

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by PowerStream Inc. pursuant to the *Ontario Energy Board Act* for an Order or Orders approving rates for the distribution of electricity for the years 2016 through 2020

**FINAL ARGUMENT
OF THE
SCHOOL ENERGY COALITION**

January 15, 2016

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TABLE OF CONTENTS

0	GENERAL COMMENTS.....	3
0.1	<u>INTRODUCTION</u>	3
0.2	<u>OVERRIDING ISSUES – ITS ABOUT RATES</u>	4
0.3	<u>SUMMARY OF SUBMISSIONS</u>	10
1	RENEWED REGULATORY FRAMEWORK	12
1.1	<u>INTRODUCTION</u>	12
1.2	<u>CUSTOM IR REQUIREMENTS</u>	12
1.3	<u>OUTCOMES</u>	15
1.4	<u>CUSTOMER ENGAGEMENT</u>	17
	BENCHMARKING.....	17
1.5	<u>INTRODUCTION</u>	17
1.6	<u>EFFECT OF USING BOARD’S ECONOMETRIC MODEL</u>	18
1.7	<u>RESULTS IMPLIED BY THE BOARD’S ECONOMETRIC MODEL</u>	19
	OEB STAFF PROPOSAL	22
1.8	<u>THREE YEAR APPROVAL</u>	22
1.9	<u>RESPONSE OF THE BOARD</u>	23
1.10	<u>SEC POSITION</u>	25
2	MERGER IMPLICATIONS	26
2.1	<u>INTRODUCTION</u>	26
2.2	<u>“STAND-ALONE” FOR AN M&A-DRIVEN UTILITY</u>	27
2.3	<u>CONTINGENCY PLANNING</u>	29
2.4	<u>LEGAL REQUIREMENTS</u>	30
2.5	<u>PRACTICAL ISSUES</u>	31
3	CAPITAL, DISTRIBUTION SYSTEM PLAN, AND RATE BASE	33
3.1	<u>OVERVIEW</u>	33
3.2	<u>UNDERSPENDING AND OVER-BUDGETING</u>	33
3.3	<u>TOO MANY ASSETS BEING REPLACED</u>	35
3.4	<u>RELIABILITY NOT ACCURATELY CONSIDERED IN CUSTOMER ENGAGEMENT</u>	36
3.5	<u>NO PRODUCTIVITY</u>	37
3.6	<u>NO THIRD-PARTY REVIEW</u>	38
3.7	<u>INTERNAL VERSUS EXTERNAL CONTRACTORS</u>	39
3.8	<u>COMMERCIAL AND RESIDENTIAL SUBDIVISION DEVELOPMENT</u>	40
3.9	<u>SYSTEM HARDENING</u>	40
3.10	<u>ASYMMETRICAL VARIANCE ACCOUNT</u>	41
3.11	<u>CIS SYSTEM</u>	42
4	LOAD AND CUSTOMER FORECASTS	44
4.1	<u>CUSTOMER FORECAST</u>	44
4.2	<u>LOAD FORECAST</u>	44
4.3	<u>REVENUE OFFSETS</u>	44
5	OM&A	45
5.1	<u>OVERVIEW AND HISTORY</u>	45

5.2	<u>NO INCREMENTAL PRODUCTIVITY SAVINGS</u>	45
5.3	<u>CAPITAL SPENDING OUTCOMES NOT REFLECTED IN OM&A BUDGETS</u>	46
5.4	<u>VEGETATION MANAGEMENT</u>	47
5.5	<u>WATER-SEWER BILLING</u>	48
6	CAPITAL STRUCTURE AND COST OF CAPITAL	50
6.1	<u>GENERAL</u>	50
7	COST ALLOCATION	51
8	RATE DESIGN	51
9	DEFERRAL AND VARIANCE ACCOUNTS	52
9.1	<u>BALANCES FOR RECOVERY IN DEFERRAL AND VARIANCE ACCOUNTS</u>	52
9.2	<u>NEW ACCOUNTS</u>	52
10	IRM COMPONENTS	53
10.1	<u>Z-FACTORS</u>	53
10.2	<u>ESM</u>	53
11	OTHER MATTERS	54
11.1	<u>EFFECTIVE DATE</u>	54
11.2	<u>REPORTING AND RECORD KEEPING</u>	54
11.3	<u>COSTS</u>	54

0 GENERAL COMMENTS

0.1 Introduction

- 0.1.1** On May 22, 2015 the Applicant PowerStream Inc. filed an Application to set just and reasonable rates for the distribution of electricity for the period commencing January 1, 2016. The Application seeks increases of \$275 million in its revenue requirement over five years¹, and an expanded five-year capital program totaling more than \$644 million.
- 0.1.2** The essence of this Application is PowerStream's claim that it needs an expanded capital program to renew and harden its distribution system. As a result, the Applicant seeks rate increases that, for many customers, will total around 50% over a period of five years².
- 0.1.3** Further, the Application is being considered by the Board against the backdrop of an announced merger, approved by all of the participants and their shareholders, of the Applicant, Hydro One Brampton, Enersource, and Horizon. While the rate impacts of the merger were determined by the Board to be out of scope of this proceeding in its decision dated October 6, 2015³, the merger remains relevant due to its independent legal and policy ramifications on the Board's decision in this matter⁴, and the evidence that the standalone utility cost forecasts likely include costs and benefits associated with the merger.
- 0.1.4** PowerStream's Argument-in-Chief was filed on December 14, 2015. This is the Final Argument of the School Energy Coalition.
- 0.1.5** The ratepayer groups who intervened in this proceeding have worked together throughout the hearing to avoid duplication, including exchanging drafts or partial drafts of their final arguments. We have been assisted in preparing this Final Argument by that co-operation amongst parties. Where we are in agreement with the submissions of other parties, we have not repeated their arguments here, but have adopted their reasoning to the extent possible.
- 0.1.6** We also note that the Final Argument prepared by OEB Staff was filed on January 13, 2016. In some cases we agree with their conclusions, and where we have we have so stated in the body of these submissions. We understand that other parties are doing so as well. In other cases, we strongly oppose the positions OEB Staff have taken⁵. In those cases we deal with our opposition specifically in the reasons below.

¹ Tr.1:40-41.

² See para. 0.2.6 of this Final Argument.

³ Decision on Threshold Question and Procedural Order No. 5 (the "Threshold Decision").

⁴ See further discussion in Section 2 of this Final Argument.

⁵ See in particular Sections 1.8 to 1.10 of this Final Argument.

0.1.7 The complexity of this proceeding necessarily required prioritization by intervenors. As a result, we have not made submissions on every issue on the Issues List. In a number of cases, we have elected to focus our resources on other areas, and not develop positions on issues, including some that have material impacts. Where SEC indicates that it does not have submissions on any issue, that should not be interpreted as agreement with the Application or any aspect of it, nor agreement with the position of any other party to this proceeding. Where we agree, we say so explicitly. Silence is just silence.

0.1.8 The numbering of Sections and Subsections in this Final Argument is not consistent with the numbering in the Issues List proposed by OEB Staff, as the issues that arose in the course of the proceeding and in the development of this Final Argument made a different logical structure necessary.

0.2 Overriding Issues – Its About Rates

0.2.1 *What Are the Main Issues?* The two most obvious issues in this proceeding are:

(a) The requirements of Custom IR and the RRFE.

(b) The Applicant’s poor actual and projected cost performance trajectory.

0.2.2 It is true that these are important, and will be discussed at length in the submissions the Board receives. SEC will also talk about them in this Final Argument.

0.2.3 But it is critical, in our view, for the Board never to take its eyes off the real main issue, not just in this proceeding, but in all rate applications, and that is rates, and in particular rate increases. The Board does not, of course, need SEC to instruct it on the importance of “just and reasonable rates”. However, we are raising it early in this Final Argument because the underlying themes in each of the other major issues really boil down to rate increases that are too high, because of cost increases that are too high. Maintaining the connection between the technical issues, and the overriding reality, is a theme in this Final Argument.

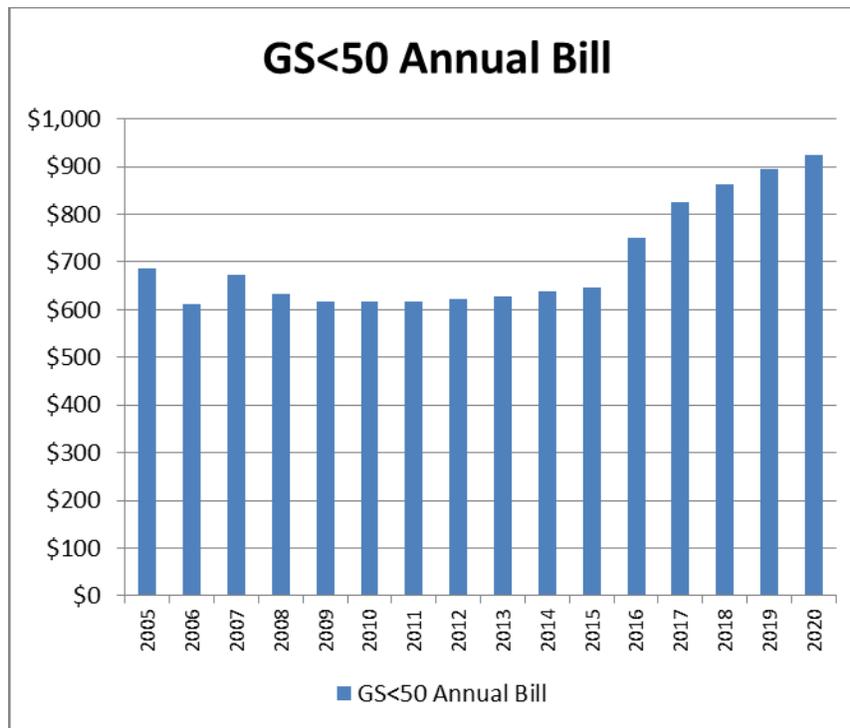
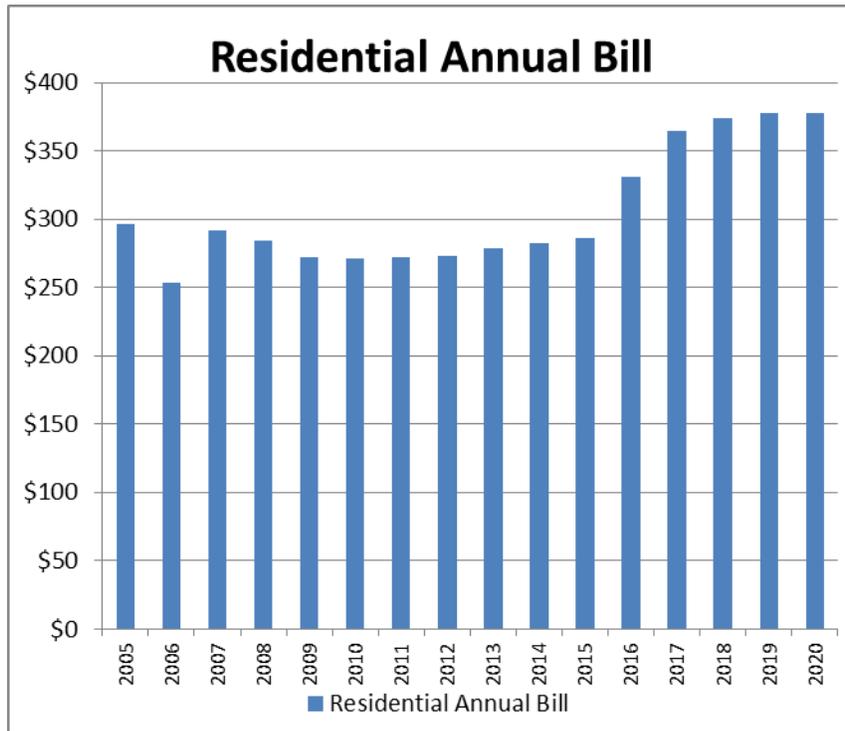
0.2.4 *Custom IR Requirements.* In Section 1.4 of this Final Argument, SEC will discuss the requirements of Custom IR, and conclude that this Application does not meet those requirements. As a result, it should be rejected as a Custom IR application, with all of the regulatory and procedural consequences that implies.

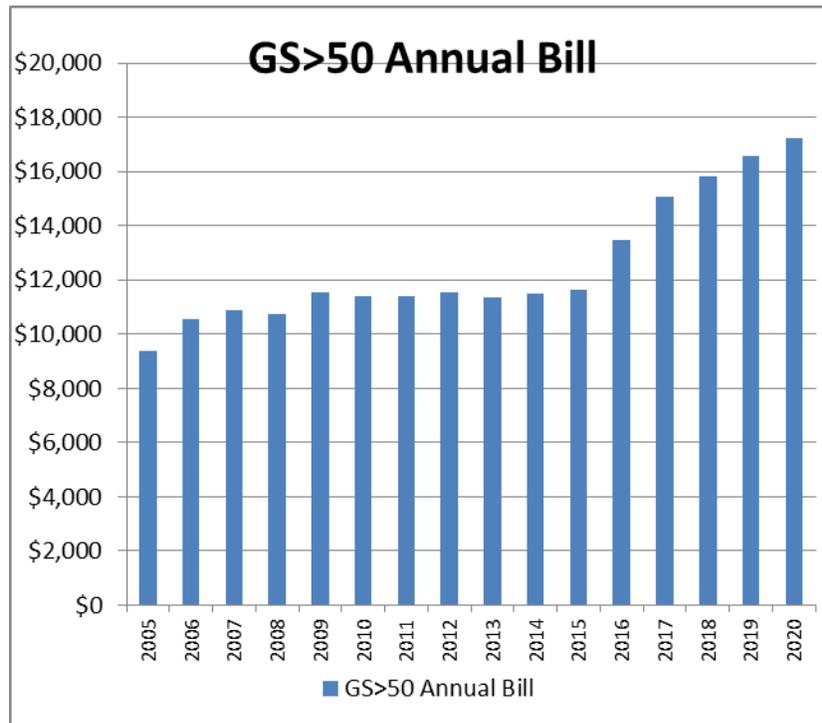
0.2.5 The connection between Custom IR and the customers is discussed in more detail in Sections 1.8 to 1.10. There, we emphasize what should be – and we think is – the Board’s central focus in dealing with Custom IR applications. That is: **Under the RRFE, and in particular Custom IR, customers are supposed to be winners, not losers.** If the end result of any application doesn’t meet that test (as here), it is not

consistent with either RRFE or Custom IR, and should not be acceptable to the Board.

- 0.2.6 *RRFE and Benchmarking.*** One of the main strengths of the Renewed Regulatory Framework for Electricity is its reliance on an empirical approach to costs. Like the competitive markets, costs in the RRFE environment can be assessed through an empirical lens. In the end, that means that the assessment is highly rational, but also uncompromising. It doesn't accept excuses (just like the marketplace). Package your budgets up any way you like, spin your story with the greatest of skill, and in the end the numbers don't lie. If your forecast costs are too high, it is the job of the regulator to spot that and deal with it.
- 0.2.7** Willard Vandiver was a Congressman from Missouri, and is widely credited as being the creator of the state motto, The Show Me State, from his speech in the House of Representatives, when he said "I come from a state that raises corn and cotton, cockleburs and Democrats, and frothy eloquence neither convinces nor satisfies me. I'm from Missouri, and you have got to show me."
- 0.2.8** So, too, the RRFE says "Don't tell a big story. Show the Board real evidence that your forecast costs are reasonable." Benchmarking is a powerful tool for the Board to assess reasonableness. It is not the only tool, but it is an important one, and in this proceeding especially so.
- 0.2.9** In Sections 1.5 to 1.7 of this Final Argument, SEC will discuss the econometric benchmarking evidence in this proceeding, which demonstrates that Powerstream is projecting deteriorating cost performance over the next five years. This shift from good cost control to poor cost control should be of concern to the Board. No amount of persuasive verbiage can change that simple fact.
- 0.2.10 *Rate Increases.*** More important, though, in SEC's view is the need to keep focused on the Board's fundamental mandate, "just and reasonable rates". This Application is about rates, and specifically about a proposal to increase those rates at an unprecedented pace.
- 0.2.11** During the course of the oral hearing, SEC put to the Powerstream witnesses a series of comparisons of historical vs. forecast rate increases⁶.

⁶ Ex. K2.1, pp. 17-19.





0.2.12 The graphs, while striking, do not show the full extent of the change in circumstances that Powerstream is proposing in this Application. A numerical comparison of historical rate increases vs. proposed rate increases makes the size of the change more evident:

Period	Annual Distribution Rate Increases		
	Residential	Small Business (GS<50)	Commercial/Industrial (GS>50)
Historical 2006-2015	1.38%	0.62%	1.10%
Proposed 2016-2020	5.66%	7.41%	8.15%

0.2.13 These increases were put to the Powerstream witnesses for explanation⁷. While they accepted the numbers, they were less helpful when it came to explaining what has happened.

0.2.14 Their first response, when asked what has changed that requires a massive jump in rates, was asset planning. The exchange is as follows⁸:

⁷ Tr.1:44-49.

⁸ Tr.1:47.

“MR. SHEPHERD: ... What I want to find out is have PowerStream's circumstances changed recently in some way that makes it suddenly necessary to have these large rate increases, when you didn't have them in the past?”

MR. MACDONALD: Yes, they've changed.

MR. SHEPHERD: Okay. What changed in your circumstances?

MR. MACDONALD: We've really improved our asset planning process, asset condition assessment, other analyses that we do. And that's the biggest driver, is we're learning that we have to systematically update and upgrade the power system to maintain -- just to maintain reliability, and that's driving capital dollars higher.”

0.2.15 This had, of course, two implications. First, they said that they were not offering their customers any improvements in their system in exchange for the higher capital and the higher rates that result. Second, and more serious, they appeared to be admitting to poor past performance. We pursued that⁹:

“MR. SHEPHERD: You didn't know that before?”

MR. MACDONALD: No, not to the extent we do -- we do now.

MR. SHEPHERD: It sounds like you're saying that in the last nine years, you haven't really been running things properly, and now you've figured out how to do it right.

MR. MACDONALD: I don't think that's fair. I think it's more appropriate that we've improved the tools we use to do asset management, and we're finding things and getting a better understanding of our system.”

0.2.16 This admission by Mr. Macdonald, that they are just now starting to understand what they have to do to maintain their system, is surprising but perhaps also a little disingenuous¹⁰.

0.2.17 However, when then asked whether the real reason for the difference between past and future savings is the past efficiencies driven by mergers, the witness was reluctant to admit it. Yes, he said, there were savings from past mergers, but in the future rate increases will be driven by growth in capital spending, where mergers generate no savings¹¹.

0.2.18 This is, of course, contrary to the evidence, including in particular the study by Navigant for Vaughan Council. Navigant – using Powerstream’s numbers – estimated that for the first ten years after a merger the savings to customers would be driven

⁹ Tr.1:47-48.

¹⁰ This is rather like vacuuming a rug, and being comfortable with how clean it is, then taking a magnifying glass to it, only to discover that there are still “creatures” in the pile. If everything was working fine before, a closer look does not mean that everything will suddenly fall apart.

¹¹ Tr.1:49.

primarily by avoided capital expenditures¹².

- 0.2.19** What SEC was actually looking for was some evidence that the external business conditions facing Powerstream were changing, justifying a massive increase in rates. What we got, instead is “We took a closer look, and we decided we should be spending more money. Nothing has changed. We just think we should spend more to get the same results.”
- 0.2.20** This is, in our submission, not an acceptable response. If your market isn’t changing, and your product isn’t changing, you should be finding ways to drive your costs down, not up. An employee can’t go to their employer and say “My family is really too big for my house, I’ve recently concluded, so I think I should get a bigger house. I’ll need a pay raise for that.”
- 0.2.21** *Role of the Board.* This is not the first time recently that a large electricity distributor has, in the face of poor or declining cost control, sought large rate increases. This puts the Board in a difficult position, particularly in this period of transition to the new RRFE. In each of the past cases that were contested, the Board has responded by giving the LDCs some, even most, of the increase they wanted, despite those applications in each case being in whole or in part non-compliant with the principles of the RRFE¹³.
- 0.2.22** To SEC, this raises a fundamental question. When a distributor seeks a big pile of additional money, yet the evidence shows poor or declining cost performance, does the Board nonetheless have any obligation (whether on legal or policy grounds) to give the utility at least some rate increases? Related to this is the question of the extent, if any, to which the statutory onus on the Applicant to show that the proposed rates are just and reasonable permits the Board to simply reject an application as unacceptable.
- 0.2.23** Put more succinctly, the question is: “Can the Board say no?”
- 0.2.24** SEC believes that it would be of assistance to the regulated utilities, the customers, and the public if the Board, in its decision in this matter, addresses its view of its legal and policy imperatives in the face of Custom IR applications that do not comply with the RRFE, or that produce unacceptable outcomes, or both. That is, under what

¹² K1.3, p. 113.

¹³ In EB-2013-0416, the Board gave Hydro One most of the large increases it requested for the first three years of a five year plan, then gave them permission to come back and ask for more for years four and five. In EB-2014-0116, the Board gave Toronto Hydro about \$700 million of \$900 million of requested increases over five years, notwithstanding benchmarking evidence showing past and continuing poor cost control. In EB-2014-0101, the Board gave Oshawa Hydro most of five years of high requested rate increases. In each case, Custom IR – even when applicants ignore its fundamental principles - has ended up being a very costly exercise for utility customers. Only Horizon, Ottawa and Kingston have resulted in outcomes that are in an acceptable range for customers, and in each case those Custom IR applications were from utilities that already had relatively good cost performance. Custom IR appears to be working well for the stronger performers, and their customers. The challenge for the Board is how to get the same positive customer outcomes when the utility has problems.

circumstances, if any, can or should the Board in fact say no to a Custom IR application?

0.3 Summary of Submissions

- 0.3.1 *Central Recommendation of SEC.*** This utility, with declining cost performance, is seeking to use Custom IR to justify early rebasing, and to support annual rate increases four to seven times greater than those in their past history. They do this without providing any empirical evidence benchmarking those proposals to hard data, and in the context of a situation in which everyone in the room knows they do not really need the money.
- 0.3.2** In these circumstances, SEC submits that the Board should reject the Application as non-compliant with the Custom IR requirements, and the principles of RRFE, and set Powerstream's 2016 rates based on the 3rd Generation IRM formula.
- 0.3.3 *Alternative Recommendations.*** In the event that the Board determines that rates should be set on a cost of service basis, whether for one year, or for longer, this Final Argument includes a number of submissions on the appropriate amounts to be included in revenue requirement. Some of the larger impacts are the following.
- 0.3.4 *Rate Base.*** SEC supports the submissions of AMPCO that capital spending should be cut by 20% per year for each of the five years in which rates are being set on a cost of service basis. This reduction of about \$130 million in capital spending would have the effect of reducing revenue requirement over five years by about \$20 million, and reduce costs borne by ratepayers after that time by many times that amount.
- 0.3.5** An asymmetrical capital additions variance account should be established to credit ratepayers with the revenue requirement impacts of underspending, or deferred spending, of the revised capital plan.
- 0.3.6** The Board should disallow a portion of the CIS project costs on the basis of cost overruns due to imprudent project management. This should reduce revenue requirement over five years by at least \$10 million.
- 0.3.7** The capital and operating costs of the new CIS properly allocable to water and sewer billing should be defined through an independent study, and the amount credited to a variance account for later disposition in favour of the ratepayers.
- 0.3.8 *Operating Costs.*** This Final Argument deals with a number of specific areas of OM&A that are forecast too high. In the end, SEC proposes that they all be dealt with through an envelope approach, as the Board often does. OM&A should be set at 2014 actual levels, plus inflation, and less a reasonable productivity assumption of 0.5%, for each of 2016 through 2020. The effect of this would be to reduce five year revenue requirement by about \$60 million.

0.3.9 Cost of Capital. SEC agrees with Energy Probe that new long term debt during the plan should be calculated using the ten year market rates. While future market rates are unknown, the normal interest rate spreads should mean that this adjustment reduces five year revenue requirement by \$10-12 million.

1 RENEWED REGULATORY FRAMEWORK

1.1 Introduction

- 1.1.1** This is an Application under the Custom IR option in the Renewed Regulatory Framework for Electricity. It is therefore important to test whether the Applicant has met the requirements of the RRFE for a Custom IR application. It is also important to assess whether the broad principles of the RRFE are being achieved if this Application, or some variation on this Application, is accepted by the Board.
- 1.1.2** We will deal with the RRFE implications of the Application under the following headings:
- (a)* Is this Custom IR?
 - (b)* Does the Application produce acceptable outcomes?
 - (c)* Has the Applicant properly included customer engagement in their planning and Application?
 - (d)* Are the Application, and the rates proposed in it, supported by appropriate benchmarking evidence?
 - (e)* How should the Board deal with the RRFE deficiencies in the Application, and in particular with the proposal from OEB Staff of a three-year approval?

1.2 Custom IR Requirements

- 1.2.1** *Why Is Custom IR Compliance Important?* On the face of it, if this Application is not a qualifying Custom IR application, then it is a five year cost of service, which is clearly contrary not only to Board policy, but also to the underlying principles of the RRFE.
- 1.2.2** There is, however, another factor at play here. The Applicant was last rebased in 2013, and so would normally not be up for rebasing, under 4th Generation IRM, until 2017. Their justification for coming in a year early is that this is a Custom IR application, and under the RRFE a utility on 3rd Generation IRM can come in for Custom IR at any time.
- 1.2.3** However, if this Application does not qualify as Custom IR, then under the RRFE a utility like Powerstream on 3rd Generation IRM must wait for rebasing until the appropriate year, in this case 2017. Thus, if the Board determines that this Application does not qualify for Custom IR, there is a simple solution: apply the 3rd Generation formula to 2015 rates to get 2016 rates.

- 1.2.4** Of course, under the RRFE, and the previous IRM regime, it was always open to a utility to file evidence showing how they are not able to survive on the IRM formula, and thus seek early rebasing. The Board has established criteria for that, and they are strict ones.
- 1.2.5** In this case, Powerstream has not provided evidence that they cannot survive another year under IRM, and indeed their ROE history and forecasts suggest that they do not have a significant problem, at least for one year anyway. Thus, in our submission if the Application does not qualify under Custom IR, the result is application of the 3rd Generation IRM formula.
- 1.2.6** SEC is, of course, conscious that applying the formula instead of considering the five year application would, indirectly, solve many of the regulatory complications raised by the upcoming merger. By the time the 2017 rate year rolls around, Powerstream will no longer be Powerstream, and any cost of service forecasts will be based on a different set of assumptions.
- 1.2.7** That is not, though, a legitimate reason in itself to refuse the Application.
- 1.2.8** In our submission, the Application either complies with Custom IR, or it does not. If it does comply, it must be considered on its merits, and given the Threshold Decision the merger implications are for another forum. If it does not comply, then 3rd Generation IRM continues to apply, and again the implications of the merger are not for this proceeding.
- 1.2.9** *Is This Custom IR?* Other parties will consider aspects of this question, and conclude that this Application does not qualify as Custom IR. Rather than repeat the more fulsome arguments on this issue that others present, we provide instead the following summary of why we believe this Application is not a Custom IR application.
- 1.2.10** The following are, in SEC's submission, the key criteria distinguishing a Custom IR application, and how this Application stacks up to each:
- (a) Benchmarking.** The application must be supported by credible benchmarking. As detailed later in this Final Argument, the Applicant has provided no independent benchmarking evidence, and the weak evidence they have provided (internally re-doing the PEG model) shows that the proposed rate increases are not appropriate.
 - (b) Outcomes.** The application must tie any larger than average rate increases to better than normal outcomes for ratepayers. We deal with outcomes below, and show that, except for much higher rates, the Applicant is not promising any "outcomes" to ratepayers.

- (c) ***Pacing of Spending and Rate Increases.*** Custom IR requires that the utility develop a spending and rate trajectory that respects the customers, and ramps up spending and rates only gradually. As we note in our rates analysis, the Applicant has done just the opposite, suddenly moving from rate increases below inflation, for ten years, to rate increases four to seven times as high, for the next five years. Instead of mitigating rate impacts to respect customer needs, this Application simply loads as much spending as possible on the customers, all at once. The theme is not the tide coming in slowly, but rather a tsunami of additional costs.
- (d) ***Independent Review of Cost Forecasts.*** The application should show evidence that the capital and operating cost forecasts are supported by reliable third party analysis. The Application contains no evidence in this category¹⁴.
- (e) ***Continuous Improvement.*** A utility has to include in Custom IR explicit productivity gains and other evidence of continuous improvement. Powerstream has, instead, simply built supposed savings into its forecasts, then calculated those savings after the fact. This is the straw man approach to productivity, and has been expressly rejected by the Board. This is not continuous improvement. Continuous improvement is setting cost reduction goals that are a stretch, and then working after rates are set to find new ways of achieving those goals. Productivity doesn't end when the rate application is filed. That's when the real work begins.
- (f) ***Live Within Their Means.*** A Custom IR application must show that the utility can live within the envelope created by the rates being set, with minimal annual or special adjustments.
- (g) ***Reporting and Metrics.*** An application under Custom IR should include proposals for measurement of progress throughout the Custom IR period. This Application has no proposals of that type, and the Applicant expressly rejects tracking unit costs and similar productivity measures.

1.2.11 SEC submits that the Board's expectations for Custom IR can be understood within a single broad theme. LDCs can apply for rates that are outside the standard 4th Generation IRM model, as long as two conditions are met:

- (a) Setting rates on a basis other than 4th Generation IRM will, in the long term, be in the best interests of the customers; and

¹⁴ This is discussed further in Section 3.6 of this Final Argument.

- (b) There is independent and empirical evidence that the rate levels that are proposed are appropriate, and will deliver the expected benefits to the customers.

1.2.12 This is, in our submission, the essence of the Board's customer-centric RRFE model. Custom IR is not intended to be a response to "We need more money". It is not intended to be a way to give utilities higher rates. Custom IR is intended to allow utilities to develop a long term plan to benefit their customers, and then show with solid external evidence that the plan will achieve that result. It is an attempt to create a true market proxy. Customers will be willing to pay for the products they want. Give them something better than they have now, and they will pay more. Conversely, if all you want to deliver to the customers is a continuation of your past "product", then the Board has 4th Generation IRM for that.

1.2.13 No part of this Application is offering to deliver a better product for more money, and no independent evidence is presented that the additional money is justified, either based on "need", objectively determined, or based on customer outcomes. This is just a utility asking for more money. It is not more complicated than that.

1.2.14 SEC therefore submits that the Application fails to quality as a Custom IR proposal, for all of the general and specific reasons noted above, as well as the analysis below.

1.3 Outcomes

1.3.1 Several utilities have now done detailed customer engagement (some good, some bad), and in any case distributors have for years been talking to their customers. With a few exceptions, there are three outcomes important to the customers, and in this order:

- (a) **Rates.** This is by far the most important priority listed in all customer engagement results.
- (b) **Reliability.** This is largely a binary measure. Most customers are happy with the reliability that they have, and are not willing to pay significantly more to get marginal increases in reliability. There are exceptions, but this is the general trend. If reliability dips below an acceptable threshold, however, this suddenly becomes a more important issue.
- (c) **Customer Service.** This is not binary. Customers who have had bad customer service experiences want customer service to improve, and will pay (small) reasonable price increases for that purpose.

This is all reflected in the oft-quoted phrase from utility managers, who say customers tell them: "Make sure the lights go on when I flick the switch, communicate with me when you need to, or when I call you (be nice), and keep my rates down."

- 1.3.2** Customers are also interested in things like CDM, and distributed generation, public safety, and even sometimes power quality, but from the point of view of distribution rates, the three items above are the ones that customers consistently mention in surveys, focus groups, and other interactions with the utility.
- 1.3.3** *Reliability and Customer Service.* The Applicant is not prepared to commit to any improvement in either reliability or customer service. In any case, there is no credible evidence from the customer engagement activities that the customers are clamouring to pay more for these outcomes. Powerstream in fact already provides good reliability, and very good customer service. The customers know that, and they respect that Powerstream does a good job in that area. For that reason, there is no evidence that they see the need to spend more money on those things. The current rates already support good outcomes in those areas.
- 1.3.4** The long and short of it is that Powerstream is not offering its customers improved reliability or customer service in return for higher rates, and the customers have not even asked them to do so.
- 1.3.5** *Rates.* The most important outcome for the customers, though, is rates. On this, Powerstream is proposing a rapidly deteriorating outcome, expressed in the rate chart we have included in para. 0.2.12 above. That shows:
- (a) Residential customers, who have had ten years of increases averaging 1.38% per year (i.e. on par with inflation less productivity), will now have to live with 5.66% per year for five years.
 - (b) Small business customers, who have had ten years of increases averaging 0.62% per year, will now face 7.41% per year for the next five years.
 - (c) Larger commercial, industrial and institutional customers, like schools, who have had ten years of increases averaging 1.10% per year, will now be asked to pay 8.15% per year for the next five years.
- 1.3.6** This is the entire Application in a nutshell.
- 1.3.7** The Applicant does not want to talk about these outcomes. The Applicant doesn't have any explanation to the school, or the dry cleaners, or the office building, or the apartment owner, or the homeowner, all of whom will see their rates suddenly increasing a lot more than in the past. Their answer? "We need more money."
- 1.3.8** If Blackberry, or Ford, or Exxon, or Shoppers Drug Mart wants to raise their prices, they can't just say "We need more money". They have to show that they are delivering more value than their competitors¹⁵, or more value than they have in the

¹⁵ Market-based benchmarking, the toughest kind.

past. They have to deliver a better product.

1.3.9 Powerstream has, in SEC's submission, failed to take appropriate account of the outcome that is uppermost in the customers' minds: cost. Consistent with the customer engagement, which showed strong resistance to large price increases, customers do not want to pay more, and they most certainly do not want to pay a lot more for the same, unimproved, product.

1.3.10 *Conclusion.* For these reasons, SEC believes that Powerstream has failed the outcomes test. They offer no improvement of any outcome, and on the one that matters the most – cost to produce the product - they offer their customers a large degradation in their performance.

1.4 Customer Engagement

1.4.1 SEC has had the opportunity to review the thorough and thoughtful submissions of BOMA on this issue¹⁶. In those submissions, BOMA concludes:

- (a) Customer engagement was commenced too late in the process, and as a result did not properly inform the utility's planning¹⁷.
- (b) Far from supporting the Applicant's rate proposals, the customers actually showed strong resistance to the size of the proposed increase, and many of the specific spending proposals.
- (c) The Innovative Research report fails to correctly characterize some of the key points made by customers, and reads in many places like advocacy.
- (d) Other processes, such as regional planning, also failed to engage customers at an appropriate stage.

1.4.2 SEC has reviewed in detail, and supports, the BOMA submissions and conclusions, and does not feel it is necessary to add anything further.

BENCHMARKING

1.5 Introduction

1.5.1 Benchmarking is a critical feature of the RRFE, and in particular the Custom IR option. It is also one of the most critical deficiencies of the Powerstream application.

¹⁶ BOMA Final Argument, pp.5-13.

¹⁷ OEB Staff takes a similar view, consistent with past Board decisions.

1.5.2 There are two problems with the Powerstream benchmarking “evidence”:

- (a) Powerstream did not produce any benchmarking specific to Powerstream’s situation. They simply did an internal analysis using the Board’s model. The problem with that is that the Board’s model is the basis for 4th Generation IRM. If that is the only benchmarking they have, it provides a foundation only for a conventional rebasing application (which would, of course, be in 2017).
- (b) The benchmarking Powerstream did do, using the Board’s model, showed that Powerstream’s cost performance is declining, and at an increasing rate. Further, even using the Board’s model, Powerstream was not faithful to the model, and had to revise their numbers during the oral hearing. Even further, those numbers are still overly rosy, and when asked about this, Powerstream fell back on criticisms of the Board model.

1.5.3 In short, Powerstream is in trouble here either way you look at it. If you take the Board’s model at face value, Powerstream should be in 4th Generation IRM. If you don’t accept that, and look at the model results as if they were somehow a “custom response”, the rate increases proposed by Powerstream are clearly contra-indicated by the model they themselves put forth.

1.6 Effect of Using Board’s Econometric Model

1.6.1 Custom IR expects that the utility will do their homework, and come up with a benchmarking study that is specific to their circumstances, and that justifies their higher than normal rate increases.

1.6.2 Powerstream did not do a study at all. They did not hire external experts, and they did not seek to establish benchmarking parameters specific to Powerstream. They asked an internal staff member, who is not an econometrician, or even an economist¹⁸, to run the PEG model for the period 2016-2020. Mr. Barrett, who did that run of the model, doesn’t even think the model is sound, and has many concerns about whether it is useful or valid¹⁹.

1.6.3 A Custom IR application is supposed to provide distributor-specific benchmarking evidence to support the reasonableness of the distributor’s forecasts. What Powerstream filed is the Board’s model, which the Board has used to support the reasonableness of the 4th Generation IRM method. In effect, what the RRFE says is that, if a distributor is on 4th Generation IRM, the Board’s model reasonably predicts costs and efficiency, and thus is a reasonable basis for productivity assignments within the 4th Generation rubric.

¹⁸ K2.2, p. 2.

¹⁹ See Tr.1:72-78. Mr. Barrett tries to undermine the credibility of the model, while at the same time supporting its use. It is not clear that he succeeds at either goal.

1.6.4 This, of course, begs the question. If the only benchmarking necessary for this Application is the Board’s model, then why is the Application not the 4th Generation IRM method for which the Board’s model is used?

1.6.5 SEC submits that, absent benchmarking evidence that deals with the specific business conditions and comparables of the Applicant, this is not a Custom IR application under the RRFE, and the Board should not set rates on the basis of Custom IR.

1.7 Results Implied by the Board’s Econometric Model

1.7.1 In the alternative, if the PEG benchmarking model is appropriate to use in a Custom IR application, then SEC submits that, even on the results proposed by Powerstream, the rate increases are not supported by the benchmarking. Further, the results proposed by Powerstream are not credible, and more realistic assumptions show even worse benchmarking results than the poor results from the Powerstream figures.

1.7.2 Powerstream supplied their version of the PEG model, including their calculation of predicted costs, and actual costs based on their Application²⁰. The table, with percentage increases added by SEC, shows the following:

PowerStream Version of PEG Model					
Year	Predicted \$	% Inc.	Actual	% Inc.	Efficiency
2010	\$212,561		\$196,831		-7.40%
2011	\$218,280	2.69%	\$203,553	3.42%	-6.75%
2012	\$216,915	-0.63%	\$218,815	7.50%	0.88%
2013	\$219,646	1.26%	\$225,894	3.24%	2.84%
2014	\$229,949	4.69%	\$242,112	7.18%	5.29%
2015	\$230,353	0.18%	\$249,034	2.86%	8.11%
2016	\$240,043	4.21%	\$264,462	6.20%	10.17%
2017	\$251,065	4.59%	\$280,334	6.00%	11.66%
2018	\$265,448	5.73%	\$293,366	4.65%	10.52%
2019	\$280,878	5.81%	\$306,453	4.46%	9.11%
2020	\$296,877	5.70%	\$319,225	4.17%	7.53%
2016/20	\$1,334,311		\$1,463,840		9.71%

1.7.3 On the face of it, Powerstream’s final benchmarking evidence shows their cost performance going from 7.4% below predicted costs, a good performance level, to 7.53% above predicted costs²¹, and along the way costs as high as 11.66% above

²⁰ J1.3

²¹ A degradation of more than \$38 million in annual costs relative to the benchmark.

predicted costs (i.e. very poor indeed). On their own evidence, their costs using the PEG analysis will be almost \$130 million too high for the period 2016-2020. This is, in fact, a majority of the difference between rates set on 4th Generation IRM, and rates set on the basis of this Application.

- 1.7.4** In short, this model confirms that, with a fairly modest rebasing bump, Powerstream can do just fine on 4th Generation IRM.
- 1.7.5** The most striking thing about this table, though, is not the increases in the Actuals for 2016 through 2020, nor the overall excess costs relative to the benchmark. Those are expected, given the high rate increases proposed.
- 1.7.6** What is most striking – almost shocking – is Powerstream’s claim that, under the Board’s own model, their costs should be rising an average of about 5.25% per year for each of 2016 through 2020.
- 1.7.7** Is that the result of the Board’s model? That model shows an average increase in predicted costs from 2010 to 2015 of 1.62% per year. Is there something in the model that causes that annual increase (which is consistent with past studies and past rate increases) to jump for the next five years more than three-fold?
- 1.7.8** The answer is no. To confirm that, we only need to go to the studies done by actual economists, using models similar to the Board’s model, but on behalf of other LDCs.
- 1.7.9** In EB-2014-0101, Dr. Malcolm Lowry, the President of PEG, and David Hovde, another PEG econometrician specializing in utility benchmarking, used a version of the Board’s model, with Oshawa PUC’s specific inputs, to forecast that LDC’s total costs for 2016-2019. His model showed that total Predicted Costs should increase 15.2% over four years²², which works out to 3.6% per year. However, that model included, as a business condition, assumed annual customer growth of 3% per year. That is significantly more than Powerstream’s customer growth expectation. Without similar growth, Predicted Costs would have risen less than 2% per year.
- 1.7.10** Another example is the work of Steven Fenrick, on behalf of Hydro Ottawa in EB-2015-0004. Although we have been very critical of the work of Mr. Fenrick in that and other proceedings, it is worth noting that even he forecasts predicted cost increases for Hydro Ottawa over the period 2016-2020 of about 3.7% percent per year, and that is using the much higher U.S. benchmarking assumptions that have not been accepted by PEG in other cases²³. The figures using Ontario numbers would be much lower still.

²² EB-2014-0101, Exhibit 10-A, p. 17. The OM&A predicted cost increase was 2.41% per year, and the capital predicted cost increase was 2.76% per year, but implied industry productivity was 0.87% per year.

²³ EB-2015-0004, Exhibit D-1(D), p. 24.

1.7.11 Neither Mr. Fenrick, nor Dr. Lowry, both hired by utilities to support their spending increases, come anywhere close to the 5.25% per year that Powerstream proposes for their Predicted Costs.

1.7.12 This is really just common sense. No-one at the Board, or in the industry, seriously expects distributor costs, before unusual events, to increase by 5.25% per year for the next five years. That is not a sensible result.

1.7.13 To test the impact of this, SEC re-did the Powerstream model table with the assumption that Predicted costs increase at the same rate as the last five years, i.e. 1.62% per year. The result is the following:

Revised Version of PEG Model					
Year	Predicted \$	% Inc.	Actual	% Inc.	Efficiency
2010	\$212,561		\$196,831		-7.40%
2011	\$218,280	2.69%	\$203,553	3.42%	-6.75%
2012	\$216,915	-0.63%	\$218,815	7.50%	0.88%
2013	\$219,646	1.26%	\$225,894	3.24%	2.84%
2014	\$229,949	4.69%	\$242,112	7.18%	5.29%
2015	\$230,353	0.18%	\$249,034	2.86%	8.11%
2016	\$234,085	1.62%	\$264,462	6.20%	12.98%
2017	\$237,877	1.62%	\$280,334	6.00%	17.85%
2018	\$241,730	1.62%	\$293,366	4.65%	21.36%
2019	\$245,647	1.62%	\$306,453	4.46%	24.75%
2020	\$249,626	1.62%	\$319,225	4.17%	27.88%
2016/20	\$1,208,965		\$1,463,840		21.08%

1.7.14 What this shows, if it were correct, is that Powerstream’s costs over the five year test period are about \$255 million higher than Predicted Costs. Put another way, in order to get down to Predicted costs, Powerstream would need to have a rate decrease. Since Powerstream was already 8.11% above Predicted costs in 2015 (based on their forecast in the Application), that would make perfect sense.

1.7.15 SEC is not suggesting that this new table replace the figures provided by Powerstream, or indeed that the Board rely on the Powerstream results to order a reduction in the proposed rate increase.

1.7.16 The simple conclusion here is that, no matter how you slice and dice the benchmarking numbers on which Powerstream based their Custom IR application, they do not even remotely support the rate increases proposed in the Application. Powerstream is left with a “Custom IR” application that is not supported by benchmarking.

OEB STAFF PROPOSAL

1.8 Three Year Approval

- 1.8.1** In their Final Argument, OEB Staff have proposed that the Board set rates for Powerstream on a cost of service basis for three years, with reductions in the revenue requirement for each of those years, in total \$30.3 million. OEB Staff proposes that at that point, Powerstream would be free to come back and ask for rates for a further five year period²⁴.
- 1.8.2** OEB Staff's rationale for three years rather than five years is "the application as filed does not incorporate sufficient RRFE features to achieve the central RRFE policy objective of providing sufficient incentives for continuous improvement." OEB Staff draws a parallel between the Powerstream application and the Board's decision in EB-2013-0416 (Hydro One Networks).
- 1.8.3** SEC strongly opposes the proposal of OEB Staff.
- 1.8.4** It is true that, like Hydro One Networks, Powerstream has filed a five year cost of service application, and it is also true that it does not comply with the RRFE. What is different is the appropriate consequences of failing to file a proper Custom IR application. Hydro One did not have any precedents to guide it, and it filed a five year cost of service application thinking it was compliant with the policy.
- 1.8.5** That is no longer true. Before Powerstream filed this Application, they had the Hydro One decision, as well as the decision in Enbridge Gas Distribution²⁵. It was clear that a multi-year cost of service would not be considered Custom IR. Powerstream filed a five year cost of service application anyway²⁶.
- 1.8.6** What OEB Staff proposes is that Powerstream, which asked for \$618.7 million over 2016-2018, as opposed to its \$490.1 million revenue at current rates (a 24% increase)²⁷, should get \$588.4 million over 2016-2018, which works out to a 20% increase.
- 1.8.7** Under these circumstances – a five year cost of service application that is not in any way compliant with the Custom IR policy - it would not be appropriate in our submission to provide Powerstream with almost \$100 million in rate increases over the next three years, as proposed by OEB Staff, and with the further right to come back for more at that time.

²⁴ OEB Staff Final Argument, p. 10.

²⁵ EB-2012-0459.

²⁶ And they admit it. See Tr.1:51-52.

²⁷ Revenue at current rates can be found in K1.2.

1.9 Response of the Board

- 1.9.1** SEC believes that rewarding a utility for ignoring the Board’s clear policies is, by itself, unwise. However, in this case the situation is even more problematic.
- 1.9.2** In this situation, Powerstream was not entitled to seek cost of service rates until 2017 under the Board’s policies, with one exception. That is, if they applied under the Custom IR method, they could rebase in 2016 rather than wait until 2017. This has the salutary effect that it allowed them to seek rate increases before their merger, although we take them at their word that the merger was no part of the motivation for rebasing early.
- 1.9.3** Without an exemption from the requirements of 3rd Generation IRM, Powerstream would in 2016 have been able to recover about \$165 million in rates²⁸. Thus, even without the issue of upcoming mergers (whether the announced one, or others), being able to rebase a year early would allow them to ask for an additional \$22 million in 2016²⁹.
- 1.9.4** Their problem was that they did not qualify for early rebasing, whether under 3rd Generation IRM or under 4th Generation IRM. Their financial performance is fine. They just wanted to spend more money.
- 1.9.5** The apparent solution is to file under Custom IR, which the Board has allowed any LDC to request, even if their IRM period has not played all the way out.
- 1.9.6** Custom IR, though, also has challenges and problems. To get this exception, a substantial effort is required on the part of the utility. They have to engage outside experts, do detailed utility-specific benchmarking that supports a different rate trajectory, and come up with a plan that will provide beneficial outcomes for the customers that are a) sufficient to justify the additional rates, and b) consistent with what the customers want.
- 1.9.7** Powerstream tried to have their cake and eat it too. They filed an application that they called Custom IR, in order to qualify for the early rebasing exception, but then they did none of the serious work required to develop a Custom IR plan³⁰.
- 1.9.8** Custom IR is not supposed to be easy. The whole point is to encourage distributors to think, in a long term way, about how they can add value for money for their customers. The Chair has made clear that Custom IR is an opportunity for distributors to take control of their own businesses, responding to their customers’ needs and

²⁸ \$162,444 revenue at current rates for 2016, plus estimated 3rd Generation IRM escalator of 1.6%.

²⁹ \$187 million requested, less \$165 million under 3rd Generation IRM.

³⁰ Cosmetic customer engagement not qualifying, in our submission, as “serious work”.

preferences directly, rather than simply following generic rules laid out by the Board. In the perfect world, a distributor, working closely with its customers, establishes a long term, value for money plan that the customers can and will support, and the Board can simply approve. It is the epitome of light-handed regulation, but it in turn requires a significant upfront and long term commitment on the part of the distributor³¹.

1.9.9 Custom IR is not intended to just be an excuse to get higher rates. The customers are supposed to be winners with Custom IR, not losers.

1.9.10 Powerstream is far from the Board's vision for Custom IR, or the RRFE generally.

1.9.11 So here the Board has a dilemma. The Board will never get utilities to use Custom IR as intended - as an opportunity to better serve their customers – if in practice it is just an easy way to get gobs of additional money. At some point, the Board has to say no when a utility doesn't comply with the Custom IR policy, or ignores the spirit and intent behind it. The Board's policy can only achieve its goal of empowered utilities, working with their customers, if the Board starts to insist that the policy be applied only in that way.

1.9.12 Right now, the message some distributors are taking from the few Custom IR decisions so far has been that it is a way for utilities to get higher rates, but this can be discounted because those were early applications, when the Board's concept and vision for Custom IR and RRFE were still not clearly understood by some within the industry. You can see that in the quite different approaches taken by the six LDCS (other than Powerstream) and one gas distributor who have filed Custom IR applications. Each time the Board responds to one of those applications, the vision becomes better understood.

1.9.13 Powerstream has filed an application that was informed by past Board decisions, whether in contested proceedings (at least Hydro One and Enbridge), or in settlements (Horizon). It is now past the time when they can legitimately say that seeking five years of cost of service is consistent with the Board's vision. Everyone knows that is not the case.

1.9.14 SEC submits that the Board should make clear, through this decision, that the RRFE, and in particular Custom IR, are intended to produce long term outcomes sought after by, and beneficial to, the customers. Distributors whose applications do not meet that test – including those that are nothing more than five year cost of service - will be rejected.

³¹ Done right, Custom IR should get everyone up off their chairs applauding their local distributor. But...that's only if it's done right.

1.10 SEC Position

- 1.10.1** In these circumstances, it is submitted that it is inappropriate to give Powerstream a 20% increase in revenues for 2016-2018, as proposed by OEB Staff. Powerstream should be on 3rd Generation IRM, consistent with the applicable Board policies, and in our submission the Board's appropriate response is to set their 2016 rates on that basis. They would still be able to seek cost of service rates for 2017, and may even be able to file on a Custom IR basis (with significant changes to their approach).
- 1.10.2** What they should not be allowed to do is file an application that is Custom IR in name only, and, despite being non-compliant, jump the queue to rebase a year early. This is just a reward for ignoring the Board's policies.

2 MERGER IMPLICATIONS

2.1 Introduction

- 2.1.1** The upcoming merger between the Applicant, Horizon, Enersource and, in a second stage transaction, Hydro One Brampton, creates some significant difficulties – for the parties and for the Board - in dealing with the evidence in this proceeding.
- 2.1.2** The implications of the merger range from obviously in-scope to obviously out-of-scope, with some in between:
- (a)* The costs of a stand-alone utility like the Applicant - one that is driven by an M&A strategy - are still part of the stand-alone utility, and are therefore clearly in scope in this proceeding.
 - (b)* The steps taken by the Applicant to consider the merger implications of its spending plans are, given the Applicant’s ongoing M&A strategy, arguably in scope. That is, if spending is decided without taking into account the contingency of any potential merger (known or unknown), it is legitimate to ask whether that spending is or will be prudently incurred?
 - (c)* The relationship of the planned merger to rates for the Applicant over 2016-2020 is unarguably in scope somewhere (this case, the MAADs application, some other application, a rule proposal, Board policy development, etc.). The Board is not legally allowed to determine, without hearing evidence, that material facts affecting the utility’s forecast rates should not be considered. That would obviously be a decline of jurisdiction to set just and reasonable rates.
 - (d)* That does not mean the Board must consider those material facts in this rate proceeding. That issue is a legal issue, and the Board is aware that it will, in due course, be considered by the courts. The Board has made a determination that those material facts are not in scope in this proceeding, and thus that matter is no longer an appropriate subject for submissions in this proceeding. Until a binding determination to the contrary, whether by the Board or by a court of competent jurisdiction, SEC must treat it as out of scope in this case.
- 2.1.3** We will deal with each of these implications in turn. Then we will deal with the practical evidentiary question that arises in this case totally apart from these implications.

2.2 “Stand-Alone” for an M&A-Driven Utility

- 2.2.1 Powerstream has for some years had a central strategy of growth by mergers and acquisitions. The evidence is replete with references to it, and the witnesses confirmed it in cross-examination³²:

“MR. SHEPHERD: ... Your target is to use M&A activity to expand the size of your core distribution business.

MR. MACDONALD: That's correct.

MR. SHEPHERD: That's correct. And that's been the case since 2004 anyway, right? Maybe before that?

MR. MACDONALD: And before, correct.

MR. SHEPHERD: Because when the three utilities originally got together, that was because one or more of them had this vision of M&A causing better returns, increased value, and better results for the ratepayers, right?

MR. MACDONALD: That's correct.

MR. SHEPHERD: And that's continued to be the case. This is one of your primary drivers in how you run your business.

MR. MACDONALD: Yes, it is.”

And the witnesses went on to confirm that they have a passive approach to M&A, largely driven by ensuring that the PowerStream brand is strong³³:

“MR. SHEPHERD: ... [The] PowerStream brand is intimately connected with your M&A strategy, right, because as you want to expand through M&A, your passive approach is because your brand is a good one, right?

MR. MACDONALD: Exactly.

MR. SHEPHERD: So you have this whole strategy to make PowerStream attractive so that people are going to call you?

MR. MACDONALD: We've worked very hard to position ourselves in everything we do to be professional. It's not really up to us to say, but we've tried to be trusted in the industry, trusted advisors, so yes.”

- 2.2.2 Powerstream has a long history of both successful and unsuccessful mergers, acquisitions, and similar activities. The company was formed in a merger of three LDCs, then acquired service territories in Aurora and elsewhere, merged with Barrie Hydro, established a 50-50 partnership with what is now called COLLUS Powerstream, and is now working on a merger with Enersource, Horizon, and Hydro One Brampton. Unsuccessful discussions with Hydro One, Veridian, Innisfil (now Innpower), and Newmarket Hydro have been widely reported over the last several

³² Tr.1:85-6.

³³ Tr.1:95.

years, although the witnesses declined to confirm any of them, citing confidentiality³⁴. There have presumably been other contacts and negotiations that have not been reported publicly.

2.2.3 A company pursuing a merger strategy necessarily has costs associated with that strategy, and SEC pursued that issue with the Applicant³⁵. The witnesses made every effort to downplay the costs they incur in this area, including producing a table³⁶ of estimated executive costs for M&A activity that has no basis in reality, and despite being expressly qualified as unsubstantiated estimates is forecast to the dollar.

2.2.4 There are three categories of costs associated with M&A activity:

- (a) Costs of external resources like lawyers and consultants to work on deals and potential deals. There is no evidence that the forecasts for 2016-2020 include any M&A specific external costs in these categories.
- (b) Costs of incremental internal resources hired to deal with actual or potential M&A activity. Powerstream is categorical that they do not hire additional resources to handle upcoming deals³⁷.
- (c) A portion of the costs of existing (i.e. in the current budget forecasts) internal staff and related costs, reflective of the relative time spent on M&A. This has two components:

1. Normal day to day activities relating to the strategy generally.
2. Actual activities in 2016 relating to possible or actual transactions.

2.2.5 How much are the costs in the test period associated with M&A? Undertaking J1.7 suggests that it will be less than \$300,000 over those five years. This is, of course, not credible. Powerstream will have spent more than \$300,000 of its internal budgeted resources on M&A before the Board renders its decision in this case, let alone over the full 2016 year or the remaining four years, and that is true whether or not the proposed merger actually proceeds as planned.

2.2.6 The difficulty we face is that, because this all unfolded late in the process, there is no properly tested evidence on the record as to the magnitude of these costs. That leaves the Board with three options: a) allow the Applicant to recover M&A costs in rates while denying the ratepayers any of the benefits from those costs; b) exclude an estimated amount of M&A costs from revenue requirement, which amount would clearly be unsupported by evidence; or c) track those costs for later disposition.

³⁴ Tr.1:88.

³⁵ Tr.1:98-108

³⁶ J1.7.

³⁷ Tr.1:108.

2.2.7 On balance, SEC believes that the Board should establish a variance account, in which the Applicant should be required to record all fully-loaded costs of internal resources (personnel or otherwise) that are actually spent on proposed or actual M&A transactions. For example, if an executive spends 50% of their time in 2016 on possible M&A transactions, then 50% of their compensation and overheads should be credited to the variance account. At a later date, the Board can determine whether all or any of the balance in that account should be disposed of in favour of the ratepayers.

2.3 Contingency Planning

2.3.1 The Applicant admits that, in preparing capital and operating plans, they do not take into account the impact on those spending decisions if they merge with another utility. There are no contingencies built in.

2.3.2 This is, in our submission, not a proper way to plan spending in an M&A-driven company. When the company's strategy has, as a central element, growth through mergers and acquisitions, spending can always be impacted by M&A transactions. Good planning takes that expected impact into account.

2.3.3 For example, if you are a true stand-alone utility, in the sense that you do not expect in the foreseeable future to merge with any other company (you are Toronto Hydro, perhaps), then certain decisions can be made based solely on what is good for your company right now. If you need a new head office building, you can plan for that, and execute, without worrying that the money will be wasted³⁸. If you need a new CIS, or a new ERP system, you can buy what's best for you, and optimize for the utility you see around you today.

2.3.4 That is not true if mergers and acquisitions are part of your normal way of doing business. In that case, in addition to your primary decision, good practice requires that you consider the scenario in which a merger or acquisition makes your spending plans redundant or wasted.

2.3.5 So, for example, a company with an M&A strategy has to consider, when they buy or build a new CIS or ERP, whether all or any part of that cost could be duplicative of a merger partner. A contingency plan should be put in place, for example by including favourable "out" clauses in the contracts, or by selecting a software solution that is consistent with that used by most of the industry (i.e. the potential merger partners). In addition to asking the question "Is this cost-effective if everything works out?", good planning requires that the utility ask the question "Is this cost-effective if we enter into a merger transaction in the near term?", or the further question "What is the scenario in which we minimize wasted costs if this asset or spending program becomes

³⁸ If you are Toronto Hydro, you will likely always need a head office. There is no real risk that it will become redundant through circumstances beyond your control.

duplicative?”

- 2.3.6** Powerstream has done none of that. This does not just impact things like computer systems. It also affects things like multi-year outsourcing, system configuration decisions (particularly in areas of the franchise where neighbouring LDCs are adjacent), fleet purchases, general purpose buildings, voltage conversion planning, and all planning that involves standardization around a certain rule, principle or technology.
- 2.3.7** This is not just a theoretical exercise. While the current proposed merger is not in scope in this proceeding, it is factually true that Powerstream has a recently-built head office, for which ratepayers are picking up the (substantial) tab, and Enersource also has a recently-built head office, for which ratepayers are also picking up the (also substantial) tab. We don't know how that will be handled operationally in the future, and in any case it is not relevant to the Board's decision in this case given the determination on the threshold issue. However, the fact that it might be a problem is indicative of just how important contingency planning is to an M&A driven utility.
- 2.3.8** There is nothing the Board can do about this at this stage. The Board can't go back and get Powerstream to re-do their planning. In our view, the only thing the Board can do at this point is put the brakes on the rapid expansion of Powerstream's capital spending. There are a lot of other reasons to do that, detailed elsewhere in this Final Argument and in the submissions of other parties. This is one more.
- 2.3.9** M&A activity - whether the current proposed merger, or something else - is in Powerstream's future. That is their strategy, and they expect it to happen. Until Powerstream establishes a method of building merger contingencies into spending plans, the prudent course of action for the Board is to ensure that spending – and particularly spending with long-term implications, like capital plans – is tightly controlled, so that any waste at the time of merger transactions is minimized.

2.4 Legal Requirements

- 2.4.1** The legal issue that arises here is whether the Board can meet the legal test of “just and reasonable rates”, which as stipulated by the courts requires that the Board give the utility the opportunity to earn a reasonable rate of return. This in turn requires that the Board establish – through one of several acceptable methods – the reasonable costs to operate the utility and earn that level of return. This is done by formula, as in IRM, or by cost of service, or through other methods. This is not a step the Board is allowed to skip, but it does have wide latitude in how it interprets this step.
- 2.4.2** The question whether the Board is legally required to consider the actual expected costs in this proceeding was raised and debated, and the Board in the Threshold Decision determined that, in this proceeding, it is not required to consider the impact of the proposed merger on the Applicant's costs in the test period.

- 2.4.3 As much as some of the parties, including SEC, may disagree with the Threshold Decision, we don't get to make that decision. The Board does, and it has done so. Parties have the ability to seek a review by the Board, or to appeal to court, but unless and until either the Board or a court determines otherwise, the Threshold Decision stands, and SEC is making its submissions in this Final Argument on that basis.

2.5 Practical Issues

- 2.5.1 There is another concern raised by the announced merger, though, and that is the reliability of the forecasts from the Applicant.
- 2.5.2 The context of this policy concern is the Threshold Decision. In that decision, the Board explained as follows³⁹:

“The pre-consolidation rate setting and MAADs policy are intended to co-exist in setting just and reasonable rates. The pre-consolidation rates approved for the consolidating entities serve as the baseline beyond which cost savings are allocated in accordance with the MAADs policy.”
[emphasis added]

- 2.5.3 The issue here is that, when utilities do cost forecasts in a non-merger environment, they have to live with the results. They are providing evidence to the Board, under oath, of what they really expect will happen, and how they really expect to spend money. That “baseline” of spending forecasts reflects the very real plans of hardworking utility employees who are, essentially, just trying to do a good job. They may ask for more money than is wise, in some cases, but everything they are talking about is real. That is why utility witnesses are so often very credible. And, that is why their cost of service forecasts operate as a good baseline.
- 2.5.4 That is not true in this case. Nothing that the witnesses said is what they actually expect will happen, because none of them in fact expect to operate as a stand-alone utility for the next five years. None of the witnesses expect to have to live with these cost forecasts. They know everything will change, and at no time will they ever be held accountable for the forecasts they gave under oath to this Board.
- 2.5.5 That is not to suggest – not for one second – that the witnesses were not truthful. They were giving truthful evidence, but it is truthful only based on the assumption, mandated by the Board, of a world they know does not exist. The phrase *“it's only make believe”* is applicable here.
- 2.5.6 If you ask a utility engineer what their actual plan is for next year, they can give you a straightforward answer, actually expecting that their answer, or something like it, will

³⁹ Threshold Decision, p. 6.

happen. They will be the ones actually delivering on that result, and accountable for it. They will have to explain if the plan changes.

- 2.5.7** If you ask a utility engineer what their actual plan is for next year on the basis of material assumptions they know are not true, their answer is not based on what they actually expect will happen. If you provide them with a fictional story, they will try their best to answer within your fictional narrative, but all the time knowing it is fiction. They answer knowing that they will not actually be delivering on this result, and they will never be held accountable if something else happens. Something else will happen. They may even have a plan for what that will be. It will not be the same as their answer, because their answer is based on fiction.
- 2.5.8** Powerstream in this case proffers a “baseline” based on a fiction. It is not a budget at all, because they don’t expect it to happen. It is solely provided to calculate how much they can collect in rates, and therefore act as a “baseline” against which they can harvest merger savings. It is, therefore, less reliable than a baseline based on actual expectations. People who give evidence that is about what they would do, if circumstances were different than they expect, are engaging in a different type of thought process. The reliability of that evidence is necessarily lower.
- 2.5.9** SEC submits that, in a situation in which forecast evidence is not based on what is actually expected to happen, and therefore reliability and accountability are reduced, empirical sources, including particularly benchmarking, take on added importance. In this case, SEC submits that the Board should place less emphasis on the subjective “what we need” evidence of the Applicant’s witnesses (their bottom-up requests), and more emphasis on the objective evidence of what they should in fact need, if the standalone assumption were true (the top-down evidence). This is a more reliable baseline in a situation in which the budgets are not actual budgets at all.
- 2.5.10** SEC deals with benchmarking in Section 1 of this Final Argument.

3 CAPITAL, DISTRIBUTION SYSTEM PLAN, AND RATE BASE

3.1 Overview

- 3.1.1** PowerStream is seeking approval to spend \$644M on capital over the 5 year Custom IR plan. This is a 40% increase over the previous 5 year period (2011-2015), which itself includes a significant year-over-year increase in the bridge year (2015).⁴⁰
- 3.1.2** SEC submits the amount is unreasonable and should accordingly be reduced. The evidence demonstrates that PowerStream is replacing more assets than its own analysis requires; it has not factored any productivity and efficiency savings, and has overestimated the cost to complete its proposed capital plan. A substantial reduction is warranted based on the evidence and is consistent with SEC's comments regarding the overall benchmarking performance.
- 3.1.3** In addition, the Board should also approve ratepayer protection mechanisms as proposed below, to ensure that if whatever amount is approved is not actually spent, then there is no windfall to PowerStream.
- 3.1.4** There is an inherent tendency for distributors to want to replace more capital assets than may be required, and to budget for that spending at an inflated cost. The Board must guard against these issues to protect ratepayers. Even when each specific issue is small, they can add up quickly, and put further unnecessary upwards pressure on rates. Moreover, in addition to paying the cost of the asset through depreciation and PILS, ratepayers pay a return on the capital assets. Thus a dollar of approved capital spending, over the asset's lifetime, may equal many multiples of its actual costs which ratepayers fund.

3.2 Underspending and Over-budgeting

- 3.2.1** PowerStream has a history of over-budgeting capital and either not being able to complete the work they plan to do, or doing it at a lower cost than was assumed for ratemaking purposes. The effect of this is that ratepayers are paying more in their rates than they should.

⁴⁰ Argument in Chief, para. 34

CATEGORY	Historical											
	2011			2012			2013			2014		
	Plan	Actual	Variance	Plan	Actual	Variance	Plan	Actual	Variance	Plan	Actual	Variance
Rate Base	\$ '000		%	\$ '000		%	\$ '000		%	\$ '000		%
System Access	17,209	21,007	22%	18,891	19,888	5%	27,612	17,030	-38%	26,208	26,229	0%
System Renewal	15,542	11,527	-26%	19,894	16,974	-15%	21,397	22,254	4%	38,857	39,186	1%
System Service	26,073	22,885	-12%	14,846	13,770	-7%	31,847	34,780	9%	17,009	17,946	6%
General Plant	10,906	7,877	-28%	23,055	24,200	5%	31,128	19,593	-37%	26,165	26,148	0%
Sub-Total	69,731	63,297	-9%	76,685	74,832	-2%	111,984	93,657	-16%	108,238	109,509	1%
Non-Rate Base	2,167	2,278	5%	4,069	1,196	-71%	2,102	2,628	25%	1,648	1,364	-17%
Grand Total	71,897	65,575	-9%	80,755	76,028	-6%	114,085	96,285	-16%	109,887	110,873	1%

3.2.2 For the previous year-end information available, the evidence shows that for 3 of the past 4 years, PowerStream spent less than they had planned to spend. In some years such as 2011 and 2013, the amount is significant. PowerStream spent 9% and 16% less than they had planned to spend.⁴¹

3.2.3 The evidence indicates this is much less a capability issue, and more an over-budgeting issue, i.e. PowerStream overestimates the cost to do the capital work. PowerStream has developed a metric to track the difference between the budget work order cost, and the actual final work order cost (the Work Order Closing Variance Metric).⁴² For both the years and data that are available for the metric, it shows the actuals came in more than 10% below the budgeted amount. This indicates that PowerStream is forecasting that it will cost more money, and thus require more ratepayer funds, than the actual cost.

Work Order(WO) Variance Metric Summary

	Sum of WO Gross Budget	Sum of WO Actual
2013	\$ 15,127,927	\$ 12,848,640
2014	\$ 51,910,676	\$ 47,257,586
Total	\$ 67,038,603	\$ 60,106,226
Variance		-10.34%

Source: G-SEC-16(c)(d)(see K2.3 p.66)

3.2.4 If this persists in the forecast budgets for 2015-2020, then it is the complete opposite to what should be occurring. This is because it would remove the strongest incentive for PowerStream to try to make their work more productive and efficient.

3.2.5 SEC does believe this over-budgeting will persist even if PowerStream learns from its past forecasting errors.⁴³ PowerStream provided no specifics of what it had learned and how it was symmetrically included in its budgets that underpin the Application. There

⁴¹ K2.3, p.2. Technical Conference Undertaking JTC1.5_App.2-AB_20150911

⁴² II-2-G-2-5.2.3, p.4. (K2.3, p.65)

⁴³ Tr.2:180

is an inherent incentive to be conservative in your budgeting under the regulatory model. SEC submits PowerStream is over-budgeting individual projects (which are made up of multiple work orders), as it has done in the past.

3.3 Too Many Assets Being Replaced

- 3.3.1** PowerStream is proposing to spend \$257.6M over the Custom IR plan on system renewal, a 94% increase over the previous period. PowerStream has utilized its asset condition information as a means of determining how many assets it believes are required to be replaced; however, it does not appear to be the primary driver as, in many significant areas, it is replacing materially more assets than the asset condition information warrants.
- 3.3.2** For example, PowerStream is proposing a significant switchgear replacement project. The ACA states that 180 switchgears are in poor condition and none in very poor condition⁴⁴, yet PowerStream is planning to replace more than double of that amount (381) over its capital planning horizon (2015-2020).⁴⁵
- 3.3.3** The replacement numbers do not even include the forecasted reactive replacement of switchgears. In addition to the 381 proposed by PowerStream during the 2015-2020 period, it plans to replace 37 a year (total 185) on an unplanned basis.⁴⁶ This itself is a significant increase in the historical level of 24 per year that were budgeted to be replaced on a reactive basis.⁴⁷ Furthermore, the evidence indicates that there are a number of other capital programs that involve, within the context of a larger capital build, the replacement of switchgears.⁴⁸
- 3.3.4** Another example of this is PowerStream's pole replacement project. The ACA states that approximately 1000 poles are projected to be in poor condition based on the test population of 38%⁴⁹, yet it plans to replace 2.5 times that level (2559) during the capital planning horizon (2015-2020) through the pole replacement program.⁵⁰ In addition, it plans to replace 432 additional poles during that time period through other programs including: storm damage and unscheduled replacements.⁵¹ As well, through its planned rear-lot conversion program, which converts backyard overhead to front-yard underground, PowerStream plans to simply remove poles that are likely in worse conditions⁵² due to the vintage.

⁴⁴ Tr.2:123. B-1, II-2-Staff-71, Appendix 71, p.27 (K2.3, p.10)

⁴⁵ Tr.2:122-123. (K2.3, p.14)

⁴⁶ B-1, I-2-Staff-51 (K2.3, p.22).

⁴⁷ III-2-G-AMPCO-20, III-2-G-AMPCO-24

⁴⁸ See for example, II-2-G-2, Appendix A - Investment Summaries, No. 102732, 102548, 101012

⁴⁹ C-2-1, B-1, II-2-Staff-71, p.51 (K2.3, p.10). PowerStream tested 14,300 poles out of 38,070 poles.

⁵⁰ in J2.10, Table 3 updated the number to 2559, an update from the original filing of 2400 based on G-SEC-24, K2.3,,p.14 (400 per year between 2015-2020).

⁵¹ Tr.2:132-133. B-1, II-2-Staff-55(a) (K2.3, p.22)

⁵² Tr.2:133

- 3.3.5** This amount also does not include pole replacements undertaken in the context of other system renewal and access programs such as line and feeder rebuilds.
- 3.3.6** In 2016 alone, each unnecessary pole replacement costs ratepayers \$12,617.⁵³
- 3.3.7** While PowerStream tried to explain away its over-replacement as accounting for the move from fair to poor condition over the life of the Custom IR term, there was no evidence provided about the rate at which that occurs. PowerStream admitted that it has not undertaken any analysis.⁵⁴ While some fair assets will move from fair to poor condition over time, the number of replacements would require that this condition degradation to happen at an extreme rate that simply is not occurring today.
- 3.3.8** This replacement of assets at a level that is not tied to condition was a concern expressed by the Board in the recent Toronto Hydro decision.⁵⁵ The Board has been clear that “actual asset condition... should be the primary determining factor when an asset should be replaced.”⁵⁶ Powerstream has not done so. They are replacing significantly more than the condition of the assets, as determined by the ACA, says they should be replacing.

3.4 Reliability Not Accurately Considered in Customer Engagement

- 3.4.1** PowerStream states that its renewal program is designed to maintain reliability.⁵⁷ On its own this would be an acceptable way to determine what type of replacement work is required. The problem though, is that the increases in capital spending are very significant, and at the same time, PowerStream already benchmarks well compared to other urban utilities in terms of reliability.⁵⁸ In its customer consultations, PowerStream did not inform its customers how it benchmarked in terms of reliability.⁵⁹
- 3.4.2** PowerStream is correct that on some level customers are more concerned with its reliability than how as a company PowerStream benchmarks.⁶⁰ Nevertheless, the information is important for customers to make an informed decision regarding the trade-off between rates and reliability. It may very well be that some customers are willing to have some degradation in already good reliability. It may also be that, knowing Powerstream has good reliability, customers may be skeptical of claims that more needs to be spent. This problem is more acute here, since there are diminishing

⁵³ \$4,933,143/391=\$12616.73 (Pole Replacement Program 2016 costs, see J2.10)

⁵⁴ Tr.3:99

⁵⁵ *Decision and Order* (Toronto Hydro - EB-2014-0116), December 29 2015, p.23-24

⁵⁶ *Decision and Order* (Toronto Hydro - EB-2014-0116), December 29 2015, p.23

⁵⁷ Argument in Chief, para 41

⁵⁸ See II-2-G-2, 5.2.3, p.15-16. K2.3, p.3-4

⁵⁹ Tr.2:103-104.

⁶⁰ Tr.2:105

returns of reliability for every additional dollar spent on renewal capital.⁶¹

3.5 No Productivity

3.5.1 PowerStream has not included any incremental efficiency improvements in its capital plan. For example, as discussed earlier, there are no externally imposed incentives that share the benefit of productivity and efficiency gains that are not known at the time.

3.5.2 Besides the single identified cable injections program⁶², PowerStream has essentially told ratepayers through their budgeting that there are no productivity improvements and programs to be had. This is demonstrated by the fact that they have not included any amount for future productivity in their budget. This is not credible, especially as the Applicant is seeking \$644M in capital spending.

3.5.3 The Board recently reiterated in the Toronto Hydro Decision, in the context of its proposed capital plan, that distributors must demonstrate in the context of a Custom IR application that they are increasing productivity:

“The OEB has consistently been clear that distributors need to strive to increase productivity. The OEB has specifically stated that custom applications require that applicants demonstrate productivity.”⁶³

3.5.4 Even the proposed cable injections program is not actually an incremental productivity program. PowerStream has been doing cable injections in lieu of cable replacements for years now. In fact, Powerstream is doing much less of it than it had planned to do over previous planning cycles. In its DSP, PowerStream proposed to spend approximately 3-4:1 on cable replacements vs. cable injections.⁶⁴ By contrast, in 2009 Powerstream’s 10 year underground primary cable program plan had the opposite ratio, with dramatically more being spent on cable injection relative to cable replacement.⁶⁵

3.5.5 Stating that certain business-as-usual methods are incremental productivity measures, does not create the correct incentive for PowerStream to seek out further improvements and efficiencies it did not or could not forecast. This would include new technologies and processes that are simply not available or may not be feasible at this time but will be during the 5 year term of the plan. It also does not encourage continuous improvement.

3.5.6 For the productivity savings that may occur, PowerStream does not propose to return

⁶¹ Tr.2:105

⁶² II-1-F-1, p.9 (K2.3, p.25) Tr.2:144-145

⁶³ *Decision and Order* (Toronto Hydro - EB-2014-0116), December 29 2015, p.25

⁶⁴ II-2-B-1-6,p.120. B-1, II-2-Staff-71, p.24

⁶⁵ Tr.2:144-145. C-2-2, II-AMPCO-8, Appendix 9f, p.117 (K2.3, p.34)

that money to customers. They simply plan that “if we do find those savings we will – if we can, we’ll achieve more units”.⁶⁶ The money will simply be put into more capital work.⁶⁷ Re-investing these savings in more capital on the surface may seem to be of benefit to ratepayers, but will create greater costs in the longer term. Ratepayers will have to pay the full cost of the incremental asset through depreciation expense over the life of the asset, and a return on equity on the undepreciated cost of the asset. The goal is not just to do more work at a lower cost, but to do the correct amount of work at the right cost.

3.5.7 It is clear that unit cost measurements and improvements are of little importance to PowerStream. SEC submits this is troubling. Throughout the proceeding, when asked to provide unit cost information on a number of assets⁶⁸, PowerStream did so with significant errors, thus making it impossible for parties to determine what the actual unit costs were for many of its significant capital projects. It was not until the oral hearing that PowerStream, during cross-examination, explained that the information they provided was incorrect.⁶⁹ When correct numbers were provided for a number of asset categories, the information showed almost uniform year-over-year increases in the forecast unit costs.⁷⁰ This means that PowerStream expects no improvement in efficiency and productivity over the term. Moreover, the year-over-year increases are higher than inflation. The Board has commented previously that it expects to see unit cost efficiencies as similar projects are undertaken over the length of the DSP period.⁷¹

3.5.8 SEC submits that a reduction should be made to account for expected incremental productivity and efficiency improvements in PowerStream’s capital program going forward. While PowerStream has included inflationary increases in its forecasting of its individual capital projects, it has neither implicitly nor explicitly budgeted a level of setting productivity it should achieve each year. The Board should expect that PowerStream be able to do similar work, each year, more efficiently through greater experience and more efficient processes. This is consistent with the RRFE’s focus on continuous improvement.⁷²

3.6 No Third-Party Review

3.6.1 PowerStream did not have any component of the capital plan reviewed. The Board was clear in the RRFE that it expected distributors to bring forward an expert review of its proposed asset management and network investment plan:

“In addition, the Board sees merit in receiving the evidence of third party

⁶⁶ Tr.2:155

⁶⁷ Tr.2:111

⁶⁸ See II-2-G-SEC-24. B-1, II-1-Staff-16

⁶⁹ Tr.2:139-141

⁷⁰ Undertaking J2.10

⁷¹ *Decision and Order* (Toronto Hydro - EB-2014-0116), December 29 2015, p.25

⁷² RRFE, p.2

*experts as part of a distributor's application, or retaining its own third party experts, in relation to the review and assessment of distributor asset management and network investment plans (along with other evidence filed by the distributor)."*⁷³

3.6.2 In Enbridge's Incentive Regulation Decision, the Board was not satisfied with the filing of third-party analysis of just some of the programs.⁷⁴ The Board wrote that "extensive external independent analysis" would have been helpful in determining the appropriateness of the proposed capital plan.⁷⁵ For the Board, it had the "expectation in a Custom IR application with a significant capital component that the applicant will provide the necessary support, including... independent assessment".⁷⁶

3.6.3 Even its ACA was not prepared independently for this Application. PowerStream simply did it itself based on Kinetrics' work from a number of years ago.⁷⁷

3.7 Internal versus External Contractors

3.7.1 There are a number of capital programs where PowerStream utilizes both internal resources and external contractors. Depending on the resources it has available to it, it may choose to have a specific program undertaken by its own staff, or contract out the work.⁷⁸ The problem is that, for the purpose of budgeting the cost of the programs for its Application, Powerstream assumes it uses only internal resources, even though it knows that a good portion of that work will ultimately be done by external contractors.⁷⁹

3.7.2 Since its own evidence is that external contracts doing the same job as internal resources will do it at 3% less⁸⁰, PowerStream is overstating the actual costs it expects to need to achieve its proposed capital program. The aggregate amount is significant considering that 48% of PowerStream's capital work in 2016 is expected to be done by external contractors growing annually to 55% by 2020.⁸¹

3.7.3 Furthermore, in terms of determining how they will allocate resources (internal and external), they do not appear to consider cost in making that decision⁸². This is troublesome, and clearly does not lead to the most efficient allocation of resources to complete the capital program.

⁷³ RRF, p.37

⁷⁴ *Decision with Reasons* (Enbridge - EB-2012-0459), July 17 2014, p.9, p.9

⁷⁵ *Ibid.*

⁷⁶ *Ibid.*

⁷⁷ B-1, II-2-Staff-71, Appendix 71, p.1 (K2.3, p.9)

⁷⁸ Tr.2:132

⁷⁹ Tr.2:133

⁸⁰ Tr.2:133. IV-1-24

⁸¹ III-1-G-SEC-27(c)

⁸² Tr.2:133

3.8 Commercial and Residential Subdivision Development

3.8.1 SEC has concerns with the additional system access costs that PowerStream has forecasted, specifically for new commercial and residential subdivision development. In both cases, Powerstream is proposing to more than double its annual average capital spending during the Custom IR term, and its previous actuals from 2011-2014.⁸³

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2016-2020 Average	2011-2014 Average	% Variance
Material Investments													
System Access													
New Connections and Subdivisions													
New Commercial Subdivision Development	6,859	316,257	1,365,649	1,249,667	1,600,010	1,601,908	1,603,808	1,605,707	1,607,707	1,609,506	1,605,727.20	731,178.50	119.6%
New Residential Subdivision Development	473,519	10,593,928	3,799,355	3,956,902	7,895,964	8,633,109	9,392,346	9,759,944	10,135,066	10,517,394	9,687,572	4,705,926	105.9%

Source: G-SEC-23, K2.3, p.7

3.8.2 This increase is unreasonable and should be denied. PowerStream’s own evidence is that its customer count is forecasted to decrease from previous periods, in some cases significantly.⁸⁴

Customer Growth Rates											
2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2.07%	2.41%	2.24%	2.21%	1.88%	1.91%	1.71%	1.69%	1.72%	1.70%	1.70%	1.72%

Source: H-3, p.2 (K1.3, p.7)

3.8.3 PowerStream has admitted that it is hard to forecast new residential or commercial subdivisions.⁸⁵ Its own Appendix J-AA spreadsheets had embedded for commercial subdivisions the comment: “Place holder [may not happen every year]”.⁸⁶

3.8.4 SEC accepts PowerStream’s submissions that there may be a lag between when a customer is connected and when new developers require connections⁸⁷, but that alone does not explain the significant increases in subdivision costs, while there is decreasing customer growth. SEC submits the Board should reduce these forecast costs to the level 2014 actuals (last year of actuals provided). Indeed, it may be advisable to approve a lower amount due to the reduction in customer growth.

3.9 System Hardening

3.9.1 PowerStream has proposed approximately \$37.6M of capital spending during the Custom IR plan for “storm hardening”.⁸⁸ PowerStream identifies this as one of its significant cost drivers of the current Application.⁸⁹ Yet, no cost-benefit analysis was undertaken to determine if there is any actual benefit to customers over the long-term

⁸³ K2.3, p.7. Tr.2:115,118

⁸⁴ II-H-3, p.2. (K1.3, p.7)

⁸⁵ B-1, II-2-Staff-86. Tr.2:117:118

⁸⁶ Tr.2:117-118. Appendix J-AA found in III-1, G-SEC-23.

⁸⁷ Tr.1:119-120

⁸⁸ III-1-1-B-CCC-16

⁸⁹ II-B-1

from undertaking this significant program. While various studies undertaken by PowerStream, as a result of the ice storm, recommended certain storm hardening measures, none of them included an analysis of whether they are actually worth the significant added cost.

3.9.2 This lack of analysis is troubling. For example, a significant component of the storm hardening capital spending is rear lot conversion. Yet, PowerStream has not actually done any studies comparing outages in its rear lot customers compared to others.⁹⁰

3.9.3 The RRFE requires customer's preferences to be considered. A capital project of this magnitude, one that is not in the ordinary course of operating the distribution system, should require customers' active consideration of the expenditures, and their agreement that the extra cost is justified. System hardening was raised at PowerStream's midmarket work shop sessions in 2014. Customers involved did not see system hardening as a priority.⁹¹ That had no impact on Powerstream's plans.

3.9.4 While customers are expected to pay for this storm hardening, they are not seeing any of the benefits. There is no decrease in the storm damage budget.⁹² Storm damage capital and O&M costs are increasing over 2014 actuals, and for each year of the DSP plan.⁹³ One would expect that with the significant storm hardening spending, there would be a decrease in capital spending.

3.10 Asymmetrical Variance Account

3.10.1 SEC is concerned that PowerStream will not bring into service the amount of assets it forecasts. This is based on its past history as discussed earlier, and the uncertainty that naturally occurs in planning specific capital projects for a 5 year period. This is especially true of the largest area, system renewal. As the Board recently stated: "[t]he OEB recognizes that five years is a relatively long planning term, and specific system renewal projects, in particular, may change based on ongoing assessments of need and scheduling".⁹⁴

3.10.2 Furthermore, there is an important distinction from a rate-setting point of view between being able to spend the entire forecast capital amounts over the 5 years, and being able to do so in the specific years forecast in this Application. If there are any delays in bringing into-service capital projects in any given year, then ratepayers will have overpaid. The concern is magnified with a capital program the size of PowerStream's, and the rate impacts which it will cause.

3.10.3 SEC recommends that the Board establish an asymmetrical variance account to protect

⁹⁰ Tr.3:75

⁹¹ II-2-G-2-Appendix F, p.75

⁹² II-2-G-2-5.23, p.32 (K2.3, p.23)

⁹³ Tr.3:92

⁹⁴ Decision and Order (Oshawa PUC - EB-2014-0101), November 12 2015, p.12

ratepayers. The account would record the annual revenue requirement difference between the approved in-service amount and actuals, if it was less. Since it is on annual revenue requirement basis, it would allow PowerStream to catch up in subsequent years. This approach would ensure that if PowerStream is behind on its capital program in any given year, ratepayers are to be held whole.

3.10.4 This approach is consistent with the RRFE⁹⁵, and similar variance accounts have been approved in other proceedings over the last few years including: Toronto Hydro (EB-2014-0116)⁹⁶, Oshawa PUC (EB-2014-101)⁹⁷, Hydro Ottawa,⁹⁸ and Kingston Hydro.⁹⁹, Horizon (EB-2014-0002)¹⁰⁰ and Hydro One Transmission (EB-2014-0140).¹⁰¹

3.11 CIS System

3.11.1 SEC submits the Board should make a partial disallowance to some costs that were incurred by PowerStream for its new Customer Information System which went into service in 2015. The new CIS system was over budget, and the evidence demonstrates that there was a lack of management oversight and risk mitigation which ultimately contributed to the significant cost overruns. Ratepayers should not bear the cost of PowerStream's imprudent actions.

3.11.2 In addition, the Board should not approve additional capital expenditures sought in this application so that the CIS system is capable of billing monthly. Those capabilities should have been included in the original CIS system, and to require ratepayers now bear the \$3M cost is unreasonable.

3.11.3 In PowerStream's last cost of service application (EB-2012-0161), it forecast that at the time, its proposed new customer care and billing system (CIS system) would cost \$34.5M to complete.¹⁰² Ultimately, the cost of the CIS system ended up being \$42.8M¹⁰³, a 24% cost overrun. PowerStream's rationale for this was that the original project was too aggressive as they "didn't fully understand the complexities back in

⁹⁵ Report of the Board, *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, October 18 2012, p. 14. Under Custom IR method of rate-setting, for deferral and variance account, the Board states "Status quo, plus as needed to track capital spending against plan"

⁹⁶ *Decision and Order* (Toronto Hydro - EB-2014-0116), December 29 2015, p.52-53

⁹⁷ *Decision and Order* (Oshawa PUC - EB-2014-0101), November 12 2015, p.12-13

⁹⁸ EB-2015-0003, Amended September 18th Settlement Proposal, Refiled December 7 2015, p.17-18. Approved in *Decision on Settlement Proposal and Procedural Order No.11* (EB-2015-003), dated November 23,2015, and *Decision and Rate Order*(EB-2015-0003), dated December 22 2015.

⁹⁹ EB-2015-0083, Settlement Proposal, as amended November 10 2015. Approved in *Decision and Rate Order* (EB-2015-0083), dated November 26 2015

¹⁰⁰ EB-2014-0002, Settlement Proposal filed September 22, 2014, p.32-35. Approved in *Decision and Order* (EB-2014-0002), dated December 11 2014.

¹⁰¹ EB-2014-0140, Section II, p.14-15. Approved in Tr.1:28.

¹⁰² III-1-1, B-CCC-15

¹⁰³ Tr.2:152

2011-2012”.¹⁰⁴ The original plan and budget did not allow enough change requests and schedule slippages.¹⁰⁵

- 3.11.4** A review of the records shows that PowerStream was completely unprepared to take on the renewal of a new CIS program, which led to significant costs that, if done properly, would not have occurred. A review of the business case originally presented to its Board of Directors shows essentially no concern or focus on the risks of undertaking the project, and no analysis of ways to mitigate those risks.¹⁰⁶ This was the largest and most complex IT project that PowerStream had ever undertaken. They did not have the internal expertise to undertake such a project.¹⁰⁷
- 3.11.5** The issue of a lack of formal risk assessment and mitigation was pointed out by KPMG in their review during the project implementation. KPMG criticized PowerStream for not having a formal risk assessment performed, and for not identifying and assessing the risks impacting the project.¹⁰⁸ It further found that of the risk identified it was “based on a subjective assessment, and has [had] not been prepared based on established criteria or framework”.¹⁰⁹
- 3.11.6** If PowerStream had mitigated some of the risks, it likely would not have had a cost overrun, or at the very least, it would have been much smaller than the one that occurred. Ratepayers should not be required to pay for PowerStream’s imprudent management of the project. SEC accepts that a new CIS system was needed, but clearly, PowerStream did not have a proper process in place to ensure that it was done properly, in according to normal industry standards for large IT projects.
- 3.11.7** Furthermore, adding to the cost of the project is the \$3M it intends to spend in 2016 to allow the new CIS system to bill monthly. For some reason, PowerStream chose not to include that capability when it designed the initial system. If it had, it would have been able to do it at a fraction of the price, but since it has to be done afterwards, it will be very expensive. \$3M dollars is an incredible amount of money to allow the CIS system to have the capability to bill monthly. This amount should not be approved.

¹⁰⁴ Tr.2:153

¹⁰⁵ Tr.2:153

¹⁰⁶ Tr.2:155

¹⁰⁷ Tr.2:157-58. In Undertaking J2.12, PowerStream identified that it had hired a consultant to help with the RFP process. No details were provided about the scope of the engagement. Since there was no ability to cross-examine on the scope of their work, and since there is no mention of this was in any of the material provided in the Application or in response to undertakings, the Board should give little weight to their involvement.

¹⁰⁸ Further Response to I-SEC-4, dated September 16 2016, ‘Review of CIS Project Implementation). (K2.3, p.54)

¹⁰⁹ *Ibid*

4 LOAD AND CUSTOMER FORECASTS

4.1 Customer Forecast

4.1.1 SEC has had an opportunity to review a draft of the VECC submissions on Customer Forecasts, and agrees with their conclusion that the Residential customer growth forecast is understated. We agree that the growth rate should be increased at least up to the historic growth level, and that the customer and connection counts for GS<50 and street lights should also be adjusted accordingly.

4.1.2 Subject to those adjustments, SEC has no submissions on the Customer Forecast.

4.2 Load Forecast

4.2.1 As with customers, SEC has had an opportunity to review a draft of the VECC submissions on the Volume Forecast, and agrees that the Streetlighting volumes should be corrected.

4.2.2 We have no further submissions on the Load Forecast.

4.3 Revenue Offsets

4.3.1 SEC agrees with VECC and Energy Probe that it is not reasonable, nor is it consistent with past history, to forecast Gains on Disposition of Property as zero for the next five years. While we agree with Powerstream that this can be sporadic, over a five year period it is reasonable to assume that the average will be similar to the most recent actuals, which works out to \$230,000 per year.

4.3.2 With respect to Water and Sewer Billing, and in particular the costs of the new CIS, SEC deals with this in Section 5.5 of this Final Argument.

5 OM&A

5.1 Overview and History

- 5.1.1** PowerStream is seeking approval of \$516M in OM&A during the Custom IR period 2016-2020. This includes a significant 5.7% increase in 2015 over 2014, and a further 8.3% increase in 2016 over 2015, with further increases of 4% and 5% in 2017 and 2018.¹¹⁰ These increases are double and triple inflation. SEC submits these are unreasonable and should be disallowed.
- 5.1.2** PowerStream's past history shows they are likely overstating their budget. After its last cost of service application in 2012, it underspent its Board approved amount by 2.3%.¹¹¹
- 5.1.3** The Board should not approve the budget as filed. Reductions should be included to incorporate productivity and efficiency measures that are likely to occur due to the planned capital spending as well as incremental savings each year so as to align the plan with the RRFE requirement of continuous improvement.
- 5.1.4** As set out in SEC's arguments regarding benchmarking information, the amount is unnecessary. Further, the significant proposed year-over-year increases are significantly above inflation and are unjustified.
- 5.1.5** In our submission, for the reasons set out below, the Board should establish 2014 Actuals as the reasonable levels of OM&A, and increase them by inflation less a 0.5% productivity factor each year thereafter. This would establish more reasonable OM&A levels for the 2016-2020 period.

5.2 No Incremental Productivity Savings

- 5.2.1** PowerStream's OM&A budget is set by way of five year forecast. Besides undertaking a more robust budgeting process, since the period is for five years, PowerStream has done little in the budget itself other than what it would under a cost of service application.¹¹² There is no index or formula that decouples the OM&A portion of rates from its costs, nor has it built in any incremental productivity or efficiencies.
- 5.2.2** Incremental efficiency and productivity improvements that should occur, but where the specifics cannot be forecast today, should be built into the plan and shared with

¹¹⁰ Tr.1:115. Appendix 2-JA (K1.3, p.2)

¹¹¹ Appendix 2-JA (K1.3, p.2)

¹¹² Tr.1:118-119

ratepayers. This is what an explicit stretch factor is supposed to represent.

- 5.2.3** While PowerStream has tried to identify productivity savings embedded in its application, which are primarily included in the OM&A budget, the Board has already said that such an approach is not adequate. It is not sufficient to simply embed savings within a distributor's forecast:

"It is not sufficient to embed savings in cost forecasts. As already noted, the OEB's Custom IR is an incentive rate-setting approach designed to drive efficiencies. Benefits from explicit, objectively determined productivity and efficiency adjustments such as stretch factors include mimicking competitive market conditions, sharing anticipated savings with ratepayers "up front", and facilitating a more outcome-based approach to regulation."¹¹³

- 5.2.4** Since the stretch factor is an incremental calculation usually applied to the growth in costs, if it is to be applied as a reduction to PowerStream's current OM&A forecasts (or a modified forecast), it must be done on a cumulative basis.¹¹⁴

5.3 Capital Spending Outcomes Not Reflected in OM&A Budgets

- 5.3.1** PowerStream admits a number of capital programs will lead to OM&A savings yet it has not quantified them, nor has it included them in its Application.¹¹⁵ In fact, PowerStream admits that it "has not attempted to measure the productivity of all capital programs".¹¹⁶
- 5.3.2** PowerStream has categorized a number of those savings as "soft financial benefits". For example, during the oral hearing, SEC took the witnesses to the Storage Expansion project.¹¹⁷ This project, with a significant capital cost, is expected to have operations savings of over \$800,000 each year. However, PowerStream did not include those cost savings in their budget as they were "soft financial benefits" calculated as the small time savings of each of its employees who have utilized the new IT storage (40 hours per employee per year).¹¹⁸
- 5.3.3** PowerStream does, though, use the savings for the purposes of its optimization process, essentially a cost-benefit analysis for the project.¹¹⁹ The problem is that, even if the cost savings, increased productivity, etc., per employee are very small, at some point they will equal hard savings that should be included in their budget.

¹¹³ *Decision and Order* (Hydro One Dx- EB-2013-0416), December 22 2015, p.14-15

¹¹⁴ For example, in 2016, the forecast costs would be reduced by 0.3%, in the second year by 0.6% (2016 stretch factor [0.3%] + 2017 stretch factor [0.3%]), in year three by .9% (2016 stretch factor + 2017 stretch factor + 2018 stretch factor [0.3%]) and so on.

¹¹⁵ See for example. Tr.2:41, Tr.2:6-7, Tr.2:181

¹¹⁶ B-1, II-2-Staff.13. Tr.2:6-7

¹¹⁷ Tr.2:180. K2.3, p.69-70.

¹¹⁸ Tr.2:182

¹¹⁹ Tr.2:182

If not, it is not clear what the point of the savings are for the purposes of any cost benefit analysis.

- 5.3.4** Powerstream never answers the basic question: Are they savings, or not? You can't assume they are savings in a cost-benefit analysis, but also that they will never show up as savings in actual costs. The two are inconsistent.
- 5.3.5** SEC submits ratepayers must be able to benefit from capital investments made by PowerStream. It is not sufficient to simply say the savings are "soft". Load forecasts are "soft". Economic forecasts are "soft". System access spending is "soft". All predictions of future costs and benefits are, in some ways, "soft", but you still have to do the forecast, and live with it. You can't just forecast the costs, and not the benefits. That's just not fair.
- 5.3.6** With all the capital spending that PowerStream is proposing, it is not forecasting overall reductions in O&M expenses, even though that would be expected. As the Board recently stated in the Toronto Hydro Decision:

"While the OEB recognizes that the relationship between capital spending and OM&A is complex, the OEB finds that it is reasonable to expect that there will be some reductions in OM&A costs, particularly those related to maintenance, from the large capital expenditures, over many years, on system renewal, general plant, and system service. New assets should require less maintenance than old assets (at least in the corrective maintenance category) and underground assets should require less maintenance than overhead assets as there is no need for vegetation management, and no issue of animal interference.

....

*The OEB finds that as aging assets are replaced the extent to which the system requires reactive maintenance should be reduced."*¹²⁰

- 5.3.7** PowerStream's forecast reactive O&M budget is increasing at approximately 2.4% per year,¹²¹ an amount higher than expected inflation. PowerStream's response during the oral hearing was essentially that more capital spending would be needed for O&M costs to decrease.¹²² Clearly, PowerStream has not actually done any analysis on the relationship as the reactive O&M costs are not correlated in any way to either renewal capital specifically, or any other type of proposed capital spending.

5.4 Vegetation Management

- 5.4.1** SEC has a concern regarding PowerStream's vegetation management budget, which is proposed to more than double between 2015 and 2020, and almost triple

¹²⁰ *Decision and Order* (Toronto Hydro - EB-2014-0116), December 29 2015, p. 11

¹²¹ II-G-2-5.3.3, p.32 (K1.3, p.25). Tr.1:153

¹²² Tr.1:153

since the last Board approved amount.¹²³

5.4.2 PowerStream justifies the increased expenditures based on reports that it had commissioned after the 2013 ice storm. The problem though is there is no way to test the reasonableness of either the increased work it proposes to do, or the cost to do it.

5.4.3 First, the recommendations from these reports¹²⁴ are based on generic “best practices” and not on any cost benefit analysis. While more vegetation management is always in some ways better¹²⁵, it does not mean that the costs outweigh the benefits. With such a significant increase in spending, one would expect that PowerStream would seek the view of its customers on these increased costs. It did not.¹²⁶

5.4.4 Second, there is no way to test the reasonableness of the increased cost. As revealed cross-examination, one cannot look at the unit cost (\$ per km of line maintained) since a different type of work is being done.¹²⁷ This could be a reasonable explanation for why the unit costs are significantly increasing¹²⁸, but since no evidence was tendered to how the new amounts were forecasted, it would appear to SEC that they are no more than very high level estimates (i.e. guesses).

5.4.5 SEC submits the Board should not allow these significant increases in vegetation management costs in light of this. PowerStream has not adequately justified either the need or the cost for a dramatic expansion of these new vegetation management activities.

5.5 Water-Sewer Billing

5.5.1 PowerStream undertakes water and sewer billing for a portion of municipalities to which it provides distributor services. It uses the same CIS system to undertake this service as it does for distribution customers’ billing. While PowerStream has invested significant amount of money in its new CIS system, it has not forecast an increase in revenue from water and sewer billing services to cover their portion of the incremental cost. This is even though the current water and sewer billing service contracts were to expire in 2015 and PowerStream was in the process of renegotiating them.¹²⁹

¹²³ III-1, F-Energy Probe 7, (K1.3, p.17-18). Tr.1:136

¹²⁴ IV-2-TCQ-2,G-SEC-19: Navigant Consulting:2013 Ice Storm Review (Appendix A) and CIMA, *Hardening of Distribution Systems Against Severe Storms* (Appendix B). Tr.1:137

¹²⁵ Although the ultimate, cutting down all the trees, would produce great reliability, most people would not consider it better. Vegetation management is always a balancing of cost, reliability, aesthetics, and other factors.

¹²⁶ Tr.1:142

¹²⁷ Tr.1:146-147

¹²⁸ B-3, III-AMPCO-21 (K1.3, p.24)

¹²⁹ B-1, II-Energy Probe -18

- 5.5.2** PowerStream has taken the position that this is not necessary since the new CIS system was implemented because of the needs of distribution customers.¹³⁰ But during the oral hearing, PowerStream acknowledged that the current system needed to be replaced, regardless of any distribution billing requirements, due to failures and old age.¹³¹
- 5.5.3** Distribution customers should not have to subsidize water and sewage customers. The appropriate approach is that those customers be charged the fully allocated cost of the new CIS system. Since PowerStream has not done any analysis on what the amount should be, the Board should require to undertake such a study and then credit distribution ratepayers the difference for the Custom IR period. That amount should be placed in a variance account to be disposed of in the future.

¹³⁰ IV-VECC-30(b)

¹³¹ Tr.2:75-76

6 CAPITAL STRUCTURE AND COST OF CAPITAL

6.1 General

6.1.1 SEC has had an opportunity to review a draft of the submissions of Energy Probe with respect to the cost of new debt. We agree with Energy Probe that using the Board's default rate for new debt in 2016, when Powerstream already expects to borrow at a substantially lower rate, is inappropriate. Energy Probe has proposed that the 10 year rate (2.7%) be used for new long term debt, which would reduce revenue requirement by \$800,000. In the event that the Board approves rates for more than one year in this proceeding, this same principle would carry forward in subsequent years, based on the annual adjustment proposed by Powerstream.

6.1.2 Subject to that adjustment, SEC has no submissions on capital structure and cost of capital.

7 COST ALLOCATION

No submissions.

8 RATE DESIGN

No submissions.

9 DEFERRAL AND VARIANCE ACCOUNTS

9.1 Balances for Recovery in Deferral and Variance Accounts

9.1.1 SEC agrees with VECC that the calculation of the LRAMVA for the GS>50 class should be adjusted to reflect the IESO methodology, which would reduce the multiplication factor for demand programs from 12 to 6..

9.2 New Accounts

9.2.1 SEC has in this Final Argument made four proposals for new deferral or variance accounts, and lists them here for the assistance of the Board:

- (a)* M&A Cost Deferral Account (para. 2.2.7)
- (b)* Asymmetrical Capital Variance Account (Section 3.10)
- (c)* Water and Sewer Costs Variance Account (para. 5.5.3)
- (d)* Earnings Sharing Variance Account (Section 10.2)

9.2.2 SEC no further submissions in this area.

10 IRM COMPONENTS

10.1 Z-Factors

10.1.1 SEC agrees with OEB Staff that the Board's most recent definition of Z factors should be applied to Powerstream if it is under any form of IRM for 2016 and thereafter.

10.2 ESM

10.2.1 SEC has been on record for many years as being opposed to earnings sharing mechanisms. We believe in the incentives inherent in IRM, and in most cases do not feel those should be diluted with earnings sharing.

10.2.2 This Application is a special case, because there is so much room built into the revenue requirement. It is also important to remember that Powerstream targets ROE above the Board-approved level, unlike most other distributors.

10.2.3 In these circumstances, SEC believes that, if rates are set in this proceeding for more than one year, an asymmetrical ESM along the lines of that approved for Horizon and Ottawa would be suitable for Powerstream as well.

10.2.4 We note that SEC remains opposed to symmetrical ESMs. Central to Custom IR, and to the RRFE, is that distributors should manage within their rate envelope. They should not be able to overspend, and come back to the ratepayers after the fact to collect part of their overspending. An ESM, when appropriate, is intended to protect customers against forecast error, reflecting the asymmetry of information between the utility and the customers. It is not intended to give utilities the freedom to overspend.

11 OTHER MATTERS

11.1 Effective Date

11.1.1 Flaws in this Application resulted in there being little likelihood that rates could be in place by January 1, 2016. Thus, if the Board determines that it should set rates on a cost of service basis for 2016, whether under Custom IR or otherwise, SEC submits that the effective date of those new rates should be the month after the Board's rate order.

11.1.2 Conversely, if the Board agrees with SEC that rates should be set for 2016 using the 3rd Generation IRM formula, SEC believes that a January 1st effective date would be appropriate.

11.2 Reporting and Record Keeping

11.2.1 Given the problems with the Application, SEC has not found it possible to propose reporting or record-keeping requirements for the 2016-2020 period. The Application is so far removed from Custom IR that there is no real context within which to propose anything that would be helpful to the Board.

11.3 Costs

11.3.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible

All of which is respectfully submitted.

Jay Shepherd
Counsel for the School Energy Coalition