EB-2008-0235

THE 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 London Hydro Inc. to the Ontario Energy Board for an Order approving just and reasonable rate and other charges for electricity distribution to be effective May 1, 2009.

WRITTEN COMMENTS OF THE CONSUMERS COUNCIL OF CANADA

On December 5, 2009, London Hydro Inc. ("**London**") applied to the Ontario Energy Board ("**Board**") for approval of its electricity distribution rates effective May 1, 2009. The Board has determined, after a full interrogatory process, that the final stage in the proceeding would consist of written submissions. These are the final submissions of the Consumers Council of Canada ("**Council**").

OVERVIEW:

London is seeking recovery of an overall revenue requirement of $64.1 million. This results in a revenue deficiency of $7.9 million (**Ex. 7, p. 5**). London's planned capital expenditures for 2009 are $27.4 million and planned OM&A expenditures are $28.2 million (**Ex 4, p. 3**). Approval of London's application would result in an increase in delivery charges for a residential consumer consuming 1000 kWh per month of 13.1% and a total bill impact of 3.9% (**Argument in Chief, p. 3**). Other key components of the application include:

1. An effective date for new rates of September 1, 2009;

2. A change in the capital structure to reflect a 40% equity component and a 60% deemed debt component and a blended long-term debt rate of 6.72%;

3. A smart meter adder of $1.00;

4. Revenue off-sets of $3.7 million;

5. A working capital allowance based on 15% of specific OM&A accounts;

6. A proposal to dispose of deferral and variance account balances of $4.3 million over a 20-month period beginning on September 1, 2009;

7. A proposal to continue with the specific service charges approved in it 2008 rate application

The Council has reviewed the pre-filed evidence and interrogatory answers provided by London. The Council generally supports London's initial proposals and the adjustments made as a result of the interrogatory process. There are a few discrete areas where the Council does not support London's application. The submissions regarding those areas are set out below.

RATEBASE/CAPITAL EXPENDITURES:

Working Capital:

London's working capital allowance forecast for 2009 is $44,214,313 as revised through the interrogatory process (**AIC, p. 9**) The amount was derived using the 15% of specific OM&A accounts approach set out by the Board in it EDR filing requirements. The Council notes that this approach has been accepted by the Board in numerous LDC rate applications for both 2008 and 2009. For 2009 the Council accepts the approach as appropriate.

The Council notes that, with respect to larger LDCs such as Toronto Hydro Electric System Limited and Hydro One Networks Inc., the working capital allowance is typically less than 15% when it is based on the results of a lead-lag study. The Council submits that, given working capital represents approximately 20% of London's rate base, London should be required to undertake a lead-lag study and bring forward the results of that study in its next rate proceeding. Given that London is one of the largest LDCs in the Province, a lead-lag study is a more appropriate approach for determining working capital requirements.

Capital Expenditures:

In 2008 London's actual capital expenditures were $23.4 million (**LPMA 9**) London's capital expenditure forecast for 2009 is $30.6 million (**Ex. 2, p. 18**) This represents a one year increase of over 30%. The increases from 2008 to 2009 relate in large part to computer hardware and software expenditures.

Computer Hardware and Software:

The most significant capital expenditures are for computer hardware and software. London has completed a number of upgrades to its existing corporate applications over the past five years including a major initiative to replace its existing Customer Information System ("**CIS**"), Geographic Information System ("**GIS**"), Document Management System and an Enterprise Resource Planning ("**ERP**") solution.

In addition new projects for 2009 include Mobile Workforce Management and an Outage Management System. Total Investment between 2004 and 2009 for hardware, software, and application development will amount to $18.9 million **(Ex. 2, p. 19**)

The Council notes that London is also seeking approval of a $294,000 increase in its 2009 Office Equipment Services and Maintenance budget, a sub-component of its overall OM&A budget. London has indicated that this increase is largely related to software maintenance fees associated with the new CIS system. (**Ex. 4, p. 41**)

The Council is not taking issue with the fact that London has a need to replace its IT systems. The Council is concerned that ratepayers are paying the full capital costs of these new systems, but will not benefit from any of the productivity gains and efficiencies expected until London's rates are rebased in three years. In response to Board Staff interrogatory # 3 London sets out a description of the expected benefits and productivity gains associated with these new systems. Although not quantified, benefits are expected throughout many components of London's distribution operations.

The Council submits that the Board should make a reduction in the revenue requirement to allow London's ratepayers to benefit, prior to rebasing, from the significant capital expenditures made with respect to the new IT systems. The Council points to the 2008 Horizon Utilities proposal to include, in the Horizon revenue requirement, benefits associated with its planned ERP system. Given the magnitude of these expenditures, the Council submits a specialized treatment of the benefits is required. In the absence of a detailed calculation of benefits, the Council submits that the revenue requirement should be reduced by $500,000. That would ensure that ratepayers get a share of the expected benefits. If London thinks that a different level of reduction is appropriate, it can suggest the amount, with the necessary justification.

OPERATING, MAINTENANCE AND ADMINSTRATION COSTS

London is proposing an OM&A budget of $28.2 million for 2009 net of depreciation and charitable expenses. This represents an increase over 2008 of 7.25%. It also represents an increase of 24% over the 2006 Board approved level. (**Ex. 4/p. 2**) Wages and salaries are the most significant component of OM&A costs.

London did not apply a uniform inflation rate when developing it 2009 OM&A budget. Wage increases were forecast at 3.25 % and material price increases ranged from 3% to 12% depending upon the commodity and the supplier (**Board Staff 16**).

The Council submits that the increase of 7.25% in London's overall OM&A costs has not been justified. If labour costs are the most significant component of the budget, and salaries and wages are set through a collective bargaining agreement based on a 3.25% annual increase, a 7.25% increase is clearly excessive. In addition, in a year where inflation was 2.3% applying costs escalators of between 3% and 12% for non-labour components of the budget is not appropriate.

In it final argument LPMA provides an analysis setting out various approaches to adjusting the overall OM&A level. Those approaches include a line by line analysis of the budget, the application of the 2008 inflation level (2.3%) to non-labour costs, and applying a 4.8% increase to the total envelope. All of these approaches result in a reduction to the budget of approximately $500,000. The Council submits that the Board should reduce London's budget by $500,000 to bring it more in line with the Board approved budgets of other LDCs. In a period of very low inflation a 7.25% increase should be rejected.

REGULATORY COSTS:

In its initial evidence London was proposing an amount of $291,000 for regulatory expenses related to this proceeding to be recovered over four years. The amount included in the 2009 revenue requirement was $72,850 which represented one year of the four year recovery. London has revised its 2009 regulatory hearing expense to $220,854 to reflect the fact that there was no technical conference, or an oral hearing phase in the proceeding. With the four year amortization the amount included in the revenue requirement is now $55,213 (**AIC, p. 14**).

The Council submits that, given the fact that there was no technical conference, Alternative Dispute Resolution ("**ADR**") process, and no oral hearing phase in this proceeding, London's regulatory expenses should be further reduced. Because the entire proceeding was dealt with on a written basis, the Council assumes that internal staff would have undertaken the majority of the work in terms of preparing evidence and answering interrogatories. In addition, given the written process, intervenor costs should be considerably less than if an ADR, technical conference and hearing were undertaken. The Council proposes a further $50,000 reduction from the $220,854 adjusted amount. In the alternative the Board should consider setting the level of regulatory costs on the basis of what other LDCs have had approved for similar rate proceedings (no hearing, technical conference or ADR).

COST OF CAPITAL

With respect to return on equity ("**ROE**") London had a return of 8.57% embedded in its initial filing, but is now proposing to use the most recent Board approved rate of 8.01%. This rate was established by the Board on February 24, 2009. The Council supports the adjustment as it is consistent with the Board's current policies regarding the 2009 rate applications.

London is also proposing an adjustment to reflect the Board approved short-term interest rate. The rate has changed from 4.47% to 1.33%. Again, the Council supports the adjustment.

With respect to long-term debt London has a long-term promissory note due to the City of London of $70 million. London's position is that, because the debt is callable on demand, it should attract the Board's deemed rate of 7.62%. London's proposal, however, is that it is only requesting a rate of 6%, which reflects the actual cost of the debt (**AIC, p. 20**). From the Council's perspective it is appropriate to use the 6% rate on the existing affiliate debt as this reflects the actual cost of the debt and is consistent with the Board's Cost of Capital Guidelines. In addition, the Council does not support

London's assertion that the debt is callable during the test year as the evidence provided indicates that it is only payable on demand with 376 days notice (**Ex. 6, p. 3**).

London is requesting a rate of 7.62% for its unfunded long term debt. London argues that its proposal to seek 7.62% on the portion of deemed long-term debt that is unfunded is consistent with the Decisions of the Board for other 2009 rebasing applicants that only have affiliate debt that is callable. (**AIC, p. 20**) The Council submits that this is not consistent with established Board policy regarding this component of the capital structure.

The Council agrees with the submissions made by Board Staff that London has misconstrued the Board's most recent decision in the 2009 Hydro One Remote Communities Inc. rate proceeding. Specifically that Decision states, "For companies with embedded debt, it is the cost of that embedded debt that is required to balance the capital structure." (**EB-2008-0232**) Given the cost of its embedded debt is 6% that rate should also apply to the notional debt. As noted by Board Staff, London's proposed treatment of unfunded or notional long-term debt is inconsistent with the Board's policy and practice for electric rate-setting as articulated in that decision and should not be approved. (**Board Staff Submissions, p. 26**)

London's proposal to apply a rate of 7.62% rather than 6% on an amount of approximately $56 million would be blatantly unfair to its ratepayers. In effect, ratepayers would be required to fund a cost differential that does not actually exist.

DEFERRAL AND VARIANCE ACCOUNTS:

London is proposing to clear the account balances to ratepayers for four of its deferral and variance accounts. The net amount to be rebated to customers is approximately $4.3 million. Board Staff in its submissions proposed that London should also dispose of the balances in a number of other accounts not subject to consideration in other proceedings. (**Board Staff Submissions, p. 38**)

The Council sees merit in this proposal for two reasons. First, there is a large credit going to customers as a result of clearing the first four accounts. This credit will off-set the debit related to the other accounts, but still provide customers with a net credit. Second, clearing account balances on a more timely basis is a preferable approach. It eliminates additional interest costs associated with carrying the account balances and avoids, to some extent, any intergenerational equity issues. The Council supports Board Staff's proposal to clear 11 of London's deferral and variance accounts. Accordingly, London should be required to re-calculate the rate riders to reflect the updated amount to be returned to customers.

CCA NORMALIZATION:

London is proposing to "normalize" the Capital Cost Allowance ("**CCA**") deduction available in 2009 and 2010 related to non-recurring software costs totaling $6.7 million (**Ex. 4, pp79-80**). This proposal would effectively "amortize" or average the Payments in Lieu of Taxes ("**PILs**") allowance related to the new CIS system for 2009 and over the next three years of the 3rd Generation Incentive Rate Mechanism. The impact of this proposal would be to increase the 2009 revenue requirement by $829,910 (**LPMA 42**).

As noted by Board Staff in its submissions, at page 14, this proposal is contrary to Board policy and practice. Board Staff submitted that, to the best of its knowledge, amortizing tax and/or PILS allowances has never been adopted by the Board. In addition, London is proposing to normalize only one component of its overall taxes effectively "cherry-picking" in order to benefit its shareholders. Taxes and/or PILs in the test year are supposed to approximate, as closely as possible, the taxes or PILS that the utility will pay in the test year. The Council agrees with Board Staff and urges the Board to reject London's proposal to deviate from accepted regulatory accounting practice.

SMART METERS:

London has indicated its intent to install 81,000 smart meters in the 2009 test year. The total expenditures are expected to be in the range of between $12 million and $16 million. (**Ex 9, p. 15**) London is proposing a smart meter rate adder of $1.00/month. The Council is concerned that the rate adder is small relative to the expected costs of the overall smart meter program. Accordingly, if collection of the costs is delayed London's ratepayers may be required, in future years, to pay a significant deferred amount for smart meter costs. In effect, it appears that the rate adder being proposed by London is not reflective of the costs to be incurred. The Council supports the proposal made by VECC that London come forward with a plan to amortize smart meter costs over a reasonable period of time and adjust its 2009 rate adder consistent with the amortization schedule.

EFFECTIVE DATE OF RATES:

London's application was filed on December 5, 2009. The Board had a filing deadline of August 15, 2008, for all 2009 EDR rate applications. London submits that the election to wait until December 2008 was made to assist the Board with its regulatory workload (**AIC, p. 6**). London also accepts that, given the late filing date, the effective date of rates would not likely be May 1, 2009, and it would not be seeking any incremental revenues for the period May 1 to August 31. The current proposed effective date of rates is September 1, 2009.

The Council submits that given London chose to delay the filing of its application to December 5, 2008, it should not be allowed any retroactive adjustments. The Board imposed a clear filing deadline for the 2009 applications. LDCs that chose to delay their filing should be subject to established Board policy. The Council notes that the Board's recent Decision regarding the 2009 application of Peterborough Distribution Inc. resulted in Peterborough's rates effective the same date as the implementation date, thereby rejecting any proposals for a retroactive adjustment. If the timing of the Board's order allows for an effective date of September 1, 2009, then rates should be put in place as of

September 1. However, if the Board's order is later London should not be permitted to retroactively recover revenues from its customers.

The Council notes that London requested an extension of the dates for the filing of interrogatories and final submissions. If London has been responsible for a further delay in the process, its ratepayers should not be required to pay for that delay.

COSTS:

The Council participated responsibly in this proceeding and should be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted.

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