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BY EMAIL

December 18, 2017

Ontario Energy Board
P.O. Box 2319
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2300 Yonge Street
Toronto ON M4P 1E4
Kirsten.Walli@oeb.ca

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: Kitchener-Wilmot Hydro Inc.
2018 IRM Distribution Rate Application
OEB Staff Submission
OEB File No. EB-2017-0056**

In accordance with Procedural Order No.1, please find attached the OEB Staff Submission in the above proceeding. This document is being forwarded to Kitchener-Wilmot Hydro Inc. and to all other registered parties to this proceeding.

Kitchener Wilmot Hydro Inc. is reminded that its Reply Submission is due by January 12, 2018.

Yours truly,

Original Signed By

Georgette Vlahos
Advisor, Incentive Rate-Setting & Accounting
Encl.

ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

2018 ELECTRICITY DISTRIBUTION RATES

Kitchener-Wilmot Hydro Inc.

EB-2017-0056

December 18, 2017

**OEB Staff Submission
Kitchener-Wilmot Hydro Inc.
2018 IRM Rate Application
EB-2017-0056**

Introduction

Kitchener-Wilmot Hydro Inc. (Kitchener-Wilmot Hydro) filed an application with the Ontario Energy Board (OEB) on August 14, 2017 under section 78 of the *Ontario Energy Board Act*, seeking approval for changes to the rates that Kitchener-Wilmot Hydro charges for electricity distribution, effective January 1, 2018.

The purpose of this document is to provide the OEB with the submissions of OEB staff based on its review of the evidence submitted by Kitchener-Wilmot Hydro.

OEB staff makes detailed submissions on the following:

- Price Cap Adjustment
- Retail Transmission Service Rates
- Tax-Savings
- Deferral and Variance Account Disposition
- Bifurcation Request

Price Cap Adjustment

In calculating its rates for 2018, Kitchener-Wilmot Hydro has used its OEB assigned stretch factor of 0.15% based on the updated benchmarking study for use for rates effective in 2018.¹ OEB staff submits Kitchener-Wilmot Hydro's Rate Generator Model requires updating for the price cap index adjustment for the 2018 inflation factor set by the OEB of 1.20%. As a result, the net price cap adjustment to be used for Kitchener-Wilmot Hydro is 1.05%.

OEB staff will update Kitchener-Wilmot Hydro's Rate Generator Model at the time of the OEB's decision on the application.

Retail Transmission Service Rates

OEB staff has no concerns with the data supporting the updated Retail Transmission

¹ Report to the Ontario Energy Board – "Empirical Research in Support of Incentive Rate-Setting: 2016 Benchmarking Update", prepared by Pacific Economics Group LLC., July 15, 2017

Service Rates proposed by Kitchener-Wilmot Hydro. Pursuant to the OEB's Guideline G-2008-0001, OEB staff notes that OEB staff will update the applicable data at the time of the OEB's Decision on the Application based on the Uniform Transmission Rates in place at that time.

Tax-Savings

In response to OEB staff interrogatory #5, Kitchener-Wilmot Hydro confirmed that at the time of its 2014 cost of service application (EB-2013-0147), it was eligible for the Small Business Deduction and had an effective tax rate of 24.45%. In 2018, Kitchener-Wilmot Hydro is no longer eligible for the Small Business Deduction and therefore is subject to a 26.5% tax rate. Tab 8 of the Rate Generator Model produces a tax-sharing amount of \$61,470 of which 50% (i.e. \$30,734) is payable by Kitchener-Wilmot Hydro's customers.

Kitchener-Wilmot Hydro proposes to move this amount into Account 1595 for disposition at a later date since the amount does not produce rate riders in one or more rate classes.

OEB staff does not take issue with Kitchener-Wilmot Hydro's request and submits that moving the tax sharing amount into Account 1595 for disposition at a later date is appropriate.

Deferral and Variance Account Disposition

Kitchener-Wilmot Hydro's 2016 year-end total balance for its Group 1 deferral and variance accounts (DVA), including interest projected to December 31, 2017, is a credit of \$5,390,652. Included in the balance of the Group 1 accounts is the Global Adjustment (GA) account balance of \$460,504.

Kitchener-Wilmot Hydro's Group 1 accounts represent a total credit claim of \$0.0030 per kWh, which exceeds the disposition threshold. Kitchener-Wilmot Hydro proposes the disposition of this credit amount over a one-year period.

OEB staff makes submissions on the following two areas related to Kitchener-Wilmot Hydro's Group 1 DVA balances:

- Account 1595 (2014) Error
- Accounts 1588-Power and 1589-Global Adjustment Errors and Resulting Audit

Account 1595 (2014) Error

Kitchener-Wilmot Hydro is requesting disposition of a residual amount in Account 1595 (2014) of a debit of \$801,123, which includes interest to December 31, 2017. In response to an OEB

staff interrogatory questioning the large balance remaining, Kitchener-Wilmot Hydro indicates that:

The remaining balance is high because the Global Adjustment Rate Rider was calculated incorrectly in EB-2013-0147. For the Residential and GS<50 customer, the rate rider was calculated using the entire load for the class instead of the load for the non RPP customer only. In addition, for the GS>50 rate class forecasted loads were not met.²

OEB staff notes that because the incorrect billing determinants were used to calculate the Global Adjustment (GA) rate rider in Kitchener-Wilmot Hydro's previous cost of service application³, Kitchener-Wilmot Hydro under-collected from non-RPP customers for GA costs attributable to that customer base. The GA rate rider approved in that proceeding was in effect from May 1, 2014 until December 31, 2014.

In response to OEB staff interrogatory #4 in the current proceeding, Kitchener-Wilmot Hydro notes that it collected \$2,189,671 when it should have collected \$2,948,416 from its customers based on the calculations done in its previous cost of service application.

OEB staff submits that although some intergenerational inequity may exist should the OEB approve the disposition of this residual amount, this error can be corrected as part of the residual balance disposition given that the purpose of Account 1595 is to true up approved balances. OEB staff is satisfied with the explanation provided by the company and does not take issue with the residual amount remaining in Account 1595 (2014).

OEB staff notes that Account 1595 (2014) would include the residual balances for all Group 1 accounts that were disposed in the 2014 cost of service application, not just the GA amounts applicable to non-RPP customers. The mechanics of Accounts 1595 are such that when residual amounts are disposed after the rate riders cease, the balances are allocated across a distributor's rate classes in proportion to the recovery share as established when the rate riders were implemented; in this case, 2014.

OEB staff submits that should the OEB approve the disposition of this residual amount, it may choose to direct Kitchener-Wilmot Hydro to separate the GA residual amount applicable to non-RPP customers remaining in this sub-account from the overall remaining balances. The GA residual amount should be allocated only to non-RPP customers, while the remaining amount would be recovered from all customers.

In its reply submission, Kitchener-Wilmot Hydro may wish to comment on its billing system

² EB-2017-0056, Interrogatory Responses, Page 4

³ EB-2013-0147

capabilities in doing this separation.

Accounts 1588-Power and 1589-Global Adjustment Errors and Resulting Audit

Background

Accounts 1588 and 1589 are ongoing variance accounts which affect different subsets of customers. Account 1588 is used monthly to record the net difference between the energy amount billed to customers, including accruals, and the energy charge to a distributor using the monthly settlement invoice received from the IESO, host distributor or embedded generator, including accruals⁴. Account 1589 is used monthly to record the net difference between the global adjustment (GA) amount billed to non-RPP consumers, including accruals and, the GA charge (i.e., under charge types as applicable) to a distributor for non-RPP consumers using the monthly settlement invoice received from the IESO, host distributor or embedded generator, including accruals (the GA charge for RPP consumers is not included in this account since the distributor settles this part of the global adjustment charge on its monthly settlement filings with the IESO)⁵.

In this application, Kitchener-Wilmot Hydro explained that the balances in these accounts as of December 31, 2016, and proposed for disposition, reflect the correction of three errors that affect entries made in 2013 and 2014. The company disposed of its year ending December 31, 2013 balances on a final basis as part of its 2015 IRM proceeding.

In its 2016 IRM application⁶, Kitchener-Wilmot Hydro discovered that in December 2013 a manual recording error (error 1) was made affecting Account 1588 - Power and Account 1589 – GA. The error culminates in 2013 balances of the GA account being understated by approximately \$3.44M and the balance of the Power account being overstated by the same amount. In that decision, the OEB did not approve the disposition of any balances for the 2014 period and ordered the OEB's Audit and Performance Assessment unit to conduct an audit of the balances in Kitchener-Wilmot Hydro's Accounts 1588 and 1589. Adjusting the 2013 DVA balances in the 2016 IRM proceeding could have raised questions of potential retroactive rate-making that went beyond the scope of that proceeding⁷.

Prior to the commencement of the audit, Kitchener-Wilmot Hydro discovered another error of \$5.6M (error 2) also relating to the December 31, 2013 balances of the same accounts but impacting the balances in the opposite direction of error 1. Error 2 relates to a misallocation of

⁴ Accounting Procedures Handbook for Electricity Distributors, December 2011, Page 37

⁵ Ibid

⁶ EB-2015-0084

⁷ Ibid

the December 31, 2013 unbilled revenue as Kitchener-Wilmot Hydro did not have separate 1588/1589 Accounts when the entry was made, and it mistakenly put the entire unbilled revenue amount into Account 1588. As per Kitchener-Wilmot Hydro's response to OEB staff IR 10, an unbilled revenue correction was made as of December 2014 relating to December 31, 2013 and was built into the 2014 and 2015 closing balances (which are being requested for disposition in the current 2018 proceeding along with the 2016 balances).

The OEB's Audit and Performance Assessment unit conducted an audit during October 2016 to March 2017 and found a third error that resulted in an immaterial impact to the 2013 balances. Audit staff examined entries in Kitchener-Wilmot Hydro's deferral and variance accounts from January 1, 2013 to December 31, 2015.

In the current proceeding, Kitchener-Wilmot Hydro summarized the findings of the now completed audit and requests to clear DVA balances for the period 2014 to 2016. The audit confirmed three errors related to previously disposed (i.e. 2013) balances:

1. A manual adjustment error
2. Misallocation of unbilled revenues as at December 31, 2013 – Kitchener-Wilmot Hydro did not separate the Power expense into its components of GA and Power until December 2014
3. Kitchener-Wilmot Hydro used the final settlement amount instead of the actual IESO bill to record the GA variance

The table below depicts the quantum of each error. The net impact is \$2.2M and represents an overall allocation error between RPP and non-RPP customers. RPP customers have underpaid by \$2.2M and non-RPP customers have overpaid by this amount for the 2013 period:

	Error 1: Manual Adjustment Error (\$)	Error 2: Misallocation of Unbilled Revenues as at December 31, 2013 (\$)	Error 3: Final Settlement vs. Power Bill (\$)	Net Impact (\$)
Account 1588 – Principle	(3,443,918)	5,637,187	(83)	2,193,186
Account 1588 – Interest	(3,217)	5,131	4	1,918
Sub-Total	(3,447,135)	5,642,318	(79)	2,195,104
Account 1589 – Principle	3,443,918	(5,637,187)	83	(2,193,186)
Account 1589 – Interest	3,217	(5,131)	(4)	(1,918)
Sub-Total	3,447,135	(5,642,318)	79	(2,195,104)

In order to correct these errors, Kitchener-Wilmot Hydro proposes an adjustment and re-allocation between its RPP and non-RPP customers. The proposed accounting adjustments would be a debit to Account 1588 – Power over a one-year period and a credit to Account 1589 – GA over the same time period. Thus, the result of the proposed adjustments, if approved by the OEB, would be that RPP customers would be left with a debit balance owing, payable over a one year period, and non-RPP customers would receive a credit over one year.

In response to OEB staff interrogatory #13, Kitchener-Wilmot Hydro provides the following table showing both the bill impacts as proposed, and if the proposed adjustment were to be denied by the OEB.

Rate Class	Consumption/ Demand	Billing Determinant	Proposed		If Denied 2013 Error	
			Increase / (Decrease) (\$)	Increase / (Decrease) (%)	Increase / (Decrease) (\$)	Increase / (Decrease) (%)
Residential TOU	280	kWh	\$ 0.84	1.7%	\$ 1.22	2.5%
Residential TOU	750	kWh	\$ (3.21)	-3.2%	\$ (2.18)	-2.1%
General Service < 50 kW	2000	kWh	\$ (7.08)	-2.6%	\$ 0.01	-1.7%
General Service > 50 kW	60	kW	\$ (68.79)	-8.9%	\$ (35.83)	-4.8%
Large Use	5250	kW	\$ (13,376.34)	-47.6%	\$ (9,877.35)	-35.5%
Streetlighting	37	kW	\$ (39.68)	-9.8%	\$ (22.92)	-5.7%
Unmetered Scattered Load	2000	kWh	\$ (7.23)	-15.1%	\$ (4.29)	-9.0%

Kitchener-Wilmot Hydro indicates that each rate class will benefit from the disposition of adjusted account balances.

OEB staff is unable to reconcile the bill impacts provided. For example, if the OEB approves the adjustment, the net impact of the error to RPP customers of approximately \$2.2M would cause an increase in bill impacts to that customer group, not a decrease as is shown in the table above (right to left).

In its reply submission, Kitchener-Wilmot Hydro may wish to comment on the assumptions and calculations used to support its analysis of the bill impacts. The company may also wish to provide a table showing RPP and non-RPP customer impacts.

OEB Staff Position on Retroactive Adjustment

For the reasons set out below, OEB staff submits that the over-collected amounts from non-RPP customers should be refunded, and as such the adjustment to Account 1589 should be approved.

OEB staff submits that no retroactive adjustment should be made to Account 1588 for the under-billed amounts attributable to RPP customers.

Submission

Generally speaking, retroactive (or out of period) rate orders are not permitted. The most commonly cited court case dealing with this issue is *Bell Canada v. Canada (Canadian Radio-Television and Communications)*⁸ (which did not specifically deal with deferral and variance accounts). There are a number of reasons why retroactive rate orders are discouraged: parties to a proceeding should be entitled to rely on “final” rates, and issues of inter-generational equity can arise when adjustments are made long after the fact.

There are, however, exceptions to the rule against retroactivity, and the OEB’s own jurisprudence shows a number of approaches to this issue.

In this proceeding, the OEB has learned that the amounts recorded in Kitchener-Wilmot Hydro’s Accounts 1588 and 1589 for 2013 balances were incorrect after the balances were cleared through a final rate order. This scenario has occurred before the OEB in the past and, depending on the circumstances of each proceeding, the OEB has dealt with this situation in a number of ways.

In the OEB’s Decision and Order in the EB-2014-0043 proceeding⁹ (Enbridge example), the OEB permitted the utility to refund over \$10 million to customers (an amount that had not previously been paid out due to the utility’s own unintentional error). Acknowledging that the utility’s adjustment would be out-of-period, the OEB stated “there is no disadvantage to customers from this approach ... [a]n out-of-period adjustment can be justified if it ensures a utility does not profit on account of its own errors.”¹⁰

OEB staff submits that the current Kitchener-Wilmot Hydro error is not the same as the Enbridge example given that the correction proposed in the Enbridge case was intended to prevent the company from making a profit on commodity. There was no misallocation between commodity accounts (or customers) in that proceeding. Not refunding the money would have caused a windfall for Enbridge.

However, in the OEB’s Decision and Order in EB-2016-0090¹¹ (Lakeland example), the distributor’s original proposal would have resulted in an adjustment to balances previously disposed on a final basis due to an after-the-fact discovery of accounting errors which raised issues of retroactive rate-making. The error in this case was similar to Kitchener-Wilmot Hydro’s in that the company did not gain or lose on account of the error (it was a similar misallocation

⁸ [1989] 1 S.C.R. 1722

⁹ Decision and Order, EB-2014-0043, April 14, 2014 (re: Enbridge Gas Distribution Inc.)

¹⁰ Ibid, Page 2

¹¹ Decision and Rate Order, EB-2016-0090, December 8, 2016 (re: Lakeland Power Distribution Inc.)

between RPP and non-RPP customers). The distributor in this case proposed that the amount overpaid by customers would be returned to those same customers and that customers who underpaid for the same period would not be charged the additional amount. Rather, the amounts underpaid by the one customer group would be absorbed by the shareholder. While this was a retroactive adjustment, in that case the OEB approved disposition of the Group 1 balances because in effect the adjustment was in favour of customers and the utility consented to this treatment.

Another example comparable to the current proceeding is Essex Powerlines' 2015 IRM proceeding¹². In that proceeding, the error related to the allocation of the Independent Electricity System Operator's (IESO) GA and Hydro One Network Inc.'s power billings for the 2011, 2012 and 2013 rate years. The allocation error affected RPP and non-RPP customers symmetrically. In that case, 2011 and 2012 DVA balances had been disposed on a final basis. To correct the error, Essex Powerlines proposed an adjustment and re-allocation between RPP and non-RPP customers of approximately \$11.5 million. As a result of these adjustments, some customers would have received a credit refund and others would have had a debit balance owing.

In that proceeding, the OEB denied the retroactive adjustment to the 2011 and 2012 balances and allowed for the correction to the 2013 balances only. In addition, the OEB ordered a complete audit of all DVA accounts, procedures and controls be undertaken.

As a result of a lack of proper controls and mismanagement, the OEB imposed certain financial consequences on Essex Powerlines. The OEB indicated that Essex Powerlines will pay for the OEB's costs to conduct the audit of all DVA accounts, noting that:

The OEB's Audit and Performance Assessment Group conducts utility audits as part of its oversight responsibility of licensed distributors. The cost of conducting the audits are usually included and recovered with other OEB operating costs.

As part of the OEB's audit program, an audit of Essex Powerlines' Group 2 deferral and variance accounts was conducted recently. In the audit report dated March 28, 2013, Essex Powerlines had been cited for a number of incorrect regulatory accounting entries and procedures.

A second audit, within two years, is not normal business practice for the OEB's audit group and extends beyond the OEB's typical oversight responsibility. The need for a second audit is a result of the quality of the evidence in this proceeding¹³.

¹² EB-2014-0072/EB-2014-0301

¹³ EB-2014-0301/EB-2014-0072, Decision and Order, June 9, 2015, Pages 13-14

The OEB also denied the Price Cap adjustment applicable to Essex Powerlines. The decision in the Essex Powerlines proceeding noted that given the Price Cap IR option is an outcomes based approach designed to incent the utility and provide value to its customers, the OEB noted that the utility "...neither demonstrated the desired outcomes nor provided value to its customers."¹⁴

Although this decision was reviewed on the OEB's own motion, the original decision was not overturned.

Utilities such as Kitchener-Wilmot Hydro have ultimate control of their books and therefore are responsible for ensuring the accuracy of their filings with the OEB. As a result of the requirement to settle commodity related activities on behalf of its customers, utilities are entrusted by ratepayers to ensure its calculations of these costs are correct. OEB staff submits that in this case, Kitchener-Wilmot Hydro has not met its responsibility to do so. While it is true that these errors by Kitchener-Wilmot Hydro were unintentional, certain customers were in fact overcharged. Non-RPP customers overpaid for a prior period and should not be out-of-pocket for errors of the utility. Similarly RPP customers should not be burdened by out of period costs in future years after rates have been declared final.

OEB staff submits that the OEB could find in favor of an asymmetrical solution; in other words allow for an out of period adjustment that favours ratepayers, but not allow for an out of period adjustment that favours the utility. This is justifiable because the error rests with the utility. An asymmetrical outcome, in effect, would act as a consequence for the errors of Kitchener-Wilmot Hydro while refunding customers that were harmed by the error.

In the OEB's Decision and Order in North Bay Hydro's 2010 proceeding¹⁵ (North Bay Hydro example), the OEB denied a retroactive correction of approximately \$2M to the balance of an account that had been previously cleared by the OEB. This error was not an allocation error between RPP and non-RPP customers, and in fact the utility had recovered \$2M less than it was supposed to from its customers for pass-through costs. Citing the rule against retroactivity, the OEB denied the proposed adjustment, and held that making correct entries into deferral accounts was the utility's responsibility. Had the error resulted in customers overpaying in a past period it might have allowed the correction. The OEB stated in that decision that it is not driven by the need for a symmetrical treatment of ratepayers and utilities in situations where correction of utility mistakes is required. The OEB noted that, for this reason, it could find in favour of the ratepayer in certain situations and not find in favour of the utility if the utility was in the same situation.

¹⁴ Ibid, Page 15

¹⁵ Decision and Order, EB-2009-0113, September 8, 2009 (re: North Bay Hydro)

Should the OEB be inclined to treat this application asymmetrically as outlined in the North Bay Hydro example, the OEB may wish to consider the relative financial impact of the two cases. The OEB in carrying out its responsibilities is guided by the objective of maintaining a financially viable electricity industry, and therefore the OEB in making its determination, should consider the financial impact of its decision on the utility's financial stability. The OEB may be guided by the relative impact of its determinations of its decision in the other cases, compared to the case on hand. In that regard, from the cases noted above, it appears to OEB staff that the North Bay Hydro example is most comparable in terms of financial impact.

In the North Bay Hydro example, the under-collection of \$2M represented approximately 17.9% of North Bay Hydro's 2009 OEB-approved revenue requirement¹⁶. In the Kitchener-Wilmot Hydro proceeding, OEB staff observe that an asymmetrical determination would result in approximately \$2.2M in unrecovered costs by Kitchener-Wilmot Hydro. This amount represents approximately 5.5% of Kitchener-Wilmot Hydro's 2014 OEB-approved revenue requirement¹⁷.

Bifurcation Request

Procedural Order No.1, issued November 1, 2017, set out dates for various procedural steps in this proceeding. Due to the anticipated complexities arising from Kitchener-Wilmot Hydro's proposal to correct balances previously approved by the OEB, procedural timelines go beyond Kitchener-Wilmot Hydro's requested effective date of January 1, 2018. Kitchener-Wilmot Hydro's reply submission is due by January 12, 2018.

On December 6, 2017, Kitchener-Wilmot Hydro filed a letter with the OEB requesting that this application be bifurcated into two parts. One being the Price Cap, RTSR and Tax-Sharing sections and the other being the disposition of Group 1 Accounts. This will allow for any changes to base rates from this application to coincide with Kitchener-Wilmot Hydro's rate year, and as such an interim rate order will not be required.

OEB staff supports the bifurcation request proposed by Kitchener-Wilmot Hydro. If the OEB is not inclined to consider other options for a financial consequence to the company such as the denial of the price cap adjustment, or other options that may require the 2018 period to remain open, then OEB staff has no concerns with the OEB approving the company's application (except for the DVA matters) on a final basis in advance of, and effective as of, January 1, 2018.

All of which is respectfully submitted

¹⁶ North Bay Hydro's 2010 OEB-approved revenue requirement was \$11.2M

¹⁷ Kitchener-Wilmot Hydro's 2014 OEB-approved revenue requirement was \$38.4M