EB-2013-0116

Ontario Energy Board

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 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.

ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")

ARGUMENT

May 12, 2014

CAMBRIDGE AND NORTH DUMFRIES HYDRO INC.
2014 RATES

EB-2013-0116

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A - INTRODUCTION

This is the Final Argument of the Energy Probe Research Foundation (“Energy Probe”) related to the issues that were not completely settled in the setting of 2014 rates for Cambridge and North Dumfries Hydro Inc. ("CNDHI") to be effective May 1, 2014.

In particular, as set out in the Settlement Agreement dated April 2, 2014, there are ten issues with a status of "No Settlement" and 8 issues with a status of “Partial Settlement".

The key areas of disagreement among the Parties to the Settlement Agreement, as shown on page 6 of that agreement, are the level of OM&A expenditures, the long term debt component of the cost of capital, the interest component of other revenues, the rate design related to the fixed/variable split for the GS > 50 kW class, and removal costs.

This Argument has been structured to reflect the issues where there was no settlement or a partial settlement. Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of CNDHI. However, in order to minimize intervenor time and costs, a comprehensive impact analysis has not been undertaken. If the Board accepts any of the Energy Probe submissions or those of other intervenors, it is assumed that the direct and indirect impacts would be determined by CHDHI and reviewed by intervenors and Board Staff through the associated draft rate order process.

B - SUBMISSIONS ON THE ISSUES

Issue 1.1 - Does the planning (regional, infrastructure investment, asset management etc.) undertaken by the applicant and outlined in the application support the appropriate management of the applicant's assets? (PARTIAL SETTLEMENT)

As noted in the settlement agreement, the Parties did not agree with the OM&A and long term debt costs. Energy Probe submits that both of these issues impact on the appropriate management of the applicant's assets. OM&A costs deal with the repair, maintenance and operation of the assets while long term debt costs deal with the financial management of the assets.

The Distribution System Plan filed in Appendix 2-8A does not include a forecast of OM&A expenses over the 2014 to 2018 period. Nor does it include a financing plan for the assets to be managed.

Energy Probe deals with the OM&A expenses in more detail under Issues 4.1, 4.2 and 4.3 below.

Energy Probe submits that the financing of rate base is a key component of any distribution system plan. When asked if the management of the financing of the assets was included in Issue 1.1, Mr. Miles indicated that they "go hand in hand". (Tr. Vol. 1, page 52)

Mr. Miles then goes on to indicate that CNDHI did not do any analysis of the impact on the 2014 revenue requirement of its decision to defer the acquisition of additional long term debt beyond the test year. He indicated that their plan was utilize the short term line of credit until such time as CNDHI had a critical mass of borrowing so that it could access the capital markets with. (Tr. Vol. 1, page 52-53)

As a result of this lack of analysis, Energy Probe submits that the planning undertaken by CNDHI and outlined in the evidence does not support the appropriate management of the applicant's assets. Energy Probe provides further submissions under Issue 7.5 dealing with appropriate treatment of the long term debt costs if the planning had been done appropriately and in the best interests of both the shareholder and ratepayers.

Issue 1.2 - Are the customer engagement activities undertaken by the applicant commensurate with the approvals requested in the application? (NO SETTLEMENT)

As indicated in the excerpts from the Residential Customer Survey in Table 1-17 in Exhibit 1, Tab 5, Schedule 2, the largest concern that customers have is with better prices/lower rates. In fact, with a response rate of 45%, this concern was nearly three times higher than the next highest response and more than the sum of the second through fifth highest response issues. Clearly rates and value for money spent are the primary concerns for ratepayers.

Energy Probe submits that the customer engagement activities undertaken are not commensurate with the approvals requested in the application. As can be seen through the evidence that deals with customer engagement, customers were asked what they would like to see changed, such as websites, access to electronic bills, use of social media, etc. However, these questions were posed in the absence of cost information or impacts on those customers. A customer that wants to remake a kitchen may want all the bells and whistles including all new high-end appliances, granite counter tops, custom cabinets, an open plan concept and so on. However, when the cost of all of these components is known, compromises are usually made and, indeed, needed. Ratepayers were not told of the costs of the things they wanted, so they were not fully engaged, in the view of Energy Probe. Full engagement includes knowing the cost consequences so that informed choices can be made and informed views can be made known.

Most importantly, customers were not engaged about their number one issue - better prices/lower rates. Ratepayers were not asked their opinions about a proposed increase in distribution rates of more than 15% (calculated using the Initial Application columns found in the Revenue Requirement Work Form found in the Settlement Agreement). Ratepayers were not asked about the key components of that made up this increase such as the cost of long term debt, salaries, wages and benefits or the proposed increase in FTE's.

These are the hard type of issues that Energy Probe submits should be dealt with through customer engagement.

However, Energy Probe accepts this is the first year of implementation for the Renewed Regulatory Framework for Electricity ("RRFE") and that because there was a short time frame between the release of the Filing Requirements and the schedule filing date for the 2014 rate application, this limited the ability of CNDHI to pursue additional activities specific to the application.

Issue 2.1 - Does the applicant's performance in the areas of: (1) delivering on Board-approved plans from its most recent cost of service decision; (2) reliability performance; (3) service quality, and (4) efficiency benchmarking, support the application? (NO SETTLEMENT)

Energy Probe's submissions on this issue are divided into the four sub-issues identified within this issue.

<u>1) Board Approved Plans</u>

First, with respect to delivering on Board-approved plans from its most recent cost of service decision, Energy Probe submits that CNDHI has failed in two areas. First, in the 2010 COS application, CNDHI proposed to move all customers to monthly billing. The Board approved an amount of $42,500 (Tr. Vol. 1, page 91). CNDHI did not move to monthly billing as had been planned. Energy Probe submits that this should be taken into account when comparing OM&A costs and cost per customer, as noted in Issues 4.1, 4.2 and 4.3 below.

The second area of failure on the part of CNDHI is the lack of reducing costs related to the loss of the water and sewer billing services contract with the City of Cambridge and Regional Municipality of Waterloo. In the EB-2009-0260 Decision dated April 20, 2010, the Board stated (pages 20-21):

> *"The Board recognizes that the termination of the service agreements does not mean that all costs can be avoided. Postage, paper and envelope costs are largely unchanged, whether billing covers both electricity, and water and sewer, or is only done for electricity. However, the Board does not agree with the Applicant's proposed normalization, which assumes that the water and sewer billing revenues are solely a subsidization of fixed costs which remain invariant. The Board considers that at least some capacity in its billing system and in its workforce, was used to provide the water and sewer billing. In other words, there were costs to provide water and sewer billing under service agreements to the municipalities that will not be necessary to provide electricity distribution services. The Board finds that such costs should not be recovered from electricity ratepayers.*
>
> *The Board accepts Board staff's submission that these are operating costs. They are not fixed or "sunk" as is the case with an investment in a capital asset, like poles, wires and transformers, which can often not be readily redeployed or salvaged. The Board also agrees with Board staff that, while the utility may not be able to fully offset any under-recovery by cost reductions immediately, it should be able to do so over time.*

Accepting that some costs, such as for postage and envelopes, will remain, the Board accepts CND's concerns over Board staff's proposal. In the absence of specific evidence on the quantum of these costs, the Board will adopt a variation of the Board staff proposal, whereby $44,000 (10% of the annual amount of $440,000) represents recovery of unavoidable and invariant costs. The Board accepts Board staff's proposal that the remainder should be reduced over the four year period, and the cumulative adjustment to Other Revenues "normalized" for recovery in 2010 and the subsequent IRM period."

Energy Probe notes that CNDHI shows a cost driver increase in 2011 of $603,131, with no subsequent reductions in the following years related to the loss of the water billing contract (Appendix 2-JD filed in the response to 9.2-Staff-40). This reflects that there has been no cost reductions reflected in the OM&A costs resulting from the loss of the water billing contract, despite a clear message from the Board that there should be cost reductions that could be achieved over the IRM period.

2) Service Quality

As shown in the response to 2.1-SEC-14 and confirmed by Mr. Miles (Tr. Vol. 1, pages 64-65), CNDHI has met or exceeded all of the service quality indicators from 2010 through 2013.

Energy Probe submits that the reliability performance exhibited over the 2010 to 2013 period illustrates that CNDHI has been able to meet and exceed every performance indicator over the entire base year and IRM period, and has done so at costs significantly lower than those forecast for 2014.

3) Reliability Performance

CNDHI notes that its reliability has deteriorated in terms of both SAIDI and SAIFI between 2008 and 2012 (Exhibit 2, Tab 3, Schedule 1, page 9).

Energy Probe submits that CNDHI should have addressed this deterioration throughout the IRM period. Rather it appears to Energy Probe that CNDHI put off spending on reliability until the rebasing application. Energy Probe submits that this type of gaming the incentive regulation mechanism does not support the application.

If the deterioration in reliability was the direct result of extreme weather events, as appears to have been the case in 2010, then there is no reason for the OM&A costs to increase to combat a trend that may not actually exist. Further, CNDHI did not provide any benchmarking of its results with other comparable distributors. While there may be an upwards trend, SAIFI and SAIDI may well be below that of other distributors.

4) Efficiency Benchmarking

Energy Probe notes for 2011 through 2013 (4.1-Energy Probe-6), CNDHI was consistently placed in cohort 2 of the three cohorts used in the efficiency cohort grouping results provided to the Board by Power System Engineering Inc. Similarly, for 2014, CNDHI was placed in group 3 of 5 for the stretch factor assignments (4.1-Energy Probe-6). As a result, Energy Probe concludes that CNDHI has been in the middle of the pack, so to speak, for the 2011 through 2014 period.

However, as confirmed by CNDHI in Undertaking J1.6, CNDHI was in the highest efficiency cohort grouping in 2010. In other words, CNDHI has moved in the wrong direction over the IRM period. This does support the application which includes a further significant increase in OM&A costs while not providing the results that one would expect from an efficient distributor.

Issue 3.1 - Are the applicant's proposed capital expenditures and operating expenses appropriately reflective of customer feedback and preferences? (NO SETTLEMENT)

Energy Probe submits that customer feedback time and time again tells distributors that the biggest concern that ratepayers have is better prices/lower rates. The significant increase in OM&A costs and the lack of a financing strategy to cover capital expenditures and rate base do not reflect this customer feedback.

As noted above, CNDHI did not consider the cost impact on its ratepayers of its financing strategy or lack thereof. CNDHI took into account the wants of customers through the customer engagement process, but failed to engage customers in a meaningful discussion around the costs of those wants to gauge the acceptability of any increases.

Issue 4.1 - Does the applicant's distribution system plan appropriately support continuous improvement in productivity, the attainment of system reliability and quality objectives, and the level of associated revenue requirement requested by the applicant? (NO SETTLEMENT)

As noted under previous issues, Energy Probe submits that the distribution system plan does not support the improvement in productivity in the 2014 test year. As shown in the response to 2.1-SEC-14, the OM&A per customer is increasing rapidly, as is the OM&A per circuit km of line. Net fixed assets per customer and per circuit km of line are also increasing significantly. Based on these accelerated cost increases, Energy Probe submits that CNDHI has not demonstrated continuous improvement in productivity. As noted above, CNDHI has slipped from the highest efficiency cohort at the time of their last rebasing application to the middle of the pack at the current time.

With respect to the attainment of system reliability, CNDHI has provided no evidence that it does not already provide system reliability at an acceptable level. While there is a short term trend that has deteriorated, it has not provided evidence that this trend is due to systemic issues or whether it has been influenced significantly by major weather events in a few of the years over which this trend appears to be taking place.

With respect to service quality, CNDHI has already attained appropriate levels and now only has to maintain them.

Energy Probe submits that the distribution system plan does not support the revenue requirement requested by CNDHI. Better planning associated with the financing of the rate base and capital expenditures would result in lower rates for customers (see Issue 7.4 below). The forecasted OM&A increases are significantly too high (see Issue 4.2).

Issue 4.2 - Are the applicant's proposed OM&A expenses clearly driven by appropriate objectives and do they show continuous improvement in cost performance? (NO SETTLEMENT)

Energy Probe submits that the proposed OM&A expenses are not driven by appropriate objectives and they do not show continuous improvement in cost performance.

Energy Probe has approached the level of OM&A expenses on an envelope basis since the filing requirements under the RRFE no longer require the filing of detailed account level information that would enable parties to review specific expenditures.

The analysis that follows in each of the following sections is based on the updated table created by Energy Probe in Exhibit K1.3 (page 16) provided in the response to Undertaking J1.5 ("updated EP table").

<u>a) OM&A Increase Based on New CGAAP</u>

As shown on line 17 in the updated EP table total OM&A costs (excluding property taxes) under New CGAAP are forecast to rise from $12,017,643 in 2012 (the first year under New CGAAP) to $14,877,658 in 2014. This represents an increase of 23.8% over only two years.

This comparison is based on three adjustments made the 2012 and 2013 figures in New CGAAP. The first is the removal of costs in 2012 associated with the disposition of smart meter costs that were actually incurred in previous years.

The other two adjustments impact 2013. The first is the removal of $214,000 associated with regulatory costs associated with this proceeding that CNDHI has recorded in 2013. As noted in the response to 4.2-Energy Probe-13, CNDHI increased the 2014 OM&A forecast by $57,400, being one-fifth of the estimated cost of this proceeding, in acknowledgement that this cost should be amortized and recovered over the IRM term. By including a significant portion of the costs in 2013 and then recovering the entire amount, including the amount expenses in 2013 in 2014 and future rates, CNDHI is double counting this amount. This results in the removal of the 2013 amount of $214,000 in recognition that it will be recovered over the next five years.

The second adjustment in 2013 is for a one-time cost of $114,125 associated with a space study, as identified in 4.2-SEC-25.

Energy Probe submits that all of the above noted adjustments are appropriate in order to provide an accurate comparison from year to year.

Given customer growth of less than 2% per year and inflation of less than 2% per year over the 2012 to 2014 period, Energy Probe submits that a 23.8% increase over two years for OM&A expenditures is excessive. Not only is this increase substantially above growth that would be expected due to inflation and customer growth, it also reflects no productivity gains.

Customer growth between 2012 and 2014 is forecast to be about 3.7% (line 25 in the updated EP table). Inflation, as measured by the GDPIPIFDD and reported by the Board for 2013 and 2014 was 1.5% and 1.7%, respectively. Compounded this would result in an increase of about 7 to 7.5% between 2012 and 2014. Doubling this figure to 15% and applying it as an escalator to the 2012 figure of $12.0 million would result in a reduction of about $1.1 million to $13.8 million.

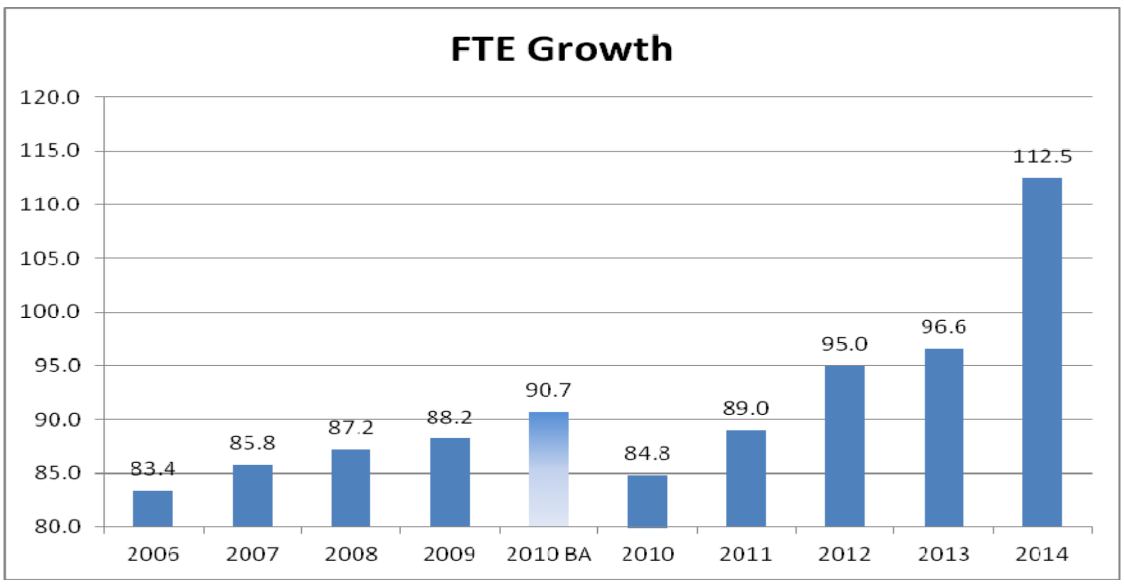
Energy Probe submits that an increase of 15% over a period of two years is more than generous, especially relative to Board decisions in other cases. This is discussed is more detail in part (d) below.

b) Increase in FTEs

The following chart demonstrates the rapid increase forecast for full time equivalents ("FTEs") in 2014 relative to previous years. The data is taken from Appendix 2-K provided in the response to Undertaking J1.7, 4.2-Energy Probe-16 and from Exhibit 4, Table 23 in EB-2009-0260, CNDHI`s 2010 cost of service application.

As the chart demonstrates, growth in the number of FTEs averaged less than 2 per year between 2006 and 2013. With the exception of 2010 and 2011, the growth has been relatively stable. The increase in 2013 compared to 2010 Board approved is also less than 2 FTEs per year.

CNDHI is proposing to increase the FTE complement by 15.9 in 2014 relative to 2013. The number of FTEs grew by only 13.2 over the seven year period from 2006 through 2013.



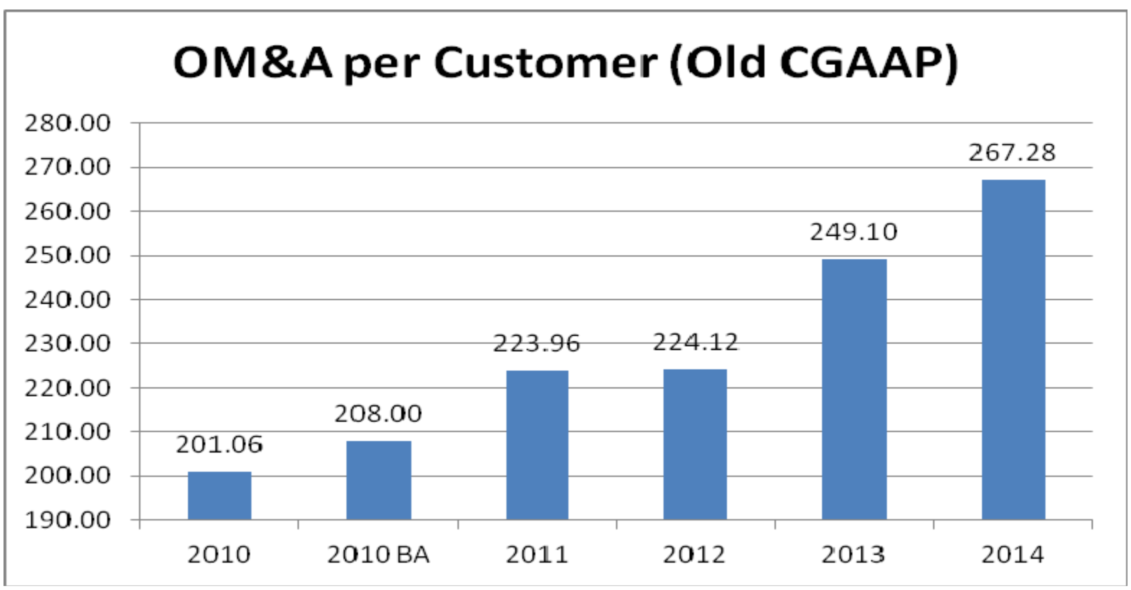
Energy Probe submits that the increase forecast for 2014 is excessive. As discussed elsewhere in this submission, CNDHI is not facing any circumstances that are unique to it. Its service quality reliability indicators have consistently exceeded the mandated levels.

Energy Probe submits that an increase in the number of FTEs to 100 in the test year is reasonable. This would represent an increase of 3.4 FTEs, approximately double the annual increase between 2006 and 2013.

The impact of reducing the number of FTEs can be calculated based on the figures provided in Appendix 2-K of Undertaking J1.7. The average total compensation for 2014 for an FTE is approximately $108,000. Multiplying this figure by the reduction of 12.5 FTEs and reducing this figure by 19% to account for average amount that is capitalized in 2014, results in a reduction in OM&A of approximately $1.1 million.

c) Trends in Cost per Customer (Old CGAAP)

The following chart has been derived based on the information provided in the updated EP table in Undertaking J1.5, with one exception. That exception is that Energy Probe has reduced the 2010 Board approved figure under Old CGAAP (line 22) to reflect the removal of costs approved by the Board for CNDHI to move to monthly billing in 2010. As noted in Issue 2.1 above, CNDHI did not move to monthly billing in 2010 or any subsequent year. This results in a reduction in the Old CGAAP OM&A cost per customer shown on line 30 in the 2010 BA column dropping to $208.00. It should also be noted that the 2010 Board approved figure includes costs for smart meters actually incurred in 2010. Since CNDHI was just beginning the process of implementing smart meters in 2010, the Board approved OM&A cost also includes repair, maintenance, operating and meter reading expenses associated with dumb meters. In other words, the 2010 Board approved figure includes some costs that have been eliminated through the implementation of smart meters.



Energy Probe submits that the above chart illustrates a significant increase in the level of OM&A costs per customer in both 2013 and 2014.

OM&A costs per customer increased by 7.75% between 2010 Board approved and 2012, or 3.8% per year on an annual compound basis. In 2013 they increased by 11.1% with a forecasted increase in the test of year of a further 7.3%.

Energy Probe submits that these increases are excessive and well above the rate of inflation. As noted above, the average increase in 2011 and 2012 was 3.8, while inflation for this period was about 2.1% per year. The positive differential of 1.7% per year reflects that there were no net productivity gains in these years.

As noted above, inflation was 1.5% in 2013 and is forecast to be 1.7% in 2014. Despite this reduction in inflation, the OM&A cost per customer accelerated in 2013 and 2014 from past increases. Energy Probe submits this is not reasonable.

Energy Probe submits that a reasonable increase would be 3.8% per year over the 2012 figure. This reflects the actual increases over the 2010 Board approved figure that were obtained by CNDHI and, with the lower inflation for 2013 and 2014 relative to 2011 and 2012, provides a higher real increase in these costs for 2013 and 2014.

Applying an escalator of 4.5% per year (3.8% and an addition 0.5% allowance) to the 2010 Board approved figure (even though this figure includes costs for both dumb and smart meters) results in a reduction in the 2014 OM&A cost per customer of just under $21 and a total OM&A reduction of just over $1.1 million.

Energy Probe submits that an escalator of 4.5% over the last Board approved OM&A per customer figure already represents a significant increase in costs, given that it is more than double the increase in inflation over this period.

d) Past Board Decisions

i) Burlington Hydro

Energy Probe notes that the Board Staff submission indicates that their proposal would be consistent with the Hydro Inc. Decision and Order (EB-2009-0259 dated March 1, 2010). Energy Probe disagrees.

The Staff proposal is a 5% increase over the 2013 bridge year figure. The 5% is one-half of the 10% increase over the historical year the Board approved for Burlington. This results in a proposed reduction by Board Staff of $680,000. Staff premises this partly on the statement that the distribution system plan and the related costs of its capital plan have been settled with most of the test year capital accepted as filed and that CND has been increasing staff to meet its capital plan.

Again Energy Probe disagrees. In particular, the parties to the Settlement Agreement agreed to a reduction of $2.6 million in capital expenditures in the test year, a reduction of approximately 15%. Secondly, in terms of staff increases, the capital plan is not driving the increase. As shown in the Appendix 2-K filed in the response to Undertaking J1.7, the capitalized labour is actually forecast to decline in 2014 to about $2.3 million from $2.7 million in 2013. On a percentage basis, capitalized labour in 2014 drops to 19% of total compensation compared to more than 24% in 2013. Clearly the capital plan is not driving the increase in total compensation costs.

In the Burlington decision, Energy Probe notes that the Board concluded that the total level of OM&A for 2010 was excessive in that at an overall level the proposed increase of 13.4% in total controllable OM&A from 2008 actual was excessive in light of prevailing conditions and reasonable expectations regarding cost control.

The CNDHI proposed increase is over a same two year span and is more than 10 percentage points higher than the Burlington Hydro request. Energy Probe further notes that there has not been any significant change in prevailing conditions, such as inflation since the Burlington Hydro decision. Nor has there been any reduction in reasonable expectations regarding cost control. On the contrary, with the RRFE and the emphasis on continuous improvement in cost control, there is more emphasis now than in the past on reasonable expectation regarding cost control.

Energy Probe notes that application of the 10% increase over the historical year (2008) granted to Burlington Hydro for their test year (2010) to CNDHI would result in an increase from $12,017,643 in 2012 to $13,219,407, a reduction of approximately $1.48 million.

Energy Probe submits that the reduction of $680,000 as proposed by Board Staff would result in an increase in OM&A over the 2012 to 2014 period of more than 18%.

Neither of the above reductions is appropriate, in the view of Energy Probe. The reduction of $1.48 million appears to be excessive, while the reduction of only $0.68 million results in a significant increase in OM&A that would still be above the increase that the Board found to be excessive for Burlington Hydro.

The Burlington Hydro decision resulted in an increase in OM&A in their test year (2010) relative to their bridge year (2009) of 2.2% (based on the table on page 8 of the Decision and Order). Application of this increase to CNDHI`s actual 2013 expenditures results in a 2014 figure of $13.776 million, a reduction of approximately $1.1 million from that proposed by CNDHI.

ii) More Recent Decisions

In the **EB-2012-0113** Decision and Order dated May 28, 2013 for Centre Wellington Hydro Ltd., the Board considered the increase in OM&A from 2009 (last rebasing year) to 2013 (test year) to be unreasonable. The average annual increase was 8%. On the same basis, the CNDHI request is an average increase of 9.1% per year.

The Board approved an increase that resulted in a test year OM&A level that represented an average annual increase of 5% from the last rebasing year actuals. Applying this decision would result in a reduction of more than $2 million to CNDHI.

In the **EB-2010-0131** Decision and Order dated July 7, 2011 for Horizon Utilities Corporation, the Board noted that the test year forecast represented an annual increase in excess of 7% since the last rebasing application. The Board found this increase to be excessive.

The figure approved by the Board represented an average annual increase of slightly more than 3% since the last Board-approved budget in the previous rebasing year. If that approach was followed in this proceeding, the reduction in OM&A costs would be more than $2.4 million.

In the **EB-2010-0132** Decision and Order dated April 4, 2011 for Hydro One Brampton Networks Inc., the Board noted that the proposed increase for the test year (2011) was an increase of 24.3% over the historical year (2009). This is virtually identical to the increase requested by CNDHI in this proceeding.

The Board noted that after making a number of adjustments, the remaining OM&A was approximately 16% higher than the historical year actual spending, or an average increase of approximately 8% per year. The Board went on to state that given the modest growth in customers (2.2% per year) and the relatively modest rate of inflation, it found this increase to be excessive. The Board found that an increase of 10% over the historical year (2009) was reasonable and stated that given the 2.2% annual growth in customers, this allowed for slightly less than 3% per annum increase in spending per customer, which was more than the rate of inflation. If this approach was applied to CNDHI, the reduction in OM&A costs would be about $1.7 million.

In the **EB-2011-0054** Decision and Order as corrected dated December 30, 2011 for Hydro Ottawa Limited, Hydro Ottawa was asking for an amount of OM&A expenses in the 2012 test year that was 3.7% higher on a compound annual basis from the 2008 Board approved figure.

The Board approved a level of OM&A costs utilizing the envelope approach and stated that given some customer growth, an identified need for some additional staff and increases in compensation, it had had determined that the approved OM&A figure would be based on a 2.5% per year over year escalation of 2008 approved levels. If this was applied to CNDHI, the reduction in OM&A costs would be nearly $2.7 million.

Energy Probe notes that in the Hydro Ottawa decision, the Board dealt with improved customer care and customer value and the pace at which these improvements occurred (page 14):

> *"The Board will not direct specific spending cuts, as these are matters for Hydro Ottawa to manage within the spending envelope approved by the Board. The Board expects that Hydro Ottawa will be able to prioritize its business activities and implement planned projects within the envelope approved. The Board notes that Hydro Ottawa has demonstrated its focus on customer care and many of its spending programs are designed to improve customer value. The Board's establishment of an allowance cap that is less than proposed is intended to adjust the pace at which the these improvements occur to a rate that it considers more appropriate in the context of avoiding adverse rate impacts."*

Energy Probe has argued elsewhere in this submission that the pace of the improvements or initiatives proposed by CNDHI needs to be moderated in order to avoid adverse rate impacts that would see distribution rates increase by nearly 15%.

In the **EB-2011-0271** Decision and Order dated June 14, 2012 for Halton Hills Hydro Inc., the Board approved a similar increase of 2.5% per year over the last Board approved level of OM&A.

Similarly, in the **EB-2012-0033** Decision and Order dated December 13, 2012 for Enersource Hydro Mississauga Inc., the Board found that a 2.5% increase over the last year of actuals (2011) was appropriate. This percentage was based on customer growth over the 2008 to 2013 period and average inflation over this period, which totalled about 3% per year. However, the Board also recognized that costs do not increase one-to-one with growth in customers and in recognition that the distributor should be accommodating incremental expenses through efficiency improvements. As a result the Board reduced the escalation factor to the aforementioned 2.5% and did not incorporate any additional factor for cost that the company had identified as incremental.

Applying the escalator of 2.5% to the 2013 actuals reported by CNDHI would result in in a reduction of the test year OM&A expenses of about $1.1 million.

e) Summary

In summary, Energy Probe has approached its review of OM&A on an envelope basis, but using a number of different approaches. Many of these approaches resulted in a reduction in the range of $1.1 million. Energy Probe submits that this is a reasonable reduction in the OM&A that should be approved by the Board and notes that it is a significantly smaller reduction than if the Board were to follow the rationale provided in numerous other decisions, as noted above, over the past several years, some of which would result in reductions more than double of that proposed by Energy Probe.

Issue 4.3 - Are the applicant's proposed operating and capital expenditures appropriately paced and prioritized to result in reasonable rate increases for customers, or is any additional rate mitigation required? (PARTIAL SETTLEMENT)

Energy Probe submits that the operating expenditures are not appropriately paced and do not result in reasonable rate increases.

As shown in the Settlement Agreement columns in the Revenue Deficiency/Sufficiency sheet of the RRWF included in the Settlement Agreement, the revenue deficiency is $3,579,781 on distribution revenues at current rates of $24,329,098. This represents an increase in distribution rates of nearly 15%. Energy Probe submits that this is not a reasonable rate increase for customers.

In terms of the pacing of the proposed operating costs, Energy Probe notes that CNDHI has indicated that it has included in the 2014 test year forecast a significant number of operational effectiveness initiatives (6.2-Energy Probe-18). However, as discussed under Issue 6.2 below, CNDHI has not forecast any savings in the test year associated with these initiatives, and has indicated that the savings are expected to be incurred over the longer term, although there is no evidence to suggest that these savings will persist to the next rebasing application, which would be the first opportunity for ratepayers to benefit from these savings.

Energy Probe submits that CNDHI has included too many operational effectiveness initiatives in the 2014 OM&A expenditures. No savings associated with these initiatives have been built into the 2014 costs. As indicated in the response to 6.2-Energy Probe-18b, CNDHI indicates that it has not been able to quantify the cost savings or cost avoidance associated with these operating efficiency initiatives.

Given the complete lack of evidence to support any benefits for ratepayers from these initiatives, Energy Probe submits that the Board should disallow the costs associated with these initiatives from the 2014 revenue requirement as they have not been adequately justified by CNDHI.

Alternatively, if the Board believes that there is customer value in these initiatives, Energy Probe submits that the pacing of these initiatives should be spread out over the IRM period. In other words, instead of doing all these initiatives in the test year, CNDHI should spread them out over five years. Energy Probe submits that the Board should approve 20% of the costs associated with these initiatives in the 2014 test year, but indicate to CNDHI that it expects it to proceed with all of the initiatives during the IRM period.

Issue 5.1 - Do the applicant's proposals meet the obligations mandated by government in areas such as renewable energy and smart meters and any other government mandated obligations? (PARTIAL SETTLEMENT)

Energy Probe submits that CNDHI's proposals do meet the obligations mandated by government in the areas such as renewable energy and smart meters as well as any other government mandated obligations. However, Energy Probe submits that the obligations are not being met at a reasonable forecasted cost to ratepayers. The cost aspect of this issue is dealt with under Issues 4.2 and 7.4.

Issue 6.1 - Do the applicant's proposed rates allow it to meet its obligations to its customers while maintaining its financial viability? (NO SETTLEMENT)

Energy Probe submits that the lack of planning for long term debt puts CNDHI's financial viability at risk over the longer term. Its actual capital structure is significantly different from its deemed structure, particularly with respect to long term debt. The deemed component of long term debt is 56,%, while its actual level is 29%. (Tr. Vol. 1, page 46) This translates into a shortfall in actual long term debt of about $35 million.

By failing to borrow an appropriate amount of long term debt at a time when long term rates are at historically low levels, CNDHI is failing to meet its obligations to its customers.

If CNDHI borrows large sums of long term debt in the future and rates have increased, the prudence of CNDHI in doing this is likely to become an issue for the Board to deal with. If CNDHI were unable to recover its actual costs of long term debt in the future, the financial viability of the distributor could well be impacted.

Issue 6.2 - Has the applicant adequately demonstrated that the savings resulting from its operational effectiveness initiatives are sustainable? (NO SETTLEMENT)

Energy Probe submits that CNDHI has not adequately demonstrated that the savings resulting from its operational effectiveness initiates are sustainable. Moreover, CNDHI has not demonstrated that there are any savings from its operational effectiveness initiatives undertaken in 2013 or 2014.

The response to 6.2-Energy Probe-18 lists and describes a number of operational effectiveness initiatives. However, as shown in the response to part (b), CNDHI indicates that it has *"not been able to quantify the capacity; cost avoidance; or cost savings generated from all of the operating efficiencies"*.

Moreover, as clearly demonstrated by the cross-examination of Mr. Shepherd (Tr. Vol. 1, pages 138-154), there are little if any savings built into the 2012 OM&A costs as a result of these operational effectiveness initiatives. As a result Energy Probe submits that the Board cannot conclude that any savings are sustainable given that there is no evidence on the record of what the savings are, or if in fact, there will be savings.

In particular, there is no evidence to suggest that any savings arising from the initiatives are sustainable to the next rebasing application. Any savings that take place during the IRM period but are not sustained to the next rebasing application accrue solely to the shareholder. Ratepayers pay the costs for the initiatives, not only in the 2014 rebasing year, but in each IRM year that follows since the costs would be built into base rates, and then receive no benefit whatsoever at the subsequent rebasing.

Energy Probe submits that the pacing of these operational expenditures needs to be adjusted under Issue 4.3 above. This is particularly important since CNDHI has not been able to quantify any savings in the test year and has not provided any evidence to suggest that if these savings do exist, they will persist to the next rebasing so ratepayers can benefit from them.

Issue 7.4 - Is the proposed allocation of shared services and corporate costs appropriate? (NO SETTLEMENT)

Energy Probe submits that the allocation of shared services and corporate costs are not appropriate for accounting services. As noted in the response to 7.1-Energy Probe-27, CNDHI charges its affiliate a fixed fee for accounting services provided to its affiliates but does not include an additional mark-up for the services provided. The response also indicates that these accounting costs are included in OM&A.

The reason is that allocation, without any mark-up, is not appropriate because the OM&A, which includes costs to provide accounting services to the affiliates, is included in the working capital analysis. This means that ratepayers are paying a return on a component of rate base that is based solely on providing services to an affiliate. It is not appropriate, in the view of Energy Probe, for ratepayers to pay for this.

Energy Probe submits that the Board should direct CNDHI to remove the OM&A costs associated with providing the accounting services from the WCA calculation to ensure ratepayers do not continue to pay this subsidy.

Issue 7.5 - Are the proposed capital structure, rate of return on equity and short and long term debt costs appropriate? (PARTIAL SETTLEMENT)

The unsettled component of this issue deals with the cost of long term debt. This includes the appropriate amount of long term debt, the associated cost of the long term debt and the impact it has on ratepayers.

As noted under Issue 6.1 above, the actual long term debt represents only 29% of rate base in the 2014 test year, significantly below the deemed long term debt component of 56%. This represents a $35 million shortfall in deemed debt as compared to actual debt.

Energy Probe notes that there is no requirement for the actual capital structure to be the same as the deemed capital structure. However, under the RRFE, with its increased emphasis on customer engagement, customer focus and outcomes brings any significant deviation from the deemed capital structure into the determination of the appropriate revenue requirement.

Energy Probe submits that a deviation of $35 million, or 27% of rate base is significant and that the Board needs to look closely at the proposal for CNDHI to determine the outcome and the impact on customers through their rates.

CNDHI is financing long term assets with short term financing (Tr. Vol. 1, pages 121-122). Mr. Miles indicated that this was an appropriate approach so it could get a critical mass of sufficient enough to go out to the market and lock in long term debt as efficiently as possible. Mr. Miles later defined this critical mass as around $30 million (Tr. Vol. 1, page 127). However, Mr. Miles had earlier testified that they were not borrowing any new long term debt in the 2014 test year because they were waiting until they had this critical mass that they could access the capital markets with.

CNDHI also indicated that it intends to update is financing plan from year-to-year on a going forward basis and that no decisions about future financing plans beyond 2014 have been made at this time (75-Energy Probe-30). Energy Probe submits that this is not an appropriate approach to planning the financial requirements associated with the management of the assets.

Energy Probe submits that CNDHI has already hit the critical mass in 2014. The critical mass by their definition is $30 million and the shortfall in actual long term debt relative to deemed long term debt is already $35 million.

Energy Probe submits that a distributor should finance long term assets with long term financing and it should plan to do so based on current interest rates and expected changes in those rates in order to minimize the costs of this long term debt that is ultimately recovered from ratepayers.

Long term interest rates are at historically low levels and are forecast to increase over the next few years. CNDHI has an opportunity to lock in financing for more than one-quarter of its current rate base and is not doing so. Energy Probe submits that this is not prudent and could easily result in higher rates for customers in future years.

Moreover, it results in a negative outcome for ratepayers in the 2014 test year, as it artificially inflates the cost of long term debt that would be built into the revenue requirement for 2014 and would be reflected as the base rates over the following four years. In other words, the outcome of the CNDHI proposal would be to burden ratepayers with an inflated cost of long term debt in their rates for five years.

Energy Probe submits that the Board should impute the addition of $30 million in long term debt for the 2014 test year. This amount is based on Mr. Miles identification of this amount being the critical mass needed to access the capital markets, and is just slightly smaller than the shortfall of $35 million between deemed and actual long term debt.

As for the appropriate rate to be used for this $30 million, Energy Probe notes that the rate would be specific to the term of the loan. The only third party debt that CNDHI currently has is a 15 year loan (Exhibit 5, Tab 4, Schedule 1, page 4).

Energy Probe further notes that CNDHI has used a rate of 3.75% in its revised budget that was presented to its Board of Directors and approved in September, 2013. This is similar to the rate available from Infrastructure Ontario of 3.62% for a 15 year term loan. As a result, Energy Probe submits that the appropriate rate to be used would be 3.75%.

If this additional $30 million at a rate of 3.75% is included in the calculation of the long term debt rate, this rate declines from 4.96% to about 4.44%. When this difference is applied to the deemed long term debt of $73,252,142 (RRWF in the Settlement Agreement), this results in a reduction in the long term debt costs to be paid for by ratepayers of approximately $390,000.

Energy Probe submits that this is a material difference. CNDHI's materiality threshold is about $140,000 (Exhibit 1, Tab 7, Schedule 1). The $390,000 reduction in the revenue requirement represents about 1.4% of the base revenue requirement. Over the projected IRM term and the 2014 rebasing year, this adds approximately $2 million to the bills of ratepayers.

Energy Probe submits that this is an inappropriate outcome of the CNDHI's failure to properly plan the financial management of its assets and ignores the benefits of locking in long term rates at historically low levels at a time when these rates are expected to increase in the future. It ignores the customer focus and customer engagement results that overwhelmingly tell the distributor, and the Ontario Energy Board, that the number one concern of ratepayers is better prices/lower rates. Clearly, a 1.3% reduction in the base revenue requirement is a significant impact on ratepayers given that CNDHI is requesting an increase of nearly 15% in distribution revenues.

Issue 7.6 - Is the proposed forecast of other revenues including those from specific service charges appropriate? (PARTIAL SETTLEMENT)

The unsettled component of this issue is related to the proposed interest income (Account 4405) for the test year.

As shown in the response to 7.6-Energy Probe-32d, CNDHI is forecasting a $0 balance in the bank account as of the end of 2014. This compares to an ending balance in the bridge year of $8.8 million.

CNDHI claims that this is because they plan on using all of the cash in the bank to finance its capital expenditures in the test year. Energy Probe notes that this would have also been the case in the 2012 and 2013, since CNDHI did not borrow any additional long term debt in those years. The decline in the closing balance between 2012 and 2013 is about $5.8 million. Energy Probe submits that it would not be unreasonable to expect a similar reduction between 2013 and 2014, to $3.0 million. Taking into account that the opening balance in 2014 should be $8.8 million (the closing 2013 balance), the average bank balance for 2014 should be about $5.9 million.

Energy Probe submits that CNDHI has not presented any evidence in this proceeding to support a reduction in the average interest rate in the test year relative to the 1.30% earned in 2013. It is therefore submitted that the interest rate forecast used in the calculation of interest income should be 1.3%.

Combining the balance of $5.9 million with an interest rate of 1.3% yields a test year forecast of $76,700.

Issue 7.7 - Has the proposed revenue requirement been accurately determined from the operating, depreciation and tax (PILs) expenses and return on capital, less other revenues? (NO SETTLEMENT)

This issue is not settled because not all of the components of the revenue requirement have been determined as part of the Settlement Agreement. As a result, Energy Probe could not determine if the revenue requirement had been accurately determined from the various components. However, Energy Probe does submit that the methodology used to determine the revenue requirement is appropriate.

Issue 8.3 - Is the proposed rate design including the class-specific fixed and variable splits and any applicant-specific rate classes appropriate? (PARTIAL SETTLEMENT)

The unsettled portion of this issue deals with the fixed and variable split for the GS 50 to 999 kW class. Energy Probe supports the maintenance of the fixed variable split that was approved by the Board from the previous rebasing application. However, where the fixed charge already exceeds the ceiling as determined using the approved methodology, or where the fixed charge would move above the ceiling, Energy Probe submits that the fixed component of the distribution rate should be capped at the higher of the previous approved charge and the ceiling calculated from the current cost allocation model.

There is no reason that the fixed charge for any rate class should exceed the ceiling for that class if it was below the ceiling to begin with and there is no reason why the fixed charge should increase further if it is already above the ceiling.

Issue 8.6 - Is the proposed Tariff of Rates and Charges an accurate representation of the application, subject to the Board's findings on the application? (NO SETTLEMENT)

There is no settlement of this issue because the rates and charges are dependent on a final revenue requirement (Issue 7.7) and the resolution of the rate design issue for the GS > 50 kW class (Issue 8.3). Even if the Board made no changes to any of the contested issues, CNDHI indicated that it had not calculated the impact on distribution rates by rate class as a result of the Settlement Agreement (Tr. Vol. 1, pages 74-75).

Energy Probe submits that the resolution of this issue is only possible following a Board decision on the issues in this proceeding that were not settled or only partially settled and following a review of the resulting draft rate order.

Issue 9.1 - Are the proposed deferral accounts, both new and existing, account balances, allocation methodology, disposition periods and related rate riders appropriate? (PARTIAL SETTLEMENT)

The only unsettled issue related to the deferral accounts is the inclusion of removal costs in the calculation of Account 1576 - Accounting Changes under CGAAP.

As shown in the response to 9.2-Staff-39, CNDHI has forecast the December 31, 2013 year-end balance in this account to be a $3,234,021 credit to ratepayers plus the associated return on rate base of $213,445, for a total refund of $3,447,466. This figure includes the impact of the change in depreciation rates, changes in burdens that can no longer be capitalized (safety and health department, building expense reallocation and municipal taxes), and removal costs for 2012 and 2013. As noted above, the only component that was unresolved was the inclusion of removal costs.

The impact of the inclusion of the removal costs is significant. As shown in the response to Undertaking J1.1 if the removal costs are removed from Account 1576, the balance at the end of 2013 is a credit to ratepayers of $4,186,050 and when the associated return on rate base is added, the amount returned to ratepayers would be $4,456,469, an increase of just over $1 million.

Energy Probe has had the opportunity to review Board Staff`s submissions with respect to the inclusion of removal costs in Account 1576. Energy Probe supports those submissions.

The EB-2008-0408 Report of the Board on the Transition to International Financial Reporting Standards (“Board Report”) dated July 28, 2009 dealt with the capitalization of indirect **overhead** and administration costs in Issue 3.3. Issue 3.4 in the Board Report dealt with the gain and losses on disposition of assets.

The February 24, 2010 Board letter "Accounting for Overhead Costs Associated with Capital Work" was clearly related to **overhead** costs.

Energy Probe submits that the removal costs are not related to the **overhead** costs associated with the cost of assets, but rather are related to the gains and losses on disposition of a different set of assets.

Finally, Energy Probe notes that CNDHI is still reporting under CGAAP and has not yet moved to IFRS. As a result the regulatory accounting treatment for the de-recognition of the groups assets that was set out under the CGAAP-based Account Procedures Handbook should remain in effect until the transition to IFRS has taken place.

Issue 9.2 - Have all impacts of any changes in accounting standards, policies, estimates and adjustments been properly identified, and is the treatment of each of these impacts appropriate? (PARTIAL SETTLEMENT)

The unsettled issue within this issue is the proper accounting treatment of the removal costs in the test year.

Energy Probe has had the opportunity to review the submissions of Board Staff with respect to this issue and support those submissions.

As indicated in the Staff submission, the key issue here is whether or not CNDHI should follow CGAAP or IFRS respect to the regulatory accounting treatment in the 2014 test year.

Since CNDHI has not adopted IFRS for the test year and the test year application was made on a CGAAP basis, Energy Probe submits that the regulatory treatment under CGAAP should be maintained.

This would entail including the removal costs as part of the accumulated amortization of the group assets, thereby including these costs in rate base. This would be in contrast to including the removal costs in the depreciation expense as proposed by CNDHI.

Again, Energy Probe submits that the removal costs are not related to the capitalization of overheads in the costs of an asset, but is a cost associated with the removal of a different asset. It should also be noted that these assets that are associated with the removal costs are group assets that have been fully depreciated (9.2-Staff-40a).

C - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe co-operated with other intervenors in this application to minimize duplication where possible.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

May 12, 2014

Randy Aiken
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