ONTARIO ENERGY BOARD

STAFF SUBMISSION

2014 ELECTRICITY DISTRIBUTION RATES APPLICATION -

Board Staff Submission

Kitchener-Wilmot Hydro Inc.

EB-2013-0147

January 23, 2014

Kitchener-Wilmot Hydro Inc. ("KWHI") filed an application (the "Application") with the Ontario Energy Board (the "Board") on May 17, 2013 seeking approval for changes to the rates that KWHI charges for electricity distribution, to be effective January 1, 2014. The Board assigned the Application file number EB-2013-0147. An amended application was filed on June 21, 2013, and additional information was filed on August 9 and 13, 2013.

Following an initial round of written interrogatories and responses, the Board established procedures to facilitate a technical conference which was held on October 28, 2013 and a settlement conference which was held on November 7 and 8, 2013. KWHI filed a proposed partial settlement agreement between itself and the registered intervenors (collectively, "the Parties") on December 3, 2013.

As documented in the proposed partial settlement agreement, the following issues remained unsettled:

> Issue 2.2:
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> "Is the working capital allowance for the test year appropriate?"
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> And
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> Issue 4.1:
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> "Is the overall OM&A forecast for the test year appropriate?"[1]

The Board conducted a transcribed oral hearing at the Board's offices on January 9, 2014 hearing testimony on these unsettled issues. Undertakings arising from the oral hearing were filed on January 16, 2014. The following are Board staff's submissions on the unsettled issues.

Working Capital Allowance ("WCA")

In its Application, KWHI proposed that the WCA factored into the Rate Base for determining the 2014 revenue requirement should be based on 13% of the sum of controllable expenses plus the cost of power. KWHI is relying on the Board's letter of April 12, 2012,[2] in which the Board stated that the default factor for the WCA should be 13%. In its letter, the Board stated that a distributor could rely on

[1] Tr. Vol. 1, January 9, 2014, pg. 12 ll. 7-13
[2] Exhibit K1.2, pp. 7-9

this 13% factor unless it wanted to undertake its own lead-lag study or was so directed to do so in a previous Board decision.

In its previous cost of service rebasing application for 2010 rates (EB-2009-0267), KWHI proposed to undertake its own lead-lag study in its reply submission. The Board's decision acknowledged KWHI's proposal to conduct a lead lag study, and encouraged KWHI to do so or to participate in any Board-initiated process to do so.[3] However, the Board did not direct KWHI that it had to do either; this is in contrast to the Board's direction in its decision on London Hydro Inc.'s 2009 cost of service application (EB-2008-0285) where the London Hydro was directed to conduct its own lead-lag study.[4] Board staff notes that London Hydro Inc. complied and filed a lead-lag study in its 2013 cost of service application. [5]

Board staff submits that KWHI's reliance on the updated default WCA factor of 13% is reasonable.
KWHI was not directed to do its own lead-lag study, although that was an option available to it (and to any other distributor preparing a Cost of Service rates application). Instead, KWHI interpreted the April 12, 2012 letter and direction as the result of a "Board-led" process, and relied on it, as confirmed by Ms. Nanninga.[6]

Board staff also submits that the use of the 13% factor in KWHI's application for 2014 rates is reasonable, on the basis that KWHI has been delayed in implementing monthly billing and in fact is not certain when the cutover to monthly billing for Residential and GS < 50 kW customers will occur.[7] While KWHI initially anticipated that it would implement monthly billing partway through 2013 in its Application as originally filed, it has delayed implementation.[8] KWHI confirmed that it has not migrated any Residential or GS < 50 kW customers to monthly billing in 2013 and incurred no costs for such a project.[9] KWHI notes that it intends to move to monthly billing in 2014, but implementation is awaiting the outcome of this hearing.[10]

As of early 2014, over 90% of KWHI's customers remain on bi-monthly billing, and are likely to remain so for some period into this year. As such, Board staff

[3] Decision and Order EB-2009-0267, April 7, 2010, pp. 26-27
[4] Decision and Order EB-2008-0235, August 21, 2009, pp. 33-34
[5] Exhibit K1.2, page 28
[6] Tr. Vol. 1, pg. 35 l. 26 to pg. 36 l. 20
[7] Tr. Vol. 1, pg. 36, ll. 24-26
[8] Tr. Vol. 1, pg. 113, l. 19 to pg. 114 l. 4
[9] Tr. Vol. 1, pg. 38 l. 21 to pg. 39 l. 1
[10] Tr., Vol. 1, pg. 117 l. 20 to pg. 119 l.3

sees the 13% WCA as being reasonable based on the current status of KWHI's billing processes.

Working Capital Allowance and Monthly Billing – A Generic Discussion

The working capital allowance represents that amount of cash working capital that a utility requires to be able to pay for materials and services it receives, wages and salaries for its employees and for the cost of power that is passed through to customers; recognizing that there is a lag before it will receive payment from its customers given the time for billing and bill processing.

Previously, the (cash) working capital allowance was 15% of the sum of the cost of power and controllable expenses. This was a formula that was derived when the former Ontario Hydro was the regulator of the predecessor municipal electric utilities. As noted in the Board's 2000 *Electricity Distribution Rate Handbook*:

> The working capital allowance to be included in the rate base for first generation PBR [Performance-Based Regulation] is 15 per cent of the sum of the 1999 COP [Cost of Power] and controllable expenses. This accounts for approximately 2 months of COP and 1½ months of controllable expenses (sum of Operations and Maintenance, Billing and Collection, and Administration), which results in approximately similar levels allowed by the previous regulator.[11]

It was recognized even then that this was a formulaic proxy that would require re-examination. Since 2006, some, generally larger, distributors have voluntarily conducted lead-lag studies to update their cash working capital requirements. In other instances, a distributor was directed to conduct a study.

The 13% factor announced in the Board's letter of April 12, 2012 was a step in updating the working capital allowance. This amendment took into account the results of the various lead-lag studies that had been filed with the Board. But Board staff sees this as a first step. At the time of that letter, very few distributors would have been on monthly billing, and none that actually had conducted recent lead-lag studies.[12]

The issue then is what should be the working capital allowance as distributors convert to monthly billing? Board staff submits that a consultation or working

[11] 2000 Electricity Distribution Rate Handbook, page 3-5.
[12] The Board's letter of April 12, 2012 makes no reference to monthly billing.

group could be considered to conduct a more extensive and generic study. This could be led by either the Board or the industry. It may be appropriate to do this in about a year or so, when more distributors, including KWHI, may have converted to monthly billing and may have better information on the leads and lags of costs and revenues with this change.[13]

OM&A

In the proposed partial Settlement Agreement, KWHI has used a proposed OM&A, net of property taxes, of $18,480,760. The OM&A is an unsettled issue. This amount of $18,480,760 reflects changes acknowledged by KWHI in response to interrogatories and Undertakings from the Technical Conference held on October 28, 2013. In particular, KWHI has documented that this amount reflects the original proposed OM&A less an adjustment of $42,440.[14] This adjustment reflects reducing the non-labour inflation from 2.0% in the Application as filed on June 21, 2013[15] to 1.6%, corresponding with the GDP-IPI announced for May 1, 2013 IRM rate adjustments based on 2012 StatsCan data published on March 1, 2013.

Board staff notes that on November 21, 2013, the Board issued its *Report of the Board on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors*.[16] Appendix C of that report documents the derivation of the new IPI, or Input Price Index, being used for IRM rate adjustments as of January 1, 2014. That number is 1.8%. In the most recent RRWF, KWHI has estimated that the impact on OM&A of going from 2.0% to 1.6% for non-labour inflation, a 0.4 percentage point change, is ($42,440). Accordingly, the impact of going from 2.0% to 1.8%, a 0.2 percentage point change, would be ½ of that, or ($21,220). Board staff notes that this is not a material amount and submits that no further changes to the proposal are required.

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[13] Tr. Vol. 1, pg. 43, ll. 5-15. Ms. Nanninga explained that a lead-lag study conducted now for KWHI would be based on bi-monthly billing for Residential, microFIT and GS < 50 KW customers and would not be representative of the situation under monthly billing.
[14] (Partial) Settlement Proposal, filed December 3, 2013, page 7 and the Revenue Requirement Work Form ("RRWF") filed as an attachment to the (Partial) Settlement Proposal.
[15] Exhibit 4/Tab 2/Schedule 2/p. 5/ll. 16-28
[16] While this Report of the Board was updated most recently on December 4, 2013, any updates do not affect Appendix C or the IPI or non-labour component GDP-IPI.

Ash Tree Removal

KWHI has documented ash tree removal as one driver of its increases to OM&A.[17] Mr. Sidlofsky reiterated on ash tree removal due to the emerald ash borer as an important factor in KWHI's proposed OM&A.[18]

Mr. van Ooteghem noted that this program has an impact of increasing OM&A by about $100,000 per year. Board staff notes that this is consistent with JT1.15, where ash tree removal is documented as increasing OM&A by $50,000 in 2013 and a further $50,000 in 2014, for a cumulative increase of $100,000. The utility's comments on ash tree removal indicate that this appears to also be an ongoing OM&A program, continuing beyond the 2014 test year. Assuming a tree removal cost of about $2,000 per tree, this amounts to 50 ash tree removals per year, or about 200 trees over the four year cycle until KWHI is next scheduled to rebase its rates.

Vegetation management is to ensure that growth of trees, shrubs, grasses, etc. have sufficient clearance from electrical equipment and buildings for employee and public safety, to allow for safe access to and working around equipment and so that safety, quality and reliability are not put at unreasonable risk through contacts, including falling trees and branches taking down poles and wires.

However, proper maintenance of vegetation is the responsibility of the property owner (including municipal, provincial or federal governments in the case of trees on public property). The recent ice storm in December 2013 has highlighted this issue.

While the ongoing trimming of trees is a necessary distribution activity, in Board staff's submission, the overall responsibility for removal of these trees rests with the property owner. On this basis, the incremental OM&A of $100,000 should not be allowed as an expense to be borne by ratepayers through distribution rates.

Monthly Billing

In its Application, KWHI had anticipated implementing monthly billing early in 2013, and showed incremental OM&A expenses of $200,000 in 2013 and a further $201,500 in 2014, reflecting the fact that 2013 would be a partial year but 2014 would be a full year under monthly billing. By the time of the Technical

[17] In opening remarks, Mr. van Ooteghem discussed ash tree removal at Tr. Vol. 1, p. 25, l. 20 and p. 26, ll. 23-27.
[18] Tr. Vol. 1, p. 163, ll. 9-14

Conference, monthly billing in 2013 was delayed, and KWHI reflected the full incremental costs in 2014, as shown in JT1.15. This was also explained by Ms. Nanninga and Ms. Yaraskavitch during the oral hearing.

KWHI has documented that moving Residential and GS < 50 kW customers to monthly billing will increase OM&A by $401,500.[19] During the oral hearing, KWHI's witnesses also indicated that postal rate increases announced by Canada Post in December 2013 would further increase OM&A, and that the additional impact on the change to monthly billing would be a further increase of $98,000. As summarized by Mr. Aiken during his cross-examination, and agreed to by Ms. Muir, this would be an increase of approximately $500,000 per annum.[20]

KWHI's witnesses noted that they did not undertake a cost-benefit analysis or otherwise quantify benefits and savings of moving to monthly billing.[21] They stated that the benefits are not as easy to estimate as those of the costs. While Board staff concurs that quantitatively estimating the benefits is more difficult than estimating the costs (which are largely doubling costs for postage, envelopes, paper and printing for the additional 6 monthly bills per month), this does not remove the responsibility to do so.

KWHI's witnesses also stated that the decision to implement monthly billing was primarily due to statements from the Minister of Energy on the possibility of mandating monthly billing. Board staff observes that deployment of smart meters, including the necessary AMI communications infrastructure and computer hardware and software which allows for regular remote reading of the smart meters is an equally important driver (or facilitator) of monthly billing by Ontario distributors, including KWHI.

Later in the oral hearing, KWHI's witnesses indicated that they have not implemented monthly billing yet, and they are not clear when monthly billing will be implemented in 2014.[22] Until such time as they do implement monthly billing, ongoing incremental costs for additional paper, printing, envelopes, postage and payment processing will not occur, and hence there is no reason to allow for recovery these in distribution rates.

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[19] 4-Energy Probe-67, 4-Staff-20 d) and Exhibit JT1.15. See also Tr. Vol. 1, pg. 89 ll. 1-19
[20] Tr. Vol. 1, pg. 39/ll. 2-11. Also, in undertaking J1.2, KWHI documents that the incremental cost for monthly billing, including the postal rate increases announced by Canada Post, would be $499,500.
[21] Tr. Vol. 1, pg. 50, ll. 9-12, pg. 117 l. 5 to pg. 118 l. 19
[22] See footnote 10.

Despite KWHI's comments in undertaking J1.2, on the bullets raised in the excerpt from the Navigant report filed in the Oakville Hydro rates application, shown on page 21 of the Energy Probe compendium, Board staff believes that there are advantages for both KWHI and its customers with respect to implementation of monthly billing. With monthly billing, the amounts of each bill will be lower. This may make it more manageable for customers to pay each bill.

Also, many customers at risk, such as welfare recipients or seniors, receive monthly income of supplements; aligning bills on a monthly basis along with other bills, such as rent that these customers may face, may allow them to better budget for payment (rather than not risk having enough saved when a bi-monthly bill comes). With suitable customer education and handling, late payments, bad debt and write-offs for the utility should decrease under these circumstances.

Board staff notes that it asked KWHI about opportunities for cost savings to help reduce the incremental costs of monthly billing. In its response to an interrogatory, KWHI stated that it currently has a customer uptake of e-billing of 9%, which it expects could increase to about 13% by the end of 2014.[23] With electronic bills, costs of paper, envelopes and postage are reduced, and the time delay for delivery is reduced. Many customers with e-billing could also have more automatic or arranged methods for payment of bills, which should reduce late payments. The postage rate increases announced by Canada Post should provide an incentive for KWHI to further promote e-billing and electronic payment options, as this would reduce the costs for the utility directly and for customers who would ultimately bear increased postage rates through distribution rates.

As discussed above, with the move to monthly billing, KWHI will have a reduced lag between the time that it is billed by and pays its charges to the IESO and when it recovers the cost of power charges from its customers. The cash working capital requirement will decrease.

Board staff sees the impact on the cash working capital and incremental operating expenses related to monthly billing as being a trade-off, in the absence of a detailed business case in evidence. Board staff thus submits that KWHI should be approved the 13% factor for determining the Working Capital Allowance but also denied most of the incremental costs. This is as much for the fact that the utility has not implemented monthly billing yet and currently does not know when it will do so, as well as for the fact that it has not quantified or, in large part, even identified benefits or cost avoidance opportunities.

[23] 4-Staff-20 f)

In summary, Board staff submits that KWHI's proposed OM&A of $18,480,760 be reduced to $18,080,000 to remove the $100k cost of the ash tree removal and $300k of the costs related to the implementation of monthly billing. Board staff is of the view that through the offsetting cost efficiencies and improved cash flow from monthly billing, KWHI can still implement monthly billing in 2014 with this level of OM&A.

– All of which is respectfully submitted –