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BY EMAIL

April 30, 2015

Ontario Energy Board
P.O. Box 2319
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Toronto ON M4P 1E4
Kirsten.Walli@ontarioenergyboard.ca

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Essex Powerlines Corporation
2015 IRM Distribution Rate Application & Smart Meter Recovery
OEB Staff Submission
Board File Numbers: EB-2014-0072 and EB-2014-0301

In accordance with the OEB's order at the oral hearing dated April 14, 2015, please find attached the OEB Staff Submission in the above combined proceeding. This document is being forwarded to Essex Powerlines Corporation and to all other registered parties to this proceeding.

Essex Powerlines is reminded that its Reply Submission is due by May 7, 2015.

Yours truly,

Original Signed By

Lynne Anderson
Vice President, Applications

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2015 ELECTRICITY DISTRIBUTION RATES

Essex Powerlines Corporation

EB-2014-0072
EB-2014-0301

April 30, 2015

OEB Staff Submission
Essex Powerlines Corporation
2015 IRM Rate Application & Smart Meter Recovery
EB-2014-0072 and EB-2014-0301

Background

Essex Powerlines Corporation (Essex Powerlines) filed two applications; the first seeking approval for its final smart meter installation costs and the second for an annual Price Cap IR adjustment to rates for the 2015 rate year[1]. The OEB decided to hear these applications together.

During the course of the proceeding, an error with respect to Essex Powerlines' annual Price Cap IR application was brought to the OEB's attention. The error related to the disposition of Group 1 deferral and variance accounts (DVAs). Essex Powerlines incorrectly allocated costs in 2011, 2012 and 2013 between Regulated Price Plan (RPP) and non-RPP customers. Accounts 1588 – RSVA Power and 1589 – RSVA Global Adjustment are the Group 1 DVAs affected by this error. Essex Powerlines proposes to correct the error by recovering undercollected amounts from non-RPP customers over a four-year period and refunding amounts to RPP customers over a two-year period.

Essex Powerlines filed its Argument-In-Chief, which outlined the application as currently understood, on April 23, 2015. OEB staff has reviewed the application, including Essex Powerlines' responses to supplemental questions (including the updated Rate Generator Model), oral examination, undertakings, and Argument-In-Chief. OEB staff discussed other items which were part of Essex Powerlines' original application in its submission on December 14, 2014 (i.e. smart meter costs, tax-sharing, retail service transmission rates), and therefore will not re-address them as part of this submission.

The purpose of this document is to provide the OEB with the submissions of OEB staff based on its review of the additional evidence submitted by Essex Powerlines and cross-examination at the oral hearing. This submission will outline the nature of the accounting error, the basis of OEB staff's view that the accounting error together with the utility's other careless errors evidenced in this proceeding is symptomatic of a

[1] The Smart Meter Application was filed on September 23, 2014 and the Price Cap IR application was filed on September 26, 2014.

general lack of proper controls, and then discuss OEB staff's recommendations. The following issues will be addressed in this submission:

- Nature of the Misallocation Error Between Accounts 1588 and 1589
- Proposed Correction to Remaining Amounts in Account 1595 (2014)
- Model Implementation Error - Account 1590 (Recovery of Regulatory Asset Balances)
- DVA Balances as at December 31, 2013 and Disposition Periods
- Omission of Consumption Data for GS 3,000 to 4,999 kW Rate Class
- Financial Consequences

Nature of the Misallocation Error Between Accounts 1588 and 1589

Overall, the source of the error occurred in the settlement forms Essex Powerlines submitted to the IESO which are used to arrive at a RPP and non-RPP split.

Essex Powerlines described that at the time the error occurred, time-of-use (TOU) pricing, changing embedded generation from Hydro One invoices, and a fluctuating Global Adjustment masked what should have been happening with the Global Adjustment percentage split[2]. The form being used at the time these changes were taking place allocated electricity costs between RPP and non-RPP customers by using information from the customer information billing system. After the introduction of TOU pricing, this form was substituted for a new form to incorporate the necessary changes for implementing TOU pricing. However, this form did not include a formula for the allocation between RPP and non-RPP customers. Consequently, Essex Powerlines staff were required to manually enter a formula. The error occurred due to the entry of an incorrect formula to perform the allocation[3].

The same form with the incorrect formula was used for subsequent settlements with the IESO and therefore the error perpetuated over time. The input error was not detected initially as the total quantum of all the variance accounts was being monitored and was not changing drastically[4].

[2] Essex Powerlines Corporation, Transcript of Oral Hearing, April 14, 2015, Page 19 (EB-2014-0072/EB-2014-0301)
[3] Essex Powerlines Corporation, Argument-in-Chief, Page 6 (EB-2014-0072/EB-2014-0301)
[4] Essex Powerlines Corporation, Response to Procedural Order No. 2, February 6, 2015 (EB-2014-0072/EB-2014-0301)

Proposed Correction to Remaining Amounts in Account 1595 (2014)

Commencing May 1, 2014 (and set to end April 30, 2015), Essex Powerlines began charging rate riders that were calculated from account balances that included Account 1588 and 1589 as at December 31, 2012. The OEB approved these rate riders as part of the decision for Essex Powerlines' 2014 IRM rate proceeding. The 2012 balances included amounts related to 2011 as the account balances had not been disposed in the previous year's rate application.

The OEB, by way of a Rate Order, ceased these 2014 DVA rate riders that were partly based on the misallocation error. In its Procedural Order No. 3, the OEB noted that the balance of each Group 1 Account approved for disposition on a final basis was transferred to the applicable principal and interest carrying charge sub-accounts of Account 1595, therefore, the OEB saw no harm in ceasing these riders effective February 1, 2015.

In response to Procedural Order No. 3, Essex Powerlines provided the residual balance in Account 1595 (2014) (i.e. the remainder, in the "stub period", after the 2014 DVA rate riders were stopped in February 2015).

OEB staff notes that the remaining amount is based on approved balances. OEB staff submits that allowing the riders to continue to overcollect from RPP and undercollect from non-RPP customers until the total remaining balance is drawn down would be an absurd result. It would not be fair to proceed to charge customers amounts that have yet to be billed and that are now known to be incorrect.

For this reason, OEB staff submits that the Board should order Essex Powerlines to correct the misallocation embedded in the residual amount. In doing so, the Board will ensure that there will be no continued over-collection from RPP customers and under-collection from non-RPP customers.

OEB staff notes that the rate riders which were ceased also contain amounts disposed which do not fall under Account 1588 or 1589 and which were calculated correctly. It is important that these amounts be disposed as was intended by the OEB in its 2014 decision in Essex Powerlines' previous application. While in the normal course, residual amounts in Account 1595 are not disposed until after audited financial statements exist to support the balance, in this case, it would make little sense to wait until 2016 rates to begin the disposition of this account. OEB staff submits that Essex Powerlines be permitted to commence the disposition of the residual balance in Account 1595 (2014) as part of this proceeding. However, to be consistent with OEB staff's observations regarding the 2013 balances (as will be noted below), this amount should be disposed on an interim basis.

In terms of the quantum, at the oral hearing OEB staff took issue with Essex Powerlines' calculation, namely that correcting the balances should be done in a way so that the misallocation is corrected dollar for dollar[5]. Ultimately, Essex Powerlines agreed with OEB staff's calculation as seen below. As of January 31, 2015, the remaining balances, as corrected over the course of the proceeding, and agreed to by Essex Powerlines are a debit in Account 1588 of $1,198,629 and a credit in Account 1589 of $1,089,506[6].

OEB staff would like to highlight that, in its Argument-In-Chief, Essex Powerlines included the following disposition summaries for Accounts 1588 and 1589, respectively, going forward:

Description	**Amount – Account 1588**
May 1, 2014 to January 31, 2015 – settled	-$3,614,779
February 1 to April 30, 2015 residual	$2,762,600
Correction to Misallocation of GA	-$1,563,971
2013 Balances	-$2,151,441
Total	-$4,567,591

Description	**Amount – Account 1589**
May 1, 2014 to January 31, 2015 - settled	$3,614,779
February 1 to April 30, 2015 residual	-$2,762,600
Correction to Misallocation of GA	$1,563,971
2013 Balances	$4,438,923
Total	$6,908,196

Essex Powerlines maintains the view that the over and under-billed amounts should be corrected in full (i.e. including the already settled amounts). OEB staff submits that the

[5] Essex Powerlines Corporation, Oral Hearing Transcript, Pages 24-26
[6] Essex Powerlines Corporation, Oral Hearing Transcript, Page 26

above is not in accordance with the OEB's decision in Procedural Order No. 3 wherein it stated "the Board therefore rejects Essex Powerlines' proposal to adjust the 2011 and 2012 DVA balances which were disposed on a final basis[7]."

OEB staff submits that Essex Powerlines should make the necessary journal entries in its books of accounts to reflect in its Account 1595, sub-account 2014 the corrected amounts with respect to the "stub period" for the 2014 rate rider. OEB staff submits that Account 1595, sub-account 2014 should be credited by $1,563,971, and Account 1595, sub-account Global Adjustment should be debited by the same amount.

Model Implementation Error - Account 1590 (Recovery of Regulatory Asset Balances)

The misallocation error affecting Accounts 1588 and1589 was not the only material error uncovered during the course of this proceeding. Essex Powerlines also conceded that a model implementation error in its 2014 IRM proceeding affected the disposition of the balance in Account 1590.

Account 1590 (along with its successor version - 1595) was intended to track the recovery or credit of all balances approved in prior proceedings. Upon approval of DVA balances, distributors must transfer the balances to these residual accounts in order to track the dispositions. Following the completion of the dispositon periods, distributors were to bring the residual balances in account 1590 (now 1595) forward for another disposition in a future proceeding.

Essex Powerlines had an approved credit balance of approximately $1.5 million to be returned to customers as part of the 2014 IRM process. However, the credit was not included in the rate rider calculations by Essex Powerlines. This balance reflected the residual amounts arising from previous dispositions but, due to Essex Powerlines' exclusion of percentages from the model attributable to each rate class, was not accounted for in the utility's rate rider calcuations.

In Procedural Order No. 3, the OEB found that, in accordance with section 41.02 of the Board's *Rules of Practice and Procedure*[8] that adresses the treatment of errors of

[7] EB-2014-0072/EB-2014-0301, Partial Decision and Procedural Order No. 3, March 25, 2015, Page 7

[8] Section 41.02 notes that "The Board may at any time, without notice or a hearing of any kind, correct a typographical error, error of calculation or similar error made in its orders or decisions."

calculation or typographical errors, Essex Powerlines could bring this amount forward in its continuity schedules (with additional carrying charges) with disposition over a one-year period as part of this proceeding.

In response to OEB staff supplemental questions that came after the issuance of Procedural Order No. 3, Essex Powerlines filed an updated continuity schedule which included its claim for the disposition of Account 1590 as part of its Group 1 DVA balances as at December 31, 2013.

At the oral hearing, OEB staff noted that Essex Powerlines (in addition to the December 31, 2012 balance approved as part of the 2014 IRM process, plus carrying charges to the end of 2013) has received approval to dispose of Account 1590 on two previous occasions as seen below.

Table 1 – Previously Approved Account 1590 Amounts

Proceeding #	Amount
EB-2009-0143	credit balance of $331,340
EB-2011-0166	credit balance of $1,618,215
EB-2013-0128	credit balance of $1,483,365

These two previous dispositions may represent residual balances from prior years' dispositions. As noted by OEB staff, Account 1590 was only to be used for dispositions approved in the 2006 EDR (Electricity Distribution Rates) Process. Furthermore, as confirmed in *Chapter 3 of the Filing Requirements for Transmission and Distribution Applications (2011)*[9], all subsequent amounts should have been booked to Account 1595 (in different sub-accounts for each subsequent disposition proceeding). At the

[9] Chapter 3 of the Filing Requirements (2011) Appendix A:
Disposition of Residual Balance in USoA Account 1590 or 1595
The 2006 Regulatory Assets process disposed of all balances in the regulatory asset accounts as of December 31, 2004. The decisions for each distributor resulted in the disposition of the approved amounts by way of final rate riders and the transfer of the approved amounts to account 1590. Likewise, any deferral and variance account balances post December 31, 2004 that have been approved by the Board for disposition were disposed on a final basis, unless otherwise noted and should have been transferred to account 1595.
Accounts 1590 and 1595 are part of the Group 1 deferral and variance accounts as defined by the Board in the EDDVAR Report. Once the rate rider ceases, the residual principal balances and any interest carrying charges in these accounts would be cleared in an IRM application (where applicable) provided that the preset disposition threshold for the Group 1 accounts has been exceeded.

oral hearing, Essex Powerlines was not able to confirm what amounts have been recorded in this account. Moreover, Essex Powerlines was unable to explain why this account continues to have balances in it.

With respect to the continued use of Account 1590, OEB staff submits that this is one more example of Essex Powerlines' general carelessness in following proper accounting procedures, protocols and guidance. The OEB on a number of occasions has issued accounting guidance with respect to Account 1590[10]. OEB staff submits that Essex Powerlines should cease to use this account on a going-forward basis and book approved disposition amounts in the appropriate sub-accounts of Account 1595.

OEB staff has reviewed the entries in the updated continuity schedule with respect to Account 1590 and notes that (subject to transfering this amount to account 1595) Essex Powerlines has implemented the OEB's directions in Procedural Order No. 3 and has included this amount (with additional carrying charges) in its proposed 2013 DVA balances for disposition effective May 1, 2015.

As this amount was directed to be included in Essex Powerlines' Group 1 DVA balances as at December 31, 2013, its disposition will be discussed in greater detail in the next section.

DVA Balances as at December 31, 2013 and Disposition Periods

Essex Powerlines provided an updated DVA continuity schedule beginning January 1, 2010 for the requested disposition of its 2013 Group 1 DVAs with no adjustment to the 2011 and 2012 balances in Accounts 1588 and 1589 (as per the OEB's decision in Procedural Order No. 3) and with the correcting adjustments to the 2013 balances only to Accounts 1588 and 1589.

Essex Powerlines' updated total Group 1 DVA balances as at December 31, 2013 amount to a credit of $1,039,911[11]. The balance of Account 1588 is a credit of $2,151,411. The balance of Account 1589 – Global Adjustment Account, applicable only to non-RPP customers – is a debit of $4,382,923. All balances include interest calculated to April 30, 2015. Based on the threshold test calculation, the Group 1 DVA balances equate to $0.0021 per kWh which exceeds the threshold.

[10] FAQs, August 2008 and Chapter 3 of the 2011 Filing Requirements as noted above.
[11] Total Group 1 DVA balances include Accounts 1550, 1551, 1580, 1584, 1586, 1588, 1589, 1590 and 1595 (2012)

At the oral hearing, Essex Powerlines confirmed its original request for the following disposition periods:

- Group 1 DVAs, excluding Accounts 1588 and 1589: one-year period commencing May 1, 2015.
- Account 1588: two-year period commencing May 1, 2015.
- Account 1589: four-year period commencing May 1, 2015.

OEB staff reviewed the entries by Essex Powerlines in its updated 2013 DVA continuity schedule. OEB staff noted obvious variances between Essex Powerlines' 2013 *Reporting and Record-keeping Requirements* (RRR) and the balances reported by Essex Powerlines in the DVA continuity schedule.

Essex Powerlines conceded the inconsistency, and identified three issues which cause these variances:

(i) 1595 Allocation: The 2012 OEB-approved disposition amounts were not moved into Account 1595 at the appropriate time. Now that these amounts have been moved into the appropriate sub-accounts of 1595, this has resulted in overstated/understated amounts in Accounts 1550, 1580, 1584, 1586, 1588, 1589, 1590 and 1595.

(ii) RPP & Non-RPP Global Adjustment Allocation: The correcting adjustment for the misallocation to Accounts 1588 and 1589 for 2013.

(iii) Account 1590 Disposition: Because a rate rider did not include the disposition of Account 1590 (as noted above), Essex Powerlines, in accordance with Procedural Order No. 3, has brought this amount forward to be disposed with its Group 1 DVAs as at December 31, 2013.

Essex Powerlines provided two sets of bill impacts showing the RPP and non-RPP impacts with the two and four-year disposition periods for Accounts 1588 and 1589 as proposed[12]. One compares to 2014 rates and the other compares to 2015 stayed rates. Essex Powerlines notes that the impacts which compare to 2015 stayed rates more accurately reflect the actual impacts that customers will experience in rates effective

[12] The bill impacts also take into account the proposed price cap adjustment and the Smart Meter Disposition Rider (SMDR) and Smart Meter Incremental Revenue Rate Rider (SMIRR) based on the information Essex Powerlines filed in its original reply submission to this combined proceeding on January 20, 2014.

May 1, 2015 since the Board approved the removal of rate riders effective February 1, 2015. OEB staff agrees with this view.

OEB staff notes that bill impacts (comparing to 2015 stayed rates) were provided by Essex Powerlines in both its responses to Parties' supplemental questions of Procedural Order No. 3 and in its Argument-In-Chief. OEB staff notes that the bill impacts provided vary between these two documents, as seen below.

Table 2 – Reponses to Supplemental Questions
2015 Bill Impacts as Compared to 2015 Stayed Rates

Rate Class	**Total Bill Impact (RPP)**		**Total Bill Impact (non-RPP)**	
	$	**%**	**$**	**%**
Residential	(7.15)	-5.95%	(3.41)	-2.79%
GS<50kW	(8.99)	-3.09%	0.76	0.26%
GS 50 – 2,999kW			(8,144.24)	-4.98%
Unmetered Scattered Load			(10.69)	-3.24%
Sentinel Lighting			(0.16)	-1.66%
Street Lighting			(0.11)	-1.17%

Table 3 – Argument-In-Chief
2015 Bill Impacts as Compared to 2015 Stayed Rates

Rate Class	**Total Bill Impact (RPP)**		**Total Bill Impact (non-RPP)**	
	$	**%**	**$**	**%**
Residential	(10.97)	-9.13%	(4.95)	-4.06%
GS<50kW	(18.55)	-6.37%	(3.10)	-1.07%
GS 50 – 2,999kW			(10,609.99)	-6.49%
Unmetered Scattered Load			(14.99)	-4.54%
Sentinel Lighting			(0.24)	-2.47%
Street Lighting			(0.18)	-1.93%

Unfortunately, OEB staff can only assume that the bill impacts are inconsistent between the two because of the inclusion in Table 3 of the residual amount for Account 1595 (2014), as discussed in the previous section. It would be helpful for Essex Powerlines to confirm this. OEB staff notes that, in any event, the bill impacts are virtually all negative.

Overall, OEB staff is concerned with Essex Powerlines' accounting procedures, protocols and review processes which have resulted in numerous material errors in the balances recorded in Essex Powerlines' variance accounts. These errors include:

- Misallocation of Global Adjustment between RPP and non-RPP rate classes
- Errors in calculating certain rate riders by excluding the Account 1590 balance
- Non-compliance with the APH and Board guidance by not moving disposed balances into Account 1595

While Essex Powerlines has filed updated information, OEB staff submits that given the materiality of the balances proposed for disposition, and the magnitude of the errors, Essex Powerlines' Group 1 DVA balances as at December 31, 2013 should be disposed on an interim basis, and should be subject to a detailed audit by the OEB's Audit and Performance Assessment Group before their final disposition by the OEB.

OEB staff takes no issue with the proposed disposition periods as they appear to mitigate the substantial impacts customers would feel otherwise (i.e. if all Group 1 DVAs were disposed over one-year).

Omission of Consumption Data for GS 3,000 to 4,999 kW Rate Class

In its application, as originally filed, Essex Powerlines removed the GS 3,000 to 4,999 kW consumption data as this class has only 2 customers - one is the embedded distributor Hydro One Networks, who does not get charged rate riders, and the other is Heinz Inc. who ceased to be a customer as of June 2014. Essex Powerlines analyzed the current usage compared to the latest Board-approved volumetric forecast and noted that "while all other classes have not changed significantly, the intermediate (GS 3,000 to 4,999 kW) class has decreased by 100% ... [d]ue to these facts Essex Powerlines has changed the volumetric data used for the intermediate (GS 3,000 to 4,999 kW) class to ensure the allocation of the tax sharing, deferral and variance and RTSR rate riders are more accurately applied[13]."

In its submission on Essex Powerlines' initial application, OEB staff supported the omission of the consumption data for the GS 3,000 to 4,999 kW class for purposes of calculating the rate riders for DVAs, tax savings and RTSR[14].

As part of OEB staff's cross-examination at the oral hearing, OEB staff requested that Essex Powerlines provide its 2013 consumption with the Heinz volumes excluded[15]. Essex Powerlines indicated that the removal of the Heinz volumes from the 2013 total consumption amounts reduces the non-RPP split from 41.23% to 41.00%[16].

OEB staff reiterates its support of the omission of the consumption data for this customer class and notes the minimal change in the overall percentage.

Financial Consequences

OEB staff is aware of the complex nature and intricacies of the Global Adjustment settlement process with the IESO. However, over the course of this proceeding, a multitude of errors have been brought forth by Essex Powerlines.

In its introductory remarks at the oral hearing, the OEB indicated that as a result of the multitude of errors, the OEB was required to take "the unprecedented step of ordering an oral hearing in what otherwise would be a mechanistic adjustment to rates through the incentive rate mechanism process". In OEB staff's view, the OEB was so underwhelmed with the utilities' application and its inconsistent responses to information requests that the OEB felt compelled to include an oral hearing component in order to "…develop a clear understanding of the nature of the errors".

[13] EB-2014-0072, Essex Powerlines Corporation 2015 IRM Application, Exhibit 1, Tab 2

[14] OEB staff noted in its submission dated December 14, 2014 that the use of the most recent data would overstate the expected consumption for that rate class in the 2015 rate year. OEB staff also noted that in a cost of service application, forecast billing determinants are often used for matters such as allocating deferral and variance accounts, and constructing the associated rate riders. Given that Essex Powerlines is proposing a discreet revision for a known change to the distributor's load for the year in which rate recovery will take place, OEB staff had no concerns with the adjustment.

[15] Undertaking J4, Response April 21, 2015.

[16] *Ibid*

Regulated utilities are required to exercise due diligence, especially when handling millions of dollars of ratepayer money. As stated in Procedural Order No. 3:

> Utilities such as Essex Powerlines have ultimate control of their books and records and therefore bear the responsibility of ensuring that there are no mistakes in their filings with the Board. Errors crystalized in final rates can have long term adverse impacts on consumers.

The company's rebalancing proposal in its Argument-In-Chief included the 2011 and 2012 balances approved on a final basis and which the OEB has already stated it will not revisit. However, to the extent that the 2013 balances are yet to be disposed, the company's proposal is focused on correcting the error but does not involve any contribution by the distributor. The question is whether Essex Powerlines should be held accountable, even if partially, for the errors uncovered during this proceeding and the overall deficiencies of both accounting practices and the rates application.

Essex Powerlines has the ultimate control over its books and is responsible for ensuring that it follows the Accounting Procedures Handbook and applies OEB guidelines to ensure the accuracy of its filings with the OEB. OEB staff submits that in this case, Essex Powerlines has not met its responsibility to do so.

Utilities such as Essex Powerlines must exercise accountability and due diligence. As a result of the requirement to settle commodity related activity on behalf of its customers, utilities are entrusted by ratepayers to be custodians of ratepayer money and to safeguard large sums.

As was witnessed during the course of this proceeding, one incorrect formula error caused the misallocation between two sets of customers in the amount of $11.5 million. This is very significant to say the least for an LDC with an annual distribution revenue requirement of approximately $12 million, and has had and will continue to have adverse impacts on customers. As with the other errors identified in this submission, this error was a preventable error. Although OEB staff understands that human error does occur, heightened care must be taken to prevent it. It was evident from the hearing that sufficient protocols were not in place at a time that Essex Powerlines acknowledged included significant changes.

At the oral hearing, parties examined to what extent Essex Powerlines could repay customers as one of the possible options identified by the Board in Procedural Order No. 3. Essex Powerlines stated that if its regulated return was reduced by more than 10%, it would cause Essex Powerlines to be operating at the edge of violating its debt covenants. Essex Powerlines has identified its average annual return to be approximately $2 million.

Essex Powerlines further clarified that any amount over $380,000 (an amount which represents approximately 20% of its annual return) would trigger a default in its debt service coverage ratio with its lender. While OEB staff does not understand why Essex Powerlines has provided two different results (the first suggesting an amount of $200,000[17] and the second an amount of $380,000), neither amount is sufficient in OEB staff's view, were the Board inclined to impose a financial consequence.

OEB staff submits that, in the light of the foregoing, the OEB could deny Essex Powerlines' IRM application or certain components of it. The OEB's denial of the requested price cap adjustment, for example, would mean a loss of revenue of approximately $160,000. In OEB staff's view, a financial consequence in this amount is so insignificant as to be only symbolic, particularly given the view shared jointly by OEB staff, VECC and SEC that utilities are to ultimately be accountable for their mistakes.

OEB staff notes that the rates for distributors such as Essex Powerlines were set based on the OEB's policy on cost of capital for Ontario's regulated utilities. In this policy the OEB accepted the Fair Return Standard, stating that a fair or reasonable return on capital should: (1) be comparable to the return available from the application of invested capital to other enterprises of like risk (the comparable investment standard); (2) enable the financial integrity of the regulated enterprise to be maintained (the financial integrity standard); and (3) permit incremental capital to be attracted to the enterprise on reasonable terms and conditions (the capital attraction standard)[18].

The return on equity compensates utilities based on their relative risk. A utility – and its shareholder – can earn a significant return on equity, with the return intended to reflect the risk scenarios faced by the utility. It is not a guaranteed return and utilities – and

[17] EB-2014-007/EB-2014-0301, Responses to Supplemental Questions, SEC 7(c). That is 20% of Essex Powerlines' regulated return.
[18] Report of the Board on Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, Page 18

their shareholders – are expected to bear a certain risk for their operations to earn this return. One such risk is facing a range of possible consequences relating to the utility's improper handling of ratepayer money. Strict adherence to proper accounting procedures can insulate a utility from such risk. Billing and settlement for the commodity, including the global adjustment, is an integral part of utilities' operations. In OEB staff's view, systemic carelessness towards ensuring proper utility accounting should be met with serious consequences; and, the result of such consequences should benefit ratepayers who have been materially harmed through no fault of their own.

Essex Powerlines' approved return on equity is 9.85%. As noted in the Board's *Chapter 3 of the Filing Requirements for Transmission and Distribution Applications*, a utility's return on equity deadband is +/- 300 basis. As such, in Essex Powerlines' situation, only if its return on equity is greater or less than 9.85% by 300 basis points, would the Board initiate a review of Essex Powerlines. OEB staff recommends that for a two-year period commencing May 1, 2015, the regulated return on equity for Essex Powerlines be reduced by 300 basis points (i.e. to 6.85%). OEB staff used Essex Powerlines' 2013 regulatory return on equity calculation to estimate the amount it would forego based on a return of 6.85%. OEB staff estimates this amount to be approximately $550,000. In OEB staff's view, a reduction in this amount is within the deadband range that does not trigger an automatic review and therefore will not financially impair the utility.

In OEB staff's view, a financial consequence in the order of $1.1 million in total is commensurate with the seriousness of the errors and will serve as an incentive for Essex Powerlines, and potentially other distributors, to have the appropriate oversight of these important settlement processes.

OEB staff is not recommending that Essex Powerlines' base rates be reset, rather to use the ROE discussion above to establish an appropriate magnitude of a financial consequence for this matter. The OEB could implement this recommendation by establishing a rate rider to credit the $1.1 million to all customers over two years.

All of which is respectfully submitted