UNDERTAKING J11.10

Undertaking

To compare 2013 actual costs for newly prescribed facilities to the proposed revenue requirement for the test period, and identify categories of key cost drivers.

Response

A comparison of 2013 actual costs to the proposed revenue requirement for the newly regulated facilities is provided in the form of a "Drivers of Deficiency" table on the following page.

The main drivers of the increase in the revenue requirement are an increase in OM&A, and a decrease in forecast ancillary and other revenues.

As discussed at Tr Vol 11, page 130, a proxy 2013 revenue requirement was created in order to make the comparison. See Chart 2 for the derivation of the proxy revenue requirement.

In this proxy revenue requirement for 2013, expense items and ancillary and other revenues are 2013 actuals as reported in Ex L1.0-1 Staff-002. Proxy capitalization was derived by applying the 53%/47% debt to equity ratio to the actual 2013 rate base, also as reported in Ex L1.0-1 Staff-002. Cost of debt was derived assuming all debt is long term at a rate of 5.04% (derived from Ex L3.1-1 Staff 017, Attachment 1). Return on equity is at a rate of 8.93%, which was the OEB established rate effective January 1, 2013.

The resultant annual total is then multiplied by 1.5 to derive an 18 month revenue requirement. Proxy income tax was derived by calculating a grossed up income tax on ROE as shown at line 13 of Chart 2.

Chart 3 shows the derivation of components of the proposed July 2014 to December 2015 revenue requirement.

The revenue requirement change values in Chart 1 are the differences between the relevant Chart 3 and Chart 2 values.

DRIVERS OF DEFICIENCY VS. PROXY 2013 REVENUE REQUIREMENT

Chart 1

Newly Regulated Hydroelectric, July 2014 – December 2015

	($M)	Notes (relative to 2013 actuals in the proxy revenue requirement)
Proxy 2013 Revenue Requirement (18 months)	**756.8**	See Chart 2.
Cost of Capital	5.1	Primarily due to higher ROE rates, partially offset by lower long term interest rates.
OM&A	59.8	Primarily due to increased base OM&A, IESO non-energy charges, other Centrally Held costs, and increases in project OM&A.
Depreciation & Amortization	5.7	Primarily due to in-service additions
Ancillary and Other Revenue	19.2	Lower forecast ancillary and other revenues relative to the 2013 actuals. The 2013 actual was unusual due to high Operating Reserve prices.
Income Taxes	4.6	Reflects cost of capital amounts.
Other	2.0	Primarily due to an increase in GRC related to production.
Total Change in Revenue Requirement	**96.4**	
Proposed Revenue Requirement for July 2014 – Dec 2015	**853.2**	
Revenue at Proxy Current Rates	**724.2**	17.9 TWh @ $40.46/MWh*
Revenue Requirement Deficiency	**128.9**	

*Proxy current rate of $40.46/MWh determined by dividing proxy 2013 annual revenue requirement of $504.5M shown at Chart 2, row 14, column a, by actual 2013 production of 12.5TWh shown at Ex L-1.0-1 Staff 002, Table 13, row 8, column d.

Chart 2
Derivation of Proxy 2013 Revenue Requirement

Line No.	Item	Note	Annual	Proxy 18 Month Revenue Requirement (col a x 1.5)
	$M		(a)	(b)
	Capitalization			
1	Total Rate Base	1	2,527.3	
2	Short-term Debt		-	
3	Long-Term Debt (line 1 x 53%)	2	1,339.5	
4	Equity (line 1 x 47%)		1,187.8	
	Cost of Capital			
5	Short-term Debt		-	-
6	Long-Term Debt (line 3 x 5.04%)	3	67.5	101.3
7	Return on Equity (line 4 x 8.93%)	4	106.1	159.1
	Expenses			
8	OM&A	1	196.6	295.0
9	Fuel and GRC	1	75.4	113.2
10	Depreciation & Amortization	1	59.0	88.5
11	Property Tax	1	0.2	0.4
12	Ancillary & Other Revenue	1	(35.7)	(53.6)
13	Income Tax (line 7 x .25/(1-.25)		35.4	53.0
14	Total (Sum lines 5 to 13)		504.5	756.8

Notes
1 Annual amounts are 2013 actuals from Ex. L1.0-1 Staff-002.
2 As there is no short term debt in 2013, long term debt is calculated as 53% of rate base.
3 Long term interest rate of 5.04% is derived as follows:

	YE 2013 Regulated Portion of Company-wide Borrowing:	
1a	Total Company-wide Borrowing ($M) (Ex L3.2-1 Staff 017, Att 1, line 13)	2,460.0
2a	Allocation percentage (Ex C1-1-2 Table 1)	77.03%
3a	Regulated Portion of Company-wide Borrowing ($M) (line 1a x line 2a)	1,894.9
4a	Coupon Rate (Ex L3.2-1 Staff 017, Att 1, line 13)	4.72%
5a	Annual Cost of reg portion of company-wide borrowing ($M) (line 3a x line 4a)	89.4
	YE 2013 Project Financing - Regulated Projects:	
6a	Total Borrowing ($M) (Ex L3.2-1 Staff 017, Att 1, line 39)	1,057.7
7a	Annual Cost of Project Financing - Regulated Projects	59.3
8a	Proxy Cost of Long Term Debt ((line 5a + line 7a) / (line 3a + line 6a))	5.04%

4 ROE rate of 8.93% is per OEB effective January 1, 2013.

Chart 3
Components of July 2014 – Dec 2015 Revenue Requirement

Line No.	Item	2014	Jul - Dec 2014 (col a / 2)	2015	July '14 - Dec ' 15 Revenue Requirement (col b + col c)
	$M	(a)	(b)	(c)	(d)
	Cost of Capital				
1	Short-term Debt	1.8	0.9	2.3	3.2
2	Long-Term Debt	62.2	31.1	62.7	93.9
3	Return on Equity	110.5	55.2	113.2	168.5
	Expenses				
4	OM&A	234.9	117.5	237.3	354.8
5	Fuel and GRC	75.6	37.8	77.5	115.3
6	Depreciation & Amortization	62.2	31.1	63.1	94.2
7	Property Tax	0.1	0.1	0.1	0.2
8	Ancillary & Other Revenue	(22.7)	(11.3)	(23.1)	(34.4)
9	Income Tax	29.9	15.0	42.7	57.7
10	Total (Sum lines 1 to 9)	554.6	277.3	575.9	853.2

Note

All 2014 and 2015 values taken from Ex. N2-1-1 Table 1.