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**BY EMAIL and RESS**

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Our File: EB20140083

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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**Attn: Kirsten Walli, Board Secretary**

Dear Ms. Walli:

**Re: EB-2014-0083– HOBNI 2015 Rates – SEC Final Argument**

We are counsel to the School Energy Coalition ("SEC"). Hydro One Brampton Networks Inc. ("HOBNI") filed an application pursuant to section 78 of the *Ontario Energy Board Act* for 2015 distribution rates. These are SEC's submissions on the unsettled issues in the proceeding:

## *A) Working Capital Allowance*

HOBNI is seeking a Working Capital Allowance ("WCA") of 13% based entirely on the Board's *Filing Requirements for Electricity Distribution Rate Application* ("Filing Requirements").[1] The Filing Requirements, which are non-binding guidelines, provide that a distributor may seek a WCA amount by either filing a lead-lag study, or by using the default value of 13%. HOBNI confirmed that it has not done any analysis, internal or otherwise, of the appropriate WCA value that it actually requires.[2] It has simply relied on the 13% set out in the Board's Filing Requirements.[3]

The Board can no longer allow distributors to discharge its onus for demonstrating the reasonableness of its working capital costs to be included in rates, solely based on the Filing Requirements. The methodology behind the 13% value in the section 2.5.1 of the Filing Guidelines are incorrect, and inflate the actual working capital that a distributor actually requires to fund its on-going operations.

[1] Ontario Energy Board, *Filing Requirements For Electricity Distribution Rate Applications*, section 2.5.1
[2] Tr.1, p.69
[3] Tr.1, p.69

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Since HOBNI provided no evidence that 13% is the appropriate WCA for its operation, the Board must look elsewhere to determine a reasonable amount of working capital costs that ratepayers should bear.

**Default Value Based on Incorrect and "Obsolete" Methodology**

The genesis of the 13% default WCA amount in the Filing Requirements is a letter from the Board, dated April 12, 2012, in which the Board stated "[b]ased on the results of the WCA studies filed with the Board in the past few years, the Board has determined that the default value going forward will be 13% of the sum of the cost of power and controllable expenses."[4]

While the letter did not list the specific studies that on which it was basing its decision, the studies were those filed in proceedings by Toronto Hydro, Hydro One, Ottawa Hydro and Horizon Utilities. This is because as far as SEC is aware, those were the only lead/lag studies filed by an electricity distributor in the 5 years preceding the issuance of the Board's April 12, 2012 letter. Further, as shown on p.2 of the K1.4**,** the average of the approved WCA in those proceedings is 13.03%.

The primary problem with the Board's default WCA is that those four studies that are the basis of the 13% value, have a significant methodological error that has now been corrected in subsequent proceedings.

In those four lead/lag studies, in calculating the revenue lag[5], specifically the service lag, the difference in bi-monthly vs. monthly billing is weighted by the number of customers. The correct methodology is to weigh the service lag by revenue, since the aim of the calculation is to determine how much money a distributor needs in capital to cover the lag.

This methodological error has been accepted by Navigant itself, who were the authors, or provided an independent review, of <u>all</u> four lead/lag studies which formed the basis of the 13% default value.[6] As Navigant explained in its lead/lag study filed for Hydro One in EB-2013-0416:

> Navigant has prepared a table comparing the components of lead-lag studies that have been filed and is public. The results are showing in Table 19 below. <u>Note that prior studies are based on data of an older vintage are mostly based on customer weight method for revenue lags. This is an obsolete methodology and HONI's current study is based upon the revenue weighting method for revenue lags.</u> [emphasis added] [7]

The methodological error is significant. A change to just the service lag component of revenue lag, which unlike billing lags, would not be affected by an upgrade to any Customer Information Systems, can have a significant effect.

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[4] K1.4, p. 4

[5] WCA Allowance is calculated by determining the net lag (days), by subtracting the expense lead (days) from the revenue lag (days) and dividing by 365. The revenue lag is made up of four components: service lag, billing lag, collection lag, and payment processing lag.

[6] See 1) Toronto Hydro (EB-2007-0680) at K1.4, p.6; 2) Hydro One Distribution (EB-2009-0096) at K1.4, p.29;. 3) Horizon Utilities (EB-2010-0131), at K1.4, p.60; 4) Hydro Ottawa (EB-2011-0054) at K1.4, p.110)

[7] K1.4, p.151

| Distributor | Service Lag | | Utility | Updated Service Lag | | Change in Service Lag | Change in WCA |
|---|---|---|---|---|---|---|---|
| Toronto 2009 | 27.1 | (1) | Toronto 2014 | 18.72 | (5) | -8.38 | -2.30% |
| Hydro One 2009 | 21 | (2) | Hydro One 2014 | 16.04 | (6) | -4.96 | -1.36% |
| Horizon 2010 | 30.27 | (3) | Horizon 2014 | 25.01 | (7) | -5.26 | -1.44% |
| Ottawa 2011 | 30.24 | (4) | Ottawa 2011 | 22.13 | (8) | -8.11 | -2.22% |
| **Average** | ***27.15*** | | | ***20.48*** | | ***-6.68*** | ***-1.83%*** |

(1) EB-2010-0142 utalized the lead-lag study from EB-2007-0680 ( for the purposes of service lag days, only just change was costs. D1-16-1, p.8 (K1.4, p.13)
(2) EB-2009-0096 D1-1-4-Attach 1, p.6 (K1.4, p.6)
(3) EB-2010-0131 Ex.2-4-1-App 2-3, p.4 (K1.4, p.69)
(4) EB-2011-0054 Ex.B4-2-1, p.5 (K1.4, p.93)
(5) EB-2014-0116 Ex.2A-3-2, p.6 (K1.4, p.200)
(6) EB-2013-0416 D1-1-3-Att 1, p.6 (K1.4, p.138)
(7) EB-2014-0002 2-Staff-23(a)-Attach 1, p.8 (K1.4, p.164)
(8) EB-2011-0054 Ex.K2-2.2-5, p.2 (K1.4, p.118)

Utilizing the best available information which, in all cases but Hydro Ottawa[8], is the service lag stated in the distributors' more recent lead/lag studies (which were done utilizing the correct methodology), shows that the average WCA of the studies should have been 1.83% lower. This is a material amount. As confirmed by HOBNI, a 1% reduction in the Working Capital Allowance yields a reduction of $435,562 in the revenue equipment.[9] A 1.83% change would result in a $797,078 reduction in the revenue requirement.

The intent of the above analysis is to show the material impact of the methodological change. SEC recognizes that the updated service lag information (with the exception of Hydro Ottawa) may have been influenced by changing of bi-monthly/monthly billing mix over time. With that said, SEC is not aware of any major change in billing mix for any of the distributors over the past few years.

It should also be noted that while during the hearing, HOBNI made reference to the reductions in the WCA being as a result of changes to the billing systems of Hydro One and Toronto Hydro, this has no effect on the above calculation. A better billing system would affect the billing lag component of the revenue lag, but would have no effect on the service lag.

**Benchmarking To Set Appropriate Working Capital Allowance**

SEC submits because of this error in the underlying methodology for the Board's 13% default value, it is not appropriate for the Board to allow distributors, including HOBNI, to rely on it for the purposes of determining its WCA. If the Board does allow HOBNI to rely on the default value, in absence of any evidence specific to it, it would not be setting "just and reasonable" rates, since the methodology set out in the non-binding Filing Requirements has been shown to be incorrect and obsolete. If HOBNI is allowed to rely on the 13% default value still, then the Board will be treating the Filing Requirements as binding, and will be fettering its own discretion.

Since HOBNI has not provided any evidence related to its actual working capital needs, the Board has <u>no</u> evidence on the record about what an appropriate WCA amount is. This is problematic since HOBNI has the onus, not intervenors, to justify its proposed WCA.[10] SEC

[8] For Hydro Ottawa, the dollar weighted calculation was provided in an interrogatory response in that very proceeding. See EB-2011-0054. Ex.K2-2-5,p.2 (K1, p.118)

[9] SEC notes that this just the rate base impact of a change in the WCA. The actual amount will be higher when the PILS impact is included.

[10] Section 78(8) of th*e Ontario Energy Board* provides that "Subject to subsection (9), in an application made under this section, the <u>burden of proof is on the applicant</u>." [emphasis added]

submits that because of the absence of evidence, the Board should look at other utilities that have filed lead/lag studies based on correct methodology, to determine a reasonable WCA for HOBNI. The studies, detailed below, show WCA amounts significantly lower than the 13% adopted by the Board as the default value in the non-binding Filing Requirements.

| **Distributor** | **WCA** | |
|---|---|---|
| Toronto 2014 | 7.47% | (1) |
| Hydro One 2014 | 7.91% | (2) |
| Horizon 2014 | 12.00% | (3) |
| London 2012 | 11.42% | (4) |
| ***Average*** | ***9.70%*** | |

(1) EB-2014-0116 Ex.2A-3-2, p.3 (K1.4, p.197)
(2) EB-2013-0416 D1-1-3-Att 1, p.2 (K1.4, p.133)
(3) EB-2014-0002 2-Staff-23(a)-Attach 1, p.3 (K1.4, p.159)
(4) EB-2012-0146 Ex.2-App 2J, p.1

This approach is no different than any other benchmarking activity that the Board undertakes and is consistent with the *Renewed Regulatory Framework for Electricity*.[11] HOBNI has taken the position that utilizing other distributors' lead/lag results to set its own WCA allowance is not appropriate.[12] SEC submits that such is wholly contradictory to how the Board determined the 13% default value. The default value was set by taking the average of lead/lag studies that were filed in previous proceedings. None of those studies were filed by HOBNI. HOBNI cannot on one hand claim that it is inappropriate to rely on lead/lag studies of other utilities for settings its WCA, and yet on the other hand rely on the Board's default value which is determined doing just that.

Using recent lead/lag studies as a benchmark of reasonableness, has been an approach adopted by the Board before in EB-2010-0131, where the Board was faced with a study that it found to be deficient with regards to the billing lag. The Board reduced the applied WCA based on an amount that is "more consistent with the results of working capital studies undertaken by Hydro One [omit] and Toronto Hydro-Electric System Limited [omit]."[13]

SEC realizes this is an imperfect approach in determining HOBNI's WCA, but with <u>no</u> evidence on the record, this is both reasonable and appropriate. At the very least, it is clear that since the 13% default value is premised on obsolete methodology, the correct amount would be a material amount less.

In addition, since all of HOBNI's customers are only monthly billing[14], their actual working capital amount would be significantly less than the 13% since the service lag would be 15.21 days. SEC adopts the submissions of Energy Probe in this regard.

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[11] See *Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, dated October 18, 2012, p.13, 56
[12] Tr.2, p.18
[13] *Decision and Order* (EB-2010-0131), at p.16 (K2.1 at p.88)
[14] Tr.1, p.32-33

Based on the absence of any evidence provided by HOBNI, and the fact that the 13% default value set out in the Filing Guidelines is methodologically flawed and cannot be relied upon, SEC submits the Board should apply a value of 9.7%, being the average of recently filed lead/lag studies.

### ***B) Account 1576***

SEC adopts the submissions of Energy Probe on this issue and has no additional submissions.

### ***C) Load Forecast – Forecast Degree Day Methodology***

SEC adopts the submissions of Energy Probe on this issue and has no additional submissions.

All of which is respectful submitted.

Yours very truly,
**Jay Shepherd P.C.**

*Original signed by*

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicant and Intervenors (by email)