October 28, 2013

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

RE: 2014 ELECTRICITY DISTRIBUTION RATE APPLICATION FOR ALGOMA POWER INC. ("API") – EB-2013-0110
SUPPLEMENTAL EVIDENCE

Please find accompanying this letter two (2) copies of API's Supplemental Evidence in the matter of the above captioned proceeding. This Supplemental Evidence is limited only to the Board's assignment of a stretch factor to be used in this Application.

A PDF version of this evidence will, coincidently with this written submission, be filed via the Board's Regulatory Electronic Submission System.

If you have any questions in connection with the above matter, please do not hesitate to contact the undersigned at (905) 994-3634.

Yours truly,

Original Signed by:

Douglas R. Bradbury
Director, Regulatory Affairs

Enclosures

2 Sackville Road, Suite A, Sault Ste. Marie, Ontario P6B 6J6

Tel: 705-256-3850 • Fax: 705-253-6476 • **www.algomapower.com**

Supplemental Evidence to the Application By Algoma Power Inc. To Adjust Electricity Distribution Rates & Rural and Remote Rate Protection Funding Effective January 1, 2014 EB-2013-0110

BACKGROUND

Algoma Power Inc. ("API") submitted its 2014 4th Generation Incentive Rate-setting Application, EB-2013-0110, on August 16, 2013. In the Manager's Summary, at page 9, of the Application, API submitted;

> *"API is submitting a price cap adjustment of 0.48% as stipulated in Chapter 3 of the Board's Filing Requirements for Distribution Applications, dated July 17, 2013. This is based on the current default metrics; an inflation factor of 1.6%, a productivity factor of 0.72%, and a stretch factor of 0.4% (representing the middle cohort). API acknowledges that the Board may update API's 2014 IR Application with the final parameters to be established by the Board in its supplemental report on the Renewed Regulatory Framework for Electricity Distributors ("RRFE")."*

Subsequent to API's Application being submitted on August 16, 2013, the Board issued the *"Draft Report of the Board on Empirical Research to Support Incentive Rate-setting for Ontario's Electricity Distributors"* (the "Report"), EB-2010-0379, on September 6, 2013. In respect of the assignment of a stretch factor to an individual distributor, the Report contemplates an additional evidentiary requirement for distributors currently making an incentive rate-setting application for electricity distribution rates. In the Report, under Section 2.2.2 Stretch Factor, at page 29, the Board wrote;

> *"During this consultation, some distributors wrote to the Board claiming extenuating circumstances that they believe should make them eligible for specific treatment in relation to stretch factor assignments. The Board believes that these requests should be addressed on a case-by-case basis. Consistent with practice to date, distributors that apply to the Board for exclusions and/or exceptions and satisfy the Board that their reasons are compelling may be assigned the middle stretch factor (i.e., 0.30%)."*

On June 26, 2013, Canadian Niagara Power Inc. submitted a letter of comment to the Board in which it described the extenuating circumstance of API in relation to the assignment of stretch factors.

API acknowledges that the September 6, 2013 Report is a draft report intended for consultation. However, on the basis of the Board's determination that distributors will be assigned to one of five tranches with stretch factors based on their efficiency as determined through the Pacific Economics Group Research, LLC ("PEG") econometric total cost benchmarking model, API believes it is compelled at this juncture of the application review process to submit supplemental evidence in relation to the assignment of a stretch factor.

SUPPLEMENTAL EVIDENCE

For the following reasons, PEG's econometric model does not accurately assess and compare the efficiency of API within the general operating environment of distributors in Ontario.

High Cost Low Revenue Service Territory

API's cost characteristics were accurately described in the Board's Decision in the matter of EB-2007-0744, an application by Great Lakes Power Limited (the predecessor to API) for an Order or Orders approving just and reasonable rates and other service charges for the distribution of electricity. In that Decision[1] the Board wrote;

> *"GLPL presents a unique challenge for the Board. In reviewing the record for this case and examining the history of this applicant before the Board it has become clear that conventional ratemaking practice cannot address the issues presented by this applicant.*
>
> *Conventional ratemaking cannot result in a rate that will cover the Company's costs, provide for a reasonable return on investment, while being reasonable from a ratepayer's point of view.*
>
> *This circumstance arises directly out of the characteristics of the Applicant's service area. The Applicant's service area is more than twice the area of the greater Toronto area. It has less than 12,000 customers and has the lowest customer/kilometer ratio in Ontario with only 6.7 customers per kilometer on*

[1] Board Decision and Order, EB-2007-0744, dated October 30, 2008, page 3

> *average. 99.9% of its service area is rugged and sparsely populated wilderness. Its service area is characterized by long runs of distribution wire between customers.*
>
> *This is a high cost, low revenue service area."*

Post EB-2007-0744, API has become unique amongst Ontario distributors in the way its distribution rates are set by the Board. Pursuant to O. Reg. 442/01, and with the exception of its Seasonal and Street Lighting Customer Classifications, API's rates are adjusted in line with the average of any adjustment to rates approved by the Board for all other distributors for the most recent rate year. The difference between Board approved revenue requirement and revenue derived from electricity rates is compensated by the Remote and Rural Rate Protection Plan.

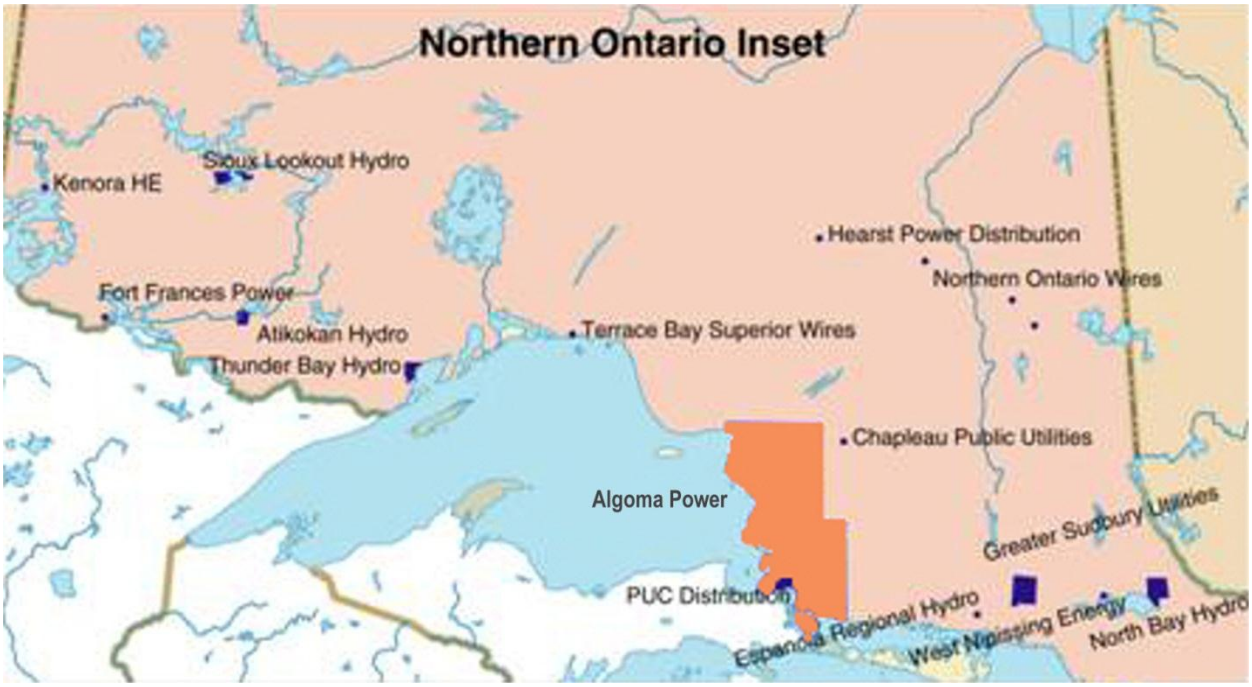
This mechanistic approach to setting the actual tariff, the monthly service charge and the volumetric distribution rate, effectively decouples electricity distribution rates for API's Residential – R1 and Residential – R2 customer classes.

The Board's recognition of API as a high cost, low revenue service area is unique and further evidence of API being an outlier in the community of Ontario distributors.

Description of API's Unique Aspects

API's distribution system covers an area of more than 14,200 square kilometres in a remote area of Northern Ontario, north and east of the City of Sault Ste. Marie. API serves less than 11,800 customers on a distribution system consisting of 1,845 kilometres of distribution line; approximately 6.3 customers per kilometer of distribution line[2]. The distribution system extends 93 km east and approximately 255 km north of the City of Sault Ste. Marie. The following map illustrates the size of API's territory, shaded in orange, relative to neighbouring LDC's denoted in blue.

[2] API 2011 Cost of Service Review, EB-2009-0278, Exhibit 1 Schedule 2 Tab1, page 3



With the exception of Hydro One Networks Inc., no other LDC in the province has a service territory as large as API's.

The low number of customers relative to its vast distribution service area, results in a very low population density within API's distribution service area. Historically, much of API's distribution system was built to service the resource sector and the communities that developed around those enterprises. As a number of those industries declined, the result was a sparsely populated service territory with predominantly residential and seasonal customers. This explains why parts of API's system are characterized by long radial lines serving very few customers. At only 6.3 customers per kilometer of distribution lines, API has the lowest utility customer/line ratio in Ontario. In comparison with the other distributors, API can best be described as an outlier warranting unique treatment by the Board.

In order to provide customer service in this vast territory, it is necessary for API to maintain and operate three service centers; the main service center hosting customer service, engineering and field operations is located in the city of Sault Ste. Marie with two additional smaller service centers hosting field services personnel located in Wawa to the north and Desbarats to the east of Sault Ste. Marie. The remote and rugged terrain found in the API service territory makes it

necessary for API to operate, in addition to the normal fleet of utility vehicles, a fleet of off road vehicles including snowmobiles, watercraft and all terrain amphibious vehicles at each of these service centers in order to make it possible for API's line crews to reach their customers. Safe and competent operation of this ancillary fleet requires specialized training for API's field personnel. In addition to the fleet of equipment that API maintains, it is often necessary for API to contract helicopter services to locate downed lines and effect repairs in remote areas in a timely manner; helicopter services routinely cost in the neighbourhood of $1,500 per hour and have increased in recent years as fuel costs increase.

At present there are eleven (11) First Nations Reserves and First Nations as well as Metis communities in API's service territory. Provision of electricity distribution service to aboriginal communities requires an increasingly engaged approach including but not limited to the duty to consult. API is committed to meeting its obligations in respect of First Nations' and Metis aboriginal and treaty rights. These increasingly complex obligations are a more recent development and continually add to API's OM&A costs.

In addition to the thirteen (13) municipalities and organized townships serviced by API's distribution system there are another seventy-nine (79) unorganized townships located on either crown land or corporately controlled land. Most often in these unorganized townships there is no formalized planning or even publicly maintained roadways. This lack of governance increases costs associated with locating land rights owners and securing rights to property necessary to build and maintain distribution plant. This composition of communities and customer enclaves, particularly the prevalence of unorganized townships, is a contributing factor to the increasing costs that API has been experiencing in recent years. In order to maintain its distribution assets, for example vegetation management, API is required to pay to the Ministry of Natural Resources (the "MNR") or the corporate land holder a stumpage fee[3] and or licencing fees. In recent years the MNR has introduced market based pricing for stumpage, therefore annually increasing API's OM&A costs. Again, a clear example of increasing costs being experienced by API, due to the nature of the service territory, which is not normally experienced elsewhere.

[3] A cost based on the number of trees cut, or "per stump" cost.

These examples are all evidence of API being an outlier in the provision of electricity distribution service in Ontario. These increasing costs, embedded within the OM&A costs, are not commonly associated with other distributors in the PEG sample group.

Remote and Rural Rate Protection Plan ("RRRP")

The RRRP is a program designed to address the higher cost of serving low density customers located in rural and remote areas of Ontario as compared to customers located in the more densely populated urban areas. These higher costs are related to serving a diverse customer base, a lower customer density, and a large and more varied geographic territory compared to municipal utilities.[4]

In its most recent cost of service application, EB-2009-0278, API had an approved revenue requirement of $20,198,813 of which $11,411,951 or 56.5% was RRRP funded. The manner in which rates are set and the RRRP funding amount is determined, has been consistent since the Board's Decision in the matter of EB-2007-0744; failure to recognize the uniqueness of API and the fact that it is a high cost, low revenue service area in this effort to define and measure performance is unfair to API. API's costs are inherent to the characteristics of the service territory in which it operates; this vast territory and low customer density have no comparators within the balance of LDCs in Ontario.

The fact that API has been recognized by Regulation, O. Reg. 442/01 Remote and Rural Rate Protection, as a distributor with higher and increasing costs related to serving a diverse customer base, a lower customer density, and a large and more varied geographic territory as compared with all other distributors in Ontario, with the exception of Hydro One, is evidence that API is an outlier in PEG's sample of Ontario distributors.

EXAMPLES OF COST DIFFERENTIALS

The following are examples of cost drivers which differentiate API from the general population of municipal distributors to which it is being compared in the PEG analysis. These examples are

[4] http://www.hydroone.com/MyHome/MyAccount/Pages/faq.aspx#billexp, the Hydro One website's Frequently Asked Questions; How do I know if I am receiving Rural or Remote Rate Protection (RRRP)?

meant to draw attention to specific and tangible cost drivers for API that are not likely cost impactive on the general populace of Ontario distributors.

Transportation Costs

Fuel costs are a major cost component of an electricity distributor's OM&A and capital costs. Distributors are required by necessity to operate and maintain a fleet of utility construction vehicles; vehicles that collectively will consume a great amount of fuel. This is particularly significant for a geographically large distributor like API where driving time is a significant cost driver.

For the period of January 2003 to December 2012, fuel prices in southern Ontario have increased by 64.4%. Over this same time frame fuel prices in northern Ontario have increased by 69.9%. The spread increases between the two regions is 7.9%; that is to say that over the same time period northern Ontario distributors have seen their fuel costs rise 7.9% more than their more southern counterparts.[5]

Fuel prices are indicative of and impact on many of the goods and services consumed by distributors. Fuel prices will impact the purchase price of most all distribution materials used to construct and maintain the distribution system. The fact that fuel prices have risen more in the north are an indicator that cost of purchasing goods and services have also risen faster. This more rapid rise in costs may be a contributor to the higher costs in recent years.

Indeed rising fuel prices is an exacerbating cost driver for API. As previously discussed and illustrated in the map provided on page 4, the vast service territory means that API field personnel are required to drive significantly longer distances than field personnel of the typical municipal distributor.

Community Governance

As discussed previously there are two specific community governance matters which are increasingly placing cost pressures on API; these same matters are not likely to introduce any form of material to other distributors other than Hydro One.

[5] Statistics Canada Table 326-0009 Average retail prices for gasoline and fuel oil, by urban centre, monthly

First is the presence of the First Nations Reserves and First Nations as well as Metis communities in API's service territory. The obligations, which API are committed to meet, related to consultation is becoming increasingly more complex and therefore more labour intensive. As these obligations develop and expand the costs to API increases. These increasing costs, embedded within the OM&A accounts, are not commonly associated with other distributors in the PEG sample group.

Second is the abundance of unorganized townships within the API service territory. These are small community enclaves located on crown land and/or corporately controlled land tracks; there is no form of local governance in these townships. Historically, many of the unorganized townships originated from resource based development in remote areas of the service territory and often connected to the distribution system by relatively long runs of distribution wire between customers. In many cases the initial construction of these distribution lines were financed by the resource industries then present. Today, API's field operations personnel are confronted with many challenges when it comes to maintaining and/or rebuilding these assets.

These challenges often relate to property rights. As many of these unorganized townships become seasonal use areas there are often disputes regarding the demarcation of property rights and road allowances neither of which are well documented, controlled or are unregistered tenant agreements. As a result, it is often relegated to an "ask a neighbour" form of dispute resolution. There is an instance on record[6] where seasonal customers in an unorganized township have escalated a property rights dispute to the OEB for resolution resulting in a significant cost to API. All of which are increasingly common cost pressures on API that are not commonly associated with other distributors in the PEG sample group.

Forestry Fees

Vegetation management costs are a significant cost driver for API. In its last cost of service review, API presented a test year budget of $2.5 million for vegetation management; approximately $2,100 per customer. API's service territory is geographically vast and heavily forested; other than Hydro One, it has no comparator in Ontario. API's distribution facilities are primarily located on crown land and/or corporately controlled land tracks. These land control

[6] OEB File No. 2010-0006362

authorities, including the MNR, are introducing new fees to API making its vegetation management cost more than otherwise forecasted. These fees include both stumpage fees and licence/permitting fees; all of which are volumetric based.

These increasing costs, embedded within the API OM&A accounts, are not commonly associated with other distributors in the PEG sample group.

Smart Meter Costs

In Table 12, Cost Measures for Empirical Analysis, of the *Empirical Research in Support of Incentive Rate-Setting: 2012 Update – Report to the Ontario Energy Board*, prepared by PEG and dated September 2013, it indicates that for distributor cost benchmarking, smart meter costs were included.

API's approved average cost per smart meter, excluding costs beyond minimum functionality, was $380.58[7] (including approved costs beyond minimum functionality the cost was $391.97).

The Monitoring Report, Smart Meter Investment – September 2010 issued on March 3, 2011 summarized the total smart meter related investments of 78 distributors, as of September 30, 2010, and showed an average cost of $226.92 per smart meter.[8]

This comparison places API's approved smart meter costs 68% above the average of these 78 Ontario distributors.

In its Decision and Order in the matter of EB-2012-0104, the Board wrote[9]:

> *"API's evidence described the unique aspects of its service territory, specifically with regard to its expanse of approximately 14,200 square kilometers; its rural and rugged terrain with dense vegetation; and its low customer density of 6.3 customers per kilometer of line, or 0.8 customers per square kilometer…*
>
> *The Board accepts API's explanation of the unique circumstances leading to its higher than average smart meter costs."*

[7] API 2013 IRM, Board Decision and Order,EB-2012-0104, March 28, 2013, page 13
[8] API 2013 IRM, Board Decision and Order, EB-2012-0104, March 28, 2013, page 13
[9] API 2013 IRM, Board Decision and Order, EB-2012-0104, March 28, 2013, page 14

API submits that this is another salient example of API being an outlier in the population of distributors included in the PEG analysis.

RELIEF SOUGHT

In the Report, the Board indicated that requests for specific treatment in relation to stretch factor assignment should be addressed by the Board on a case-by-case basis.

API had submitted its 2014 4th Generation Incentive Rate-setting Application, EB-2013-0110, on August 16, 2013. This submission pre-dated the Report and the Board's draft determination in respect of the assignment of stretch factors in its September 6, 2013 Report.

In order to be consistent with the Board's expectation that an applicant apply to the Board with their reasons for specific treatment, API is filing this Supplemental Evidence to its Application for electricity distribution rates effective January 1, 2014, EB-2013-0110.

API is requesting that the Board assign the middle stretch factor (i.e., 0.30%) for use in API's 2014 4th Generation Incentive Rate-setting Application, EB-2013-0110.