EB-2014-0073

Ontario Energy Board

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Festival Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2015.

ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")

ARGUMENT

November 26, 2014

FESTIVAL HYDRO INC.
2015 RATES APPLICATION

EB-2014-0073

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A- INTRODUCTION

Festival Hydro Inc. ("Festival") filed a Settlement Proposal in this proceeding with the Board on October 23, 2014. The Board approved the Settlement Agreement as filed (Tr. Vol. 2, page 81).

This is the Argument of the Energy Probe Research Foundation ("Energy Probe") related to the unsettled issues in this proceeding. These unsettled issues are listed below in the Submissions section of this argument and follows the Issues List as approved by the Board in the Issues List Decision dated September 25, 2014.

Energy Probe notes that the Report of the Board - Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach dated October 18, 2012 ("RRFE") states that the renewed regulatory framework is a comprehensive performance-based approach to regulation that is based on the achievement of outcomes and the provision of value for money for customers. The emphasis is be on results rather than activities and will better respond to customer preferences.

Energy Prove further notes that Festival has fallen significantly in the efficiency cohort grouping results from the highest efficiency cohort in 2010 through 2013 to the second lowest group (Group IV) in 2014 and 2015 (Tr. Vol. 1, pages 38-39). Festival stated that this change was due to the change in the methodology which is used to group the distributors. The 2013 and 2014 results are based on a total cost model. Energy Probe submits that it is the total cost that is important to ratepayers.

B - SUBMISSIONS

Issue 1.1
Is the level of planned capital expenditures appropriate and is the rationale for planning and pacing choices appropriate and adequately explained, giving due consideration to:
- **customer feedback and preferences;**
- **productivity;**

- **benchmarking of costs;**
- **reliability and service quality;**
- **impact on distribution rates;**
- **trade-offs with OM&A spending;**
- **government-mandated obligations; and**
- **the objectives of the Applicant and its customers.**

Energy Probe provided a summary of the net capital additions closed to rate base over the 2010 through 2019 period on page 228 of Exhibit K1.1. Festival agreed that this was a reasonable representation of normalized net additions closed to rate base (Tr. Vol. 1, page 25).

This table shows that once adjustments are made for one-time capital expenditures closed to rate base for the new transformer station (2015), smart meters (2012) and the CCRA and Bypass agreements (2013), net capital additions closed to rate base in the test year are $2,471,500. This compares to the historical 2010 through 2014 period average of $2,721,000 and the forecasted average over the remaining four years of the IRM from 2016 through 2019 of $2,615,000.

Energy Probe submits that Festival's forecast for 2015 is appropriate, with one exception that is noted later.

The Festival forecast for 2015, while slightly lower than both the historical spend ($250,000) and the future spend ($144,000) shows a relatively flat spending profile over a ten year horizon.

Energy Probe submits that this is appropriate in light of customer feedback and preferences, reliability and service quality, the impact on distribution rates and the objectives of the applicant and its customers.

Festival undertook a customer survey as part of its customer engagement activities (Exhibit A, Tab 3, Schedule 1, Attachment 1). In that survey, customers were quite clear that their two most important aspects of their electricity supply were total price and reliability (page 235 of Exhibit K1.1).

With respect to reliability, more than 77% of the customers surveyed indicated that they found the existing level of reliability acceptable. The remaining ratepayers were equally split between the opinions that Festival should be spending more to decrease the frequency and duration of outages that would result in an increase in the monthly bill and those that were willing to tolerate increased outages and thought Festival should be spending less if it meant a decrease in the monthly bill (page 229 of Exhibit K1.1).

Ratepayers were equally clear on their choices on other topics. Nearly 88% of customers did not want Festival to invest in a web-based outage map but rather focus on improvements that would decrease the frequency and duration of outages (page 230 of Exhibit K1.1). Similarly, customers did not support (74%) a program to start burying hydro lines if it meant an increase in the monthly hydro bill (page 231 of Exhibit K1.1). Finally, ratepayers were clear (85%) that they did not want real-time information about their electricity usage and price it if raised their bill by $1 per month page 233 of Exhibit K1.1).

Based on this customer feedback and preference, along with the acceptable reliability and service quality, the impact on distribution rates and the objectives of the applicant and its customers, Energy Probe submits that the Board should accept the capital additions as forecast for the 2015 test year, with the following exception.

Festival has included a place holder of $70,000 for expenditures for an electric vehicle and charging station. In Exhibit 2, Tab 2, Schedule 1, Attachment 1 (pages 41-42), Festival states that this is to study and demonstrate new technologies. It would look at the effects of electric vehicles within Festival's distribution system on how vehicle charging patterns affect transformer loading and end user voltage, and provide data regarding OM&A costs of an electric vehicle vs. a gas fueled vehicle for long term operation decisions on future fleet replacement plans.

Later, in an interrogatory response (2 OEB Staff 25), Festival indicates that the City of Stratford is unique in that over 600,000 tourists per year visit Stratford's Shakespearean Festival and it is this influx in population with the potential of electric vehicles that it is trying to understand, especially the impact of charging electric vehicles in commercial locations, such as hotels, restaurants, shopping areas, etc.

The electric vehicle is a replacement of an existing vehicle and has a net incremental cost of $30,000 to $40,000 (Tr. Vol. 1, page 28).

Energy Probe submits that the Board should reject the addition to rate base of the incremental cost of about $35,000 for the electric vehicle and charging station.

In the customer survey in Exhibit A, Tab 3, Schedule 1, Attachment 1, ratepayers indicated nearly 91% of them had no plans to purchase an electric vehicle in the next five years. A further 7% indicated that would not purchase an electric vehicle in the next five years if the price difference was more than $3,000 (page 232 of Exhibit K1.1). Energy Probe submits that this clearly illustrates that electric vehicles are not a priority for Festival ratepayers and should not be for Festival either.

Energy Probe submits that using an electric vehicle as part of its fleet will not provide the type of information that Festival says it may need because of the influx of tourists. Further, if Festival wants information on the impact of its distribution system, it should be able to obtain that information from the 2 customers that indicated in the survey that they already have electric vehicles.

Of more importance, however, is that in the Board Supplementary Report on Smart Grid dated February 11, 2013 (EB-2011-0004), the Board stated in Section 5.4.5.2 Material Investments - Electric Vehicle that some distributors have already undertaken pilot and demonstration projects related to electric vehicle recharging and that it expected that distributors would report on the outcomes and learning from these pilots for the benefit of all regulated entities. The Board indicated that this was consistent with its policies which emphasize the need to avoid duplication of efforts in testing out and learning about new technologies.

Festival had not done an analysis for the purchase of an electric vehicle, and Festival indicates that before the purchase, it would speak with some other distributors to gain insight on their programs to ensure their efforts were not be duplicated (2 OEB Staff 5). Festival also indicates in that response that the total cost of the electric vehicle may not be material.

Given all of the above, Energy Probe submits that Festival has not provided evidence to support the need for its own pilot project. It admits it has done no analysis and has not consulted with other distributors that do have pilot projects underway.

Energy Probe deals with the inclusion of the costs associated with the Bypass Agreement under Issue 4.1 below.

Issue 1.2

Is the level of planned OM&A expenditures appropriate and is the rationale for planning choices appropriate and adequately explained, giving due consideration to:

- **customer feedback and preferences;**
- **productivity;**
- **benchmarking of costs;**
- **reliability and service quality;**
- **impact on distribution rates;**
- **trade-offs with capital spending;**
- **government-mandated obligations; and**
- **the objectives of the Applicant and its customers.**

As noted under Issue 1.1 above, customers were clear that reliability and total price are the two most important aspects of their electricity supply. Based on this feedback and preferences, Energy Probe submits that the 2015 OM&A expenditures of $15,188,505 requested by Festival is too high. This figure includes property taxes and leap funding, as well as the $17,100 increase in regulatory costs filed by Festival in the November 6, 2014 update to Appendix 2-M.

Energy Probe submits that the increase between 2010 and 2015 does not reflect the outcomes which the Board indicated were appropriate for distributors in the RRFE.

i) Envelope Approach

In the RRFE the Board stated that the renewed regulatory framework was a comprehensive performance based approach to regulation that was based on the achievement of outcomes that ensure that Ontario's electricity system provided value for money for customers. The Board believed that emphasizing results rather than activities would better respond to customer preferences, enhance distributor productivity and promote innovation. The Board found that the following outcomes were appropriate for the distributors (RRFE, page 2):

Customer Focus: services are provided in a manner that responds to identified customer preferences;

Operational Effectiveness*:* continuous improvement in productivity and cost performance is achieved; and utilities deliver on system reliability and quality objectives;

Public Policy Responsiveness*:* utilities deliver on obligations mandated by government (e.g., in legislation and in regulatory requirements imposed further to Ministerial directives to the Board); and

Financial Performance*:* financial viability is maintained; and savings from operational effectiveness are sustainable.

With respect to **customer focus**, Energy Probe notes that the Festival survey of customers included in Exhibit A, Tab 3, Schedule 1, Attachment 1 clearly identifies customer preferences as being reliability and total price. The survey also shows that Festival's customers believe the current level of reliability is satisfactory and vast majority do not want Festival to spend additional money to increase reliability if it means an increase in the monthly bill.

When it comes to **public policy responsiveness**, Energy Probe notes that Festival has delivered with respect to its government mandated obligations and continues to do so.

With respect to **financial performance**, Energy Probe notes that Festival has earned healthy returns on equity in each of 2011 through 2013 (Undertaking J2.2) ranging from 9.75% to 11.71%. This compares to the 9.85% that was built into the 2010 rates.

However, **financial performance** is more than just the maintenance of financial viability. It is also related to the sustainability of savings from operational effectiveness.

Operational effectiveness is defined by the Board in the RRFE as the continuous improvement in productivity and cost performance while utilities deliver on system reliability and quality objectives. Energy Probe submits that the Festival increase in OM&A costs between 2010 and 2015 do not reflect continuous improvement in productivity or sustainable savings. In fact, Energy Probe submits that the forecast provided by Festival reflects a lack of productivity and the associated savings to ratepayers over this entire period.

Table 1 below summarizes the submissions of Energy Probe with respect to the level of OM&A expenses in 2015.

Section 1 of Table 1 shows the calculation of an inflation factor that is specific to OM&A expenditures in that it is driven by an inflation factor specific to employee costs and an inflation factor that is applied to all other OM&A costs. Specifically, the inflation factors used are identical to the measure of labour and non-labour inflation used by the Board in setting the overall 2-factor IPI used to determine the inflation factor for IRM purposes as set out in Appendix C to the November 21, 2013 EB-2010-0379 Report of the Board - Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors. The percentage increases shown in lines 12 and 13 are the most recent historical information available from Statistics Canada for 2011 through 2013. The figures used for 2014 come directly from Appendix C in the above noted EB-2010-0139 Report of the Board, while the 2015 figures come from the Board's website which shows the inflation rates set out as of October 30, 2014 for use in 2015 IRM rate applications.

Using the breakdown of labour related costs in total OM&A to the non-labour related OM&A, the weighted average OM&A inflation escalator is calculated in Table 1 at line 14 and averages just over 1.5% per year.

Section 2 of Table 1 shows the calculation of an overall escalator for OM&A costs. In addition to OM&A inflation, the escalator takes into account reductions in costs as a result of base productivity that was assumed in the 3rd generation IRM period, along with

the stretch factor specific to Festival based on the efficiency cohort in which it was placed for each of 2011 through 2015. The escalator also reflects an increase due to customer growth. This increase reflects a 1 to 1 ratio in that each one percentage increase in customers reflects a one percent increase in total OM&A costs. Energy Probe submits that this is a very liberal estimate of the impact on OM&A of customer growth. It does not take into account any scale economies. As a result, the overall escalator calculated in Section 2 is at the top of the range of reasonable increases.

The average increase in this escalator is 1.7% per year. However, as shown on line 37 in Section 3 of Table 1, adjusted OM&A costs have increased at levels significantly higher than 1.7% per year between 2011 and 2015. They have in fact, increased by an average of 4.4% per year over this period.

Section 3 of Table 1 shows a number of adjustments to OM&A expenses as reported in order to provide a normalized level of OM&A expenditures over the years shown so that increases from one year to another reflect normalized expenses. The adjustments in lines 29 through 35 were discussed with the Festival witnesses (Tr. Vol. 1, pages 36-38). In addition to the changes shown, Festival stated that additional adjustments should be made for incremental smart meter costs and OMERS premium increases. Energy Probe disagrees.

Both of these two costs reflect changes in costs that are already included in the costs shown in Table 1. They are not new costs (OMERS costs have been incurred every year and smart meter costs have been allocated based on actual expenditures in each of 2010 through 2012).

Furthermore, Energy Probe notes that in the recoverable OM&A cost driver table shown in Appendix 2-JB in Exhibit 4, Tab 2, Schedule 1, Attachment 2, there are no smart meter related cost increases shown for either 2014 or 2015. The OMERS premium increases are immaterial at $10,246 in 2014 and $6,541 in 2015, especially when the increases in 2011 through 2013 averaged more than $50,000 per year.

In Exhibit 4, Tab 3, Schedule 1, page 3, Festival discusses the increases in billing and settlement costs between 2010 and 2015 which they say began in 2013 as the result of new operation costs required with the implementation of smart meters, which resulted in the addition of 1 headcount in the IT department. However, the evidence also notes that while the IT headcount has grown, Festival's overall headcount did not increase because they effectively reallocated some labour costs with this reorganization. In other words, Festival managed the increase in one part of its operation with decreases in other parts.

Energy Probe submits that line 36, Adjusted Total in Section 3 of Table 1 is a good starting point to compare increase in OM&A over the 2010 through 2015 period.

Section 4 in Table 1 then calculates the actual and forecasted adjusted OM&A per customer. As shown in line 45, the average increase in 2011 through 2015 is about 3.5% year, significantly above the average inflation rate of 1.5% per year. This also does not take into account the base productivity and stretch factor gains that were supposed to be sustainable and passed on to ratepayers upon rebasing. Line 46 shows the difference in the growth of OM&A per customer that is in excess of the total escalator shown in line 22.

Line 47 in Section 3 of Table 1 shows the adjusted OM&A per customer if the total escalator from line 22 is used, and line 48 shows the difference in dollars per customer.

Line 49 shows the impact of the $20.05 reduction in OM&A per customer times the forecasted number of customers, resulting in a reduction of approximately $412,000. However, Energy Probe is not arguing for a reduction of this amount. Rather, Energy Probe submits that the Board should approve a reduction in OM&A of $272,000. The $140,000 difference is related to the costs forecast for the transformer station (Appendix 2-JB, Exhibit 4, Tab 2, Schedule 1, Attachment 2). Since no costs were included in the 2010 through 2014 costs, this is a new cost that should be reflected in the OM&A requirement in the test year.

This envelope approach is, in the view of Energy Probe, consistent with the outcomes based approach of the RRFE. It reflects both the base productivity gains of 0.72% that were built into the IRM adjustments for each of 2011 through 2013, along with stretch factor gains of 0.2% in each of those same years and 0.45% in each of 2014 and 2015. This meets the **operational effectiveness** outcome under the RRFE, as well as the **financial performance** outcome, where savings from operational effectiveness are sustainable and passed through to customers upon rebasing. As noted earlier, during the 2011 through 2013 period, Festival consistently earned a return on equity at or above the level built into the 2010 base rates, while rates increased by the price cap which included the reductions related to the base productivity gains and stretch factors.

Now upon rebasing, these productivity gains are lost. Energy Probe submits that this violates the outcomes that are deemed appropriate under the RRFE. This does not deliver value for money to ratepayers.

1	**Table 1**							
2	**(NORMALIZED OM&A - INCLUDES PROPERTY TAXES & OTHER)**							
3								
4	**SECTION 1**	**OM&A INFLATION**						
5								
6			2010	2011	2012	2013	2014	2015
7								
8	Total OM&A - E4T2S1 Att 1, 2015 from RRWF & Updated App. 2-M		4,039,859	4,002,784	4,739,503	4,950,908	5,016,404	5,188,505
9	Employee Costs Allocated to OM&A - 4-Staff-40		3,088,858	3,334,551	3,345,148	3,710,598	3,800,695	3,895,712
10	Percent of OM&A that is Employee Costs		76.46%	83.31%	70.58%	74.95%	75.77%	75.08%
11	Percent of OM&A that is Other		23.54%	16.69%	29.42%	25.05%	24.23%	24.92%
12	Labour Increase			1.36%	1.42%	1.55%	1.50%	1.50%
13	GDP IPI FDD			2.40%	1.70%	1.70%	1.80%	1.60%
14	**Weighted Average OM&A Inflation Escalator**			**1.53%**	**1.50%**	**1.59%**	**1.57%**	**1.52%**
15								
16	**SECTION 2**	**ESCALATORS**						
17				2011	2012	2013	2014	2015
18	OM&A Inflation - line 14			1.53%	1.50%	1.59%	1.57%	1.52%
19	Base Productivity			0.72%	0.72%	0.72%	0.00%	0.00%
20	Stretch Factor			0.20%	0.20%	0.20%	0.45%	0.45%
21	Customer Growth - line 40			0.94%	1.20%	0.70%	0.85%	0.85%
22	Total Escalator (lines 18 - 19 - 20 + 21)			1.56%	1.78%	1.37%	1.97%	1.92%
23								
24								
25	**SECTION 3**	**ADJUSTMENTS TO OM&A**						
26								
27		2010 BA	2010	2011	2012	2013	2014	2015
28	Total OM&A - E4T2S1 Att 1, 2015 from RRWF & Updated App. 2-M	3,980,676	4,039,859	4,002,784	4,739,503	4,950,908	5,016,404	5,188,505
29	Special Purpose Charge - App 2-JB		(114,813)					
30	Smart Meter Expense - E4T2S1				(546,293)			
31	Smart Meter Expense - 4-EP-23	115,494	115,494	189,001	241,798			
32	PST costs - E4T2S1					(79,393)		
33	PST costs - 4-EP-23			11,593	32,627	35,173		
34	Accounting Change - App. 2-DA & 4-EP-26					(254,313)	(167,816)	(148,417)
35	Billable Work - 4-SEC-15 & 4-EP-46TC					(44,433)		(25,000)
36	Adjusted Total	**4,096,170**	**4,040,540**	**4,203,378**	**4,467,635**	**4,607,942**	**4,848,588**	**5,015,088**
37	% Increase per Year			**4.03%**	**6.29%**	**3.14%**	**5.22%**	**3.43%**
38								
39	Customers -E4T2S1 Att 3	19,828	19,647	19,832	20,069	20,210	20,381	20,554
40	Customer Growth		-0.91%	0.94%	1.20%	0.70%	0.85%	0.85%
41								
42	**SECTION 4**	**OM&A PER CUSTOMER**						
43		2010 BA	2010	2011	2012	2013	2014	2015
44	Adjusted OM&A per Customer - line 36 / line39	206.59	205.66	211.95	222.61	228.00	237.90	244.00
45	Increase in Adjusted OM&A per Customer			3.06%	5.03%	2.42%	4.34%	2.56%
46	Increase in Excess of Total Escalator - line 45-line 22			1.50%	3.25%	1.05%	2.37%	0.64%
47	Adjusted OM&A per Customer - Based on Total Escalator (line 22)		205.66	208.86	212.57	215.48	219.72	223.95
48	Difference - line 44 - line 47		0.00	3.09	10.05	12.52	18.18	20.05
49	Test Year Reduction (line 48 x line 39)							**412,033**

Energy Probe notes that the reduction proposed of $272,000 reflects both base productivity gains and stretch factor gains. If both of these gains were eliminated and set to zero, the figure of $412,033 shown above in Table 1 would fall to approximately $244,000. Reducing this amount by $140,000 for the same reasons noted above for costs associated with the transformer station, would result in an overall reduction of $104,000.

However, because this reduction in OM&A expenses reflects neither any base productivity or stretch factor gains in any years, it does not meet the RRFE outcome of operational effectiveness in that it does not continuous improvement in productivity and cost performance and it does not reflect any sustainable savings. In other words, even in the absence of key components of the RRFE (continuous improvement in productivity and sustainable savings), the OM&A forecast is still $104,000 higher than if no productivity increases took place over the last five years and no savings achieved during that period were sustainable.

Energy Probe does not believe this scenario is reasonable and it certainly does not meet the requirements of the RRFE. As a result, Energy Probe submits that a reduction of $104,000 to OM&A expenses is the minimum reduction that the Board should approve for Festival.

Energy Probe notes that this issue has several components in its evaluation of whether or not the forecasted OM&A expenditures for the test year are appropriate.

Customer feedback and preferences clearly demonstrate that customers are happy with the level of reliability and that they want lower rates. The OM&A increase proposed by Festival is not aligned with that preference. The increase also does not match the objectives of its customers for lower rates or low rate increases. As noted earlier, the increase in the average OM&A cost per customer is 3.5% per year over the 2010 to 2015 period. This increase is more than twice the increase in inflation and is not acceptable to ratepayers under the RRFE.

Festival has provided no evidence of productivity improvements or that any such savings are sustainable. In fact, as noted above, the OM&A costs are forecast to increase even more than if there was zero productivity. In other words, Festival's forecast reflects negative productivity.

Festival has provided evidence that its reliability and service quality are meeting customer expectations and that further improvements are not wanted by customers if it means higher monthly bills.

With a base revenue requirement of approximately $10,600,000 (Settlement Proposal RRWF, Settlement Agreement column in Revenue Requirement sheet), the minimum reduction proposed by Energy Probe of $104,000 is reduction of 1% in the base revenue requirement which translates into a 1% reduction, on average, in rates, or more specifically in the rate increase proposed. Energy Probe submits that even this minimum reduction in OM&A has a significant impact on distribution rates.

There is no evidence in this proceeding that a reduction in the OM&A expenses of the magnitude suggested by Energy Probe would have impact on the trade-offs with capital spending, government-mandated obligations or the objectives of the application.

Finally, there is the issue of benchmarking of costs. Energy Probe notes that approximately 75% of Festival's OM&A costs are labour related costs (see line 10 in Table 1).

Festival indicated that the summary of inflationary increases as shown in the table on page 250 of Exhibit K1.1 for 2015 was 1.75%. Over the 2010 through 2015 period, the average inflationary increase is 2.5%. However, this increase does not account for changes in overtime or progression through salary ranges. Line 9 in Table 1 shows that that labour costs increased from $3,088,858 in 2010 to a projected $3,895,712 in 2015. This is an average annual compound increase of 4.75% per year and ignores the fact that the number of FTE's in 2015 (45) is less than in 2010 (47) (Exhibit 4, Tab 2, Schedule 1, Attachment 3, Appendix 2-L). If this decrease in FTE's and corresponding increase in labour cost per FTE is taken into account, the 4.75% is even higher.

Festival says it compares its increases to those of neighbouring distributors (Tr. Vol. 1, page 46 & 4 OEB Staff 40). Energy Probe submits that such benchmarking is inappropriate. Benchmarking to a small number of neighbouring distributors is a vicious circle. The change in one distributor from the average has a significant impact on the average of the distributors. In other words, an increase at one distributor will set off an increase at all of the distributors, creating a benchmarking spiral.

Energy Probe submits that the benchmark for labour cost increases should be the labour factor used by the Board in its 2 factor input price index used for IRM price cap setting purposes. As shown on line 12 of Table 1, the increase in this factor - the average weekly earnings for all employees, including overtime in Ontario - is about 1.5% per year. In other words, the 4.75% average annual increase for Festival is more than 3 times higher the benchmark increase.

In summary, Energy Probe submits that based on an envelope basis, based on the outcomes approach of the RRFE, an appropriate reduction in OM&A for Festival is between $104,000 and $272,000.

ii) Specific Reductions

Energy Probe notes that there are a number of specific reductions that could be considered and provides them here in support of the range provided above.

First, Energy Probe notes that the Filing Requirements for Electricity Distribution Rate Applications - 2014 Edition for 2015 Rate Applications last revised on July 18, 2014, states in Chapter 1 that with regard to updating an application, when changes or updates are contemplated in later stages of a proceeding, "applicants should proceed with the update only if there is a material change to the evidence already before the Board." (page 3).

Energy Probe notes that Festival has made a number of updates to its OM&A costs. In particular, Festival updated its labour costs by a net increase of $27,155 of which $24,859 was allocated to OM&A expenses (4 OEB Staff 40 & 1-Staff-68 TCQ). In 1-Staff-68-TCQ, Board Staff noted that the increase reflected an increase of $38,193 for management and a reduction of $13,298 for non-management labour. In the response to Undertaking J1.1 (Tr. Vol. 1, page 47), Festival indicated that the net increase was the result of a $42,000 increase related to compensation changes and a $17,000 decrease due to inflationary increases.

Festival made a further increase in OM&A of $17,100 in its November 6, 2014 letter that included an updated Appendix 2-M to Exhibit 4, tab 3, Schedule 1, Attachment 1 associated with regulatory costs.

Energy Probe notes that Festival has used a materiality threshold of $59,355 (Exhibit 1, Tab 5, Schedule 1). Energy Probe further notes that none of the updated figures exceed the materiality threshold and the net addition to OM&A costs of all these changes is $41,995 (24,895 + 17,100). Based on the filing guidelines quoted above, Festival should have proceeded with the updates only if the change was material. Since the total change and each of its components is immaterial, Energy Probe submits that the OM&A should be reduced by $41,995.

Second, as noted earlier in this submission, Energy Probe submits that the total compensation per FTE has increased by an average of more than 3 times that of the Ontario benchmark, at 4.75% per year. A reduction to an average of 4.0%, which is still significantly higher than the Ontario benchmark at 1.5% per year, would result in a reduction in 2015 OM&A costs of more than $137,000.

Third, Energy Probe notes the significant decrease in the level of capitalized OM&A expenses between 2013 and 2015. Comparisons to previous years are not possible because of the change in accounting.

As shown in the updated Appendix 2-K provided in the response to 4 OEB Staff 40, the actual total compensation allocated to capital was 20.9% of total compensation. In 2015, this percentage falls to a forecasted level of only 13.2%. Festival identified the main driver of this change as the reduction in capital expenditures and did not provide any other drivers of this change (Tr. Vol. 1, pages 45-46).

Energy Probe accepts that the reduction in capital expenditures will result in lower amounts being capitalized. However, the changes would be expected to be similar, especially since Festival is holding the number of FTE's at a constant level. As shown in the table on page 228 of Exhibit K1.1, the normalized additions drop by 76.1% between 2013 and 2015. The normalized figures are the appropriate figures to use because they do not include costs associated with the transformer station that were incurred prior to 2015 nor do they include costs associated with the CCRA and Bypass agreements, which do not include any capitalized labour costs.

However, the ratio of capitalized compensation drops to 63.2% of the 2013 level (20.9%) to 2015 (13.2%). Energy Probe submits that this reduction is disproportionate to the reduction in capital expenditures of 76.1%. If the capitalization ratio declined by the same 76.1% between 2013 and 2015 as do the capital expenditures, the ratio of capitalized compensation costs would increase from 13.2% to 15.9% and would result in a shift of approximately $120,000 from OM&A expenses to capitalized costs. This increase in capitalized costs would bring the net additions closed to rate base in 2015 to just under $2.6 million, more in line with the forecasts for 2016 through 2019 and the bridge year forecast. Energy Probe realizes that a straight comparison of the ratios may not be the most accurate way to approach this issue. To account for this, Energy Probe submits that the $120,000 should be cut in half to $60,000, an amount which is still a material change.

Finally, Energy Probe notes that there is a $25,000 increase to the OM&A expense because of changes in billable work because Festival no longer charges mark ups on billable work (4-Energy Probe-46TC). As discussed with Festival (Tr. Vol. 1, page 37), this change is simply the result of a systems issue. Overhead costs associated with the labour being utilized for the billable work is being allocated directly to OM&A rather than to the billable work. Energy Probe submits it is not appropriate that ratepayers are effectively subsidizing billable work because of a systems issue. Energy Probe submits that the OM&A recoverable from ratepayers should be reduced by $25,000.

The specific reductions noted above are not supposed to be exhaustive of individual reductions to the forecast. The reductions identified above total more than $260,000. This figure would be considerably higher if the average increase in compensation were dropped below the 4.0% used by Energy Probe in its calculations.

Issue 2.1

Are all elements of the Base Revenue Requirement reasonable, and have they been appropriately determined in accordance with Board policies and practices?

Under this issue Energy Probe deals solely with the working capital allowance ("WCA") proposal to use the default percentage provided in the guidelines.

Energy Probe submits that a WCA percentage of 13%, based on the Filing Guidelines is significantly overstated, is no longer a valid figure that the Board can rely on and violates the spirit of the RRFE. Furthermore, the 13% cannot be considered reasonable when the distributor itself has not done any analysis of its future cash flow requirements (Tr. Vol. 1, pages 31-32). Nor does the 13% reflect Board policies and practices with respect to setting cost based just and reasonable rates.

i) The 13% Default Value - Where Did It Come From?

On April 12, 2012 the Board issued a letter related to an *Update to Chapter 2 of the Filing Requirements for Transmission and Distribution Applications - Allowance for Working Capital*.

In that letter, the Board stated (Exhibit K1.4, pages 3-4):

> *"...the Board has reviewed the results of lead/lag studies filed by distributors in cost of service applications and in each of those cases both the applied-for WCA and the final Board-approved WCA have been lower than 15%. The Board has determined that it is not appropriate for a default value for WCA to be set at a higher level than those resulting from lead/lag studies. Based on the results of 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 cost of power and controllable expenses."*

Energy Probe notes that the update to the guidelines for the working capital allowance was not done in a transparent manner as there was no consultation with interested parties as had originally been proposed by the Board. This has resulted in questions as to how the Board determined that a figure of 13% was appropriate.

Energy Probe submits that it is clear that the Board reviewed the results of lead/lag studies filed by distributors in cost of service applications. This is what the above noted letter says. The letter does not say that the Board reviewed the results of some of the lead/lag studies filed by distributors. Nor would this make any sense. The Board would

use the results of all the lead/lag studies it would have seen and approved when the letter was issued. It would have had no basis to include some studies/decision while not including other studies/decisions.

This is supported by the Board's Decisions in a number of cases (EB-2011-0130 and EB-2013-0122 are examples) where it states that it did not consider it appropriate to adopt the results of a lead-lag study from another utility without a thorough analysis concluding that the two utilities are comparable. Clearly the Board's guideline is based on its belief that it was appropriate to adopt the results of lead-lag studies and Board decisions from a number of utilities even though those utilities may not be comparable to others.

The question then becomes, how many lead-lag studies and decisions did the Board see before issuing its April 12, 2012 letter. Energy Probe submits that the Board had the results from four lead-lag studies and resulting decisions. These four lead-lag studies and decisions are shown in Table 2 below. A review of applications and decisions prior to April 12, 2012 indicates that these were the only lead-lag studies that were filed by electricity distributors. These four studies are shown in the top table on page 2 of Exhibit K1.1.

As shown in Table 2 the average of the Approved WCA percentages is 13.03%, virtually identical to the default value in the Board's April 12, 2012 letter. Furthermore, as noted in the EB-2014-0198 Draft Report of the Board Electricity and Natural Gas Distributors' Residential Customer Billing Practices and Performance dated September 18, 2014 ("Billing Practices Report"), the Board acknowledges that *"...the Board's current policy on working capital allowance **is based on an average approach** that has not attempted to quantify the effect on cash flow..."* (page 9) (emphasis added).

Energy Probe therefore submits it is reasonable to conclude that the Board's 13% default value is based on the four electricity distributor lead-lag studies and Board decisions that had been rendered before the issuance of the guideline. There were only four studies and it is reasonable to conclude that the Board included all of them in setting this guideline.

ii) Problems With The 13%

There are two glaring problems with the use of the 13% as a default for all electricity distributors. The first deals with the issue of monthly versus bi-monthly billing and the second deals with the calculation of the service lag for those distributors that bill at least some of their customers on a bi-monthly basis.

With respect to the first issue, it is clear that all four of the distributors that filed lead-lag studies and where a decision was made by the Board on the appropriate WCA percentage billed at least some of their customers on a bi-monthly basis. This can be seen in Table 2 by looking at the Service Lag column. If a distributor billed all of its customers on a monthly basis, by definition the service lag would be 15.21 days, which is the midpoint of the service period and is calculated as ((365/12)/2). Similarly, for customers billed on a bi-monthly basis, the service lag is 30.42 days ((365/6)/2). For customers that bill some customers on a monthly basis and some on a bi-monthly basis, the resulting service lag is somewhere between 15.21 and 30.42 days. As shown in Table 2, all of the service lags are greater than 15.21 days, meaning each of the four distributors billed some of its customers on a bi-monthly basis.

Energy Probe submits that the Board's current policy on the working capital allowance ignores that benefit of monthly billing in terms of improved cash flow. The Board has confirmed this in the Billing Practices Report (page 9) where it states that *"An additional benefit of a change to monthly billing is the improvement in cash flow of the distributors."*

Festival currently bills all of its customers on a monthly basis. Energy Probe submits that using a default value for the WCA percentage that is based on distributors that bill on both a monthly and bi-monthly basis for a distributors that bills all customers monthly is not appropriate. As noted earlier, in the EB-2013-0130 Decision and Order dated August 14, 2014, the Board concluded that it was not *"appropriate to adopt the results of a lead-lag study from another utility without a thorough analysis concluding that the two utilities are comparable."* (page 15). Energy Probe submits it is equally inappropriate to adopt the results from the average of a number of lead-lag studies where the utilities included in the average are demonstrably different to Festival. A utility that bills all customers monthly is not comparable to utilities that bill customers on both a monthly and bi-monthly basis.

The second issue noted above is calculation of the service lag for each of the distributors used in the calculation of the 13% default value. As is clearly noted in each of the lead-lag studies shown in Table 2 below (and included in Exhibit K1.1), the service lag is calculated using customer weights between those that are billed monthly and those that are billed bi-monthly. This can be seen in Exhibit K1.1 for each of the four lead-lag studies shown in Table 2. In particular, page 13 of Exhibit K1.1 (EB-2007-0680 - Toronto Hydro), page 38 of Exhibit K1.1 (EB-2009-0096 - Hydro One Distribution), pages 69 and 81 of Exhibit K1.1 (EB-2010-0131 - Horizon Utilities) and page 92 and 93 of Exhibit K1.1 (EB-2011-0054 - Hydro Ottawa). The last reference clearly demonstrates the calculation of the service lag based on customer weights.

The problem with a service lag calculated using the number of customers to weight the customers that are billed monthly and bi-monthly, is that it does not reflect cash flow, which is what a lead-lag study is supposed to measure.

Each of the four lead-lag studies in the calculation of the average of 13% was performed by Navigant, or reviewed by Navigant. Navigant has, however, revised its methodology in calculating the service lag for utilities that bill both monthly and bi-monthly. This is highlighted in that 3 of the 4 original studies have since been updated - all by Navigant - and the methodology used to calculate the service lag has been changed from customer weighting to revenue weighting. The rationale for this change is clear and is included in the studies, including the most recent study for Horizon Utilities in EB-2014-0002, where the following is included under Key Concepts (page 162 of Exhibit K1.1):

> *"**Dollar-Weighting**: Both "Leads" and "Lags" should be dollar-weighted where appropriate and where data is available to more accurately reflect the flow of dollars. As an example, suppose that a transaction has a Cash Outflow Lead time of 100 days and its dollar value was $100. Suppose further that another transaction has a Cash Outflow Lead time of 30 days with a dollar value of $1M. A simple un-weighted average of the two transactions would give us a Cash Outflow Lead time of 65 days ([100+30]/2). On the other hand, dollar-weighting the two transactions gives us a Cash Outflow Lead time closer to 30 days; an answer which is more representative of how the dollars actually flowed in this example."*

Equally important is that Navigant describes the old methodology, upon which the Board has set the 13% used in the guides as "obsolete methodology" in reference to the use of customer weighting method for revenue lags (Exhibit K1.1, page 151). This is the most recent Navigant lead-lag study prepared to Hydro One Distribution (EB-2013-0416, Exhibit D1, Tab 1, Schedule 3, Attachment 1).

Energy Probe submits that the Board should not continue to impose a figure of 13% that is based on a clearly out-of-date methodology on ratepayers. Nor should it impose a percentage that is clearly based on an average of utilities that are obviously not comparable when it comes to billing frequency.

iii) The Correct Approach

Energy Probe submits that the correct approach to determining the appropriate WCA percentage, based on the information before the Board in this proceeding is to simply re-calculate the average percentage WCA based on a service lag of 15.21 days that represents the fact that Festival bills all of its customers on a monthly basis.

Energy Probe submits that, other than a reduction in the HST, replacing the service lag for each of the four lead-lag studies with 15.21 days, no other component of the revenue lags or expense leads would be changed. The Festival witnesses agreed with this (Tr. Vol. 1, pages 32-33). In other words, changes to the service lag to reflect billing frequency do not have any impact on the other components of the WCA calculation.

Energy Probe notes that the change in the HST due to monthly billing is a further reduction in the WCA requirement. This is confirmed and can be seen in the response to 2-Energy Probe-11 in EB-2014-0002 (Exhibit K1.1, pages 179-192). In particular, a comparison of the tables provided in Attachment 1 of that response shows that the only changes in the working capital requirement of monthly billing as compared to a mixture of monthly and bi-monthly billing is a reduction in the number of days of the service lag (included in the revenue lag) and a reduction in the HST. None of the other lags or leads are impacted.

Energy Probe further notes that by replacing the customer weighted service lag (based on the obsolete methodology) with 15.21 days to reflect monthly billing, eliminates the need to calculate a weighted service lag. This results in key improvements to the Board's out-of-date guideline. First, it makes the lead-lag studies used by the Board comparable to Festival in that all the figures represent monthly billing. Second, it eliminates the obsolete weighting methodology that has invalidated the 13% because no weighting methodology is needed to calculate the service lag. All of the customers and all of the revenue is based on monthly billing.

Table 2 shows the adjustments proposed by Energy Probe to arrive at a comparable (monthly billing) WCA percentage that does not suffer from an out-of-date obsolete methodology.

Table 2

FILE NO.	DISTRIBUTOR	BOARD APPROVED	SERVICE LAG	CHANGE IN SERVICE LAG (e) = 15.21-	% CHANGE IN SERVICE LAG	WCA IF BILLED MONTHLY	
(a)	(b)	(c)	(d)	(d)	(f) = (e)/365	(g) = (c) + (f)	
EB-2007-0680 (1)	TORONTO HYDRO	12.90%	27.10	-11.89	-3.26%	9.64%	(3)
EB-2009-0096 (2)	HYDRO ONE DIST.	11.50%	21.00	-5.79	-1.59%	9.91%	(3)
EB-2010-0131	HORIZON UTIL.	13.50%	30.27	NA	NA	9.00%	(4)
EB-2011-0054	HYDRO OTTAWA	14.20%	30.24	NA	NA	9.60%	(5)
AVERAGE		13.03%	27.15			9.54%	

(1) 12.90% RESULTED FROM EB-2010-0142 - NO CHANGE IN LEAD/LAG STUDY, ONLY CHANGE IN MIX OF COSTS

(2) SEE EB-2009-0096 DECISION & WORKING PAPERS

(3) CALCULATED BASED ON A REDUCTION OF SERVICE LAG TO 15.21 DAYS & NO CHANGES TO ANY OTHER COMPONENTS

(4) EB-2010-0131 INTERROGATORY RESPONSE - EXHIBIT K1.4, PAGES 80-84

(5) EB-2011-0054 INTERROGATORY RESPONSE - EXHIBIT K1.4, PAGE 115)

Table 2 adjusts the WCA percentage to reflect monthly billing for Toronto Hydro and Hydro One Distribution. No adjustments are needed for Horizon Utilities or Hydro Ottawa since the response to interrogatories in those proceedings provided the WCA percentages associated with monthly billing.

Other than the reduction in the average WCA percentage, Energy Probe submits that standardizing the results to reflect monthly billing has reduced the variance or volatility in the WCA percentages. Based on the obsolete method of calculating the service lag, the WCA percentages ranged from 11.50% to 14.2%, for a range of 2.70%. Based on the adjusted calculations this range is much narrower, ranging from 9.00% to 9.91%, a range of 0.91% or approximately one-third of the original range.

As the above table illustrates, these changes reduce the WCA percentage from 13% to approximately 9.5%.

As noted during cross-examination the impact of a one percentage point reduction in the WCA percentage results in a reduction of about $56,000 in costs to ratepayers (page 1 of Exhibit K1.1 and Tr. Vol. 1, page 31). Reducing the WCA from 13% to 9.5% would, therefore, result in a reduction of more than $195,000 in rates. This reduction represents a significant portion of the base revenue requirement, which is $10,601,485, as shown in the RRWF attached to the Settlement Proposal in the Settlement Agreement column. Put another way, the reduction in the working capital allowance of $195,000 represents more than 1.8% of the base revenue requirement.

iv) The Correct Approach Extended

Energy Probe notes that a number of more recent lead-lag studies have been filed and/or approved by the Board since the original four studies used by the Board to set the 13% figure. These studies are found in Exhibit K1.1 at page 2 in the second table. The list includes the updated studies for 3 of the 4 original lead-lag studies. Hydro Ottawa is the only one that has not yet filed an updated study.

Energy Probe submits that the Board may well want to use the most recent studies available to determine an appropriate figure for Festival. Energy Probe further notes that the list provided contains 7 lead-lag studies, which is a larger and more robust sample than that used by the Board in determining the 13%.

Using the same approach as in Table 2 and extending it to the larger group of studies included in Exhibit K1.1 (second table on page 2), Energy Probe has converted the figures to the comparable monthly billing calculation of the WCA. In doing this, it should be noted that only 1 of the 7 lead-lag studies shown in the list bills on a monthly basis. As can be seen in the Service Lag column of Table 3, this is London Hydro (EB-2012-0146). The results of this approach for the larger and more current sample of lead-lag studies are shown in Table 3 below.

Several of these studies still suffer from the use of the customer weighting lag for the service lag, while the more recent ones (Horizon, Toronto Hydro and Hydro One Distribution) use the revenue weighting. No weighting was required in the London Hydro study.

Table 3

FILE NO.	DISTRIBUTOR	APPLIED OR APPROVED	SERVICE LAG	CHANGE IN SERVICE LAG (e) = 15.21-(d)	% CHANGE IN SERVICE LAG	WCA IF BILLED MONTHLY	
(a)	(b)	(c)	(d)		(f) = (e)/365	(g) = (c) + (f)	
EB-2014-0002	HORIZON UTIL.	12.00%	25.02	NA	NA	8.72%	(1)
EB-2013-0416	HYDRO ONE DIST	7.40%	16.40	-1.19	-0.33%	7.07%	
EB-2014-0116	TORONTO HYDRO	7.99%	18.72	-3.51	-0.96%	7.03%	
EB-2013-0174	VERIDIAN	13.40%	22.30	-7.09	-1.94%	11.46%	
EB-2011-0054	HYDRO OTTAWA	14.20%	30.24	NA	NA	9.60%	(2)
EB-2012-0033	ENERSOURCE	13.50%	28.75	-13.54	-3.71%	9.79%	
EB-2012-0146	LONDON HYDRO	11.42%	15.21	0.00	0.00%	11.42%	
		11.42%	22.38			9.30%	

(1) EB-2014-0002 INTERROGATORY RESPONSE - EXHIBIT K1.4, PAGE 179

(2) EB-2011-0054 INTERROGATORY RESPONSE - EXHIBIT K1.4, PAGE 115

Table 3 adjusts the WCA percentage to reflect monthly billing for all of the utilities shown except for Horizon Utilities and Hydro Ottawa. No adjustments are needed for either of these utilities since the response to interrogatories in those proceedings provided the WCA percentages associated with monthly billing. As can be seen in Table 3, the adjustment for London Hydro was 0% because their lead-lag study already reflected monthly billing.

As noted with reference to Table 2 earlier, Energy Probe submits that standardizing the results to reflect monthly billing has reduced the variance or volatility in the WCA percentages. The WCA percentages range from 7.4% to 14.2%, for a range of 6.80%, reflecting a mix of monthly and bi-monthly billing. Based on the adjusted calculations this range is much narrower, ranging from 7.03% to 11.46%, a range of 4.43% or approximately 65% of the original range.

As the above table illustrates, these changes reduce the WCA percentage from 13% to approximately 9.3%. This figure is virtually identical to the 9.5% calculated in Table 2.

Table 3 also clearly shows that the 13.0% average based on the original four lead-lag studies and decisions is now 11.42%, based on the updated studies and larger sample. If Hydro Ottawa is removed this average (because the study is based on the obsolete methodology), the average for the remaining 6 utilities is less than 11%.

v) Benchmarking

Energy Probe submits that the use of a default percentage for the WCA is akin to benchmarking. In particular, the utility is being set at a percentage equal to the average percentage of the lead-lag studies and decisions that the Board had seen or issued prior to the release of the April 12, 2012 letter.

Energy Probe has no issues with this concept. However, the benchmark must be reasonable and reliable. In the RRFE (page 56), the Board indicated that benchmarking would become increasingly important, as comparisons among distributors was one means of analyzing whether a given distributor is as efficient as possible. The Board also indicated that the role of benchmarking under the 4th Generation IR rate-setting method was to assess the reasonableness of distributor cost forecasts (page 13).

Energy Probe notes that the working capital allowance is provided in order to allow a distributor to recover its costs associated with the financing it requires in order to finance its cash flow requirements.

Thus, any working capital allowance requirement has to be reasonable and in line with its forecasted costs.

In the current proceeding, the benchmark of 13% has been shown to be obsolete and not directly comparable to a utility that bills all of its customers on a monthly basis. When these shortcomings are adjusted for, as has been done in Tables 2 and 3 above, a more appropriate benchmark of 9.5% is arrived at. This benchmark reflects the best information available to the Board at this time.

Given the importance of benchmarking within the RRFE, Energy Probe submits that a correct benchmark needs to be used, and in this case, based on the information the Board has in front of it from several lead-lag studies over the last several years, this benchmark is 9.5%.

vi) 13% Default Conflicts with RRFE

Energy Probe submits that the 13% default in the filing guidelines is not compatible with the RRFE.

The RRFE emphasizes outcomes, value for money, customer preferences and customer engagement, none of which are reflected in the 13% default in the filing guidelines. This is not surprising given that the RRFE was issued after the default value was included in the filing guidelines.

Without a doubt, the most important outcome for ratepayers is rates. In survey after survey rates consistently rank at the top of the most important things to ratepayers. Festival provided a summary of the results of a customer survey in Exhibit 1, Tab 3, Schedule 1, Attachment 1, parts of which were included at pages 229 through 235 of Exhibit K1.1. In particular, when asked what is the most important aspect of your electricity supply, customers responded by stating reliability (47.87%) and total price (43.40%). The next highest aspect was 6.49%.

As noted earlier, a one percentage point change in the WCA percentage represents a cost to ratepayers of about $56,000. Based on the 13% proposed by Festival, this amounts to about $750,000, or nearly 7% of the base revenue requirement shown in the RRWF attached to the Settlement Proposal. Clearly the revenue requirement associated with the working capital represents a significant component of the rates.

Also included in those rates is the cost associated with monthly billing. With more than 27,000 customers, Festival issues more than 320,000 bills a year. On a bi-monthly basis, this would be about 160,000 a year. The cost associated with incremental postage costs alone are nearly $130,000, based on the $0.80 cost identified by Festival (Tr. Vol. 1, page 41). Festival was unable to quantify other incremental costs associated with monthly billing which would include envelopes, paper and payment processing.

The outcome that is being proposed by Festival is that ratepayers are paying for all of the costs associated with monthly billing, but not receiving all of the benefits associated with monthly billing. In particular, ratepayers are not receiving the cost reductions associated with the improvement in cash flow for Festival. The Board recognizes that this is an additional benefit associated with monthly billing in the Billing Practices Report noted earlier in this submission. As explained earlier, the default WCA percentage is based on distributors that did not bill on a monthly basis, resulting in a percentage that is higher than for a distributor such as Festival that bills monthly.

Energy Probe submits that the improved cash flow is just not an additional benefit, it is the largest benefit to ratepayers. In EB-2013-0159, at Exhibit 4, Appendix A, Oakville Hydro filed a report by util-assist titled Billing Frequency: Moving to Monthly Billing. In section 2.1.1 of that report, it was reported that *"LDCs which have created business cases to justify increasing the billing frequency have found the largest* ***quantifiable*** *benefit to be improved cash flow."* (page 4)

By excluding the cash flow benefits from monthly billing in the revenue requirement, Energy Probe submits that the outcome is rates that are higher than they should be. This is a negative outcome for ratepayers under the RRFE that should be corrected.

With regards to customer preferences, Energy Probe notes that customers prefer monthly billing, but not at any cost. The Board has had the opportunity to see many surveys conducted by or for electricity distributors in Ontario. A consistent theme across the survey results is that customers prefer to receive monthly bills, but not if there is an additional cost of $1 or more per bill.

In the Billing Practices Report, the Board, quite correctly, states that *"it is essential to look at the costs and benefits from both an electricity distributor and customer perspective"* (page 8) in relation to monthly billing.

From the customer perspective, Energy Probe submits that by including the incremental costs associated with monthly billing, while not fully recognizing and reflecting the cost reductions associated with improved cash flow, does not and cannot result in value for money for ratepayers. The cost reductions to Festival are not being passed on to ratepayers, as they ought to be.

There has been no customer engagement and no focus on what customers think is appropriate with respect to the costs associated with billing frequency. Energy Probe submits that educated customers would prefer monthly billing but only if all the benefits and cost reductions are reflected in the rates they pay for this service.

In conclusion, Energy Probe submits that the use of the 13% default guideline for the WCA percentage is not compatible with a regulatory framework that is a comprehensive performance-based approach to regulation that is based on the achievement of outcomes that ensure that Ontario's electricity system provides value for money for customers.

In this particular proceeding, it is clear that the 13% guideline value is obsolete and not reflective of the practice of monthly billing. This results in an unacceptable outcome in terms of rates and clearly does not provide value for money for customers.

vii) Unique Circumstances for Festival

Mr. Semsedini responded to a question by Member Fry (Tr. Vol. 1, pages 33-34) explaining his view that the main driver is not whether the utility does monthly or bi-monthly billing, but rather than the main driver is the individual circumstances of the particular distributor with such things as when the distributor pays an invoice or how frequently it pays its employees. Energy Probe agrees with this to a limited extent.

As Me. Semsedini agreed, the largest cost paid by Festival is the IESO cost of power invoice, which it pays on the same basis as all utilities. Moreover, as can be seen in the RRWF attached to the Settlement proposal in the Rate Base and Working Capital sheet, based on the proposed agreement, the cost of power represents 93.2% of the total controllable costs and cost of power used in the WCA calculation.

As a result, Energy Probe submits that while there may be some differences from distributor to distributor, the vast majority of the expenses (i.e. cost of power) are paid on the same basis across the industry. Moreover, the Board has already taken these differences into account when it has indicated in various Decisions noted earlier that it was not appropriate to adopt the results of a lead-lag study from another utility without a thorough analysis concluding that the two utilities are comparable. This is why the Board

adopted an average of the four studies it had seen. By using an average, the Board was benchmarking rather than adopting a study from one distributor to be used for another. As noted in Table 3 above, the Board actually has a larger sample (7 distributors rather than 4) upon which to base and average and establish a more robust benchmark.

Finally, as noted earlier in this submission, changing the service lag to reflect monthly billing does not have any impact on other components of the revenue lag or on the expense leads (Tr. Vol. 1 pages 32-33). If the Board's 13% average is appropriate to apply, then certainly all of those components which do not change as a result of the difference between monthly and bi-monthly billing (i.e. everything except the service lag which is dependent only on billing frequency) will also not change and will continue to be appropriate. If not, the Board's guideline of 13% is wrong by definition.

viii) Summary and Recommendations

Energy Probe submits that the Board cannot rely on the default 13% for setting rates for Festival. It has been clearly demonstrated that this figure is based on an obsolete methodology that is out-of-date and did not accurately reflect cash flow requirements.

It is further submitted that the Board should reflect a WCA percentage that is comparable to other utilities if those utilities also billed on a monthly basis, as does Festival. This reflects proper benchmarking, a hallmark of the RRFE.

Based on the calculations in Tables 2 and 3 which provide an apples to apples (or in this instance, monthly billing to monthly billing) comparison, Energy Probe submits that the Board should direct Festival to use a WCA percentage of 9.5%.

Use of a 9.5% WCA will reduce rates by $195,000 a year. Over the term of the IRM plan, this will result in savings to ratepayers of nearly $1 million.

Based on the outcome approach of the RRFE and the focus on customers and providing value for money, Energy Probe submits that the Board cannot approve the requested 13% as it has been demonstrated that this figure is obsolete and does not reflect a comparable figure for a distributor that bills all customers on a monthly basis.

Given the magnitude of the potential reduction in the base revenue requirement of more than 1.8% noted above, Energy Probe submits that if the Board approves a 13% WCA for the 2015 test year, it should direct Festival to complete a lead-lag study and file it as part of its 2016 IRM application. As part of that application, the study would be examined and the results would be incorporated into the 2016 rate setting process.

It would be inherently unfair for ratepayers of Festival to continue to pay $195,000 a year, or 1.8% of their distribution bill, because Festival chose to not file a lead-lag study and relied on a default that has been shown to be obsolete and not based on the billing frequency that Festival uses and that ratepayers pay for.

Finally, Energy Probe notes that Board Staff has referenced a policy review on this matter in 2015 in its Submissions dated November 24, 2014). Energy Probe submits that there is no guarantee that such a policy review will take place. Ratepayers were promised a review/consultation process when it became apparent that the 15% WCA originally set by the Board was too high. That review never took place. Instead, the Board issued the April 12, 2012 letter that has resulted in ratepayers that are served by distributors that bill on a monthly basis paying significantly higher rates than they should be. Ratepayers deserve better from this Board.

Isue2.2

Has the Base Revenue Requirement been accurately determined based on these elements?

Energy Probe submits that this issue can only be answered in the affirmative as part of a review of the draft rate order that results from the Board's determinations of the various issues at play in this proceeding. Energy Probe submits that the Board should make a provision, as it normally does, in its Decision to allow Board Staff and intervenors to review the draft rate order to ensure that it properly reflects the Decision.

Issue 3.4

Are the applicant's proposals regarding its fixed/variable ratios appropriate?

At issue here is the treatment of the fixed/variable ratios for the GS>50 kW class only.

The current fixed charge for the GS>50 kW class is higher than the ceiling for this class calculated using the PLCC Adjustment Rate as calculated in the Cost Allocation Model on the O2 Fixed Charge sheet.

Festival proposes to maintain the current fixed charge. Energy Probe supports this proposal, as it is consistent with past Decisions of the Board with respect to this issue.

Issue 4.1

Have all impacts of any changes in accounting standards, policies, estimates and adjustments been properly identified and recorded, and is the rate-making treatment of each of these impacts appropriate?

The unsettled issues here are related to the treatment of the Bypass Agreement ("BPA") and costs related to the 2013 and 2014 incremental costs related to the Transformer Station. Energy Probe deals with the treatment of the BPA here and deals with the incremental OM&A costs incurred in 2013 and 2014 under Issue 4.2 below.

Energy Probe does not support the capitalization of the cost related to the Bypass Agreement. Further, Energy Probe has reviewed the submissions of Board Staff with respect to the Bypass Agreement and agrees with those submissions.

Energy Probe submits that it is clear that there is no link between the payment associated with the BPA and the cost of the construction of the transformer station. Further there is no physical constraint on the use of the new transformer station associated with the BPA (Tr. Vol. 1, pages 49-50).

The evidence in this proceeding is clear. The new transformer station was built in anticipation of picking up overload from the Hydro One station. However, when two factories in Stratford closed, this overload disappeared. It was now possible to move the load from the Hydro One station to the new station, resulting in cost savings to ratepayers. In other words, the only reason a BPA was needed at a cost of $1.2 million is that it will save ratepayers $475,000 a year. If the load reduction had not taken place, there would not have been any need for a payment.

Energy Probe notes that if the transformer station that went into service in December, 2013 had been in place for several years prior to that date the current circumstances would have been similar. Festival would have been served by both this station and the Hydro One station as neither station would have been large enough by itself to serve the load and projected growth. When the two factories in Stratford closed, the remaining load could now be served through one station. This reduces the costs to ratepayers by eliminating the $475,000 annual payment to Hydro One for the station. Festival would have been required to compensate Hydro One for lost revenue, just as it is now.

In this circumstance, however, it is difficult to see how this expense could be tied to a station that would have been in place for several years

Energy Probe submits that it clear that the $1.2 million BPA payment is an expense. This payment will be made in order to reduce costs to ratepayers by approximately $475,000 per year.

Energy Probe notes that the payment has not yet been made to Hydro One. Energy Probe submits that the Board should approve a deferral account into which this expense should go when paid by Festival. It would attract carrying charges at the Board's approved rate for deferral and variance accounts. The amount would be recovered from ratepayers over a 3 or 5 year period. Energy Probe submits that a 3 year period would seem to be appropriate as this would amount to about $400,000 per year, similar to the reduction in costs of $475,000 that this payment produces. At the end of 3 years, ratepayers would then see a reduction in their cost for the full savings.

Issue 4.2

Are the applicant's proposals for deferral and variance accounts, including the balances in the existing accounts and their disposition, the continuation of existing accounts, and the two proposed new accounts, appropriate?

As noted above, Energy Probe deals with the request for a new deferral and variance account related to the transformer station for the recovery of 2013 and 2014 incremental OM&A costs which were not part of the 2010 approved rates.

Energy Probe submits that the Board should not approve the recovery of the 2013 and 2014 incremental OM&A costs associated with the transformer station. These were out of period costs for which Festival did not have and did not ask for deferral or variance account treatment before the costs were incurred. As such they are out of period expenses that cannot be recovered from ratepayers.

The evidence with respect to this issue is clear. Festival did not expressly request OM&A expenses as part of its ICM application in 2013 and the Board did not expressly provide approval for any such OM&A expense (9-Staff-76 TCQ (a)). Festival further noted that, in error, it did not request a separate deferral account to track the incremental OM&A expenses associated with the transformer station but assumed that theses costs would be dealt with using the same accounting practices as followed for smart meters (9-Staff-76 TCQ (b)).

Energy Probe submits that there is no allowance for incremental (or decremental) OM&A expenses in the ICM model. The model deals only with the costs associated with capital expenditures, being the return on capital (debt and equity), PILs, and depreciation.

Festival was aware of the incremental OM&A costs but never brought these costs to the attention of the Board until this proceeding. Festival never requested a deferral or variance account to track these costs and recover them in the future.

Instead, Festival relied on an e-mail from Board Staff stating that the OM&A costs in question could be recorded in a sub-account of account 1508 rather than in the regular OM&A accounts (Undertaking J1.5). However, the Staff response says nothing about being able to recover those out of period expenses through future rates.

Attached to the e-mail response from Staff was Section 2.2.7 ICM Accounting Treatment from the filing guidelines in place when Festival filed its ICM application and evidence. A read of that material shows that there is no mention of OM&A costs or the recovery of such OM&A costs. This is, of course, because the ICM is an incremental capital module, not an incremental OM&A module or an incremental revenue requirement module.

In the response to Undertaking JT1.12, Festival states that in the event that the incremental OM&A costs are removed from the ICM account, it would request that these expenses be placed into a variance account and be given Z factor recognition. Festival withdrew this request and indicated that it would not be seeking Z factor treatment of these costs (Tr. Vol. 1, pages 99-101) if the Board determines that the incremental OM&A costs are not eligible for recovery.

Energy Probe submits that the amount forecast in the original ICM application related to training costs should be recoverable by Festival. These costs, which totalled $39,826 in 2013 with an additional forecast cost of $3,000 in 2014 (Undertaking JT1.12) were included in the capitalized costs associated with the transformer station project in the ICM application. However, due to the accounting change that took place, these costs were no longer eligible to be capitalized. Energy Probe submits that it would not be appropriate to penalize Festival by not allowing the recovery of the training costs because of the accounting change.

In summary, Energy Probe submits that the incremental OM&A costs, other than the training costs noted immediately above that were initially forecast to be capitalized, should not be recoverable from ratepayers. There was no Board approved deferral or variance account in which to include these costs. The incremental capital module deals only with the revenue requirement impacts of capital - cost of capital, PILs and depreciation. If Festival had wanted to recover the incremental OM&A costs it should have sought Board approval for these costs. It did not.

Issue 5.1

Is the true-up of cost related to Festival Hydro's new 62MVA Transformer Station appropriate?

Energy Probe submits that the true-up of costs related to the transformer station are appropriate, with two exceptions.

The first exception is that the incremental OM&A costs associated with the transformer station should not be recovered from ratepayers, as they are not part of the true-up related to the incremental capital module. Energy Probe's submissions with respect to this request are found under Issue 4.2.

The second exception is the amount being requested by Festival.

Festival filed updated evidence in Exhibit 9, Tab 3, Schedule 12 (3 pages) on November 6, 2014, showing the true-up amount to be $415,111. Energy Probe submits that the methodology used by Festival for the true-up is appropriate. This methodology was discussed in detail (Tr. Vol. 1, pages 56-61).

While the rate rider was based on the use of the half year rule for depreciation, the actual depreciation costs are based on the actual depreciation costs booked in December, 2013 and in 2014. The true-up should be based on these two figures, as has been done by Festival. Energy Probe submits that the use of the half year rule for the ICM rate rider is only a proxy and does not mean that the actual costs should be based on the same half year rule. In fact, Festival has actually used the month in service to calculate the depreciation expense for 2013 and then has appropriately used a full year of depreciation for 2014.

Festival has also trued up the calculation to reflect actual capital expenditures, which Energy Probe submits is also appropriate.

The one area where Energy Probe disagrees with Festival, is the calculation of the capital cost allowance ("CCA") used in the calculation of the incremental revenue requirement. This figure, $951,896 is shown on the table on page 3 of the updated Exhibit 9, Tab 3, Schedule 12.

In the response to Undertaking J1.2, Festival provided the breakdown of the CCA by class. However, Festival did not provide the calculation using these figures to arrive at the CCA of $951,896 used in the true up calculation. As a result of the figures provided

in Exhibit K1.2, Festival updated the evidence in Exhibit 9, Tab 3, Schedule 12 as part of the Responses to Undertakings filed on November 18, 2014.

In the calculation, the CCA was corrected to $1,107,004. Energy Probe has reviewed the calculation of this figure and submits that it is the correct figure.

As a result of this increase in the CCA, the true up amount to be collected from ratepayers has declined from $415,111 to $389,681. Energy Probe submits that this is the correct true-up amount that should be approved by the Board. Again, please note that this excludes the $244,815 OM&A claim for incremental costs in 2013 and 2014, which is addressed under Issue 4.2 above.

Issue 5.2
Is funding through an additional ICM funding adder appropriate?

Festival has requested the approval of a new incremental capital rate rider effective January 1, 2015 for a period of one year (Exhibit 9, Tab 3, Schedule 12, page 9). This rate rider would a volumetric rate rider applied to kWh and kW based on the forecast for 2015.

Energy Probe submits that this proposed recovery is appropriate and should be accepted by the Board.

Festival has provided the calculation of the rate riders on the final page of the Responses to Undertakings filed on November 18, 2014. However, this calculation includes the recovery of $244,815 associated with incremental OM&A costs incurred in 2013 and 2014.

As noted above in Issue 4.2, Energy Probe submits that this figure should be reduced to an amount equal to the training costs that Festival had originally capitalized in the ICM model but had to expense because of the accounting change.

Issue 5.3
Are the incremental capital amounts to be incorporated into rate base prudent?

Festival proposes to transfer a net amount of approximately $14,946,000 into rate base associated with the transformer station (2OEB Staff 8 and Tr. Vol. 1, pages 61-62). Energy Probe submits that this amount is correct, in that it matches the costs and accumulated depreciation used in the true-up calculations noted under Issue 5.1 above.

C - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe worked with other intervenors in this proceeding to ensure complete coverage of the issues with a minimum of duplication.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

November 26, 2014

Randy Aiken
Consultant to Energy Probe