

**IN THE MATTER OF a consultation by the Ontario Energy
Board on the Cost of Capital and 2nd Generation Incentive
Regulation for Electricity Distribution Companies.**

TECHNICAL CONFERENCE FINAL SUBMISSION COMMENTS

OF THE

GRIMSBY POWER

Grimsby Power is a small sized utility, which has some real concerns regarding the potential impacts on our operation and our ability to operate effectively for the customers we serve.

We believe that the depth of study related to the staff proposal on Cost of Capital and 2nd Generation Incentive Regulation fails to explore many unanswered questions as noted in Board staffs responses to the CLD and others. We contend that many of these areas need to be fully explored before any implementation of a revised cost of capital methodology can be undertaken.

Grimsby Power contends that the changes to the debt structure and ROE will restrict our access to capital markets and put us offside with our bank covenants. During the Technical Conference October 17, 2006, Grimsby Power was asked the following by Mr. Richie.

Now, if your embedded cost of debt and your deemed capital structure remained the same as what is in the 2006 EDR but the ROE was to be adjusted, say, to about 8.6% as shown in the response, in Board Staff's response to the CLD question 15, would you still be offside of your debt covenants in terms of interest coverage ratio?

Grimsby Power did multiple analyses related to this matter. In our calculations of the interest coverage and debt service coverage, we used a Return on equity of 6.61, 8.37 and 8.65 plus we made the following assumptions. They are:

- Additional debt was added to the current debt load resulting in a debt:equity ratio of 60:40;
- The interest rate on the new debt was 4.75%;
- We used the 2005 audited financial figures; and
- We used an impact proposal developed by the EDA, which is illustrated below.

In all cases, Grimsby Power failed to meet the interest coverage ratio and the debt service coverage. Meeting these financial covenants is a requirement in our current banking agreement. Failure to meet the covenants creates risk and may result in debt being called by the bank.



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assuming a debt:equity ratio of 50: Under this scenario, with a ROE of 8.37%.

- We offer customers a reasonable market based rate structure;
- We have an efficient operation that provides customers with excellent customer service;
- We have an on going capitalization program to ensure adequacy of supply, at the distribution level, and on going replacement of assets without over harvesting or risk of the safe and efficient delivery of power to customers;
- OEB regulation should not be a driver to cause rationalization and increase customer rates; and
- We offer good control and responsiveness to customer needs as a small LDC.

Throughout this process it was stated that larger utilities are generally more efficient and have opportunities of scale and scope. However, we contend that this is not entirely correct. During Questioning on the efficiency of LDCs Dr. Yatchew stated the following.

I did do studies and I published work in the Journal of Applied Econometrics based on data from the '90s. What I found rather surprising was the relatively small size the minimum that was required, to achieve efficient scale.

I can't remember the exact numbers, but there were utilities in Ontario, based on data in the mid- 90s, who were achieving really most of the scale economies at size ranges of 20- to 30,000 customers. I found that actually quite surprising.

I looked at studies that have been performed in Norway and in New Zealand They were also consistent with this conclusion.

We encourage the Ontario Energy Board to use this technical workshop to spring board and more in depth study similar to the 2006 EDR process that allowed parties to work together to reach consensus where possible and to bring items where there is no consensus to the Board for a Hearing and a subsequent imposed decision.

STATUS QUO	
Using Updated Cannon Methodology	
Impact of Proposal (low)	-21,218
Impact of Proposal (high)	-29,099
OPTION 1	
Using Board Staff Proposal	
Impact of Board Staff Proposal	-66,806
OPTION 2	
Using Updated Cannon Methodology with one single capital structure for all LDCs	
Impact of Proposal	-53,227
OPTION 3	
Using Camfield Proposal	
Impact of Proposal	-31,463