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HYDRO OTTAWA

Ontario Energy Board
2006 Electricity Distribution
Rate Handbook

Argument with Respect to Draft 2
Issued on January 10, 2005

February 14, 2005

As set out in Procedural Order No.5 issued by the Board on February 4, 2005, Hydro Ottawa is providing its argument with respect to the draft 2006 Distribution Rate Handbook (the "Handbook"). Comments follow the chapters set out in the draft Handbook and provide Hydro Ottawa's position on each of the alternatives presented.

First, there are many positive aspects of the 2006 Distribution Rate Handbook since consensus was achieved in a variety of different areas. Hydro Ottawa is focusing its comments on areas where there are concerns rather than pointing out the many positive aspects of the Handbook.

Hydro Ottawa is concerned about the timelines that have been set out for this process. Hearings ended on February 4, 2005. This provided only 5 ½ working days to review hundreds of pages of transcripts for which argument may be required. Furthermore this is all occurring at a time in which there are numerous other regulatory matters facing LDCs including 2005 distribution rates, RPP, CDM plans, global adjustments and normal year-end closing processes.

Hydro Ottawa had hoped to file a joint submission with the Coalition of Large Distributors (CLD). However, the timelines have been too short to develop internal positions on each matter, reach consensus views with the CLD, prepare a joint document and get individual approvals for the document. This is unfortunate since it would have resulted in a more efficient regulatory process and a better overall result.

There has also been insufficient time to test draft spreadsheets to ensure that there are no discrepancies between the Handbook and the associated models. As a result, Hydro Ottawa is concerned that at the time its application is being prepared, it may be apparent that some aspect of the Handbook or spreadsheet requires revision. The Board should consider now what process will be used to deal with these eventualities.

Summary of Major Concerns

While Hydro Ottawa has outlined it positions on the issues within the text of this argument, of particular concern are those issues which, if not addressed, will leave Hydro Ottawa little alternative but to file using a forward test year in order to achieve even close to the maximum regulated return deemed by the Board.

Normally, cost of service studies would be based on the forward test year of 2006. However, for expediency, the draft Handbook is based on the adoption of a historic test year. No guidelines have been provided on the use of a forward test year and Board staff have repeatedly warned of the extensive filing requirements and regulatory scrutiny for a forward test year. As noted by Board Counsel, Ms. Lea, in her comments to the panel on Friday, February 4, 2005[1]:

> *"According to the draft handbook, distributors have a choice to make. They can use the 2004 figures and the required tier-1 adjustments, or they can file a forward test year application. The amount of evidence necessary to justify a forward test year application is very substantial. If the distributors want to see the type of evidence filed for a forward test year application, they*

[1] Transcript Volume 11 at paragraph 877

can look at the evidence filed by the two major gas utilities regulated by the Board. It's a lot of evidence, and it is, necessarily, given significant scrutiny by the Board and intervenors."

Even distributors of the size of Hydro Ottawa currently have insufficient internal resources on which to build the kind of cost of service studies filed by the two major gas utilities. If Hydro Ottawa must adopt a forward test year to achieve a reasonable return, external resources will have to be found and retained. The timeline to complete an application of this magnitude is also impossibly short. Therefore, Hydro Ottawa would prefer to adopt the historic test year, provided that the following three issues can be addressed.

1. Allowance for funds used during construction (AFUDC) on assets until placed in rate base

The appropriate rate for AFUDC on construction work in progress (CWIP) is the weighted average cost of capital (WACC), as indicated in the evidence presented by VECC from Mr. Matwichuk. AFUDC should continue until such time as the asset is placed in rate base and can earn a return for the shareholder. The evidence of Mr. Matwichuk in answering Q7 stated that: "*Before being placed in rate base, there is a recognition that there is a financing cost to building new facilities. Consistent with the capital cost principle noted above, a regulated utility should be given a reasonable opportunity to recover the capital costs of its construction funds[7]."* As such, distributors should be permitted to continue to record AFUDC on 2005, 2006 and 2007 assets until such time as they are included in a rate base, presumably at the next re-basing in 2008. With this approach, distributors with a growing rate base are not unduly penalized by the use of the historic test year.

Hydro Ottawa is therefore proposing that section 4.4 of the Handbook be revised as follows:

"The interest rate to be used for construction work in progress (CWIP) is the weighted average cost of capital (WACC) and termed the Allowance for Funds Used During Construction (AFUDC). The Applicant can continue to record AFUDC for any assets not included in its rate base, other than assets that have been disallowed, until such time as the asset becomes part of the Applicant's rate base."

2. Tier 1 Adjustments to Historical Test Year

Hydro Ottawa is concerned that the only non-routine / unusual adjustments contemplated as tier 1 adjustments are transformer stations. In decades past, these may have been the only major capital undertakings of distributors, but with the increased application of systems and technology to improve the quality and efficiency of services, this is no longer the case. Hydro Ottawa's single most significant project in 2005 is the implementation of a Geographic Information System (GIS). This has been a multi-year project that is completing its final phase in 2005. Hydro Ottawa acknowledges that the number of tier 1 adjustments, particularly of the non-routine/unusual category, must be kept to a minimum or there is no point in adopting the historic test year. However, this project of Hydro Ottawa's is several times larger than the materiality limit of 0.2% of net fixed assets being proposed. Hydro Ottawa would support an increase to materiality limit, just for non-routine/unusual adjustments, in order to permit different categories of 2005 capital projects while minimizing the number of adjustments filed by distributors.

3. Amortization Expense to be included in revenue requirement

The 2006 Distribution Rate Handbook is silent on the amortization expense to be used in the revenue requirement. The only discussion is on the amortization rates to be used yet there are many other aspects to be considered. Hydro Ottawa recommends the inclusion of a new section in Chapter 6, Distribution Expenses as follows:

"Section 6.3 Amortization Expenses

As per Section 4.2, amortization rates outlined in Appendix C are to be used for the purposes of 2006 filings. The amount of amortization expense to be included in the Applicant's revenue requirement is a full year of amortization expense on all assets included in the rate base, with the exception of any 2006 assets included as tier 1 adjustments. Eligible 2006 additions must use the half-rate rule and include only half of the normal annual amortization. In calculating the amortization expense for the revenue requirement, Applicants should adjust the historic 2004 amortization expense to reflect tier 1 adjustments and assets that came in service in 2004 and therefore were subject to the half-rate rule in 2004."

This is an important issue to Hydro Ottawa. At the end of 2004, Hydro Ottawa went live with a new Customer Information System (CIS). Such systems assets are amortized over a much shorter timeframe than distribution plant assets, and therefore represent a significant amortization expenses each year. However, the application of the half-rate rule resulted in a much lower amortization expense on this asset in 2004 than will be present in 2006. A distributor must be permitted to include a full year of amortization on the 2004 assets.

Furthermore, Hydro Ottawa is implementing a GIS in 2005, and as per the concerns expressed in item 2 previously. Hydro Ottawa feels that this system should be permitted as a tier 1 adjustment. The amortization expense associated with the inclusion of this tier 1 adjustment in the rate base should be permitted in the revenue requirement. This adjustment to amortization expense would be true for any tier 1 capital adjustment.

Chapter 1: Introduction

Section 1.2 sets a filing date of July 4, 2005 for all applications. This may be an appropriate deadline for those filing on a historic test year. However, there is significantly more work required for those distributors who are filing on a forward test year, making July 4, 2005 an unrealistic deadline. While the use of a forward test year is set out as an option for distributors, in many cases there is no real choice if unique circumstances force the use of a forward test year to achieve a reasonable return in 2006.

Therefore, Hydro Ottawa proposes the following change to Section 1.2.

"Rate applications for 2006 must be filed no later than July 4, 2005 for those distributors using a historic test year. Distributors filing on a forward test year will provide notice to the Board on July 4, 2005 and will file their applications no later than September 1, 2005."

Chapter 2: Description of Application

Hydro Ottawa has no comments on this chapter.

Chapter 3: Test Year and Adjustments

3.0 Test Year and Adjustments

Hydro Ottawa recommends Alternative 1. There should be no obligation to disclose material 2006 events for those distributors filing on a historic test year. This would be a requirement for those filing on a forward test year.

3.2 Option 1: Tier 1 Adjustments

- Distribution Expenses – Transformer Stations

Hydro Ottawa supports Alternative 1 for cases in which all approvals have been granted for the transformer station with a clear in-service date in 2006 and construction work has already commenced in the field at the time of filing. This provides reasonable assurance that the project will proceed as scheduled. The implementation time for larger transformer stations is much longer than for smaller stations. It would be unfair to penalize one distributor who may have started a project in 2004 at the same time as another distributor, but due to added complexities, approvals, environmental assessments, delivery times on materials, construction times and other factors beyond their control, does not complete the work until 2006. Hydro Ottawa does not have any transformer stations with an expected in-service date of 2006.

Hydro Ottawa is however concerned that transformer stations are the only type of non-routine/unusual adjustments being contemplated as tier 1 adjustments. It is true that in the past, stations were typically the only major capital undertakings that a distributor might have. However, distributors are now regularly implementing new technology to improve their operations and services to customers. For instance, in 2005, Hydro Ottawa is planning to complete implementation of a multi million dollar Geographic Information System (GIS). As it stands now, to include this project it appears that Hydro Ottawa will have to file for a forward test year.

- Distribution Expenses – Low voltage / wheeling adjustments

While Alternative 2 would normally be a reasonable approach, it becomes problematic if there has not been a timely and clear approval process for low voltage wheeling costs. This would penalize distributors for something beyond their control. Therefore, for 2006 distribution rates, Alternative 1 would be a fairer approach, provided the distributor can justify the existence of these costs.

- Rate Base – 1) New transformer stations

Hydro Ottawa is concerned that an approval process is being contemplated for assets that were already included in the 1999 rate base. Hydro Ottawa has a number of small high voltage distribution stations

(HVDS) with a voltage of 115 kV / 8 kV. The technology, configuration and use are the same as for a low voltage distribution station (LVDS) but the 115 kV sub transmission connection was used simply because of location. These assets have been in place for many years, pre-dating the restructuring of the industry. Furthermore, leave was already granted by the Board in 2000 to deem these assets as distribution assets. (Attached as reference is an example of one of the letters received from the Board with respect to this issue). It is assumed that other distributors received similar letters. Further approval should not be necessary. Therefore, Hydro Ottawa recommends that this section be amended as follows:

"Distributors wishing to have any transformation-related assets included in the distribution rate base that were not already included in the 1999 rate base and which would not be included in the definition of the distribution rate base, as specified in Appendix B …".

- Rate Base – 5) Non-routine / unusual adjustments

As discussed in Section 3.2, Hydro Ottawa would favour Alternative 1 in cases in which all approvals have been granted and construction has already commenced at the time of filing.

Furthermore, as discussed in section 3.2, a distributor should be able to include as a tier 1 adjustment any non-routine / unusual adjustments that meet the 0.2% of net fixed assets materiality threshold, not just transformer stations. As discussed in Item 2. of Hydro Ottawa's Summary of Major Concerns, Hydro Ottawa would accept a higher materiality threshold for this category to allow more types of non-routine/unusual adjustments while minimizing how often these adjustments are used.

Option 2: Tier 2 Adjustments

Hydro Ottawa does not anticipate filing for Tier 2 Adjustments. However, for those distributors that have experienced material financial hardship that has resulted in a degradation to their distribution system, they should be permitted to put their case forward for relief. Therefore, Alternative 2 is favoured.

Chapter 4: Rate Base

4.1 Definition of Rate Base

Hydro Ottawa accepts the level of detail contemplated in Alternative 1, with the exception of the proposed in-service date. Further level of detail would only create an administrative burden with no discernable benefit. Areas of particular concern, such as IT related capital, have already been identified as requiring addition detail. Comparison of account by account details between distributors would have no relevance because there is a large degree of variability in the application of the Uniform System of Accounts (UsofA).

Hydro Ottawa follows the APH, which in Article 410, anticipates the pooling or "grouping" of assets. Grouping occurs for many asset classes including meters, poles, overhead conductors and devices, transformers and services. Using this grouped approach, the in-service date is an irrelevant concept.

The asset is brought in service in 2006 and the half-year rule is applied to the grouped assets. Even if an asset is not grouped, there could be multiple capital expenditures in an asset class, and to have to provide the in-service date of each would provide no meaningful information and would be a significant administrative burden. Based on this, the requirement to provide the in-service date should be removed.

As discussed previously in section 3.2, distributors should not have to seek approval for assets that were included in the 1999 rate base, particularly since the Board has provided previous approval.

For distributors filing on a historic test year, the use of the year-end net fixed assets from 2004 (Alternative 1) is the only fair approach. 2004 is being used essentially as a proxy for 2006, therefore using fixed assets closest to 2006 is the most reasonable approach. Furthermore, since distributors cannot increase rates until May of 2006, there is already 4 months of return for 2006 that cannot be realized until the next year. The Board needs to keep in mind that if it does decide to adopt the mid-year approach either for the historic test year, forward test year or both, than for consistency, all load and customer forecasts would also have to be from the mid-year for appropriate matching.

This section of the Handbook defines controllable expenses as the sum of operations and maintenance, billing and collection, and administration expenses. This should be the same as defined in table in section 5.4 as follows:

"the sum of operations and maintenance, billing and collection, community relations and administration expenses."

4.3 Capital Investments

Hydro Ottawa supports Alternative 2 for the materiality threshold of non-IT capital investment solely based on 0.2% of net fixed assets, not a set dollar value threshold. The intent of this disclosure is to review the prudence of capital investments that have a material impact on distribution rates. To set both a percent and dollar value threshold would once again put additional regulatory burden on larger distributors that is not shared by smaller distributors.

4.4 Interest on Deferral Accounts and Construction Work in Progress (CWIP)

Hydro Ottawa worked with the Coalition of Large Distributors (CLD) to prepare reply evidence on this issue and supports the position in that paper. Interest on CWIP should be the weighted average cost of capital (WACC), not the embedded cost of debt. This is not one of the options provided, but clearly a distributor that finances from both debt and equity should be able to use the full cost of capital. This was also the position stated in the evidence filed by M.G. Matwichuk on behalf of VECC, which for Q 8 states that:

> *"The review of regulatory practices involved canvassing regulators across Canada[9]. The treatment of carrying charges was generally consistent in respect of CWIP. Currently, where there is equity financing of rate base, CWIP is attracting carrying charges as AFUDC calculated using the rate of return on rate base. Where there is essentially no equity financing,*

as in the case of some crown owned utilities, the carrying charge associated with CWIP is IDC."

And Q27 states that:

> *"With respect to CWIP the issue is fairly straightforward. Given the regulatory principles, history and generally accepted regulatory practice, the appropriate carrying charge for CWIP would be AFUDC (using rate of return on rate base) in the case of utility whose capital structure includes an equity component and IDC for a utility that is essentially financed by debt."*

Therefore, given the debt / equity structure of the distributors in Ontario, Hydro Ottawa recommends the adoption of a new Alternative 3 that uses the WACC as the appropriate interest rate on CWIP.

Furthermore, with AFUDC adopted as the appropriate approach for interest on CWIP, Hydro Ottawa notes that typical regulatory practices have been to continue AFUDC until such time as the asset is put into rate base to earn a return. This was brought forth in the evidence by M.G. Matwichuk in which the answer to Q7 states that:

> *"CWIP is commonly considered as the costs incurred during the construction period of an asset up to the time where the asset becomes used and useful, and is then placed in rate base. Before being placed in rate base, there is a recognition that there is a financing cost to building new facilities. Consistent with the capital cost principle noted above, a regulated utility should be given a reasonable opportunity to recover the capital costs of its construction funds[7]. Historically, official recognition of that financing cost has evolved.*
>
> *Prior to the 1970s Interest During Construction ("IDC") was commonly capitalized as the carrying cost of an asset while it was being constructed and before its transfer to rate base. Largely, beginning in the early part of that decade, IDC was substituted by what is commonly referred to as Allowance for Funds Used During Construction ("AFUDC") in the case of investor owned utilities and implemented into the uniform system of accounts used in the U.S[8].*
>
> *AFUDC provided recognition for a component of equity financing usually at the allowed rate of return on equity and is, generally, in the same proportions as the allowed capital structure. Essentially, the financing cost for CWIP became equivalent to the rate of return on rate base, but is a non-cash amount for utilities as that cost was capitalized. Typically, publicly owned or crown corporations continued with their use of IDC, given that they rarely had an equity component of a significant degree. More recently, however, a number of crown owned utilities are, indeed, financed by equity injections through shareholder arrangements with their owners, often municipalities. They have tended to adopt AFUDC treatment.*
>
> *As IDC is purely interest, it is intended to reflect the interest financing cost alone. In the case of AFUDC, both the equity and debt components are to be representative of an investor owned financing, but part is recorded as current income and part as an offset to interest expense incurred. However, no cash payments are made by ratepayers for either the cost of debt or equity during construction.*

In any event, the entire cost of constructing the plant, including the appropriate IDC or AFUDC, if approved, is added to rate base where it earns an allowed rate of return and is depreciated over its useful life – the costs that are recovered through revenue requirement in a ratepayer tariff."

Clearly, for a distributor filing using a historic test year, the AFUDC should continue on all capital assets from 2005 and beyond until those assets are placed in a rate base and can earn a return for the shareholder. Hydro Ottawa therefore recommends that this be made clear in the 2006 Distribution Rate Handbook and Accounting Procedures Handbook. Section 4.4 should read as follows:

"The interest rate to be used for construction work in progress (CWIP) is the weighted average cost of capital (WACC) and termed the Allowance for Funds Used During Construction (AFUDC). The Applicant can continue to record AFUDC for any assets not included in its rate base, other than assets that have been disallowed, until such time as the asset becomes part of the Applicant's rate base."

For deferral accounts, a short-term debt rate is only appropriate when deferral accounts are recovered on a routine basis within 1 year. This has not been and is still not the case in Ontario. Therefore, Alternative 1, the embedded cost of debt is the appropriate rate at this time.

4.5 Capitalization Policy

Hydro Ottawa believes that Alternative 1, in which the relevant details of capitalization policies are documented, provides all of the necessary information on which to assess applications.

4.7.2 Depreciable Assets Not Sold to an Affiliate

The title should be changed to: *"Depreciable Assets Sold to a Non-Affiliate"*.

Chapter 5: Cost of Capital

5.1 Maximum Return on Equity

Hydro Ottawa supports the principle of Alternative 2 in that return on equity should be set as close as possible to the date of implementation. However, with this accelerated timeframe for the 2006 rates, Alternative 1 would be acceptable in this situation.

5.2 Debt Rate

Hydro Ottawa recommends Alternative 2 in which the debt rate used is the lower of the actual debt rate and the deemed debt rate at the time of issuance. Long-term debt, by definition, is a commitment made for a long-term that cannot be changed every time a regulator sets a new deemed debt rate based on the current long Canada bond rate. A distributor that prudently issued debt in a previous period, at a rate that cannot be changed, should not be penalized.

5.4 Working Capital Allowance

Hydro Ottawa supports Alternative 2 to better reflect the cost of power that will occur in 2006. As a minimum, if forecast pricing is not available, an adjustment should be permitted to reflect a full year of costs at the new RPP pricing for the fixed price customers. In 2004, the cost of power only reflected 9 months at the new two-tier pricing, which was a significant increase over the previous 4.3 cents per kWh. The actual cost of power is reduced by the rebates claimed to the IESO for the difference between the spot market price and the amounts billed to customers, therefore the amounts billed to customers become relevant to the cost of power expense to be included in the working capital allowance.

Distributors pay interest on security deposits at a rate of prime minus 2%. Therefore, security deposits are not a source of working capital but more like a source of short-term financing. Therefore, security deposits should not reduce the working capital allowance and Additional Adjustment Alternative 2 should be adopted. However, should the Board require the removal of security deposits from the working capital accounts, distributors should be able to use the most current level of security deposits at the time of filing. As of February 1, 2005, distributors became required to pay back security deposits for all customers with a good payment history, as defined by the Distribution System Code. Hydro Ottawa is anticipating a significant drop in the amounts held for security deposits in the first half of 2005, prior to the filing deadline for 2006 rates. Therefore, if adopted, it is proposed that Additional Adjustment Alternative 1 be revised as follows:

"The sum of the working capital accounts is to be reduced by the dollar value of the customer security deposits. Distributors may update the dollar value of security deposits to the 2005 amount."

Chapter 6: Distribution Expenses

6.0 Introduction

Hydro Ottawa believes that the level of detail provided in Alternative 2 is sufficient for the purposes of reviewing the level of distribution expenses. The amount of detail in Alternative 1 can be of no use in comparing distributors because of lack of consistency, and furthermore the Comparators and Cohorts have been determined as the mechanism for doing such comparisons.

6.2.1 Insurance Expense

Hydro Ottawa accepts Alternative 2 as appropriate for distributors filing on a historic test year, in that changes to self-insurance reserves should not be included in insurance expenses. However, distributors filing on a forward test year may have changes between 2004 and 2006.

6.2.4 Advertising, Political Contributions, Employees Dues, Charitable Donations, Meals/Travel and Business Entertainment, Research and Development

Hydro Ottawa believes that reasonable amounts of charitable contributions that support the service area in which the distributor operates are appropriate for recovery, as set out in Alternative 3. It is

unfair to distributors to set new rules after the fact, since if this criteria had been known it is unlikely that the expenses would have been incurred in 2004.

If the Board adopts the Alternative 1 for partial recovery, Hydro Ottawa strongly believes that there are charitable contributions beyond those that provide assistance to customers in paying their electricity bills that would also be appropriate for 100% recovery. For instance, contributions that include a safety aspect would also be appropriate. Safety is a critical issue for electricity distributors, both from a public and staff perspective. Conservation and demand management is another important area.

While Hydro Ottawa does not support Alternative 1, if it is adopted it should be revised as follows:

"100% of charitable contribution expenses made to programmes that provide assistance to the distributor's customers in paying their electricity consumption bills, that assist customers with conservation or demand management or that relate to safety, will be included in the determination of the applicant's 2006 revenue requirement."

For meals/travel and business entertainment expenses, Alternative 2 is appropriate because a description of the policy should provide the details necessary to review the controls that a distributor maintains for such expenses.

6.2.5 Employee Total Compensation

- Minimum Filing Requirements

There seems to be little value in requiring a distributor with less than 3 employees to provide compensation information, therefore Alternative 1 appears reasonable.

Requirements to file the individual salaries for all employees making in excess of $100,000 provide no benefit other than to satisfy the curiosity of external parties. Total compensation is to be provided by category of employee and this is the only information that is relevant to the regulation of distribution rates. Therefore, Alternative 2 is appropriate for this requirement.

- Incentive Plans

Hydro Ottawa believes that all of its performance incentive plans are of substantial benefit to ratepayers by leading to a more effective and efficient company. Therefore Alternative 1 is appropriate.

The compensation package for all of Hydro Ottawa's non-union employees includes a base salary plus an amount for achieved performance on goals that are set each year. Most of these goals are specific to that employee and therefore form a confidential contract between the employee and their manager. With roughly 100 non-union staff and an estimated average of 5 individual goals per employee, this translates into 500 different performance goals at Hydro Ottawa each year used for the performance incentive plans. Clearly, reporting on this level of detail would be completely irrelevant and would breach the confidentiality of those employees. Furthermore, it is simply not possible to separate goals

into shareholder-related and rate-payer related components. If a goal is set for a target net income, and this is achieved by becoming more productive and efficient, then clearly the rate-payer has benefited since this improved efficiency will lower costs to be recovered in rates. Alternative 2 Minimum Filing Requirements could not be effectively implemented.

Hydro Ottawa adopts a balanced score card approach to its performance incentive plans in that some goals relate to the financial performance of the company and some to the quality of services to customers. Hydro Ottawa could summarize the main categories used to set the performance goals without providing the detailed goals set for each employee.

6.2.7 Distribution Expenses Paid to Affiliates

The 2006 EDR process is not the appropriate vehicle for determining if a distributor is compliant with the Affiliate Relationship Code. There are other avenues that can be used on an ongoing basis through the Board's Compliance Department. Therefore the Proposed Additional Filing Guidelines and Additional Wording are not appropriate inclusions for the 2006 Distribution Rate Handbook.

Chapter 7: PILs

7.1.1 General Principles Underlying the 2006 Tax Calculation

- True-Up of 2006 actual taxes paid to taxes recovered in rates

For PILs, Hydro Ottawa supports Alternative 1 in which PILs will only be trued up for legislative or regulatory changes to the tax rates or rules, new assessing or administrative policy of the Federal or Provincial tax authorities or impacts to 2006 PILs from a tax re-assessment. The 100% Pass-Through/True-Up option rated low in fairness in the evidence provided by Mr. Erling of KPMG. The pass-through option would result in increased risk to distributors from the uncertainty and more rate volatility for customers.

7.1.2.2 Non-recoverable and disallowed expenses

Hydro Ottawa supports the evidence and conclusions of Kathleen McShane on behalf of the Coalition of Issue Three Distributors. Of particular note is the principle that "benefits follow costs". As indicated in Section 4, Page 2 of 31 of this evidence: *"To allocate the tax savings to the ratepayer when the shareholder has borne the costs constitutes an unfair "double dip" for the ratepayer."*

7.1.2.5 Loss carry-forwards

Similar to the question of PILs on disallowed expenses is the application of loss carry-forwards for the 2006 PILs. If a distributor has a loss carry-forward from a previous period it is likely the result of costs incurred in previous periods that have not, and will not, be recovered from customers through rates. Therefore, applying the principle of "benefits follow costs" as discussed in the evidence of Kathleen McShane, a distributor should not lose the benefit of a loss carry-forward when they have incurred these additional costs not recovered from customers.

Chapter 8: Revenue Requirement

Section 8.1 Service Revenue Requirement

The Service Revenue Requirement is defined as (Rate Base x Cost of Capital) + Distribution Expense + PILs. However, Chapter 4 on Distribution Expenses does not clearly define that distribution expenses include amortization expenses on assets. Hydro Ottawa is concerned about the lack of discussion on Amortization Expense included in the Handbook. The only reference to amortization is included in section 4.2, indicating that the amortization rates as set out in Appendix C should be used.

However, the service revenue requirement must include amortization expenses. For a historic test year, this could be the amortization expenses from 2004 or more appropriately the amortization expenses that will occur in 2006 for 2004 assets. This distinction is important. An LDC that adds a major capital asset in 2004 will apply the half rate rule to the asset as required by Generally Accepted Accounting Principles (GAAP), and will record only 50% of the annual amortization on that asset in 2004 but will incur 100% of the annual amortization in 2006 for this 2004 asset. If a 2004 asset has been permitted in the rate base, the full annual amortization on that asset should also be permitted.

Furthermore, Chapter 3 of the Handbook discusses test year adjustments. Some of these adjustments affect capital. An LDC making Tier 1 and/or Tier 2 capital adjustments to the test year should adjust the amortization expense accordingly.

Section 8.2 Service Revenue Requirement and Base Revenue Requirement

A materiality threshold of 2% of total revenue is set for unusual and non-recurring revenue adjustments. This should be clarified as referring to 2% of total 2004 distribution revenue.

Section 8.3 CDM, Smart Meter, and Regulatory Asset Amortization Revenue Requirements

Hydro Ottawa is concerned about the absence of detail on the recovery of regulatory assets or other deferral accounts such as Account 1508 OEB Cost Assessments. The Board issued its Decision with Reasons on December 9, 2004 on regulatory assets incurred up to December 31, 2003. The 2006 Distribution Rate Handbook should include information on the disposition / recovery of regulatory asset and deferral accounts for 2004 and beyond. This should be an integral part of the 2006 rates. This lack of direction once again puts distributors in a situation in which recovery is uncertain.

Chapter 9: Cost Allocation

Section 9.3 refers to “regulatory asset revenue requirement”. Since amounts collected from customers to recover regulatory assets are not revenue to LDCs, but rather draw down assets on the balance sheet, this term is not appropriate. Hydro Ottawa would recommend the use of term “regulatory asset recovery” instead of “revenue requirement”.

In the case of unmetered scattered load, three years of data may not be available if the LDC has been treating this load as a General Service < 50 kW customer. In these cases, an estimate based on current connected load should be permissible.

Chapter 10: Rates and Charges

10.2 Unmetered Scattered Load

Section 10.2 includes detailed instructions on the setting of rates and charges for unmetered scattered load. This is to be revenue neutral to LDCs and therefore is a reasonable approach in the absence of a cost allocation study. However Hydro Ottawa has the following comments about unmetered scattered load.

LDCs must continue to have the authority to determine which loads are permitted to be unmetered. Chronic problems with being notified of load changes have resulted in significant costs to LDCs of tracking these loads. For unmetered services to be successful, both the LDC and the customer have a responsibility to keep accurate records and periodically perform joint field audits for on-going demand changes and load units actively connected to the distribution system. If not properly monitored, the LDC is exposed to unauthorized (for both intentional or un-intentional) energy usage.

Within Ottawa, low demand unmetered services have typically been provided to groups located within the public road right-of-way for their convenience, simplicity of installations and aesthetics. Although the LDC does have some minor benefits with unmetered services, the customer enjoys substantial savings with this type of electrical installation. As well, the road authority is a large benefactor by having a cleaner, safer corridor that typically tends to be already fairly congested.

With the benefit already being strongly in the customer's favour, and with the lower distribution rates being proposed, Hydro Ottawa feels that it should not incur additional costs to provide all of the service levels provided to a metered customer. For instance, the Distribution System Code requires that LDCs provide notice of planned power interruptions. This is typically done by having field staff involved in the project leave a pre-printed card at the premises of customers in the affected area. Leaving a card for an unmetered load would be of no value. Therefore to provide this notification to unmetered customers, Hydro Ottawa would have to incur the additional costs of having office staff review the affected area to determine the location of unmetered loads and notify the owner of the load. Where an LDC is required to provide specialized processes for unmetered load, not required for metered loads, these should be permitted on a fee for service basis.

10.3 Transformer Ownership Allowance

Hydro Ottawa concurs with the approach for 2006 of keeping the existing transformer ownership allowance credit. Hydro Ottawa has treated transformer ownership allowances much like a miscellaneous distribution revenue for reporting purposes, and therefore has no information on the dollars or demand by class of customer. However, since no change is being made to the rate, the additional step of completing Schedule 10-4 seems superfluous and this data provides no benefit in this proceeding. Hydro Ottawa therefore recommends that Schedule 10-4 be removed.

10.5 Update of Loss Adjustment Factor

At this time, Hydro Ottawa supports the continuation of existing practices for loss adjustment factors. Loss factors can be very complicated and rely heavily on an estimate at year-end of electricity purchased that has not yet been billed to customer (associated with the year-end unbilled revenue accrual). With bi-monthly billing cycles, it is mid-March before all energy is billed for December. However, Hydro Ottawa closes its year-end books in January and therefore must estimate what will be billed for the next 1.5 months. Changes in weather or billing cycles can have a significant impact on the estimate of what will be billed. If this estimate is high, the loss factor will be lower in that year but will be higher in the subsequent year. This means that any alternative that makes adjustments based on only one year of losses is inappropriate, therefore Hydro Ottawa cannot support Alternative 2. The status quo is the only reasonable alternative at this point.

10.6 Distributed Generation

Most of the embedded generation within Hydro Ottawa's service territory was grandfathered at market opening and therefore is net metered. Net metered customers would not be eligible for any credits. Hydro Ottawa is recommending that the status quo be maintained until a full review can be completed in 2007.

10.7 Standby Charges

Hydro Ottawa has no issues with the proposed standby charge methodology. Clarification is required on when the standby charge is applied and when it is dropped to avoid double billing.

Chapter 11: Specific Service Charges

11.6 Other Service and Charges

Hydro Ottawa is concerned about the last paragraph in this section that indicates that distributors still need approval of the regulator for services provided in competition with other service providers. Under this situation, the distributor would lose any competitive advantage, with the net result that any additional revenues for these services would be lost. You cannot possibly compete for business if charges can only be set based on the normal rate setting timelines and processes, and are made public in advance to all possible competitors. Since these additional revenues form part of the distributor's overall revenue requirement, the net result of losing this revenue would be increased distribution rates to all customers. The kinds of competitive services that Hydro Ottawa would currently provide would include such activities as vault maintenance, meter verifications or the monitoring of power quality. These services leverage the internal skills and resources that Hydro Ottawa already requires to operate its distribution system, and allows the resources to be used more efficiency to the benefit of its customers.

The intent of regulatory oversight is to ensure that a monopoly is not abused. But since this is a competitive situation this regulatory oversight is not required in the setting of charges. The only criteria must be that revenue from distribution rates in no way subsidizes the provision of these

services, i.e. the services must be provided on a cost plus basis. Therefore, Hydro Ottawa recommends that the last paragraph of section 11.6 be removed.

Schedule 11-2: Specific Service Charges: Standard Formula and Amounts

Hydro Ottawa supports the methodology set out in the schedule and may have to adopt the approach rather than the actual standard rates. This is because it appears the standard rates were developed without a fully allocated cost approach and as a result the burden rates are significantly lower than is reasonable. These charges are expected to cover the true costs of providing these services, however the charges do not include burdens for the facilities in which the employees work, the computer that is used to complete the work or the supervision of the work.

Chapter 12: Other Regulated Charges

12.2.4 Service Transaction Requests (STR)

- Fee for specific STRs

Hydro Ottawa disagrees with the proposal that a $2 charge is appropriate for requests for customer information that exceed the two free requests provided each year. This charge would cover a small fraction of the cost of providing this service outside of the EBT system. This charge should be considered under Chapter 11 Specific Service Charges and distributors should be permitted to seek approval for a charge that reflects the cost of providing this service. Hydro Ottawa therefore recommends that this section be revised as follows:

"Where requests exceed two per year, a distributor may establish an information delivery charge. The distributor should determine this charge as part of its filing for Specific Service Charges as outlined in Chapter 11."

Chapter 13: Mitigation

Hydro Ottawa is concerned by any proposal that would reduce the revenue requirement for Hydro Ottawa after a review of the cost of service has already been completed and has determined the revenue requirement to be just and reasonable. Any strategies implemented for rate mitigation should be revenue neutral to distributors.

Mitigation is of particular concern to distributors, such as Hydro Ottawa, who's distribution rates are already well below average in the province simply because of its particular situation at the time the last rate base was set. Any review of rate impacts must not only look at the percentage increase, but also examine if these rates still remain well below the provincial average.

Chapter 14: Comparators and Cohorts

Inconsistency between distributors means that this information will be of little or no value for the 2006 EDR process. The only thing to be gained by gathering the information is to identify further the inconsistencies so that these can be reduced for future periods.

Of particular importance is how comparator information will be used. Board staff has repeatedly indicated that information will only be used to screen applications for further review. Therefore, once the screening is completed, the comparator information should no longer be of relevance to the review, and should not be used to question any aspect of the application. Furthermore, given the experimental nature of this use of comparators, and the inconsistencies that have been acknowledged by all expert witnesses, any comparator information should be kept confidential by Board staff.

Chapter 15: Service Quality Regulation

Hydro Ottawa has no concerns with this chapter.

Conservation and Demand Management

Hydro Ottawa takes very seriously the responsibilities it has been granted to create a conservation culture in Ontario. Hydro Ottawa was in the first group of distributors to receive approval on its CDM plan, and implementation of that plan is well underway. As indicated in the hearing on its CDM plan, distributors are still in the early stages of CDM, and will be developing measurement and evaluation tools for monitoring the results of programmes as part of implementing the approved plan. This is one of the outputs from this first phase of CDM that will be a critical input to the second phase. Therefore, an important factor for the 2006 EDR process is to adopt a simple approach that can be updated and revised for the second phase of CDM when more experience has been gained.

Hydro Ottawa has reviewed the argument being put forth by Hydro One on CDM. Hydro Ottawa supports the comments provided by Hydro One and particularly the three elements required by distributors of cost recovery, compensation for lost revenue and incentives for undertaking CDM.