.

As a result I'll limit my comments today on the five outstanding areas of dispute. I realize we've spoken about these five areas before, but just for the sake of clarity and for the benefit of the transcript I will walk through them again one more time now.

First, the parties did not agree that the applicant's proposed OM&A costs for the test year are appropriate. Second, the parties did not agree that the applicant's proposed long-term debt cost for the test year is appropriate. Third, the parties did not agree that the applicant's proposed other revenues derived from interest income for the test year is appropriate. Fourth, the parties did not agree that the applicant's proposed fixed and variable split for the GS greater than 50 class is appropriate. And fifth, the parties did not agree on the proper accounting treatment for removal costs in the test year and, related to that, the parties also did not agree to the inclusion of removal costs in Account 1576 during the historic period.

# 1. Context

Before I move into my discussions on each of these areas of dispute I would like to briefly set the context for the application. Specifically, CND is amongst the first LDCs to file a rebasing application under the Board's fourth-generation incentive regulation mechanism, pursuant to the Board's renewed regulatory framework for electricity distributors, which I will refer to throughout my submissions as the RRFE.

CND is, I believe, the first LDC to proceed to an oral hearing under the RRFE, so I think it does merit to spend some time on this upfront, and I would like to refer to at first the report of the Board dated October 18th, 2012 in respect of the RRFE. And I think James has that up on the screen in front of you.

And just reading from the second full paragraph on that page:

"The renewed regulatory framework is a comprehensive, performance-based approach to regulation that is based on the achievement of outcomes that ensure that Ontario's electricity system provides value for money for customers. The Board believes that emphasizing results rather than activities will better respond to customer preferences and enhanced distributor productivity and promote innovation."

The Board then goes on to list its four core RRFE outcomes, and it is in this context that CND prepared an application that had as a core focus these four key elements of the RRFE.

First, the application has an emphasis on customer focus and responding to customer preferences. Second, the application includes an emphasis on operational effectiveness and continuous improvement. Third, the application demonstrates public-policy responsiveness and delivering on obligations mandated by government. And fourth, the application demonstrates financial viability and shows sustainable savings from operational effectiveness initiatives.

Throughout my submissions today I will address each of these four elements of the RRFE, with specific reference to the evidence in this application. However, CND submits that in making its determination in this proceeding the Panel should take into consideration the fact that this is a transition year.

Specifically, I would refer the Panel to Procedural Order No. 2 in the Orangeville Hydro proceeding, EB-2013-0160, where at page 3 of that procedural order that Board panel stated, and I quote:

"However, in conducting this proceeding and making its decision the Board will take into consideration the fact that this is a transition year."

Now, it is my understanding that this panel did make reference to this procedural order when adopting the approved issues list in this proceeding, and our submission is simply that this Panel consider taking a similar approach, as was stated by that panel in that proceeding.

It is consistent with the applicant's December 19th letter of comment on the draft issues list in this proceeding. It is also consistent with the settlement proposal that was filed, where at page 5 the parties state, and I quote:

"The parties recognize that the application is among the first to be filed under the RRFE. The parties further recognize that this is a transition year. The parties have taken these facts into consideration when developing the settlement proposal."

I would also note that Board Staff referenced this fact when providing their submissions in support of the settlement proposal.

I would like to now move to the first of the five areas of dispute, specifically OM&A. The parties are not in agreement on the applicant's proposed OM&A for the test year are appropriate. CND is requesting in 2014 an OM&A amount after all adjustments of $15,033,322.

At the start of this oral hearing you heard from Mr. Ian Miles, president and CEO of CND. Mr. Miles acknowledged at the outset of the discussion that CND's OM&A costs are increasing. He specifically pointed this Panel to Exhibit 4 of the application, which shows the year-over-year changes in OM&A. A variety of intervenors have explored this theme further in their cross-examinations yesterday.

The balancing -- the balance of Mr. Miles' opening remarks focused on setting out the key drivers for those increases in OM&A. Those drivers include many that are common to other LDCs in the industry, such as the introduction of smart meters and time-of-use pricing, new regulatory requirements arising out of the Green Energy Act and the lead program, regulatory and IFRS-driven accounting changes, rising wage and benefit costs, and the hiring of certain positions related to succession planning.

What I wanted to say is that the quantitative impacts of all of the key OM&A drivers, including the ones that I just listed, are described in considerable detail in the evidence at Exhibit 4, tab 2, schedule 1 of the application.

It's not my intent to go through each of those key drivers now. Rather, I would like to focus on some of the additional drivers that Mr. Miles identified in his evidence in-chief which are specific to CND.

In doing so, Mr. Miles walked you through the specific business planning processes that CND as an organization undertook in the fall of 2012. The process included a corporate risk assessment, which has been filed on the evidence in this proceeding in response to 1.1, SEC 3.

In summary, it illustrates a well-documented approach to identifying key risks, mitigation strategies, and in circumstances where those mitigation strategies were found not to be adequate solutions were proposed.

Based on this, Mr. Miles walked you through what he felt were some of the key priorities which arose for CND as a result of this process.

These included addressing inadequate resourcing in the IT department, addressing inadequate control room resourcing, and cessation planning.

It is also worth noting that this 2012 risk assessment formed an input into the comprehensive strategic planning work undertaken by CND in 2012 that is described further in the evidence at Exhibit 1, tab 4, schedule 1, really starting at the bottom of page one.

There were a number of inputs into this formal process, including input from staff, management, the board of directors, and an effort to reflect customer preferences. The results of this effort included a five-year strategic plan, which is available at Exhibit 1, appendix 1-6A, as well as a new vision, mission and core values, which are described more fully at Exhibit 1, tab 4, schedule 1, starting at page 2.

Flipping forward perhaps to page three of this same schedule, I did find it helpful that CND took the time to explain how its vision, mission, and core values align directly with the Board's RRFE objectives. It says to me that the management of CND understands the Board's performance-based approach under the RRFE, and that they are consciously managing their utility to meet those specified objectives.

And perhaps now is as good a time as any to speak to the four RRFE objectives, and reference the evidence and what has to say for them.

# Customer Focus

First, in respect of customer focus and responding to customer preferences, I previously mentioned this, but Cambridge considered customer preferences as a key input into their corporate risk assessment and strategic processes, which is documented at Exhibit 1, tab 4, and schedule 1 of the application.

In addition to this, Cambridge also describes its customer engagement activities at Exhibit 1, tab 5, schedule 1, and these activities include formal surveys conducted by a third party research organization, the results of which are attached to the application as appendix 1-1A and 1-1B to Exhibit 1, tab 5, schedule 1, as well as collecting informal feedback from customers based on employee interactions and other media channels, including social media.

In addition, in response to 1.2 Staff 3, Cambridge identified several other elements of their customer engagement activities. This included holding a pre-application meeting with the intervenors and Board Staff, initiating a commercial, industrial, and institutional customer survey, inviting CND's largest commercial customer to a board of directors' meeting, and enhancing the CND corporate website.

In response to part (b) of this same interrogatory, CND highlights how it is implemented formal policies and procedures to facilitate customer engagement, increase interactions with customers, and obtain feedback with respect to customer satisfaction levels, needs and preferences.

CND has also demonstrated its efforts to further improve its capacity, to solicit and understand customer feedback and preferences. Specifically, in 2013 CND hired a communications manager in recognition of the importance of customer feedback will play in this new RRFE environment.

Also in 2013, CND developed a corporate communication strategy and tactical plan, which is on the evidence in this proceeding at Exhibit 1, appendix 1-2.

Finally, it is worth noting that this customer focus has resulted in incremental costs of about $115,000 per year, as detailed in the evidence in response to 1.2 SEC 7. In addition, a focus on customer preferences has driven a number of capital and OM&A initiatives, which are detailed in response to 3.1 Staff 6, and 3.1 Staff 8.

In this context, it's the applicant's submission that the customer engagement activities undertaken by the applicant are commensurate with the approvals requested in the application. And further, it's the applicant's submission that the applicant's proposed capital expenditures and operating expenses are appropriately reflective of customer feedback and preferences.

# Operational Effectiveness

Moving on to the second of the RRFE objectives, an emphasis on operational effectiveness and continuous improvement, I want to start briefly just to mention the objectives the applicant has set for its OM&A activities. And these are set out in response to 4.2, SEC 30, where the applicant makes the observation that its OM&A objectives are the same as its corporate mission, vision and strategic imperatives, which I've already walked you through and which were derived through a well-documented and detailed risk assessment and strategic planning process.

Moving from objectives to specific initiatives, my friend, Mr. Shepherd, walked the witnesses through a fair number of these operational effectiveness initiatives yesterday. In addition to that, I would bring the Board Panel's attention to the response to 6.2 Energy Probe 18, which provides a summary of the operational effectiveness initiatives undertaken, or yet to be undertaken by the applicant in the test year.

At the outset of this interrogatory response, CND describes how it has interpreted the term "operational effectiveness initiatives" for the purposes of answering the question. We do believe definitional clarity is important in this regard.

CND then goes on for several pages to list these operational effectiveness initiatives. In summary, they include various IT-related initiatives, including several customer-focused initiatives, such as home connect and bill connect, an electronic document management system which will be used to capture, store, and provide locate information using flow automated work flow processing, an outage management system and distribution management system which will enable quicker determination of outage causes, improving response and restoration times, as well as providing more detailed information to customers on power outage situations, as well as the use of virtualization technologies to reduce the requirement for additional server hardware and associated licensing resulting in approximately one million dollars in avoided costs.

I would like to stop on that one, particularly to address a comment that my friend made yesterday, just simply to observe that just because a particular operational effectiveness initiative has such a compelling value proposition that other organizations will likely pick it up as well does not mean that it's not the right thing for this utility to do, nor does it mean it's not something we should be drawing the Board's attention to in the evidence.

In addition to these IT initiatives, the applicant has also undertaken various business process initiatives, including the outsourcing and bill printing and mailing functions, as well as hiring a third party to review CND's work flow management processes to identify specific improvements. A copy of that specific report was filed on the evidence in this proceeding, and my friend actually made reference to it during his cross-examination yesterday.

In addition to these, CND has actively engaged in collaboration with other utilities, such as through the GridSmartCity initiative, which recently resulted in direct savings in terms of a 16 percent reduction in benefit costs, which reduction is now being proposed to flow directly to the benefit of ratepayers, as detailed in response to interrogatory 7.4 VECC 32.

In addition to this, the applicant is also undertaking numerous improvements to the distribution system, including continued investment in remotely operable SCADA switches, which will remove the requirement to send employees out to manually operate those switches, as well as the acquisition of GPS surveillance technology, which will greatly reduce the manual required for those efforts, amongst various other initiatives.

Finally, the applicant identified that it is leveraging use of smart meters and AI for variety of purposes, including reducing meter-reading expenses.

In this context, CND concludes its response to the interrogatories by stating that the operational efficiencies it has identified are both sustainable and reflected in the application. CND further commits to undertaking future initiatives, with a focus on minimizing future cost increases and, to the extent possible, achieving future cost savings.

Given this, it is our submission that Cambridge’s proposed OM&A expenses are clearly driven by appropriate objectives, and do show continuous improvement in cost performance.

The real challenge here is that the cost drivers are currently outpacing the benefits seen from these operational effectiveness initiatives, resulting in a net rate increase in the test year.

However, that fact in and of itself does not negate the fact that the applicant is undertaking a variety of very good operational effectiveness initiatives which are otherwise making the costs lower than what they would otherwise have been.

Finally, I would conclude that the applicant has adequately demonstrated that the savings resulting from its operational effectiveness initiatives are sustainable. They confirmed as much expressly in response to 6.2 Energy Probe 18(c), and it is apparent when the Panel considers each of the operational effectiveness initiatives on its merits.

MS. LONG: Mr. Vellone, I don't want to interrupt your flow, but I do have a question about something that you've said. Is it your position that these initiatives that are being undertaken now are currently resulting in savings, or are you saying that this is something that's going to be realized further down the road, that there will be future savings? I wasn't quite sure with what you were -- what you were stating with respect to the timing of those savings.

MR. VELLONE: Sure. I would say it depends on the specific initiative you're looking to. To the extent that the initiatives are currently resulting in savings, those have been expressly quantified and identified in the application, so a good one is the virtualization efforts that are undertaken by the applicant, as well as the savings in meter-reading costs as a result of the use of the smart-meter data. Those savings are quantified.

Other savings are going to happen in the future. Some of the initiatives haven't even yet been implemented. What's important, I think, is that directionally as a result of these initiatives costs will go down, workers will be freed up to do other tasks, and ratepayers at the end of the day will benefit.

MS. LONG: Thank you for that.

# Public Policy Responsiveness

MR. VELLONE: I would like to move on to the third RRFE outcome, demonstrating public policy responsiveness and delivering on obligations mandated by government, and I would note specifically in respect of this outcome that the settlement proposal in respect of issue 5.1, all of the parties agreed that the applicant's proposals meet obligations mandated by government in areas such as renewable energy and smart meters and the other government-mandated obligations.

The parties did not agree on the proposed OM&A budget, so I'll limit my comments to that respect.

In response to part (a) of 5.1 Energy Probe 17, CND provided a detailed list of the obligations that have been mandated between 2010 and 2014. This list is not intended to be exhaustive. But as you read through it, it becomes less and less surprising that Cambridge has identified new regulatory requirements as one of its key OM&A cost drivers.

In response to part (b) of 5.1 Energy Probe 17, CND goes on to detail how it has taken steps to meet each of these mandated obligations.

And finally, in response to 5.1 VECC 19, CND provides a summary of those identifiable incremental costs associated with meeting these obligations.

I say identifiable because CND was not able to specifically quantify all of the ongoing costs associated with each of these obligations. Rather, they answered the interrogatory as best they could, given the information that they had.

# Financial Performance

I would like to move on now to the fourth RRFE outcome. That is demonstrating financial viability. And I would note in respect of this outcome that I've already spoken to the sustainability of savings arising out of operational effectiveness initiatives, so I'll limit my comments here on specifically financial viability.

And in this regard I would note that the applicant has recently filed its 2013 audited financial statements in response to 7.1 SEC 40, and I would also note that the applicant has provided evidence of its key financial ratios using the Board's proposed form of balanced scorecard.

An undated copy of that form is found in response to 2.1 Staff 5, and looking at the financial measures as they relate to this RRFE outcome in respect of liquidity, the scorecard notes that CND's current ratio was 3.0 in 2012, and the trend is improving.

In respect of leverage, the total debt-to-equity ratio was 0.59 in 2012, and again, the trend is improving.

And finally, on profitability, CND earned within 300 basis points of the Board's allowed ROE in all years except 2009. And while the trend is declining, if you take a close look at the numbers you will see that past actuals have all been very close to the allowable ROE in all years except 2009, and I'm not sure the trend information is all that helpful in that circumstance.

In this context it is our submission that the applicant's proposed rates allow it to meet its obligations to customers while maintaining its financial viability.

And finally, I would also like to speak briefly to benchmarking. During cross-examination yesterday my friend made reference to a paid comparison on distributors' total cost to the PEG model's cost prediction in its November 21st, 2013 report, which was updated December 19th, 2013 and again on January 24th, 2014.

In this analysis at Table 17 PEG found that CND's average historic costs between 2010 and 2012 is lower; that is, 7 percent less than PEG's model's prediction. With an average cost of 7 percent below PEG's model prediction, CND is ranked twenty-eighth by PEG in their econometric benchmarking of the 73 LDCs that participated in the studies. The results speak for themselves.

This is why CND was assigned to Group 3 by the Board, and will result in a stretch factor which will apply for the balance of the IRM term.

That is performance across the province. What about in the region? The applicant included just such a comparison in Exhibit 1, tab 4, schedule 1, pages 9 and 10, in comparing Cambridge with its neighbours, Waterloo, Kitchener, and Guelph. Specifically, at table 1-2 provides a comparison of proposed rates with neighbouring LDCs for both the residential and GS less than 50 customer classes.

This particular comparison was expanded to include the GS greater than 50 class in response to 2.1 SEC 15. And the conclusion is that, even after the proposed rate increase in the application, CND's rates remain comparable to that of each of its neighbours.

While this is a fairly high-level comparison, CND also engaged in a more detailed benchmarking analysis for many aspects of its proposed OM&A budget. My friend touched on one of these areas of analysis in respect of FTE benchmarking during his cross-examination yesterday.

In addition, I would refer you to the response to 2.1 SEC 12, which details all the ways in which benchmarking evidence was considered by CND in preparing its application.

It's my observation that this type of analysis formed a key part of the CND risk assessment and strategic review, it helped CND identify some of the key gaps that it is currently trying to address in this application, and it formed a key input into its proposed OM&A budget.

Given this, CND submits it is clear that its performance in the area of benchmarking supports the application.

And while I'm on issue 2.1, I probably should cover off the balance of the areas covered in that issue, specifically by noting that it is the applicant's view that there are no Board-approved plans from 2010, the 2010 cost-of-service decision, therefore that aspect of issue 2.1 is not applicable, and that the evidence in respect of the applicant's performance in the areas of reliability and service quality does support the application as filed.

Specifically, I would refer the Board to 2.1 Staff 4 and 2.1 Staff 5, the latter of which is the scorecard which I already spoke to. And when you look at the scorecard outcomes on reliability and service quality, it's worth noting that, while service-quality measures have exceeded industry targets, the reliability performance is trending negatively. This is consistent with the proposed OM&A and capital spending in the application before the Panel.

# 2. Long Term Debt Cost

I would like to move now to the second area of dispute; that is, cost of capital, the long-term debt component. The parties are not in agreement that the applicant's proposed long-term debt costs in their test year are appropriate, and in making your determination, I would draw the Board's attention to Exhibit 5, tab 2, schedules 1 and 2 of the application.

However, I want to note at the outset that CND acknowledges that it did make two errors in the original application when calculating the cost of long-term debt. First, CND used the actual debt rate for affiliate debt that is payable on demand by the lender, even though the Board's deemed rate was lower.

Second, CND computed a notional amount of debt in excess of its actual debt, and described this computation in its application, although I would note that I don't think CND actually used that number in its revenue requirement model.

Both of these errors were pointed out by Board Staff through the interrogatory process, and the applicant corrected both errors immediately once identified. And specifically, I would refer you to the responses to 7.5 Staff 20(c), and 7.5 Staff 21(b).

Because of this, I would suggest the Board Panel make a direct reference to the interrogatory responses when considering this issue, and specifically 7.5 Staff 21(a), which shows the corrected calculation of the weighted average cost of long-term debt.

Specifically CND is proposing a weighted average cost of long-term debt of 4.96 percent, which is based on two elements. First, a $35 million promissory note payable to Sun Life at an interest rate of 4.962 percent, and this promissory note has been filed on the evidence in this proceeding. And second, on a $3,019,708 promissory note payable on demand to the Township of North Dumfries, an affiliate of the applicant, at a rate of 4.88 percent.

I would note while the actual rate on the note is 4.993 percent, the use of the Board's deemed rate of 4.88 percent is the correct application of Board policy in this circumstance.

I would also bring the Panel's attention to 7.5 Energy Probe 30 parts (b), (c), and (d). In the responses to those interrogatories, CND confirms it has not forecasted any incremental third party long-term debt in 2014. Rather, CND manages will determine that it would fund capital expenditures in 2014 from cash from operations, existing cash and cash equivalents, and short-term debt.

In response to part (c) of that same interrogatory, CND has confirmed it has not made any decisions about future financing plans beyond 2014.

If you move on to part (d) of the same interrogatory response, you'll see that CND is considering a number of financing options, including discussions with chartered banks and financing institutions, as well as discussions with Infrastructure Ontario.

During cross-examination yesterday, Mr. Miles mentioned CND is also considering a private placement bond issuance which, in his view, was a very attractive financing mechanism. But to do that, CND has to meet a minimum dollar threshold, and I believe he mentioned it was $30 million, to qualify for this type of financing.

This simply wouldn't happen in 2014. So one approach would be to wait a number of years and accumulate your financing needs, before going out to take advantage of that particularly attractive financing opposite.

In this context, I would note that CND's approach to the calculation of the cost of long-term debt, as shown in 7.5 Staff 21, is entirely consistent with the Board's policy approach to the termination of cost of capital. The Board does not permit the use of notional debt in the calculation, and the applicant readily acknowledges its error in that regard.

The Board has heard rationale from management as to their financing plans of the utility. It does not include obtaining any new third party debt during the test year. The rationale is clear, cogent, and demonstrates a reasonable approach to the financing of the utility in the circumstances. It is simply good business practice.

Given this, the applicant submits that the proposed long-term debt costs in the test year are appropriate.

# 3. Other Income - Interest Components

Moving now to the third area of dispute, the interest component of other revenues; in the settlement proposal, subject to the applicant making two adjustments, the parties were able to agree on all aspects of the other revenue forecast, with one exception; the parties did not agree that the applicant’s proposed interest revenues for the test year are appropriate. That is, the parties were unable to agree on the forecast for Account 4405.

In making your determination on this area of dispute, I would refer the Panel to a few key areas of the evidence. First, Exhibit 3, tab 4, schedule 1, of the application at table III-30, where in the line for Account 4405, Cambridge proposed a 2014 interest revenue amount of $52,712.

Moving forward in the same schedule, at pages 11 and 12, Cambridge provides table 3-41 and explains the variances for this account. In short, CND explains that it does not earn any dividend income, that short-term interest rates have reduced considerably since CND's last cost of service application, and finally that CND intend to utilize surplus cash to finance its capital investment program.

I would note this last point is consistent with what we have talked about in respect of the other area of dispute in respect of long-term debt. Simply put, why go further into debt and incur additional interest expenses when you have sufficient cash on hand that can be used to fund the capital program?

I would also refer you to the interrogatory response to 7.6 Energy Probe 32(d), which shows specifically how the $52,712 interest income was calculated. And I won't get into the details, except to say that it was calculated on an average balance basis, that the balance for the end of the year is forecasted to be zero dollars, because the cash will be used to fund capital programs, and that it was applied against a lower interest rate of 1.13 percent.

In light of this evidence, the applicant submits that the forecast of other revenues as it relates to interest income is appropriate.

MS. LONG: Just to clarify for my own edification, are you saying that the interest income is directly related to how we decide on cost of capital?

I guess what I'm getting at is if we decide that the way that CND has decided to finance using their own cash flow, that -- I guess that is the whole amount of interest income that we're talking about here, or is there a component part that we need to consider that is due to something else? Do you understand what I'm saying?

MR. VELLONE: I do. Unless the intervenors raise an issue with the specific interest rate that's being applied to calculate interest income, I think their challenge is going to be in respect of the zero dollar balance at the end of the year, which is directly related to the long-term debt, part of the --

MS. LONG: I see these as being somewhat of the same issue. So while they're specified differently because they're in the issues list, really deciding one will impact the other for us.

MR. VELLONE: Correct. And you can imagine it's the applicant's view that management is -- there is a presumption of prudence in respect of what management does in its financing.

MS. LONG: I wanted to make sure we weren't missing something there, because it seems to me they're directly related. So thank you for that clarification.

# 4. Rate Design G5750 Class

MR. VELLONE: You're welcome. I would like to move on to the fourth area of dispute, the rate design for the GS greater than 50 class. I'm not going to spend too much time on this, because there wasn't a whole lot of questions on it, but I do need to cover it off.

The parties are not in agreement that the fixed and variable split for the GS greater than 50 class is appropriate, and the evidence that is relevant to this particular area of dispute is Exhibit 8, tab 1, schedule 2 of the application, and the interrogatory response to 8.3 Energy Probe 42.

However, I also note that in respect of issue 8.3 in the settlement proposal itself, it is noteworthy that the parties agree that the applicant's proposed rate design, including class specific fixed and variable splits, are appropriate for all classes, with the exception of the GS greater than 50 class.

So the first question I asked my client was: Is CND proposing to treat the GS greater than 50 class differently than all of the other rate classes? And the answer I got back was no, they're not. Specifically, they pointed me to the response to 8.3 Energy Probe 42, where at table 8-6 the applicant showed the proposed fixed and variable splits for all classes, including the GS greater than 50 class, in the 2014 test year being computed on the basis of holding it constant based on 2013 levels.

I would note that that table formed the basis of the settlement, summarized in appendix F of the settlement proposal for all other classes.

So the question I ask myself is this: If this principled approach worked for all the other classes, why shouldn't the same approach be used for the GS greater than 50 class?

It is our submission that the applicant's proposal to maintain the fixed and variable split for the GS greater than 50 rate class in the test year, the same as it was in 2013, is consistent with the settlement on all other classes, is entirely appropriate and principles-based, and should be approved by the Board.

In this regard I would also note that the Board's October 18th, 2012 report on the RRFE does make express reference to the Board's revenue decoupling initiative.

And I took a look at the Board's March 31st, 2014 draft report on rate design for electricity distributors, Board File No. EB-2012-0410, which indicates the Board's intention to pursue a fixed-rate design solution to achieve revenue decoupling for residential and small commercial customers.

I would note at the outset that this particular report would not be applicable to the GS greater than 50 class. However, I thought it was useful to look at for the principles that are articulated in the report. And specifically -- and I'm quoting here:

"The Board believes that a fixed rate design for the recovery of electricity distribution costs is the most effective rate design for ensuring that rates reflect the cost drivers for the distribution system and best respond to the current environment."

In this -- sorry?

MS. SPOEL: I just want to ask this question while it's still fresh in my mind.

MR. VELLONE: Sure.

MS. SPOEL: So looking at the table that showed the fixed and variable splits --

MR. VELLONE: Yeah.

MS. SPOEL: -- is -- we don't have any information as to what the proposal is, I think, other than what you've put forward, what the applicant's put forward, which would -- we're just looking at the GS greater than 50 that proposes a fixed/variable split -- a fixed charge of $126.44, and do you have any information as to what alternative is being proposed?

MR. VELLONE: I honestly don't know what the intervenor will ask for, although I can speculate, certainly, that it's going to be for a lower fixed charge.

MS. SPOEL: Right. But we don't have any -- there is no evidence on the record at the moment as to what their proposal is?

MR. VELLONE: You do have the floors and ceilings from the cost allocation --

MS. SPOEL: Okay. So --

MR. VELLONE: -- study which are there as well.

MS. SPOEL: So we can infer that they will be asking for something at 96, 99, or less.

MR. VELLONE: In that ballpark.

MS. SPOEL: But you can't help us any more --

MR. VELLONE: I'm sorry.

MS. SPOEL: -- and how it's proposed -- how it will be proposed, how it will be implemented?

MR. VELLONE: I think implementation would not be an issue. Whatever the Board makes its determination, we will just --

MS. SPOEL: Okay. So leave that --

MR. VELLONE: -- do what we're told to do.

MS. SPOEL: Okay. Thank you very much. Sorry --

MR. VELLONE: Does that help?

MS. SPOEL: -- I interrupted your flow, but I wanted to just make sure I was on the right page. Thank you.

MR. VELLONE: So back to the revenue decoupling initiative briefly, really, in the context of the principles set out in that Board report. The applicant simply does not believe that the fixed cost for the GS greater than 50 class should be reduced further in this proceeding. Rather, the applicant submits that its proposal to maintain the fixed and variable split for the GS greater than 50 class, the same as it was in 2013 for the test year, is reasonable in the circumstances.

# 5. Removal Costs

Moving on to the fifth and final area of dispute, in respect of removal costs, the parties are not in agreement on the proper accounting treatment of removal costs in the test year, and the parties are also not in agreement on the inclusion of removal costs in Account 1576 over the historic period.

The issue here is simple. Cambridge has undertaken a change in capitalization policy to align with the Board's regulatory accounting requirements and ultimately with the adoption of IFRS. I don't think any party is going to take issue with what we're talking about here is a change in capitalization policy.

As a result of this change in capitalization policy, prior to January 1st, 2012 removal costs were capitalized, and after January 1, 2012 removal costs were and are now expensed.

The dispute around Account 1576 relates to the treatment of this change in capitalization policy prior to the test year, and the remaining dispute relates to the treatment of this change in capitalization policy during the test year itself.

During examination-in-chief you heard from Ms. Sarah Hughes, the CFO of the applicant, a chartered professional accountant, and a member of the Institute of Internal Auditors, who walked you through detailed pre-filed evidence on removal costs which has been marked as Exhibit K1.2.

I won't go into all of the detail of the pre-filed evidence now, but I do have to say that as a simple lawyer, not an accountant by any stretch, I look at the IFRS requirements, and I look at the facts underlying how the utility incurs removal costs, and CND's capitalization policy does make sense to me.

The facts as they are on the evidence is that removal costs are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating.

The simple fact, as explained by Ms. Hughes in her testimony, is that removal costs are often incurred long after the assets are installed and brought into service. This is done for very good and practical reasons, primarily to minimize the interruptions that customers see from the replacement program.

In such a circumstance it would be very difficult to characterize such costs as site preparation costs. But you don't need to take my word for it. As noted in page 2, line 29 of the pre-filed evidence on removal cost, CND's views has been reviewed and confirmed by its external auditors, KPMG.

In fact, you also have the most current copy of the audited financial statements of CND, which were filed as an update in response to 7.1 SEC 40, part (a). And I'll quote now from note 1-G of those audited financial statements in respect of significant accounting policies at page 13, and I quote:

"Costs incurred to remove an existing asset from service that are not directly attributable to site preparation for the construction of new assets are expensed."

I'll also briefly take you forward to page 2 of the audited financial statement, which is the independent auditor's report, where KPMG states that:

"In our opinion, financial statements present fairly in all material respects the financial position of Cambridge and North Dumfries Hydro Inc. as at December 31st, 2012 and its results of operations in cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. Signed, KPMG LLP, dated April 22nd, 2014."

Turning now from financial accounting to regulatory accounting, Ms. Hughes brought this Panel's attention to a July 17th, 2012 Board letter which was attached as appendix A to the pre-filed evidence. She referred you to a quote from this letter which I believe bears repeating again now, because I think much determines -- much hangs on it.

Specifically, the quote states:

"The Board encourages and will permit distributors that have deferred changeover to IFRS in 2012 to also implement regulatory accounting changes for depreciation expense and capitalization policies effective January 1, 2012."

Simply put, the applicant did defer changeover to IFRS in 2012, and the applicant implemented regulatory accounting changes for its capitalization policies effective January 1, 2012.

The Board in its letter expressly encouraged LDCs like Cambridge to do exactly this, and the Board went even further to say that these changes would be permitted. This is why Cambridge is now proposing the treatment for removal costs in the application that it has. Such an approach is consistent with its financial accounting policies and with the ultimate adoption of IFRS, and this approach was encouraged and permitted by the Board in its July 17th, 2012 letter.

Finally, in respect of Account 1576, Cambridge carefully considered the Board's frequently asked questions, also dated July 17th, 2012, and the relevant excerpt is set out at page 6 of the pre-filed evidence on removal costs.

I won't go through it all now, but in consideration of this fact, Cambridge concluded the account was to be used to record financial differences arising as a result of a change in capitalization policies permitted by the Board in CGAAP in 2012. This is exactly what Cambridge has proposed to do.

In this context, Cambridge submits that its proposed capitalization policy, as it relates to the treatment of removal costs, is appropriate. And CND's recording of the financial differences arising as a result of this change in capitalization policy during the historic period is consistent with the stated purpose of Account 1576.

The final matter I would like to speak to in my argument-in-chief relates to the effective dates for rates in this proceeding. CND thanks the Board for its approval of interim rates, and understands that that approval was done on without prejudice basis.

In this regard, CND requests an effective date for its rates of May 1, 2014, and in support of this request, CND notes it has participated prudently and responsibly throughout this proceeding. With considerable effort, the applicant filed its cost of service application on October 1, 2013. The applicant has met all other procedural deadlines in this proceeding which were solely in its control, including in respect of filing over 1,300 pages of interrogatory responses.

And finally, it should be recognized that this is a transition year, and that the applicant is among the first of the applicants to file under the new RRFE framework, and this fact should be taken into consideration when setting the effective date for rates.

Thank you very much. Those are my submissions.

MS. LONG: Mr. Vellone, thank you very much. You've provided a segue for me to ask what was going to be a question.

You started off your comments by saying that the Panel should consider this application in respect of this being a transition year for the RRFE. You've highlighted for us just now one concrete example of us taking that into account, when we determine when your new rates will commence.

But I am wondering are there any other issues you want to highlight with respect to us considering this a transitional year, or was your comment more general in our review and decision on your application?

MR. VELLONE: I would say that at this stage in the proceeding, the comment is a general one. We may refine that a little further in reply, depending on what we see. MS. LONG: Thank you. All right. Well, thank you very much for presenting your argument to us orally today. We appreciate that, and we have no further questions. So if there are no other matters, I believe we are adjourned. Thank you.

### --- Whereupon the hearing concluded at 10:30 a.m.