June 29, 2009

BY EMAIL & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

**Board File No. EB-2008-0235**
**London Hydro Inc. – 2009 Rates Rebasing Application**
**Argument of Energy Probe**

Pursuant to Procedural Order No. 3, issued on June 10, 2009, please find two hard copies of the Argument of Energy Probe Research Foundation (Energy Probe) for the Board's consideration in the EB-2008-0235 proceeding. An electronic version of this communication will be forwarded in PDF format.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc: David B. Williamson, London Hydro Inc. (By email)
James C. Sidlofsky, Borden Ladner Gervais LLP (By email)
Peter Faye, Energy Probe Counsel (By email)
Intervenors (By email)

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**EB-2008-0235**

**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 **London Hydro Inc.** for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2009.

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# Final Argument On Behalf Of

# Energy Probe Research Foundation

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**June 29, 2009**

# LONDON HYDRO INC.

# EB-2008-0235

# Final Argument On Behalf Of

# Energy Probe Research Foundation

## How these Matters came before the Board

**1. On December 8, 2008, London Hydro Inc. (the "Applicant" or "London Hydro"), filed an Application seeking approval for changes to the rates that it charges for electricity distribution, to be effective May 1, 2009. The Board issued a Notice of Application and Hearing on December 24, 2008. Energy Probe filed a Notice of Intervention on January 5, 2009 as a full time intervenor.**

**2. Procedural Order No. 1 was issued by the Board on January 26, 2009 and provided both a List of Applicant and Intervenors and a procedural schedule for the proceeding.**

**3. Energy Probe filed Interrogatories on February 20, 2009, and received Responses from the Applicant on March 20, 2009.**

**4. Procedural Order No. 2 was issued by the Board on April 23, 2009 and provided a schedule for supplementary interrogatories and submissions by parties on the need for an oral hearing..**

**5. Energy Probe filed Supplementary Interrogatories on May 7, 2009, and received Responses from the Applicant on May 26, 2009. Energy Probe provided the Board with Submissions on June 2, 2009, stating that it did not oppose a written hearing process.**

**6. Procedural Order No. 3 was issued by the Board on June 10, 2009 and provided a schedule for argument submissions, including an Argument-in-Chief from London Hydro which required the Applicant to highlight the revisions to its application that have occurred as a result of the interrogatory process.**

## Argument Overview

**7. Energy Probe has conducted itself as an all issues intervenor throughout this proceeding.**

**8. In its Argument, Energy Probe will not seek to explore all outstanding Issues before the Board, but will be examining those Issues of concern to Energy Probe where we believe we can be of most assistance to the Board, and has addressed some matters that might not be as thoroughly canvassed by other consumer-oriented groups.**

## RATE BASE

### Working Capital Allowance

**9. Energy Probe accepts the approach taken by London Hydro to calculate the working capital allowance component of its rate base for 2009, Revised for Interrogatory Adjustments, as presented in its Argument-in-Chief Tables.**

**10. However, Energy Probe continues to believe that the 15% methodology overstates the required allowance for working capital, especially for a larger utility, and submits that the Board should direct London Hydro to prepare a working cash (lead lag) study for its next rebasing application.**

## RATE BASE

**Capital Expenditures**

**11. Rate base is forecast to increase from $208 M to approximately $225 M over the bridge and test years (Exhibit 2, Table 1). Through its Interrogatories #3 –13, Energy Probe tested the assumptions used by the Applicant for capital expenditures contributing to the rate base increase.**

**12. In Interrogatory #3, the Applicant's estimate for increased consumption of 1.7% in the commercial/industrial classes was questioned. The explanation for the estimate was that it was based on historical information of load growth. Energy Probe submits that under current economic conditions, historical information might not be an accurate predictor of short term consumption. However, in the absence of any better method of forecasting consumption, Energy Probe takes no issue with the predictions.**

**13. In Interrogatory #4 the Applicant's estimates of housing starts for the bridge year was questioned. The response indicates that actual 2008 housing starts exceeded CMHC predictions on which the estimates were partly based. Therefore, Energy Probe takes no issue with the 2008 estimates for housing starts.**

**14. In Interrogatory #5 the Applicant's estimates for 2008 spending on overhead and underground distribution work to service commercial development was questioned. The response indicates that actual expenditures exceeded estimates in 2008. Therefore, Energy Probe takes no issue with the 2008 estimates for capital spending in this category.**

**15. Interrogatory #6 questioned the Applicant's increased forecast of capital required to respond to developer works in 2009. The explanation provided was that industrial development in a new "innovation park" required a 27.6 kV supply that had not been in the previous 2008 forecast. Therefore, Energy Probe takes no issue with the 2009 estimates for spending in this category.**

**16. Interrogatory #7 questioned the Applicant's increased forecast of capital spending related to city works. The response provided cited increased activity in municipal infrastructure spending expected under federal infrastructure incentives that would in turn drive the need for relocations of distribution plant. Energy Probe finds this to be a reasonable basis for the estimates and takes no issue with them.**

**17. Energy Probe found the Applicant's responses to these and other Interrogatories reasonable and consistent with the evidence and therefore takes no issue with the rate base projections.**

## OPERATING COSTS

**18. OM&A costs are projected to increase from $25.2 M in 2007 to approximately $28.2 M in 2009 (Exhibit 4, Table 1). Part of this increase is attributed to base labour cost increases.**

**19. Energy Probe Interrogatory #22 questioned the Applicant's labour cost increases relative to other similar sized distributors. The response indicates that London's wage increases have been below those of its comparators during the past five years. The response also indicates that the 5.2% increase in total base labour over the time frame is partly attributable to the need to train new apprentices to replace an aging baby boomer workforce. Energy Probe finds these explanations reasonable and takes no issue with the increased OM&A costs impact.**

**20. Energy Probe Interrogatory #27 questioned the Applicant's post retirement benefit plans. The response indicates that the cost of the plan is funded by London Hydro only until retirees reach age 65, after which they can continue in the plan but must pay 85% of the cost. The response also notes that the plan includes both annual and lifetime caps on some benefits. Energy Probe finds the Applicant's post**

**retirement benefit plans to be reasonable and responsible in comparison to some other distributors' plans that have been examined in applications before the Board. Therefore, Energy Probe takes no issue with these costs.**

## COST OF CAPITAL

### Long-Term Debt Rate – Embedded Debt

**21. Energy Probe was bemused by the Applicant's suggestion, presented in its Argument-in-Chief, at Paragraph 14, that it had voluntarily forgone revenue of $1,134,000 by requesting a rate of only 6.0%, the actual rate of interest on its $70 million embedded debt, rather than requesting the Board's deemed rate of 7.62%.**

**22. In its Response to an Interrogatory from Mr. Aiken, acting on behalf of the London Property Management Association ("LPMA"), the applicant appeared to present its request for 6.0% on its embedded debt in a less altruistic manner:**

> **... London Hydro has actual long term debt of $70 million at 6.0%, and London Hydro assumes that the rate for this portion of its long-term debt will be 6.0%....**
> **(Response to LPMA's IR # 30, Filed March 20, 2009)**

**23. Energy Probe submits that under the Board's guidelines as outlined in the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Board Report"), issued December 20, 2006, the actual rate of interest as requested by the Applicant is the applicable rate for the Applicant's embedded debt, being the lower of the actual debt and the Board's deemed debt rate.**

## COST OF CAPITAL

### Long-Term Debt Rate – Notional Debt

**24. As one of three intervenors in the EB-2008-0232 Hydro One Remote Communities Inc. ("Hydro One Remotes") 2009 rates rebasing proceeding, Energy Probe is aware of the manner that the Board Panel dealt with notional long–term debt and the applicable interest rate in its Decision and Order, issued April 30, 2009.**

**25. In that proceeding, Hydro One Remotes sought to apply the Board's then current deemed long-term debt rate to its notional or deemed long-term debt, rather than applying the effective rate of its own affiliate debt.**

**26. The Board Panel, in its Decision and Order, determined that Hydro One Remotes misinterpreted the Board's Guidelines as presented in the Board Report. The Decision and Order stated, at page 12:**

> Board Findings
> **The Board finds that it is not appropriate to apply the Board's deemed long-term debt rate to the notional or deemed long-term debt. The two are quite separate concepts. The deemed long-term debt rate is intended to apply in the absence of an appropriate market determined cost of debt, such as affiliate and variable rate debt situations. For companies with embedded debt, it is the cost of this embedded debt which should be applied to any additional notional (or deemed) debt that is required to balance the capital structure.**

**27. In a second Hydro One proceeding ending this year, being EB-2008-0272 Hydro One Networks Inc. Transmission Rates Request for 2009 and 2010, the Board Panel at the last paragraph on Page 54 in its Decision With Reasons, issued May 28, 2009, came to the same conclusion in respect of the appropriateness of applying the Board's deemed long-term debt rate to the notional debt or deemed long-term debt of the Applicant in that proceeding:**

> **The Board agrees with intervenors that it is not appropriate to apply the Board's deemed long-term debt *rate* to the notional or deemed long-term debt. The two are quite separate concepts. The deemed long-term debt rate is clearly intended to apply in the absence of an appropriate market determined cost of debt, such as affiliate and variable rate debt situations. For companies with embedded debt, it is the cost of this embedded debt which should be applied to any additional notional (or deemed) debt that is required to match the capital structure to the Board's deemed capital structure. This is consistent with the treatment given to LDCs that have undergone rebasing in 2008 and 2009.**

**28. It is the Submission of Energy Probe that the Applicant's Weighted-Average Cost of Capital, subject to being updated if necessary for any revised Cost of Capital Parameters for 2009 Cost of Service Rate Applications prior to the decision in this proceeding, which is now unlikely, should be as set out in the Table below.**

| | % of Total Capital Structure | 2009 Test Year Amount $ | Cost Rate (%) |
|---|---|---|---|
| | | | |
| Deemed short-term debt | 4.0 | 9,004,467 | 1.33 |
| Affiliate long-term debt | 31.1 | 70,000,000 | 6.0 |
| Notional long-term debt | 24.9 | 56,069,467 | 6.0 |
| Common Equity | 40.0 | 90,049,620 | 8.01 |
| Weighted-Average Cost of Capital | | | 6.62 |

## Costs

29. **Energy Probe submits that it participated responsibly in this proceeding. Energy Probe requests the Board award 100% of its reasonably incurred costs.**

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

**June 29, 2009**

**Peter Faye**

**Counsel to Energy Probe Research Foundation**