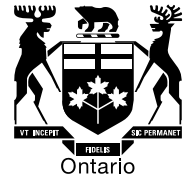


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**BY EMAIL**

January 19, 2015

Ontario Energy Board  
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[Kirsten.Walli@ontarioenergyboard.ca](mailto:Kirsten.Walli@ontarioenergyboard.ca)

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: Espanola Regional Hydro Distribution Corporation  
2015 IRM Distribution Rate Application  
Board Staff Submission  
Board File No. EB-2014-0071**

In accordance with Procedural Order No.1, please find attached the Board Staff Submission in the above proceeding. This document is being forwarded to Espanola Hydro and to all other registered parties to this proceeding.

Espanola Hydro is reminded that its Reply Submission is due by February 2, 2015.

Yours truly,

*Original Signed By*

Georgette Vlahos  
Analyst, Electricity Rates & Accounting

Encl.



# **ONTARIO ENERGY BOARD**

## **STAFF SUBMISSION**

2015 ELECTRICITY DISTRIBUTION RATES

Espanola Regional Hydro Distribution Corporation

EB-2014-0071

**January 19, 2015**

**Board Staff Submission  
Espanola Regional Hydro Distribution Corporation  
2015 IRM Rate Application  
EB-2014-0071**

**Introduction**

Espanola Regional Hydro Distribution Corporation (“Espanola Hydro”) filed an application (the “Application”) with the Ontario Energy Board (the “Board”) on October 10, 2014, seeking approval for changes to the distribution rates that Espanola Hydro charges for electricity distribution, to be effective May 1, 2015. The Application is based on the 2015 Price Cap IR option.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by Espanola Hydro.

Retail Transmission Service Rates

Board staff has no concerns with the data supporting the updated Retail Transmission Service Rates proposed by Espanola Hydro. Pursuant to the Board’s Guideline G-2008-0001, Board staff notes that the Board will update the applicable data at the time of the Board’s Decision on the Application based on the Uniform Transmission Rates in place at that time.

Tax-Savings

In response to Board staff interrogatory #5, Espanola Hydro confirmed that it had entered the incorrect total rate base amount in cell L19 on tab 11 of the Rate Generator Model, and requested that Board staff make the necessary correction. Board staff notes that the model, as revised with the corrected information reflects the Revenue Requirement Work Form from the Board’s decision in EB-2011-0319 (Espanola Hydro’s 2012 cost of service application). Board staff notes that since there have not been any changes in tax legislation since the filing of Espanola Hydro’s 2012 cost of service application, the tax savings are \$0.

### Deferral and Variance Account Disposition

Espanola Hydro completed the Deferral and Variance Account continuity schedule included in the 2015 IRM Rate Generator Model at Tab 5 for its Group 1 Deferral and Variance Accounts. Espanola Hydro's total Group 1 Deferral and Variance Account balances amount to a credit of \$106,410. The balance of Account 1589 – Global Adjustment Sub-Account is a debit of \$67,412, and is applicable only to Non-RPP customers. These balances also include interest calculated to April 30, 2015. Based on the threshold test calculation, the Group 1 Deferral and Variance Account balances equate to a credit of \$0.0017 per kWh which exceeds the preset disposition threshold, and as such, Espanola Hydro requested disposition of these Accounts over a one-year period.

Board staff has reviewed Espanola Hydro's Group 1 Deferral and Variance Account balances and notes that the principal balances as of December 31, 2013 reconcile with the balances reported as part of the *Reporting and Record-keeping Requirements*. Also, the preset disposition threshold has been exceeded. Accordingly, Board staff has no issue with Espanola Hydro's request to dispose of its 2013 Deferral and Variance Account balances at this time over the requested one-year period.

### Over-Earning in 2013

As part of its interrogatories, Board staff noted that Espanola Hydro's 2013 RRR 2.1.5.6 return on equity ("ROE") filing shows an ROE of 29.92%, a difference of 20.8% in excess of the Board-approved 9.12% ROE.

Board staff asked Espanola Hydro to explain, among other things, the drivers for this over-earning, whether it expects that the over-earning was a one-time occurrence or if it will continue, and why Espanola Hydro felt that it is reasonable to apply an increase to its base rates given the over-earning in 2013.

In its responses, Espanola Hydro provided the following table noting the drivers for the over-earning<sup>1</sup>:

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<sup>1</sup> EB-2014-0071, Interrogatory Responses, PDF Page 11

**Table 1**

	Board- Approved 2012	Actual 2013	Adjusted 2013
<b>Net Income</b>	\$154,847	\$508,647	\$508,647
<b>Revenue Drivers</b>			
1 Rate Rider - Disposition of Residential Smart Meter Costs			-\$45,770
2 Rate Rider - Recovery of Lost Revenue			-\$38,485
3 Rate Rider - Recovery of Foregone Revenue			-\$127,211
4 Increase in Late Payment Charges			-\$9,900
5 Regulatory Carrying Cost Revenue			-\$10,878
<b>Cost Drivers</b>			
1 2012 OEB Reduction in Depreciation recorded in 2013			-\$29,250
2 Correction in Historical Years Excess Depreciation			-\$54,800
3 Lower Meter Read Expense			-\$42,620
4 Recovery of Tree Trimming Exp. Recovered in revenue over 4 years (incl. 1/4 in 2013, actual exp. in 2012)			-\$56,500
5 Temporary Labour Vacancy			-\$8,000
6 Management Salaries - As per CoS rate approval - Finance Officer head count at 2 in 2012 to train retiree replacement; recovered in revenue over 4 years; exp. in 2012			-\$26,030
7 Increase in PILs due to higher income			\$124,917
<b>Normalized Income</b>			\$184,120
Rate Base	\$4,244,735	\$4,249,913	\$4,249,913
4% ST Debt	\$169,789	\$169,996	\$169,996
56% LT Debt	\$2,377,051	\$2,379,951	\$2,379,951
40% Equity	\$1,697,894	\$1,699,965	\$1,699,965
<b>ROE</b>	9.12%	29.92%	10.83%

Espanola Hydro noted that it felt it is reasonable to apply for an increase to its base rate despite the over-earning due to the fact that the normalized ROE for 2013 (10.83%) only differed by 1.71% in excess of the Board approved 9.12%. In addition, Espanola Hydro submits that the average ROE of 8.36% for 2012 and 2013 (-13.19% and 29.92% respectively) is within the deadband of the Board-approved 9.12%.

In response to Board staff interrogatory #9a and VECC interrogatory #1c, Espanola Hydro provided its ROE for 2011, 2012, 2013 and forecast ROE for 2014 which are shown below:

**Table 2**

	2011	2012	2013	2014 - Forecast
Espanola ROE	-0.56%	-13.19%	29.92%	15.11%
Board-Approved ROE	8.57%	9.12%	9.12%	9.12%
Difference	-9.13%	-22.31%	20.80%	5.99%

Espanola Hydro also noted that although it expects that the over-earnings will continue,

the earnings over the 4 year period set out in the table above will be within the dead band of the Board approved ROE of 9.12%.

## **Submission**

Chapter 3 of the *Filing Requirements for Electricity Distributors Rate Applications for Price Cap Incentive Rate-Setting and Annual Incentive Rate-Setting Index* dated July 25, 2014 (page 13) states:

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

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

Board staff submits that the level of earnings in 2013 and the expected level of over-earning in 2014 by Espanola Hydro warrants evaluation on whether the Price Cap IR plan for Espanola Hydro properly balances the interests of customers in paying reasonable rates and the interests of the utility in earning a financial reward commensurate with its business risks.

*What is the appropriate ROE result for 2013?*

Board staff accepts that there may be certain items, either in revenue requirement or on a distributors Tariff of Rates and Charges that do not reflect a distributor’s normal day to day operations, and that can result in a distributor exceeding the trigger mechanism for earnings in a given year. The nature of these items should be a consideration in whether a modification of a rate-setting plan is appropriate.

Espanola Hydro has identified two types of items for which the 2013 ROE calculation requires adjusting. Both work in the same direction, that is, to lower net income for the subject year.

First, Espanola Hydro proposed that certain additional revenues be removed when calculating the regulated ROE when considering over-earning. Board staff notes that the approximate \$212,000 that relate to historical smart meter costs, lost revenue from conservation activities and foregone revenue due to a difference between the Board approved effective and implementation dates arising from the 2012 COS proceeding, are all revenues in 2013 that relate to activities from a prior period. Board staff has no concerns with this adjustment because, as a result of timing, these are being accounted for in the period in question and do not constitute earnings relating to 2013 activities.

Board staff notes that if Espanola Hydro's ROE was re-calculated to exclude the impact of these riders (and associated PILs impact), but no other adjustments, the revised ROE is 20.94%, which is still in excess of 300 basis points above the Board-approved ROE of 9.12%.

Second, Espanola Hydro has identified a list of costs which should be increased for the 2013 year based on such outcomes as lower actuals than were approved at rebasing, or to account for their onetime nature. However, given the limited details on each of the cost drivers provided, Board staff is unable to verify that these activities are not part of ongoing regular day-to-day operations or expected as part of the cost of service. For example, line item 3, lower meter expenses are likely to be ongoing and could be the result of an inaccurate forecast in the most recent cost of service rate application. An adjustment for this would not be appropriate.

Board staff performed a high level recalculation of the ROE, accepting only the line items in Table 1 above, which Board staff is of the view may be one-time occurrences, and excluding the impact of the aforementioned (revenue) rate riders. Board staff's recalculated ROE is 17.17%, which is still in excess of 300 basis points above the Board-approved ROE of 9.12%. The calculation is attached to this submission.

*Should the Board allow a base rate increase for 2015 rates?*

Board staff notes that under similar overearning circumstances, the Board has previously ordered distributors to file for early rebasing<sup>2</sup>. In this particular circumstance however, Board staff highlights that in 2011 and 2012, Espanola Hydro was in fact significantly under earning as seen in Table 2 above. Board staff notes that Espanola Hydro has not provided any details in this Application with respect to the drivers responsible for the under-earning in 2011 and 2012. However, the fact that Espanola Hydro has not been over-earning year-after-year and has in fact lost money for the two previous years (i.e. 2011 and 2012), mitigates, in staff's view, the need for any action to be taken such as an earlier than planned rebasing, or in this case because the next rebasing is scheduled shortly, for 2016 rates, any actions with respect to declaring rates interim pending the next rebasing application. Reviewing Espanola's ROE from 2011 to its forecasted 2014 ROE, the fluctuations do not indicate any particular trend.

Board staff notes that Espanola Hydro is currently on the Price Cap IR option and, as noted previously, is expected to rebase its rates effective in 2016. Accordingly, ordering an early rebasing application is not the most feasible option and would not necessarily provide a remedy for the large swings in ROE experienced by Espanola Hydro.

Given the level of overearning and expectation that it will continue, the Board has reasonable grounds to deny the Price Cap adjustment in this application. While Board staff is concerned with the current over-earnings position of the company, it is noted that the average ROE over the 4-years in the table above is only 7.82%. On that basis, and because Espanola Hydro is scheduled to file a cost of service application in 2015 for 2016 rates, Board staff does not oppose Espanola Hydro's Price Cap adjustment in this Application.

Board staff submits that the Board may wish to continue to monitor Espanola Hydro's earnings over the next year until it is scheduled to rebase in 2016 and to consider this issue as part of its next cost of service application. This should also be a consideration should Espanola Hydro seek to defer its cost of service application. Board staff submits that for the current proceeding, a declaration of interim rates due to the over-earning is not required.

All of which is respectfully submitted

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<sup>2</sup> Wasaga Distribution Inc., 2012 Cost of Service Application, EB-2011-0103