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Ontario

BY EMAIL

November 3, 2014

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Hydro One Brampton Networks Inc.
Application for Rates
Board File Number EB-2014-0083

Please find attached Board Staff's submission in the above-noted proceeding. Hydro One Brampton Networks Inc. and the intervenors have been copied on this filing.

Hydro One Brampton Networks Inc.'s reply to the submission is due on November 10, 2014.

Yours truly,

Original Signed By

Martha McOuat

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2015 Distribution Rate Application

Hydro One Brampton Networks Inc.

EB-2014-0083

November 3, 2014

Board Staff Submission
Hydro One Brampton Networks Inc.
2015 Distribution Rate Application
EB-2014-0083

Introduction

Hydro One Brampton Networks Inc. ("Hydro One Brampton") filed an application with the Ontario Energy Board on April 23, 2014 seeking approval for changes to its electricity distribution rates, to be effective January 1, 2015.

The Board held a technical conference on September 3, 2014 and a settlement conference on September 15 and 16, 2014.

Hydro One Brampton and intervenors filed a partial settlement proposal on October 9, 2014. On October 15, 2014, Board staff submitted with respect to this proposal that parties had considered the settled issues within the context of the Renewed Regulatory Framework for Electricity, and that the Board's approval of the proposal as filed would adequately reflect the public interest and would result in just and reasonable rates for customers.

The following issues remained unsettled:

- The forecasted balance of Account 1576 - Accounting Changes under CGAAP Deferral Account, and the proposed disposition period;
- The methodology pertaining to weather normalization in the load forecast; and
- The appropriate percentage factor to be used to calculate Hydro One Brampton's 2015 Working Capital Allowance.

The Board held an oral hearing to hear the unsettled issues on October 22 and 24, 2014. At the outset of the oral hearing, the Board accepted the partial settlement as filed.

The following are Board staff's submissions on the unsettled issues.

Account 1576 – Accounting Changes Under CGAAP

Hydro One Brampton proposes to dispose of a debit balance in Account 1576 – Accounting Changes Under CGAAP of $4,835,562 and associated rate of return at the weighted average cost of capital of $1,785,740. The total proposed to be collected from Hydro One Brampton's customers is $6,622,303 over 5 years. As per the settlement agreement, Hydro One Brampton has agreed to update its cost of capital to reflect the Board's parameters for 2015 Cost of Service Applications[1]

The account balance captures the differences in an LDC's property, plant and equipment ("PP&E") values arising from the transition from CGAAP to IFRS accounting, and is made up of changes in the capitalization of overhead burdens; depreciation expense changes; and accounting for losses on retirement of assets.

Hydro One Brampton explained that among other factors, the depreciation expense changes as calculated include the impact of Hydro One Brampton's change to monthly in-service dates from the half-year rule[2] and are consistent with the depreciation expense as calculated in the Settlement Proposal.

Hydro One Brampton also testified that the calculation of the balance in Account 1576 had not been updated to incorporate changes to capital expenses in the bridge year that had been agreed to as part of the settlement agreement, because these changes amounted to approximately $3,000 to $5,000 and were immaterial[3].

Hydro One Brampton stated that, unlike all other utilities in Ontario[4], its balance for disposition is a debit to be collected from customers because it had adopted changes to its depreciation policies to incorporate longer useful lives in its 2011 cost of service application, and therefore, lowered its depreciation expense as well. As a result, the impact of this change to depreciation expense was not experienced in the transition to IFRS in 2013. Hydro One Brampton stated that the adoption of longer useful asset lives for depreciation purposes resulted in depreciation expense savings to customers of approximately $5 million per year[5], beginning in 2011.

Board staff notes that Hydro One Brampton's materiality threshold is $368,000[6] and agrees that the impact of the changes to capital expenditures of $3,000-$5,000 as

[1] EB-2014-0083, Settlement Proposal, Issue 2.1.5, page 29
[2] EB-2014-0083, Transcript vol. 1, page 6
[3] EB-2014-0083, Transcript vol. 1, page 4
[4] EB-2014-0083, Transcript vol. 1, page 13
[5] EB-2014-0083, Transcript vol. 1, page 10
[6] EB-2014-0083, Exhibit 8, Tab 1, Schedule 1

contained in the settlement agreement is immaterial. Board staff submits that the balance in Account 1576 has been calculated in accordance with the Board's policies and is consistent with the depreciation expense as calculated for the purposes of the settlement agreement.

Hydro One Brampton stated in its evidence that a five-year disposition period was chosen to take into consideration customer bill sensitivities and the financial requirements of the company[7]. It further stated that it selected a longer disposition period to reflect the long useful lives of the related assets that would have earned a return over a long period of time had the accounting changes not been made[8].

In response to Undertaking J1.1, Hydro One Brampton calculated the change in return component and resulting bill impact that would arise from a reduction in the disposition period from 5 years to 3 years. The shorter disposition period results in a reduction in the return component from $1,786,740 to $1,072,044, or an overall saving to ratepayers of $714,696. Under the 3-year disposition period, the total bill impact for residential customers would increase by $0.16 per month to $2.20 from $2.04. Hydro One Brampton also testified that it would not be adversely affected if a 3-year disposition period was chosen[9].

Board staff submits that the benefits of $714,696 in cost reductions associated with a shorter disposition period outweigh the small bill increases required to dispose of the balance of that account in two fewer years. It therefore supports a 3-year disposition period, especially given that the company would not be adversely affected. Board staff notes that this amount will be revised in the final rate order to reflect the Board's approved cost of capital parameters for 2015.

Weather Normalization Methodology

Hydro One Brampton has used a 10-year average to calculate its heating degree days and cooling degree days underpinning its 2015 Load Forecast. Hydro One Brampton stated that the impact to its revenue requirement from changing to the use of 20-year trend data is approximately $166,000[10].

[7] EB-2014-0083, Exhibit 9, Tab 4, Schedule 1, page 3
[8] EB-2014-0083, Transcript vol. 1, page 16
[9] EB-2014-0083, Transcript vol. 1, page 26
[10] EB-2014-0083, Transcript vol. 1, page 77

Board staff notes that, although Chapter 2 of the Board's Filing Requirements for Electricity Distribution Rate Applications ("Filing Requirements") state that an LDC must prepare both 10-year average and 20-year trend for the purposes of weather normalization, it does not specify which methodology should be used. Considering the immateriality of the impact of using a 20-year trend methodology, Board staff submits that Hydro One Brampton's use of a 10-year average is appropriate.

Working Capital Allowance Factor

In its letter to Distributors of April 12, 2012, the Board updated its Filing Requirements to establish its approach to the calculation of Working Capital Allowance ("WCA") for LDCs for 2013 cost of service applications. That approach, which continues to be in place in the 2014 Edition of the Filing Requirements, allows applicants to calculate their WCA either on the basis of the Board's 13% Allowance Approach or by filing a lead/lag study. The only exception to this approach is if the applicant has been previously directed by the Board to undertake a lead lag study on which its current WCA is based. Under those circumstances, an applicant proposing a revision to its WCA must file an updated study in support of its proposal.

The 13% Allowance Approach is calculated as follows:

> The 13% Allowance Approach is calculated to be 13% of the sum of Cost of Power and controllable expenses (i.e., Operations, Maintenance, Billing and Collecting, Community Relations, Administration and General).
>
> The commodity price estimate used to calculate the Cost of Power must be determined by the split between RPP and non-RPP customers based on actual data and using the most current RPP (TOU) price. The calculation must reflect the most recent Uniform Transmission Rates approved by the Board (EB-2012-0031), issued on January 9, 2014 for 2014 rates and effective January 1, 2014. The calculation must include the impacts arising from the new Smart Metering Entity charge approved by the Board on March 28, 2013 in its EB-2012-0100/EB-2012-0211 Decision and Order[11].

Prior to the issuance of the Board's letter, the Board's default WCA factor had been 15%. The Board is currently examining its approach to WCA as part of its Review of

[11] Filing Requirements for Electricity Distribution Rate Applications, July 18, 2014, Chapter 2, s. 2.5.1.3, page 19

Residential Customer Billing Practices and Performance, which is intended to examine factors beyond the impact of monthly billing on WCA[12].

Hydro One Brampton has filed its WCA on the basis of the 13% Allowance Approach. Hydro One Brampton has not completed a lead lag study, nor has it ever been directed to do so by the Board[13]. Hydro One Brampton stated that, although it examines its cash flow needs as part of its budget process, it has not performed a specific analysis of whether its cash flow needs are higher or lower than that which is provided by the 13% Allowance Approach[14].

Based on the settlement agreement, Hydro One Brampton proposes a WCA of $64,373,953 to be included in its rate base. At the pre-tax return rate of 8.80%[15], Hydro One Brampton would recover $5,664,908 per year from ratepayers over the five year IRM term. In accordance with the settlement agreement, these amounts will be updated to reflect the cost of power contained in the Board's Regulated Price Plan Report for November 1, 2014 to October 31, 2015, as well as the Board's approved cost of capital parameters for 2015.

As stated in the Board's letter, the Board's consideration of an appropriate default value for calculating WCA in the absence of a lead/lag study was based on a review of lead/lag studies filed in cost of service applications in the few years leading up to the issuance of the letter. The derivation of the 13% default value has not been provided, nor have the specific lead/lag studies been identified.

Energy Probe has filed a compendium at Exhibit K1.4, which contains lead lag studies for Toronto Hydro, Hydro One Networks - Distribution, Horizon Utilities and Hydro Ottawa (collectively, "the original studies") conducted between 2006 and 2011, prior to the issuance of the Board's letter. The exhibit also contains new lead/lag studies conducted for Toronto Hydro, Hydro One Networks - Distribution and Horizon Utilities (the "new studies") in 2013 and 2014. All of the studies filed in this proceeding, with the exception of the Hydro Ottawa study, were conducted by Navigant Consulting. The results of these studies have been summarized below[16]:

[12] EB-2014-0198, Board Letter to Jay Shepherd, October 7, 2014
[13] EB-2014-0083, Transcript vol. 1, page 33
[14] EB-2014-0083, Transcript vol. 1, page 71
[15] EB-2014-0083, Exhibit K1.4, page 1
[16] EB-2014-0083, Exhibit K1.4, page 2

Summary of Lead Lag Study Results		
LDC	**Original Study WCA Factor**	**New Study WCA Factor**
Toronto Hydro	12.90%	7.91%
Hydro One Networks - Distribution	11.50%	7.47%
Horizon Utilities	13.50%	12.00%
Hydro Ottawa	14.20%	n/a

Energy Probe has calculated the simple average working capital percentage of the results of the original studies to be 13.03%. The average working capital percentage for the new studies, as calculated by Energy Probe is 9.13%, or a reduction of approximately 4%.

The new studies contain numerous explanations for the decrease in working capital percentage. Navigant describes the following refinement to the methodology utilized in the new studies:

> Note that the prior studies are based on data of an older vintage and are mostly based on the customer weighting method for revenue lags. This is an obsolete methodology and HONI's current study is based upon the revenue weighting method for revenue lags[17].

Board staff agrees that the revised method of weighting the service lag by revenues instead of customers is an appropriate refinement to Navigant's model.

Various other explanations are provided by Navigant to explain the decrease in working capital percentage between the original and new studies, including: a shift of customers to monthly billing frequencies; upgrades to Customer Information Systems; and changes to collection practices. In no case has the impact of each of these changes been quantified for the individual LDCs studied.

Hydro One Brampton testified that it was inappropriate for the Board to adjust any one element of an LDC's expense and revenue pattern without looking at the entire picture[18]. Hydro One Brampton pointed to its own comparison of lead/lag studies among

[17] EB-2014-0083, Exhibit K1.4, page 151
[18] EB-2014-0083, Transcript vol. 1, page 35

LDCs, which showed a significant variance in the calculated lead and lag days for the various components of the studies[19]. Hydro One Brampton stated that the operations of each utility are different and the leads and lags for each utility are unique[20].

The Board has in the past found it to be inappropriate to adopt the results of a lead/lag study from one utility to apply to another utility without a thorough analysis concluding that the utilities are comparable. Most recently, in a Motion to Review and Vary by the School Energy Coalition for a review of the Board's Decision and Order in proceeding EB-2013-0147, the Board stated:

> The Board finds that using a consistent WCA default value in cases where lead/lag studies have not been conducted to be a better approach than attempting to use simplified methods to derive a utility-specific WCA value for each case from other lead/lag studies which may not reflect the unique circumstances of such utility[21].

Board staff submits that Hydro One Brampton has calculated its WCA in accordance with the Board's policies, and that there is no evidence in this proceeding that would allow for specific reductions in the WCA factor to be directly applied to Hydro One Brampton.

However, Board staff notes that there are certain operating characteristics for Hydro One Brampton which would logically suggest that some reduction to its WCA factor may be appropriate.

Hydro One Brampton bills all of its customers on a monthly basis[22], which means that its service lag should be fewer days than a distributor billing bi-monthly. Service lag measures the time between the provision of service and the time customers' meters are read. For an LDC that bills its rate classes at different frequencies (monthly, bi-monthly, etc.), the service lag is calculated as an average of this lag for all rate classes, weighted by revenue. A higher service lag indicates a longer time period between the LDC providing a service and reading the meter, generally contributing to a higher WCA.

The service lags from the original studies and new studies are shown below.

[19] EB-2014-0083, Exhibit K1.1, page 2
[20] EB-2014-0083, Transcript vol. 1, page 35
[21] EB-2013-0147/EB-2014-0055, Decision and Order, October 23, 2014, page 4
[22] EB-2014-0083, Transcript vol. 1, page 34

Service Lags Calculated in Original Studies		
LDC	**Service Lag**	**Reference**
Toronto Hydro	27.10	Exhibit K1.4, page 13
Hydro One Networks - Distribution	21.00	Exhibit K1.4, page 38
Horizon Utilities	30.27	Exhibit K1.4, page 69
Hydro Ottawa	30.24	Exhibit K1.4, pages 92-93

Service Lags Calculated in New Studies		
LDC	**Service Lag**	**Reference**
Toronto Hydro	18.72	Exhibit K1.4, page 200
Hydro One Networks - Distribution	16.4	Exhibit K1.4, page 138
Horizon Utilities	25.02	Exhibit K1.4, page 163

These changes in service lag may be related to the change in methodology to weight the service lag by revenues (referenced previously), changes in billing frequency, new processes incorporated with a new CIS (as discussed below) or other factors.

Another explanation put forth by Navigant to explain reductions in the WCA factor between studies for Hydro One Networks - Distribution is the ability to collect outstanding balances more efficiently[23]. Hydro One Brampton has indicated that it has changed its policy of collecting accounts to begin after 60 days, rather than after 90 days, effective October 1, 2013[24]. This policy change allows Hydro One Brampton to more effectively manage its bad debt exposure, but would also be expected to somewhat reduce the company's collections lag. Hydro One Brampton states that it has not considered the impact of this policy change on its WCA[25]. While this may be appropriate for a distributor which has elected to calculate its WCA via the 13% method rather than a lead/lag study, Board staff submits that the applicant's change in policy

[23] EB-2014-0083, Exhibit K1.4, page 150
[24] EB-2014-0083, Interrogatory Response to 4-Energy Probe-26
[25] EB-2014-0083, Interrogatory Response to 2-Energy Probe-51TC

would further widen the gap between the applicant's working capital needs and what it receives as a result of applying the policy alone.

Hydro One Brampton has also undertaken certain other efficiency measures that could be expected to have an impact on its collections lag, including self-serve options for equal billing and pre-authorized payment requests, as well as payments and credit card payments[26].

Finally, Navigant has concluded that the primary reason for the reduction in WCA for Toronto Hydro is the upgrade of its Customer Information System ("CIS") since its last lead /lag study[27]. This is also noted as a driver for the reduction in WCA for Hydro One Networks - Distribution[28]. Hydro One Brampton testified that this factor does not apply in its case, as its system is over 35 years old[29].

At Exhibit 2, Tab 5, Schedule 1, Hydro One Brampton states that it plans to replace its aging system with a new ERP over the five year planning period. The evidence states that Hydro One Brampton has budgeted $10 million for this capital project. Board staff submits that, while Hydro One Brampton does not have the benefit of a new CIS now, it appears that it will have one well before its next cost of service application. Although the impact of a new CIS has not been quantified for either of Toronto Hydro or Hydro One Networks - Distribution, this factor is considered by Navigant to be a significant driver of the reduction in WCA.

As illustrated in Exhibit K1.1, clearly there is a wide range among LDCs in the revenue lags and expense leads that are calculated within the individual lead/lag studies filed to date[30], and Board staff agrees that it would be inappropriate to apply the full results of one study to any one utility. Given the uncertainty on the implications to Hydro One Brampton of various factors, it is reasonable for the Board to approve the WCA based on the Board's policy of 13%.

However, Board staff submits that the evidence in this case would appear to indicate that at least some of the WCA reductions calculated recently would logically apply to Hydro One Brampton, and that it may be appropriate for the Board to take this into

[26] EB-2014-0083, Interrogatory Response to 4-Staff-52
[27] EB-2014-0083, Exhibit K1.4, page 215
[28] EB-2014-0083, Exhibit K1.4, page 148
[29] EB-2014-0083, Transcript vol. 1, page 76
[30] EB-2014-0083, Exhibit K1.1, page 2

consideration in approving a WCA below 13% but not as low as the average of the new studies given the degree of uncertainty.

Specifically, Board staff submits that certain factors, such as the methodological change to revenue weighting, monthly billing for all customers and changes to collection practices, as well as the potential of a new CIS would appear to indicate that Hydro One Brampton's WCA needs are below the result from the 13% approach. Given that Hydro One Brampton has not considered what its actual WCA needs are, Board staff submits that it may be appropriate for the company to consider conducting a lead/lag study of its own.

While the Board is currently considering changes to its approach regarding WCA, any changes will be applied on a prospective basis[31]; therefore any resulting savings in WCA will be unavailable to Hydro One Brampton's ratepayers until its next cost of service proceeding. Hydro One Brampton's WCA as approved in this proceeding will be collected in rates over its five year IRM term.

As Board staff's discussion above illustrates, there are a range of reasonable options for the Board's consideration. As a reference for the Board, Board staff notes that Energy Probe has calculated the impact to Hydro One Brampton's ratepayers of a 1 percentage-point reduction in the WCA factor to be $435,562 per year[32] at the current pre-tax cost of capital.

All of which is respectfully submitted

[31] EB-2014-0198, Board Letter to Jay Shepherd
[32] EB-2014-0083, Exhibit K1.4, page 2