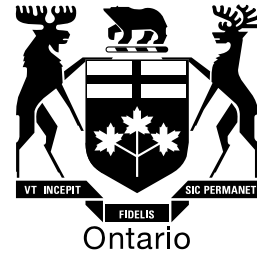


Ontario Energy Board

Commission de l'énergie de l'Ontario



Ontario Energy Board

Filing Requirements For
Electricity Distribution Rate Applications
- 2014 Edition for 2015 Rate Applications -

Chapter 3 Incentive Regulation

July 25, 2014

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Chapter 3 **Filing Requirements for Incentive Regulation Rate Applications**

3.1 **Introduction**

On October 18, 2012, the Board issued its *Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* (the “RRFE Report”). The RRFE Report provides a comprehensive performance –based approach to regulation and sets out three rate-setting methods: 4th Generation Incentive Rate-setting (“Price Cap IR”), Custom Incentive Rate-setting (“Custom IR”) and the Annual Incentive Rate-setting Index (“Annual IR Index”).

The RRFE Report also established a transition plan to facilitate the adoption of the three new rate-setting methods. Those distributors who are within the term of their current 3rd Generation IR will continue to have their rates adjusted annually for the remaining years of their 3rd Generation IR. The annual adjustment mechanism and other potential rate adjustments will be the Price Cap IR mechanism. Distributors may opt for the Annual IR Index at any time.

These Filing Requirements set out the Board’s expectations for filings by electricity distributors applying for annual rate adjustments under Price Cap IR or the Annual IR Index. These Filing Requirements replace the 2013 edition of the Filing Requirements for Electricity Distribution Rate Applications (“Filing Requirements”), dated July 17, 2013.

The key elements for the three rate-setting methods were set out in the RRFE Report in the following table:

Table 1: Rate-Setting Overview – Elements of the Three Methods

		4 th Generation IR	Custom IR	Annual IR Index
Setting of Rates				
“Going in” Rates		Determined in single forward test-year cost of service review	Determined in multi-year application review	No cost of service review, existing rates adjusted by the Annual Adjustment Mechanism
Form		Price Cap Index	Custom Index	Price Cap Index
Coverage		Comprehensive (i.e., Capital and OM&A)		
Annual Adjustment Mechanism	Inflation	Composite Index	Distributor-specific rate trend for the plan term to be determined by the Board, informed by: (1) the distributor’s forecasts (revenue and costs, inflation, productivity); (2) the Board’s inflation and productivity analyses; and (3) benchmarking to assess the reasonableness of the distributor’s forecasts	Composite Index
	Productivity	Peer Group X-factors comprised of: (1) Industry TFP growth potential; and (2) a stretch factor		Based on 4 th Generation IR X-factors
	Role of Benchmarking			To assess reasonableness of distributor cost forecasts and to assign stretch factor
Sharing of Benefits		Productivity factor		
		Stretch factor	Case-by-case	Highest 4 th Generation IR stretch factor
Term		5 years (rebasings plus 4 years).	Minimum term of 5 years.	No fixed term.
Incremental Capital Module		On application	N/A	N/A
Treatment of Unforeseen Events		The Board’s policies in relation to the treatment of unforeseen events, as set out in its July 14, 2008 EB-2007-0673 Report of the Board on 3rd Generation Incentive Regulation for Ontario’s Electricity Distributors , will continue under all three menu options.		
Deferral and Variance		Status quo	Status quo, plus as needed to track capital spending against plan	Disposition limited to Group 1 Separate application for Group 2
Performance Reporting and Monitoring		A regulatory review may be initiated if a distributor’s annual reports show performance outside of the ±300 basis points earnings dead band or if performance erodes to unacceptable levels.		

3.1.1 Key References

The documents listed below are key to understanding these Filing Requirements:

- *Report of the Board on the Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach – October 18, 2012;*
- *Report of the Board on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors;*
- *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009;*
- *Guidelines for Electricity Distributors' Conservation and Demand Management (EB-2012-0003) – April 26, 2012;*
- *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors– July 14, 2008;*
- *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors – September 17, 2008;*
- *Addendum to the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors – January 28, 2009;*
- *Guideline (G-2008-0001) on Retail Transmission Service Rates – October 22, 2008 (Revision 3.0 June 22, 2011 and any subsequent updates);*
- *Guideline G-2011-0001: Smart Meter Funding and Cost Recovery – Final Disposition, December 15, 2011;*
- *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR) – July 31, 2009;*
- *Chapter 5 of the Filing Requirements for Electricity Transmission and Distribution Applications: Consolidated Distribution System Plan Filing Requirements – March 28, 2013;*
- *Report of the Board on Transition to International Financial Reporting Standards EB-2008-0408 – July 28, 2009;*
- *Addendum to Report of the Board EB-2008-0408 – Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment – June 13, 2011; and*
- *Report of the Board on Performance Measurement for Electricity Distributors: A Scorecard Approach – March 5, 2014.*

3.1.2 Grouping for Filings

Distributors that are seeking rate adjustments effective January 1, 2015 under an IRM will be required to file their application by August 13, 2014. For those distributors that are seeking IRM rate adjustments effective May 1, 2015, the Board has assigned electricity distributors to one of three application groupings noted below based on the expected level of complexity of the application. The length of time required to review an

application is commensurate with its level of complexity. Applications of greater complexity will be expected to be filed first.

The Board conducted a survey in June of 2014 to identify the expected elements of an applicant's IRM application. The results of this survey have been taken into account in the Board's assignment of IRM filing deadlines. If a distributor expects that its application will be significantly more complex than it disclosed during the survey, it should so advise the Board and is encouraged to file in an earlier grouping.

Distributors filing under the Annual IR Index method will be placed in the last grouping. Staggering of the applications allows the Board and other stakeholders to appropriately schedule resources to allow for adequate review of the applications. The deadlines for filing an IRM application have been determined so that, in the normal course of events, a Decision and Order will be issued in time for a May 1 implementation date.

The application deadlines are as follows:

- Friday September 29, 2014
- Friday October 20, 2014
- Friday November 3, 2014

The assignment of distributors to these filing dates has been detailed in the cover letter accompanying these filing requirements.

3.1.3 Components of the Application Filing

Whether filing under Price Cap IR or the Annual IR Index, each application must include:

- A Manager's Summary thoroughly documenting and explaining all rate adjustments applied for;
- The contact information for the application - the primary contact for the application may be a person within the applicant's organization other than the primary licence contact. The Board will communicate with this person during the course of the application. After completion of the application, the Board will revert communication to the primary licence contact;
- A completed Rate Generator¹ and supplementary work forms² as applicable, provided by the Board, both in electronic (i.e. Excel) and PDF format;
- A PDF copy of the current Tariff Sheet;
- Supporting documentation cited within the application (e.g. excerpt of relevant past decisions and/or settlement agreements, relevant Reporting and Record-

¹ The Rate Generator is a Microsoft Excel workbook that calculates a distributor's proposed tariff of rates and charges in a Price Cap IR or Annual IR Index Application. The 2015 Rate Generator incorporates the RTSR model and the Tax Sharing Model.

² Includes the Revenue Cost Ratio Adjustment Workform and the Incremental Capital Module ("ICM") Workform, as applicable.

keeping Requirements (“RRR”) data and Revenue Requirement Work Form (“RRWF”)³;

- A statement as to who will be affected by the application; and
- A text-searchable Adobe PDF format for all documents.

3.1.4 Bill Impacts

The Rate Generator includes a bill impact calculation by rate class, and produces total bill impacts, in which commodity rates based on time-of-use and regulatory charges are held constant. These calculations are similar to those used in assessing rate applications in recent years. The latest RPP at the time of publication of the Rate Generator model will be used and will remain unchanged for the duration of the application process.

3.1.5 Applications and Electronic Models

The model(s) issued by the Board are intended to assist the applicant in filing a rate application and to provide consistent formatting for all distributors for greater efficiency of the review process. For the 2015 IRM process, the Board has issued a Rate Generator model, which incorporates the Retail Transmission Service Rate (“RTSR”) Adjustment Workform and Shared Tax Savings Workform. A distributor seeking a revenue-to-cost ratio adjustment due to a previous Board decision must continue to file the Board’s Revenue-to-Cost Ratio Adjustment Workform in addition to the Rate Generator. For an incremental capital module (“ICM”) cost recovery, a distributor must file the Incremental Capital Workform as well as the Incremental Capital Projects Summary Workform.

An application to the Board is the applicant’s responsibility and the Board expects that the application will be complete and accurate. The applicant also bears the responsibility of ensuring the accuracy and appropriateness of all inputs to and outputs from the models that it uses in supporting its application. The applicant is responsible for advising the Board of any concerns it may have regarding calculations flowing from the models as well as any changes that the applicant may have made to the models to address its own circumstances. Given the variety of different circumstances to be considered, the use of a Board model does not necessarily mean that the Board will approve the results.

³ The Revenue Requirement Work Form was filed as part of the draft rate order in the last cost of service application.

3.1.6 Other Rate Adjustments

The Rate Generator will be made available on the Board's website. The model will include generic base rates, RTSRs and shared tax savings adjustments, rate adders and rate riders common to most applicants. Where a distributor has continuing adjustments, and/or rate adders and/or rate riders from previous decisions that are not in the generic model (such as the phased implementation of a rate harmonization process), the distributor should contact Board staff for specific guidance.

3.2 Elements of the Price Cap IR and the Annual IR Index Plan

3.2.1 Annual Adjustment Mechanism

The annual adjustment mechanism is defined as the annual percentage change in the Inflation factor less an X-Factor (i.e. productivity factor and a stretch factor).

Inflation Factor

In its Report of the Board: *Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* the Board adopted a 2-factor IPI methodology. The Board will use the year-over-year change in the GDP-IPI (FDD), and the AWE ("Average Weekly Earnings")-All Employees-Ontario, to calculate the 2-factor IPI. The percentage change will be calculated as the weighted sum of 70% of the annual percentage change in the GDP-IPI (FDD) for the prior year relative to the index value for two years prior and 30% of the annual percentage change in the AWE for the prior year relative to the data for years prior.

Productivity Factor

The Board also determined that the appropriate value for the productivity factor (Industry TFP) for the Price Cap IR and Annual IR Index is zero. Distributors will be assigned into one of five groups with stretch factors ranging from 0.00% to 0.60%, based on their efficiency as determined through a total cost benchmarking model, which will be updated annually.

Distributors shall use the 2014 rate-setting parameters as a placeholder until the stretch factor assignment and inflation factor for 2015 are issued by the Board.

The Board determined that the X-factor for the Annual IR Index will be set using the highest stretch factor set for the new IR regime.

Board staff will update each distributor's Rate Generator with the 2015 price cap parameters once they are available. Distributors will have an opportunity to comment on the accuracy of Board staff's update as part of the draft Rate Order process.

3.2.1.1 Application of the Annual Adjustment Mechanism

The annual adjustment mechanism will apply to distribution rates (fixed and variable charges) uniformly across customer rate classes.

The annual adjustment mechanism will not be applied to the following components of delivery rates:

- Rate Adders;
- Rate Riders;
- Low Voltage Service Charges;
- Retail Transmission Service Rates;
- Wholesale Market Service Rate;
- Rural Rate Protection Charge;
- Standard Supply Service – Administrative Charge;
- MicroFIT Service Charge;
- Specific Service Charges;
- Transformation and Primary Metering Allowances⁴; and
- Smart Metering Entity Charge.

3.2.2 Electricity Distribution Retail Transmission Service Rates

In preparing its application, the distributor should refer to the Board's Guideline G-2008-0001: Electricity Distribution Retail Transmission Service Rates, Revision 4.0, issued June 28, 2013⁵.

The Board will provide a filing module to distributors to assist in calculating the distributor's class-specific RTSRs. The filing module will reflect the most recent UTRs approved by the Board (EB-2012-0031), issued on January 9, 2014 and effective January 1, 2014. Once any January 1, 2015 UTR adjustments have been determined, Board staff will adjust each distributor's 2015 RTSR section of the Rate Generator to incorporate these changes. Similarly, for embedded distributors whose host is Hydro One Networks Inc. ("Hydro One") Board staff will adjust the 2015 RTSR section to reflect any changes in Hydro One's Sub-Transmission class RTSRs. For hosts other than Hydro One, Board staff will adjust the 2015 RTSR section to incorporate the host embedded distributor class RTSRs. Distributors will have an opportunity to comment on the accuracy of Board staff's updates as part of the draft Rate Order process.

⁴ and any other allowances the Board may determine.

⁵ Originally issued October 22, 2008

3.2.3 Review and Disposition of Group 1 Deferral and Variance Account Balances

The Report of the Board on Electricity Distributors' Deferral and Variance Account Review Report (the "EDDVAR Report") provides that under the Price Cap IR or the Annual IR Index, the distributor's Group 1 audited account balances will be reviewed, and disposed if the pre-set disposition threshold of \$0.001 per kWh (debit or credit) is exceeded. The onus is on the distributor to justify why any account balance in excess of the threshold should not be disposed. Consistent with a letter from the Board on July 25, 2014, distributors may now elect to dispose of Group 1 account balances below the threshold. Distributors should assess the practicality of disposing what may be small balances for one or more classes; for further guidance on considerations relevant to rate riders, see Appendix B.

In their application distributors must include Group 1 balances, as of December 31, 2013, to determine if the threshold has been exceeded. A continuity schedule, found on sheet 5 of the Rate Generator, must be completed as part of the application.

Group 1 consists of the following Uniform System of Accounts ("USoA"):

- 1550 Low Voltage Account;
- 1580 RSVA Wholesale Market Service Charge Account;
- 1584 RSVA Retail Transmission Network Charges Account;
- 1586 RSVA Retail Transmission Connection Charge Account;
- 1588 RSVA Power Account;
- 1589 RSVA Global Adjustment Account; and
- 1590 Recovery of Regulatory Asset Balances Account (if applicable); and
- 1595 Disposition and Recovery/Refund of Regulatory Balances Account.

The EDDVAR Report states that the default disposition period to clear the Group 1 account balances by means of a rate rider should be one year. However, a distributor could propose a different disposition period to mitigate rate impacts or address any other applicable considerations, where appropriate.

Distributors must establish separate rate riders to recover the balances in the RSVAs from Market Participants ("MPs") who must not be allocated the RSVA account balances related to charges for which the MPs settle directly with the IESO (e.g. wholesale energy, wholesale market services).

The global adjustment account captures the difference between the amounts billed (or estimated to be billed) to non-RPP customers by the distributor and the actual amount paid by the distributor to the IESO.

Distributors must establish a separate rate rider included in the delivery component of the bill that would apply prospectively to non-RPP customers to dispose of the global adjustment account balance. Distributors who serve Class A customers per O.Reg 429/04 (i.e. customers greater than 5 MW) must propose an appropriate allocation for the recovery of the global adjustment variance balance based on their settlement process with the IESO.

Distributors must provide an explanation if the account balances in the continuity schedule differ from the account balances in the trial balance reported through the *Electricity Reporting and Record-keeping Requirements* and the Audited Financial Statements.

The Board expects that no adjustments will be made to any deferral and variance account balances previously approved by the Board on a final basis. Distributors must make a statement in their application as to whether or not any such adjustments were made. If an applicant reports that any adjustments have in fact taken place, a distributor must provide explanations in its application for the nature and amounts of the adjustments and include supporting documentation under a section titled "Adjustments to Deferral and Variance Accounts."

3.2.4 LRAM Variance Account (LRAMVA) for 2011 – 2014

For CDM programs delivered within the 2011 to 2014 period, the Board established Account 1568 as the LRAMVA to capture the variance between the Board-approved CDM forecast and the actual results at the customer rate class level. Accounting guidelines regarding the LRAMVA can be found in Appendix B of the 2012 CDM Guidelines. Distributors should refer to the CDM Guidelines for further details.

3.2.4.1 Disposition of the LRAMVA

At a minimum, distributors must apply for the disposition of the balance in the LRAMVA as part of their cost of service applications. Distributors may apply for the disposition of the balance in the LRAMVA on an annual basis, as part of their IRM rate applications, if the balance is deemed significant by the applicant.

In support of its application for lost revenues, and specifically the actual results used in the determination of the LRAMVA balance to be disposed, distributors must file the following:

- A statement indicating that the distributor has used the most recent input assumptions available at the time of the program evaluation when calculating its lost revenue amount;
- A statement indicating that the distributor has relied on the most recent and appropriate final CDM evaluation report from the OPA in support of its lost revenue calculation and include a copy of this report;
- Separate tables for each rate class showing the lost revenue amounts requested by the year they are associated with and the year the lost revenues occurred. Within each rate class table, include a list of all the CDM programs/initiatives applicable to that rate class and provide the energy savings (kWh) and peak demand (kW) savings assigned to those programs/initiatives;
- Lost revenue calculations, determined by calculating the energy savings by customer class and valuing those energy savings using the distributor's Board-approved variable distribution charge appropriate to the class;
- A statement, and, if applicable, a table, that indicates if carrying charges are being requested on the lost revenue amount;
- For Board-approved programs, a third party report, in accordance with the OPA's EM&V Protocols as set out in Section 6.1 of the CDM Code, that provides a review and verification of the lost revenue calculations, including:
 - o Confirmation of the use of correct input assumptions and lost revenue calculations;
 - o Verified participation amounts;
 - o The net and gross kW and kWh impacts of each program and for each class, both gross and net of free riders, separated by year; and
 - o Verification of any carrying charges requested.

A separate third party review of the distributor's OPA-Contracted Province-Wide CDM programs is not required.

An application to dispose of the balance in an LRAMVA may only be filed as part of an Annual IR Index application if the Board's decision for the distributor's last cost of service (or settlement agreement approved by the Board) has a clear description of class-specific CDM adjustments made to the load forecast to be used in the calculation of the LRAMVA balance. Any LRAMVA applications determined by the Board to be more complicated than appropriate for an Annual IR Index application will be bifurcated and heard separately from the Annual IR Index application.

3.2.5 Revenue-to-Cost Ratio Adjustments

Board Decisions regarding cost of service rate applications may sometimes prescribe a phase-in period to adjust the revenue-to-cost ratios. The Supplemental Filing Module and Rate Generator will include schedules for a distributor to effect revenue-to-cost ratio

adjustments if previously approved by the Board. The process will adjust base distribution rates before the application of the price cap adjustment.

3.2.6 Tax Changes

Board policy, as described in the Board's 2008 report entitled *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Supplemental Report"), prescribes a 50/50 sharing of impacts of legislated tax changes from distributors' tax rates embedded in its Board approved base rate known at the time of application. These amounts will be refunded to customers over a 12 month period. If applicable, applicants must complete sheets 9 -12 of the Rate Generator model. The model will calculate a volumetric rate rider using the annualized consumption by customer class underlying the Board approved rates.

3.2.7 Z-factor Claims

Price Cap IR applicants have the ability to include in their application a request to recover costs associated with unforeseen events that are outside the control of a distributor's ability to manage, such as damage that is the result of a storm. The cost to a distributor must be material and its causation clear. Costs are to be recorded in Account 1572, Extraordinary Events Costs. To recover these amounts, a distributor must follow the guidelines discussed in section 2.6 of the Board's Report on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors – July 14, 2008. The materiality thresholds, described in the Board's Policy Manual, must be met on an individual event basis in order for the distributor to apply for recovery of the relevant costs.

3.2.7.1 Z-factor Filing Guidelines

A distributor must submit evidence that the costs incurred meet the three eligibility criteria. A distributor must also:

- Notify the Board promptly by letter to the Board Secretary of all Z-factor events. Failure to notify the Board within six months of the event may result in disallowance of the claim.
- Apply to the Board for any cost recovery of amounts recorded in the Board-approved deferral account claimed under Z-factor treatment. This will allow the Board and any affected distributor the flexibility to address extraordinary events in a timely manner. Subsequently, the Board may review and prospectively adjust the amounts for which Z-factor treatment is claimed.

- Provide a clear demonstration that the management of the distributor could not have been able to plan and budget for the event and that the harm caused by extraordinary events is genuinely incremental to their experience or reasonable expectations.
- Demonstrate that the costs are incremental to those already being recovered in rates as part of ongoing business exposure risk.

3.2.7.2 Z-factor Accounting Treatment

The distributor will record eligible Z-factor cost amounts in Account 1572, Extraordinary Event Costs, of the Board's USoA contained in the Accounting Procedures Handbook ("APH") for electricity distributors. Monthly carrying charges shall be recorded in Account 1572. Carrying charges are calculated using simple interest applied to the monthly opening balances in the account and recorded in a separate sub-account of this account. The rate of interest shall be the rate prescribed by the Board for deferral and variance accounts for the respective quarterly period published on the Board's web site.

3.2.7.3 Recovery of Z-Factor Costs

As part of its claim, a distributor must outline the manner in which it intends to allocate the incremental revenue requirement to the various customer rate classes, the rationale for the selected approach and a discussion of the merits of alternative allocation methods. Recovery will be through a rate rider⁶. The request must specify whether the rate rider(s) will apply on a fixed or variable basis or a combination thereof, and the length of the disposition period and a rationale for this proposal. A detailed calculation of the incremental revenue requirement and resulting rate rider(s) must be provided.

3.2.8 Regulatory Accounting Policy Changes to the Depreciation Expense and Capitalization Policies

Per the Board's letter of July 17, 2012, electricity distributors electing to remain on CGAAP or choosing to adopt Accounting Standards for Private Enterprise ("ASPE") were required to implement regulatory accounting changes for depreciation expense and capitalization policies by January 1, 2013. These changes were mandatory as at January 1, 2013 for all distributors that have not yet made these changes, and therefore all applications for 2015 IR rates should reflect that these changes were made in 2012 or 2013. These accounting changes under CGAAP and ASPE were to be implemented consistent with the Board's regulatory accounting policies as set out for modified IFRS as contained in the *Report of the Board, Transition to International Financial Reporting Standards*, EB-2008-0408, the Kinectrics Report, and the APH, effective January 1, 2012.

⁶ See Appendix B

Where a distributor seeks an ICM and/or Z-factor treatment in its IRM application, the financial information supporting the ICM and/or Z-factor must incorporate the changes for the depreciation expense and capitalization policies as per Board's letter of July 17, 2012.

3.2.9 Conservation and Demand Management Costs for Distributors

CDM activity is funded either through OPA Contracted Province Wide CDM Programs, or through a Board-approved CDM program. Both of these approaches fund the programs through the global adjustment mechanism, and therefore must not be included in distribution rates.

3.2.10 Off-ramps

For each of the Board's three rate-setting options, a regulatory review may be triggered if a distributor's earnings are outside of a deadband of +/- 300 basis points from the Board-approved return on equity. The Board monitors results filed by distributors as part of their reporting and record-keeping requirements and determines if a regulatory review is warranted. Any such review will be prospective, and could result in modifications, termination or the continuation of the respective Price Cap IR or Annual IR Index plan for that distributor.

The Board reminds distributors that the filing of an application for an increase to base rates during the IR period or under Annual IR index is the decision of the applicant; it is not a Board requirement. A distributor whose earnings are in excess of the deadband can refrain from seeking an adjustment to its base rates through a Price Cap IR or Annual IR Index plan. If not, the level of earnings may be raised as an issue in the application.

A distributor may choose to file only for disposition of Group 1 deferral and variance account balances in accordance with Board policies, without applying for adjustments to its base rates.

3.3 Elements Specific to the Price Cap IR Plan

3.3.1 Incremental Capital Module

The incremental capital module ("ICM") is only available to electricity distributors opting for Price Cap IR. The ICM is intended to address the treatment of capital investment needs that arise during the rate-setting plan which are incremental to the materiality threshold defined below. Applicants should note that custom approaches to rate-setting

should be addressed by selecting the Custom IR option, not by customizing an ICM application.

The requested amount for an ICM claim must be incremental to a distributor's capital requirements within the context of its financial capacities underpinned by existing rates and satisfy the eligibility criteria of materiality, need and prudence set out in section 2.5 of the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, dated July 14, 2008.

Criteria	Description
Materiality	The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.
Need	Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.
Prudence	The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

3.3.1.1 ICM Filing Guidelines

The Board requires that a distributor requesting relief for incremental capital during the IRM plan term must include comprehensive evidence to support the need, which should include the following:

- An analysis demonstrating that the materiality threshold test has been met and that the amounts will have a significant influence on the operation of the distributor;
- Justification that the amounts to be incurred will be prudent. This means that the distributor's decision to incur the amounts represents the most cost-effective option (but not necessarily the least initial cost) for ratepayers;
- Justification that amounts being sought are directly related to the cause, which must be clearly non-discretionary and clearly outside of the base upon which current rates were derived.
- Evidence that the incremental revenue requested will not be recovered through other means (e.g., it is not, in full or in part, included in base rates or being funded by the expansion of service to include new customers and other load growth);
- Details by project for the proposed capital spending plan for the expected in-service year, segregated between discretionary and non-discretionary;

- A description of the proposed non-discretionary capital projects and expected in-service dates;
- Calculation of the revenue requirement (i.e. the cost of capital, depreciation, and PILs) associated with each proposed incremental non-discretionary capital project;
- Calculation of revenue requirement offsets associated with each incremental non-discretionary projects due to revenue to be generated through other means (e.g. customer contributions in aid of construction);
- A description of the actions the distributor would take in the event that the Board does not approve the application.
- Calculation of a rate rider to recover the incremental revenue from each applicable customer class. The distributor must identify and provide a rationale for its proposed rider design, whether variable, fixed or a combination of fixed and variable riders.

3.3.1.2 ICM Materiality Threshold

The ICM materiality threshold is discussed in section 2.3 of the Supplemental Report.

The Board determined that the following formula is to be used by a distributor to calculate the materiality threshold that will apply to it:

$$\text{Threshold Value} = 1 + \left(\frac{\text{RB}}{\text{d}} \right) * (\text{g} + \text{PCI} * (1 + \text{g})) + 20\%$$

Where:

- RB = rate base included in base rates (\$);
- d = depreciation expense included in base rates (\$);
- g = distribution revenue change from load growth (%); and
- PCI = price cap index (% inflation less productivity factor less stretch factor).

The values for “RB” and “d” are the Board-approved amounts in the distributor’s base year rate decision.

The value for “g” is the percentage difference in distribution revenues between the most current complete year and the base year.

The following table provides an example of the calculation of the materiality threshold values.

An Illustration:

Assumptions:	RB	=	\$100 million;
	d	=	\$5 million;
	g	=	1.5% (0.015); and
	PCI	=	0.75% (0.0075).
Calculation:	$1 + \left(\frac{100,000,000}{5,000,000} \right) * (0.015 + .0075 * (1 + 0.015)) + 0.20 = 1.65$		
Result:	The materiality threshold (CAPEX/Depreciation) is 1.65 or 165%. That is, given the assumptions in this example, the Board expects the distributor to manage a CAPEX level of up to \$8.26 million (\$5 million * 1.65) before being eligible to apply to recover incremental amounts.		

3.3.1.2 Eligible Incremental Capital Amount

In the Supplemental Report, the Board determined that the eligible incremental capital amount sought for recovery should be capital in excess of the materiality threshold. This is in effect a capital expenditure threshold which serves to demonstrate the level of capital expenditures that a distributor should be able to manage with its current rates. Accordingly, the materiality threshold value, as calculated using the formula discussed in Section 2.2.1, establishes eligibility for incremental capital spending and also marks the base from which to calculate the maximum amount eligible for recovery. A distributor applying for recovery of incremental capital should calculate the maximum allowable capital amount by taking the difference between the forecasted 2015 total non-discretionary capital expenditures and the ICM materiality threshold.

3.3.1.3 Application of the Half-Year Rule

The Board's general guidance on the application of the half-year rule is provided in the Supplemental Report. In this report the Board determined that the half-year rule should not apply so as not to build a deficiency for the subsequent years of the IRM plan term. However, the Board's approach in decisions has been to apply the half-year rule in cases in which the ICM request coincides with the final year of a Distributor's IRM plan term⁷.

3.3.1.4 Revenue Requirement Calculation

When calculating the revenue requirement associated with the ICM, a distributor should use the following parameters:

⁷ EB-2010-0130, *Guelph Hydro Electric Systems Inc.*, Decision and Order, p. 15

- Cost of Capital
 - In the December 11, 2009 Report of the Board on Cost of Capital for Ontario's Regulated Utilities (the "2009 Report") the Board confirmed the continuation of a deemed 60/40 debt-equity ratio. A distributor filing for an ICM adjustment shall use this deemed capital structure.
 - The 2009 Report sets out revised cost of capital parameters to be effected in cost of service applications. A distributor filing an ICM adjustment, shall use the last Board-approved cost of capital parameters determined during the distributor's last rebasing application when calculating the revenue requirement associated with the ICM.
- PILS
 - Since currently known legislated tax changes from the level reflected in the Board-approved base rates for a distributor will be reflected in the rate adjustments for Price Cap IR, a distributor filing for an ICM adjustment should apply the current tax rates when calculating the revenue requirement associated with the ICM.
- Working Capital Allowance ("WCA")
 - A distributor filing an ICM adjustment shall use the last Board-approved WCA determined during the distributor's last rebasing application when calculating the revenue requirement associated with the ICM.

3.3.1.5 ICM Reporting Requirements

At the time of the next rebasing, a distributor will need to file a calculation of the actual ICM amounts to be incorporated into rate base. At that time the Board will make a determination on the treatment of any difference between forecast and actual capital spending during the IRM plan term.

3.3.1.6 ICM Accounting Treatment

The distributor will record eligible ICM amounts in Account 1508 Other Regulatory Asset, sub-account Incremental Capital Expenditures, subject to the assets being used and useful. For incremental capital assets under construction, the normal accounting treatment will continue in the construction work in progress ("CWIP") prior to these assets going into service and hence being eligible for recording in the 1508 sub-account. The amortization of capital assets for the relevant accounting period will be recorded in a separate amortization account of the sub-account, Incremental Capital Expenditures. In addition, the revenues collected from the rate rider will be recorded in Account 1508, Other Regulatory Asset, sub-account, Incremental Capital Expenditures Rate Rider.

The distributor shall also record monthly carrying charges in sub-accounts Incremental Capital Expenditures and Incremental Capital Expenditures Rate Rider. Carrying charge amounts are calculated using simple interest applied to the monthly opening balances in the account and recorded in a separate sub-account of account 1508. The rate of interest shall be the rate prescribed by the Board for deferral and variance accounts for the respective quarterly period published in the Board's web site.

3.3.1.7 Rate Generator and Supplemental Filing Module for ICM

The supplemental filing module supporting the Rate Generator will assist the distributor in calculating the distributor's threshold. The distributor will then tabulate the value of its eligible non-discretionary investments and compare this to the threshold. Other calculation work forms will be provided to calculate the revenue requirement for each project proposed for inclusion in the ICM request in the supplemental filing module. Once all work forms are completed and listed in the supplemental module, the tabulated revenue requirement will be converted into class-specific rate riders.

3.3.2 Treatment of Costs for 'eligible investments'

On March 28, 2013, the Board issued Filing Requirements for Electricity Transmission and Distribution Applications – Chapter 5: Consolidated Distribution System Plan Filing Requirements ("Chapter 5"). As noted in section 5.0.5, Chapter 5 supersedes the Filing Requirements: Distribution System Plans - Filing under Deemed Conditions of Licence.

As indicated in the cover letter to Chapter 5 dated March 28, 2013, distributors who have yet to file under Chapter 5 will continue to be able to record renewable energy generation costs and smart grid demonstration costs in the deferral accounts that were established for that purpose. However, no new deferral accounts for these types of expenditures will be established. Distributors under Price Cap IR, who have yet to file a cost of service application containing a consolidated capital plan pursuant to Chapter 5, will continue to be able to request advance funding through a funding adder for renewable generation connection costs and smart grid development costs. Where a distributor seeks a funding adder, sufficient information must be provided to allow the Board to assess the need for the mechanism and the nature and quantum of the costs to be collected from ratepayers and the basis for calculating the funding adder. The costs recovered through the funding adder will be subject to a prudence review in the first cost of service application following the implementation of the funding adder.

Distributors proposing to file an Annual IR Index application must make a Chapter 5 filing within five years of the date of the most recent Board decision approving their rates in a cost of service proceeding and are required to do so at five year intervals thereafter while using the Annual IR Index method.

3.4 Specific Exclusions from Price Cap IR or Annual IR Index Applications

The IRM application process is intended to be mechanistic in nature. For this reason, the Board has determined that the IRM process is not the appropriate way for a distributor to seek relief on issues which are specific to only one or a few distributors, more complicated relative to issues typical of an IRM application, or potentially contentious. The following are examples of specific exclusions from the IRM rate application process:

- Rate Harmonization, other than that pursuant to a prior Board decision;
- Disposition of the balance of Account 1555 – Smart Meter Capital Costs, sub-account Stranded Meter Net book Value;
- Changes to revenue-to-cost ratios, other than pursuant to a prior Board decision;
- Loss Factor Changes;
- Establishing or changing Specific Service Charges;
- Loss Carry Forward Adjustments to PILs/taxes;
- Disposition of Group 2 Accounts; and
- Loss of Customer Load.

These items are to be addressed in the distributor's next cost of service application. With respect to smart meter cost recovery, a distributor under the Price Cap IR plan may elect to include this element as part of its 2015 application if the timing of the smart meter cost recovery application coincides with the filing of the IRM application. Otherwise, the review of smart meter costs should be addressed in a separate (or stand-alone) application.

The exclusions above also apply to the Annual IR Index plan. In addition, distributors seeking adjustments that are inconsistent with Board policy should consider whether one of the other rate-setting options is more appropriate. As indicated in the RRFE Report, distributors filing under the Annual IR Index plan must file a separate, stand-alone application for the review and disposition of Group 2 Accounts. Smart meter costs (including stranded meters) should also be addressed in a separate, stand-alone application.

Appendix A: Application of Recoveries in Account 1595

When final approval for disposition of deferral and variance account balances is received from the Board, the final approved amounts of principal and interest carrying charges is transferred to account 1595.

The cumulative principal balance transferred to account 1595 is drawn down by the rate rider recoveries first, before the interest balance transferred to account 1595 is drawn down. Interest carrying charges are applied to the principal balance net of recoveries.

The following approach is used for the application of recoveries (via rate riders) to the transferred amounts under two scenarios:

Scenario 1: Rate Rider ceases with Principal amount remaining.

If the rate rider ends before the principal is fully drawn down, the principal balance is held static and interest carrying charges are applied to the remaining principal balance. The approved rate rider flowing from the next application to dispose of deferral and variance accounts should include the remaining principal and interest carrying charges.

Scenario 2: Rate Rider ceases with no Principal amount remaining but with Interest Carrying Charges remaining.

The approved rate rider flowing from the next application to dispose of deferral and variance account balances should include the cumulative interest carrying charge amounts.

Appendix B: Rate Adder versus Rate Rider

Rate Adder

A rate adder (or funding adder) is a tool designed to provide advance funding on an interim basis to distributors for certain investments or expenses as prescribed by the Board and to mitigate or smooth the anticipated rate impact when recovery of these costs are approved by the Board. Approval of a rate adder does not constitute regulatory approval of any costs actually incurred. The prudence of incurring such costs is examined, and the costs may be approved in whole or in part, at the time at which the distributor brings the matter forward for regulatory review.

Rate adders are identified and listed separately on a distributor's Tariff of Rates and Charges and may have a sunset or termination date.

Rate Rider

A rate rider differs from a rate adder in that it is designed to recover or refund Board-approved amounts following a review of the proposed costs to determine that it is reasonable for the distributor to incur and recover them. Rate riders are identified and listed separately on a distributor's Tariff of Rates and Charges, with an explicit sunset or termination date.

Treatment of negligible rate adders and rate riders

Rate adders and rate riders normally apply to one or more select rate classes on a fixed basis, a volumetric basis or a combination of both. A rate adder or rate rider is usually determined by dividing the Board-approved allocated amounts by the Board-approved forecast or historical energy use or demand.

Occasionally, the calculated rate adders or rate riders for one or more rate classes may be negligible. In the event where the calculation of any rate adder or rate rider results in a volumetric rate rider that rounds to zero at five significant digits (ie, the fourth decimal place) per kWh or per kW, the entire Board-approved amount for recovery or refund will typically be recorded in a USoA account to be determined by the Board for disposition in a future rate setting. Distributors may propose alternatives to this approach in the event that there is a significant discrepancy in the size of the riders among classes – e.g., if a rider is of a non-negligible size for one or more classes, but negligible or insignificant for another class.