Ontario Energy Board
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416-481-1967
Facsimile: 416-440-7656
Toll free: 1-888-632-6273

Commission de l'énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416-481-1967
Télécopieur: 416-440-7656
Numéro sans frais: 1-888-632-6273

VT INCEPIT FIDELIS SIC PERMANET
Ontario

BY EMAIL

February 10, 2014

Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4
Kirsten.Walli@ontarioenergyboard.ca

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Hydro One Remote Communities Inc. ("Hydro One Remotes")
2014 IRM Distribution Rate Application
Board Staff Submission
Board File No. EB-2013-0142

In accordance with Procedural Order No.1, please find attached the Board staff Submission in the above proceeding. The applicant has been copied on this filing.

Hydro One Remotes' reply Submission, if it intends to file one, is due by February 24, 2014.

Yours truly,

Original Signed By

Georgette Vlahos
Analyst, Applications

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2014 ELECTRICITY DISTRIBUTION RATES

Hydro One Remote Communities Inc.

EB-2013-0142

February 10, 2014

Board Staff Submission
Hydro One Remote Communities Inc.
2014 IRM Distribution Rate Application
EB-2013-0142

Introduction

Hydro One Remote Communities Inc. ("Hydro One Remotes") filed an application (the "Application") with the Ontario Energy Board (the "Board") on October 25, 2013, seeking approval for changes to the rates that Hydro One Remotes charges for electricity distribution, to be effective May 1, 2014. The Application is based on the 2014 Incentive Regulation Mechanism ("IRM").

As Hydro One Remotes is not connected to a transmission grid and is not billed by the IESO and does not pay taxes, many of the issues that apply to other distributors under IRM do not apply in this case. The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by Hydro One Remotes.

Background – Stretch Factor

Under the Board's policies as set out in the *Report of the Board: Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* (the "Report"), a distributor will be assigned a stretch factor, which can range from 0.0% to 0.6%, based on a distributor's cost evaluation ranking. Hydro One Remotes is excluded from the benchmarking analysis because their *Reporting and Record-keeping Requirements* data is not available (as noted in the Report). Since this is the first application for Hydro One Remotes under 4th Generation IRM, Hydro One Remotes requires a stretch factor to be assigned by the Board.

Under 3rd Generation IRM, Hydro One Remotes was assigned a stretch factor of 0.2% in EB-2009-0230. Hydro One Remotes was assigned the same stretch factor under each of its applications under 3rd Generation IRM.

The Application

As part of an update to its Application, filed on December 20, 2013, Hydro One Remotes requested a stretch factor of 0.0% and provided three main supporting arguments for its request:

1. The stretch factor of 0.2% under 3rd Generation IRM represented the lowest of the available factors. In the revised parameters, the lowest factor is now 0.0%.

2. Hydro One Remotes is designed upon a capital structure of 100% debt with no equity return. In its parameter update, the Board stated that stretch factors are “analogous to earnings sharing mechanisms”. Since Hydro One Remotes has no earnings, there are no earnings to share. Therefore, an “earnings sharing mechanism” of 0.0% is most appropriate for Hydro One Remotes.

3. An increase that attempts to reflect actual inflation is most appropriate for Hydro One Remotes as it has minimal ability to implement marked productivity initiatives given its unique franchise, and that the majority of its costs are due to forces outside of its control.

Board staff interrogatories, among other things, asked Hydro One Remotes to elaborate further on why it believes it is appropriate to be given the lowest stretch factor and if it is solely relying on its unique characteristics to warrant approval of a 0.0% assignment.

In its responses, Hydro One Remotes noted that because of its unique situation, “the shareholder is not rewarded if it achieves efficiency gains in its operation. Any surplus is sent to the RRRP variance account and returned to the RRRP ratepayers of Ontario. The imposition of a stretch factor greater than 0% serves only to lower customer rates and increase the burden paid by RRRP ratepayers[1]”.

Hydro One Remotes also noted that due to the small size of its customer base and the high volatility of its costs, RRRP ratepayers bear the risk associated with an operational shortfall. Therefore, it is appropriate that any reward associated with an operational surplus should be made available to those same RRRP ratepayers. Assigning a stretch factor of 0.0% accomplishes this goal.

[1] EB-2013-0142, Board staff Interrogatory Responses, #1(a)

Submission

As stated in the Report, productivity gains are expected for each of the three rate setting methods (i.e. Price Cap IR, Annual IR Index and Custom IR) to help ensure that the benefits from increased productivity are appropriately shared throughout the rate setting term between the distributor/shareholder and its customers.

As stated in Hydro One Remotes' responses to interrogatories, the incentive rate mechanism in question was designed to benefit the shareholders of other distributors; however, Hydro One Remotes' shareholder does not receive any benefit if there is an operational surplus. Board staff notes that Hydro One Remotes conducts its operations under a cost recovery model applied to achieve breakeven results of operations after the inclusion of Payments in Lieu of Taxes. Any excess or deficiency in remote rate protection revenues necessary to lead to breakeven results of operations is added to, or drawn from, the RRRP variance account, which was established in 2002 for this purpose.

As part of its response to Board staff interrogatory #2, Hydro One Remotes provided the following table reflecting its estimated revenue in 2014 for each of the stretch factors set out in the Report.

	Board-Approved Stretch Factors (2014 Rates)				
All costs in $M	**0.0%**	**0.15%**	**0.30%**	**0.45%**	**0.60%**
Estimated 2014 Revenue Collected through Rates Adjusted by Stretch Factor ^	**17.55**	**17.53**	**17.50**	**17.48**	**17.45**
Revenue from RRRP *	32.19	32. 19	32. 19	32. 19	32. 19
External Revenue &	0.52	0.52	0.52	0.52	0.52
Estimated Total 2014 Revenue	**50.26**	**50.24**	**50.21**	**50.19**	**50.16**
Estimated Costs for 2014 #	**50.81**	**50.81**	**50.81**	**50.81**	**50.81**
Shortfall to RRRP Variance Account	0.55	0.57	0.60	0.62	0.65
Cost/Benefit to Shareholder	**0**	**0**	**0**	**0**	**0**

^ Estimated 2013 Revenue of 17.26 after application of Inflation less Stretch factor
* RRRP amount is fixed at 2013 levels
& Assumes external revenues grow at inflation rate of 1.7%
# Assumes costs = revenue from Estimated 2013 revenue table below. Any additional efficiencies / costs flow to the RRRP variance account

Board staff observes that the above table displays the regulatory construct for Hydro One Remotes. Its construct includes a "variance" account that eventually records any difference between the actual costs to provide Hydro One Remotes service and the dollars it receives from customers and the RRRP payment in any given year. Board staff notes that this Hydro One Remotes variance amount is then included in the larger RRRP variance account administered by Hydro One. The balance in the latter account is used in the calculation of the annual RRRP charge for the province.

Therefore, from an incentive perspective, when a stretch factor is applied, and Hydro One Remotes is unable to realize the expected savings, the ratepayers of Ontario make up the difference. Because any operational surplus, if any, goes into the RRRP variance account, the imposition of a stretch factor greater than 0.0% offers no incremental incentive to lower costs.

With respect to costs, as stated in the Report, the approach to assigning stretch factors to distributors is based on a distributor's actual costs relative to its predicted costs. Board staff interrogatory #3 asked Hydro One Remotes if it is of the view that it cannot achieve continuous improvement in its business and operations resulting in efficiencies and lower distribution costs. In its response, Hydro One Remotes noted that it is committed to continuous improvement and continues to pursue any productivity initiatives. "However, the controllable costs that might be rationalized by Hydro One Remotes are a small fraction of the total costs and are substantially dwarfed by the volatility inherent in the non-controllable portion of its cost base, related to diesel fuel, generation maintenance, transportation and winter road access[2]".

Board staff is mindful of the high cost of providing services in remote communities. As noted in its 2013 cost of service application (EB-2012-0137), Hydro One Remotes has implemented several strategies to mitigate the impact of cost pressures and improve productivity, including improved coordination of work and flights to transport staff and equipment; more competitive fuel supply contracts; improved planning to maximize winter road usage; and customer-focused conservation initiatives and station efficiency standards.

Based on the above arguments, Board staff takes no issue with Hydro One Remotes' request for a stretch factor of 0.0%. Board staff submits that the matter of incentive regulation as it applies to Hydro One Remotes should be reviewed as part of Hydro One Remotes' next cost of service rate application in the context of determining whether a

[2] EB-2013-0142, Board staff Interrogatory Responses, #3(a)

customized incentive rate setting structure can or should be established for Hydro One Remotes.

All of which is respectfully submitted