EB-2014-0101

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998;*

AND IN THE MATTER OF an Application by Oshawa PUC Networks Inc. for an Order approving rates and other service charges for the distribution of electricity for the years 2015 through 2019.

ARGUMENT IN CHIEF

INTRODUCTION

Key Drivers

1. There are two key factors that have driven, and shaped, Oshawa PUC Networks Inc.'s (OPUCN) application for 2015-2019 rates.

2. First, OPUCN is facing significant capital expenditure requirements in the coming years to complete its system renewals plans while relocating and investing in infrastructure to serve planned growth in the Oshawa area of 3% per year. The pace of largely non-discretionary capital expenditures is forecast to exceed the level of annual depreciation expense by a factor of 2 (3 in 2015), as illustrated in the following table [from Exhibit 1, Tab C, page 6]:

	Test Years				
	2015	2016	2017	2018	2019
Capital Expenditures	13,509,900	11,627,000	12,372,000	12,476,000	10,761,000
Depreciation Expense	4,491,588	4,847,338	5,000,972	5,203,071	5,370,697
Multiple	3	2	2	2	2

3. Second, OPUCN has invested a significant amount of time, and energy responding the Board's Renewed Regulatory Framework for Electricity Distributors policy *(RRFE)*. In particular, OPUCN has conducted internal, and commissioned external, benchmarking of its rate proposal, and has investigated and proposed implementation of two innovative incentive mechanisms to share risks and rewards with its customers.

4. The result is the 5 year Custom IR rate setting proposal evidenced in this application, which has been subject to comprehensive external and internal benchmarking, and which includes a number of thoughtfully interrelated components.

How OPUCN Got Here

5. In May, 2011, Oshawa PUC Networks Inc. (OPUCN) filed an application for rate rebasing, for rates effective January 1, 2012. That application [EB-2011-0073] was the subject of a settlement agreement, which the Board approved. OPUCN then commenced annual rate adjustments (for 2013 and 2014) under 3rd Generation IR.

6. In 2012, 2013 and 2014, OPUCN continued to significantly invest in non-discretionary System Renewal and System Access facilities. During this period, OPUCN's ROE eroded from 9.3% in 2012 to under 6% (about 300 basis points below the Board approved ROE) in each of 2013 and 2014.[1]

7. On October 18, 2012, the Ontario Energy Board (OEB, or Board) released its report on a *Renewed Regulatory Framework for Electricity Distributors: A Performance-based Approach* (*RRFE Report*). Among other things, the *RRFE Report* provides for a new option for setting distribution rates; Custom IR.

8. July 12, 2013, OPUCN wrote to the Board to advise of its intention to file a Custom IR application, for rates effective January 1, 2015.

[1] December 23, 2014 Letter from Phil Martin to OEB – Request for Interim Rates; Exhibit K1.2, page 5.

9. On December 23, 2014, OPUCN again wrote to the Board, confirming its intention to file a Custom IR application to set rates for each year of a f5 year period commencing January 1, 2015. OPUCN advised the Board of its intention to file its full application prior to the end of January, 2015. OPUCN advised the Board that, despite diligent efforts, the scale and scope of the application, involving 5 test years, preparation of a comprehensive Distribution System Plan, and commissioning of a number of supporting external reviews/reports at the end of 2013 and through 2014, had all resulted in a delay in OPUCN's filing of its Custom IR application. Given its interim earnings erosion, which was expected to continue under its then current rates, OPUCN requested that the Board declare its then current rates interim, pending disposition of its upcoming Custom IR application.

10. The Board issued an Interim Rate Order on December 30, 2014, declaring OPUCN's then current rates interim effective January 1, 2015.

11. On January 29, 2015, OPUCN (through counsel) filed its 2015-2019 Custom IR rate application. This application involves:

    a. comprehensive cost forecasts, cost allocation and rate modelling for 5 test years;

    b. a comprehensive 5 year Distribution System Plan prepared in accord with Chapter 5 of the Board's *Filing Requirements for Transmission and Distribution Applications* (March 28, 2013);

    c. 4 supporting external reviews/reports commissioned at the end of 203 and through 2014 which provide third party review and benchmarking of OPUCN's Capital Investment Plan and OM&A forecasts; and

    d. Two innovative efficiency incentive mechanisms, intended to provide strong incentives for continued efficiencies in both operating costs and capital expenditures.

12. OPUCN has also filed customer survey reports, and an externally prepared lead/lag study, in support of its application.

13. OPUCN presented an overview of its application to the Hearing Panel and interested parties on April 2, 2015.

14. OPUCN has answered in excess of 1,000 questions through the interrogatory process, responded to further questions over a two day Technical Conference, answered 32 Technical Conference transcript undertakings, presented 3 days of oral testimony, answered an additional 21 transcript undertakings resulting from the oral testimony, and filed two comprehensive updates (Exhibit K1.1 in May prior to the Technical Conference, and Exhibit K1.2 in June prior to the oral portion of the hearing).

15. This argument will address the rationale for OPUCN's election of Custom IR to set its rates for 2015 through 2019, and will address the main issues related to OPUCN's application that have emerged during the course of this hearing.

16. This argument is organized in accord with the main topics on the Board Approved Issues List for this proceeding. Not every sub-topic on the Approved Issues List is addressed in this argument. In respect of all of the topics on the Approved Issues List OPUCN relies on the comprehensive record developed in this proceeding in support of its updated requested Revenue Requirement for each of its proposed test years, as set out at Exhibit K4.1. The year over year rate impacts of this request are set out in Exhibit J2.11, Updated, as filed July 8, 2015.

ISSUE 1: CUSTOM APPLICATION

<u>Why Custom IR?</u>

17. The Board's Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach (*RRFE*) provides 3 options for an electricity distributor to set distribution rates.[2] The 3 options are:

    a. *4th Generation IR*, a 4 year price cap mechanism under which a distributor's rates are adjusted annually by a formula which takes into account a cost inflation factor, and a productivity factor (composed of a generic productivity factor and a more utility specific stretch factor).

    b. An *Annual Index*, which is a year to year rate adjustment using essentially the same formula as that used in the 4th Generation IR mechanism, but in all cases applying the highest of the OEB's mandated productivity stretch factors.

    c. *Custom IR*, the specific parameters of which are to be determined on a case by case basis, in accord with considerations outlined in the *RRFE Report*.

18. While the precise nature of a particular Custom IR plan is for determination on a case by case basis, the function of the Custom IR method is clear. Custom IR is intended to address the revenue needs of distributors with significantly large multi-year or highly variable investment commitments that exceed historical levels.[3]

19. OPUCN is faced with significantly large and variable multi-year investment commitments that exceed historical levels.

20. Applying the 4th Generation IRM formula to OPUCN's requested (rebased) 2015 rates would result in the following forecast earnings profile for the years 2016 through 2019[4]:

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[2] *RRFE Report*, page 3.
[3] *RRFE Report*, page 19.
[4] Exhibit J2.8.

Year	ROE Shortfall	Cumulative Income Shortfall (before PILs)
2015	Rebase	Rebase
2016	2.7%	$1,281
2017	2.6%	$2,666
2018	3.6%	$5,146
2019	3.7%	$7,976

21. Under 4th Generation IRM, OPUCN would be expected to earn, on average, 315 basis points below the Board approved return on equity (ROE) in the years 2016 through 2019, to be in an "off ramp" situation by 2018, and to suffer an income shortfall of almost $8 million over the proposed rate plan period.

22. It is important to note that OPUCN has been placed in the OEB's efficiency cohort 2; the second most efficient cohort[5]. It has been evidenced, as discussed below, that OPUCN's proposed revenue requirement over its proposed rate plan term already embeds superior cost efficiencies. It would not be reasonable to expect that OPUCN could appreciably offset the earnings shortfalls indicated above through further efficiencies.

23. For rates to be "just and reasonable" as a matter of law, they must be set in order to permit the rate regulated utility a fair opportunity to earn a "fair return".[6] By definition, setting OPUCN's rates with an expectation that it would earn below the Board mandated ROE, which is the expected result under 4th Generation IRM, would be "unjust", "unreasonable" and unlawful.

24. The Annual Index, as applied to OPUCN, would have a higher "stretch factor", and thus result in lower earnings, than would 4th Generation IR. Accordingly,

[5] In the course of working with Pacific Economics group on benchmarking in support of this application, it was discovered that OPUCN had erroneously recorded and reported one of the efficiency benchmarking inputs; kms of line, for the years 2002 through 2005. The impact of this could have been that OPUCN was placed in efficiency cohort 2, rather than efficiency cohort 3, for the years 2013 and 2014 (though that has not been confirmed). This error would not impact OPUCN's cohort ranking beyond these two test years. PEG has noted that if OPUCN had been placed in this less efficient cohort in one or both of these years, its benchmarking in support of this application would have resulted in even greater efficiency than indicated in the results of PEGs studies. [See Technical Conference Transcript, May 21, 2015, page 60; Exhibit 10.0-Staff-58, part a)]

[6] See, for example, *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009 [EB-2009-0084], Pages 15-18.

applying an Annual Index to set OPUCN's rates would also be expected to result in earnings below the Board mandated ROE, which would be "unjust", "unreasonable" and unlawful.

25. Given its forecast spending requirements, including in particular its forecast capital spending requirements, OPUCN cannot choose either 4th Generation IR or Annual Index rate setting. It must, therefore, choose Custom IR to set its rates from 2015 through 2019.

What is Custom IR?

26. The Board's policy on how Custom IR plans should be structured is set out at pages 18 through 20 of the *RRFE Report*. That policy is as follows:

a. ***Rates are set based on a five year forecast of a distributor's revenue requirement and sales volumes.*** The Board expects that a distributor that applies under this method will file robust evidence of its cost and revenue forecasts over a five year period, as well as detailed infrastructure investment plans over that same time frame.

b. ***The specifics of how the costs approved by the Board will be recovered through rates over the term will be determined in individual rate applications.*** This rate setting method is intended to be customized to fit the specific applicant's circumstances. The exact nature of the rate order that will result may vary from distributor to distributor.

c. ***The allowed rate of change in the rate over the term will be determined on a case-by-case basis.*** That determination will be informed by:

(i) the distributor's forecasts (revenues and costs, including inflation and productivity);

(ii) the Board's inflation and productivity analysis; and

(iii) benchmarking to assess the reasonableness of distributor forecasts.

Expected inflation and productivity gains will be built into the rate adjustment over the term.

d. ***Distributors will be expected to operate under their Board-determined multi-year rates.*** The Board expects a distributor's application under Custom IR to demonstrate its ability to manage within the rates set, given that actual costs and revenues will vary from forecast. There will not be an ICM in the Custom IR method.

e. ***The minimum term will be 5 years.***

27. In the course of this proceeding, it has been suggested that a Custom IR framework is expected to include an index formula (like 4th Generation IR and Annual Index) for adjusting rates. OPUCN submits that the *RRFE Report* should not be read or applied this way.

28. The term "Index" is not used in any part of the description in the *RRFE Report* of the parameters for a Custom IR plan. In contrast, in respect of both the 4th Generation IR and the Annual Index method, the indexing requirements for each of those methods are addressed in detail, including description of what the components of the indexing formula will be, and why.

29. The term "index" is mentioned in only one place in the *RRFE Report* in reference to Custom IR. That is in the table in the report which provides a comparison overview of the 3 rate setting methods.[7] In the "Form" row of the table, the "Custom IR" column uses the term *"Custom Index"*. There is no explanation provided anywhere in the *RRFE Report*, or elsewhere in any Board policy document, which necessitates a restrictive reading of the *RRFE Report* to the effect that *"Custom Index"* is intended by the Board to mean a formula to apply to determine year over year rate changes.

30. A fair read of the *RRFE Report* suggests the contrary:

a. In the *"Role of Benchmarking"* section of the *RRFE Report*, the Board distinguishes rate adjustment mechanisms under the formulaic (4th Generation IR and Annual IR Index) and the Custom IR approaches as follows [emphasis added]:

> *The empirical work on the electricity distribution sector will inform the rate-adjustment mechanisms under 4th Generation IR and the Annual IR Index and will inform <u>the Board's review</u> and approval of*

[7] *RRFE Report*, page 13.

applications under the Custom IR method. Consequently, regardless of the rate-setting plan under which a distributor's rates are set, the distributor will continue to be included in the Board's benchmarking analyses.

b. The approach to year over year rate changes under the Custom IR method are addressed in the *RRFE Report* without reference to an index[8] [emphasis added]:

> *<u>The allowed rate of change in the rate over the term</u> will be determined on a case-by-case basis, informed by empirical evidence including:*
>
> - *the distributor's forecasts (revenues and costs, inflation and productivity);*
> - *the Board's inflation and productivity analysis; and*
> - *benchmarking to assess the reasonableness of distributor forecasts.*
>
> *Expected inflation and productivity gains will be built into the rate adjustment over the term.*

31. OPUCN is not suggesting that a Custom IR framework <u>could</u> not have an index formula to be applied for the purposes of determining annual rate changes during the rate plan term. A Custom IR framework is to be customizable, to suit the specific circumstances of the applying distributor.

32. The Board's direction in respect of determining the allowed rate of change in rates over a Custom IR term is that such rate of change is to be determined in consideration of the distributor's forecasts of revenues, costs, inflation and productivity. This direction is <u>not</u> tantamount to a requirement for an index (which would have been easy enough to say had this been intended as the exclusive approach to Custom IR).

33. Of course, OPUCN could develop a formula to suit its circumstances. A formula can be developed to fit any pattern of change, more or less precisely. However, OPUCN does not believe that it would be appropriate, and it would certainly not

[8] *RRFE Report*, pages 19-20.

be transparent, in the circumstances underlying its Custom IR rate application, to "back into" a formula developed to "fit" (more or less accurately) a pattern of cost and consequent rate change.

34. The pattern of cost and consequent rate change faced by OPUCN in the coming years is dictated by the need to address significantly large multi-year investment commitments that exceed historical levels. That pattern is best addressed by the forecasts, in each proposed test year, which result in the revenue requirement forecast for that year.

35. Of the two Custom IR rate plans that have been approved by the Board to date, one uses a customized formulaic index to adjust rates year over year (Horizon's, which arises from a negotiated settlement), and one does not (Enbridge's).

36. OPUCN has chosen to propose a Custom IR plan that does not use a customized formulaic index, as the more transparent approach to setting rates in its particular circumstances. In support of this choice, OPUCN has provided robust evidence of expected revenues and costs, and benchmarking evidence (internal[9] and external[10]) which demonstrates the efficiencies inherent in OPUCN's proposed Custom IR plan term rates, all as anticipated by the Board's *RRFE Report*.

<u>How OPUCN's Proposed Rate Plan Addresses the *RRFE*</u>

37. OPUCN has put a significant amount of time and effort into considering the Board's requirements for, and its guidance on, the *RRFE* in general, and Custom IR rate plans in particular.[11]

38. A full discussion of the way in which OPUCN's rate plan proposal responds to these requirements and this guidance is set out in Exhibit 1, Tab C, pages 15 through 19.

[9] See paragraphs 70 and 71, below.
[10] See paragraphs 73 to 79, below.
[11] Transcript Volume 1, page 23, lines 2-5; page 148, line 25 to page 150, line 21.

39. OPUCN's proposed rate plan addresses each of the outcomes identified by the Board for the *RRFE*[12]:

a. ***Customer focus, with responsiveness to identified customer preferences*** is reflected in planned distribution system investment in tools to minimize outage response time and duration, which are priorities identified in customer surveys.

b. ***Operational effectiveness and continuous improvement in system and service reliability*** is addressed by system renewal investments to maintain, and improve, system and service reliability.

c. ***Continuous improvement in productivity and cost performance*** is evidenced through external benchmarking provided by;

(i) METSCO Energy Solutions (*Asset Condition Assessment and Asset Management Plan*, including benchmarking of OPUCN's system renewal projects [Exhibit 2, Tab B, Schedule 3; Exhibit 10, Tab C, page 7, Table 6];

(ii) NBM Engineering (cost benchmarking of OPUCN's system renewal plan and MS9 capital investment forecast) [Exhibit 2, Tab B, Schedule 4];

(iii) UtiliWorks financial analysis related to the "smart grid" projects which it recommended (and some of which OPUCN is proposing to implement); and

(iv) Pacific Economics Group (PEG) total cost benchmarking, which demonstrates that OPUCN will remain among the most cost efficient distributors in the province through its 2015-2019 rate plan term [Exhibit 10, Tab A].

d. ***Public policy responsiveness*** is addressed through prioritization of certain "smart grid" projects that will affordably increase efficiencies in OPUCN's distribution system operations[13], lower costs to OPUCN's customers and facilitate quicker outage identification, communication and restoration[14].

e. ***Financial viability*** is the driver for OPUCN seeking rebasing one year early, and proposing a Custom IR rate plan.

[12] *RRFE Report*, page 19.
[13] Transcript Volume 1, page 15, lines 9 *et seq.*
[14] Exhibit 2, Tab B, pages 70-71; page 90, Table 41, rows 11-15.

f. ***Sustained operational savings*** are embedded in OPUCN's proposed rates, as demonstrated by both external benchmarking (by PEG) and OPUCN's own statistical analysis[15]. OPUCN has also proposed two innovative incentive mechanisms - an efficiency carryover incentive mechanism (under which OPUCN has agreed to assume the onus for demonstrating sustainable efficiencies in order to benefit from that incentive[16]) and a capital investment incentive mechanism - to further encourage efficiency in capital spending and resulting long-term sustainable cost savings.

40. In responding to the Board's expectations for Custom IR in particular:

a. OPUCN has proposed a rate smoothing mechanism, having regard to the impact of its capital investment requirements on its customers' bills. This mechanism addresses the specifics of how its costs are appropriately recovered through rates.

b. OPUCN has provided robust evidence of its cost and revenue forecasts for each of the 5 test years in its proposed rate plan, and has subjected its costs forecasts to robust internal (statistical) and external benchmarking.

c. OPUCN has provided a comprehensive, 3rd party, asset condition assessment and asset management plan, and a detailed 5 year capital investment plan directly linked back to its asset condition assessment and management plan.

d. OPUCN has considered the allocation of the risks of a 5 year rate plan, and has proposed a balancing of those risks as between the shareholder and the ratepayer. OPUCN is assuming the risk associated with more than 85% of its revenue requirement[17], and proposes certain pre-defined annual rate adjustments to address risks that OPUCN cannot control and that neither OPUCN nor its customers should appropriately bear.

e. OPUCN has proposed extensive annual reporting[18], including detailed reporting against its Capital Investment Plan, as well as a set of specific reliability and customer service quality metrics[19].

f. In addition to the productivity built into the rate adjustment over the course of OPUCN's proposed rate plan period, OPUCN has proposed two

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[15] See paragraphs 70-76, below.
[16] Exhibit K1.2, June 2015 evidence update.
[17] Exhibit TC1.2; Exhibit J2.1.
[18] Exhibit 10, Tab F.
[19] Exhibit J1.3.

innovative incentive mechanisms, both of which as now presented[20] focus on achieving long term benefits for ratepayers.

41. The Board has recently stated [the Hydro One decision; EB-2013-0416, at page 14] that incentive rate setting differs from cost of service-rate setting in that it relies less on a utility's internal cost, output and service quality to establish rates, and more on benchmarks of cost, output, and service quality that are external to the utility revealing superior performance and encouraging best practice, all of which permits of an "outcomes based approach" to regulation.

42. OPUCN has presented evidence and proposed a rate plan that supports an "outcomes based approach" to setting its rates for the period 2015 through 2019 by:

a. presenting robust external benchmarking of its costs and productivity gains (the PEG study[21], the Metsco study[22], and the NBM Engineering study[23]), which illustrate that its requested revenue requirement reflects continuing superior productivity and cost efficiency;

b. presenting further internally generated statistical illustration of its forecast of continuing superior cost and productivity performance relative to its peers[24];

c. presenting a comprehensive Distribution System Plan and related Capital Investment Plan[25], reflected in its proposed revenue requirement, against which its plan period performance will be reported and tracked;

d. accepting further performance metrics to satisfy the Board that its plan period investments achieve its stated reliability and service quality goals[26], delivering "value for money";

e. proposing two innovative incentive mechanisms, in response to the Board's stated interest in mechanisms which support long-term

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[20] In respect of the proposed Total Cost Efficiency Carryover Mechanism (TCECM), OPUCN has agreed (see Exhibit K1.2, June 2015 Update) to assume an onus to demonstrate savings from sustainable efficiencies in order to qualify for an incentive payment.
[21] Exhibit 10, Tab A.
[22] Exhibit 2, Tab 3.
[23] Exhibit 10, Tab B.
[24] See paragraphs 70-71, below.
[25] Exhibit 2, Tab B and Exhibit 10, Tab E.
[26] Exhibit J1.3.

productivity improvements and encourage innovation and asset optimization[27]; and

f. committing to live within the rates approved in this proceeding for 5 years commencing in 2015, subject to certain pre-defined adjustments to fairly allocate uncontrollable risks as between the shareholder and ratepayers.

43. In doing so, OPUCN has addressed all of the essential elements and intentions of the *RRFE* in general, and of the Custom IR rate setting option in particular.

Description, and Rationale For Elements, of the Proposed Plan

44. An overview of the elements of OPUCN's Custom IR proposal is provided at Exhibit 1, Tab C, pages 8 through 11.

Cost of Service Based Rates

45. As contemplated by the Board's *RRFE* policy, OPUCN has proposed rates for the 2015-2019 plan period based on a five year forecast of revenue requirement and sales volumes, and has filed comprehensive evidence of its cost and revenue forecasts for the five year period.

46. In June, 2015 OPUCN updated its load forecast, reducing forecast growth and associated customer connection activities for 2015[28]. Based on year to date results through May 31st, OPUCN is forecasting a 1.5% customer growth rate for 2015. The growth forecast for the balance of the rate plan period has remained at 3%, in light of continued indicators from the City of Oshawa, the Region of Durham and local developers for rapid growth through 2019.

47. The updated rate impacts by customer class of OPUCN's forecast revenue requirement are provided at Updated Exhibit J1.2, page 4, "Table 20".

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[27] EB-2012-0459, *Decision with Reasons*, July 17, 2014, pages 16 and 17; *RRFE Report* page 61.
[28] Exhibit K1.2.

Rate Smoothing Overlay

48. Starting with rates calculated on the basis of forecast revenue requirements, OPUCN then considered that Custom IR provides flexibility in determining *"the specifics of how costs approved by the Board will be recovered through rates"*[29]. The Board has indicated that the extended (minimum 5 year) term of a Custom IR Plan is intended, *inter alia*, to *"help to manage the pace of rate increases for customers through adjustments calculated to smooth the impact of forecasted expenditures"*[30].

49. Recognizing that the increase in rates arising from 2015 rate rebasing is particularly marked, OPUCN has proposed to smooth the impact of this increase through the rate plan period. OPUCN proposes to defer portions of the increase in rates from 2014 to 2015 required to restore OPUCN's earnings position, and recovery the deferred amounts over the balance of the rate plan period. OPUCN proposes to use rate riders to smooth this rate increase, rather than adjusting rates *per se*, in order to allow for continued use by OPUCN of the Bard's rate filing models and a separate and transparent overlay of the rate smoothing adjustments proposed. The rate smoothing proposal is detailed at Exhibit 8. The rate impact of the proposed smoothing is presented in Updated Exhibit J1.2, page 4, Table 21.

50. OPUCN has requested a Rate Smoothing Deferral Account to capture the timing impacts of the proposed 2015 revenue requirement deferral.[31] It is important to note that this rate smoothing proposal entails no net "costs" to customers. While OPUCN proposes that the deferred portion of the 2015 revenue requirement would attract carrying costs, deferring recovery of this revenue requirement reduces near term costs to ratepayers. This "time value of money" mechanism keeps OPUCN whole, but does not entail a net cost to consumers.

[29] *RRFE Report*, page 18, bottom.
[30] *RRFE Report*, page 19, 2nd full paragraph.
[31] Exhibit 1, Tab C, page 39.

Annual Adjustments

51. The Board expects a distributor applying for Custom IR to demonstrate its ability to manage within the rates set. A *quid pro quo* for having rates set, in advance, for 5 years is a willingness to manage within those rates.

52. OPUCN accepts that proposition, and has proposed a rate plan that puts it at risk for in excess of 85% of its revenue requirement over the plan term.[32]

53. OPUCN has proposed annual rate adjustments for 3 factors. These proposed annual adjustments are intended to protect both its shareholder and its ratepayers from external, uncontrollable risks. These risks are:

    a. load growth being slower (or, though unlikely, faster) than forecast;

    b. changes in the Board's cost of capital parameters; and

    c. changes in the cost of power, insofar as those costs affect working capital.

54. OPUCN's load growth forecast presents particular risks, for both the shareholder and ratepayers.

55. With its updated evidence[33], OPUCN has forecast annual load growth at 3% for the period from 2016 through 2019 (having adjusted growth in 2015 from the initially forecast 3% to the now observed 1.5%). This forecast is based on information from the City of Oshawa, the Region of Durham, and local developers who are planning significant residential and commercial development, particularly in the north end of the City of Oshawa.

56. This pace of load growth is aggressive (though, using its judgement, OPUCN has forecast 3% growth, rather than the 4% or 5% which would be indicated by

[32] Exhibit TC1.2; Exhibit J2.1.
[33] Exhibit K1.2.

strictly applying the information which it has obtained from the City, the Region and developers[34]).

57. Both the shareholder and ratepayers are at risk should load not materialize at the rate forecast. If growth is slower than forecast;

a. OPUCN would suffer a revenue shortfall based on rates which are set on the basis of a higher customer connections and volumes than will be realized in the period; and

b. ratepayers would have paid for net new connection costs not ultimately incurred by OPUCN.

58. Overpaid net new connection costs would not fully offset the revenue shortfall to OPUCN.[35] OPUCN is already a highly efficient distributor, and has embedded further efficiencies in its proposed rates. Revenue deficiencies resulting from reduced revenue from slower than forecast growth could not be offset by OPUCN through yet further efficiencies.

59. OPUCN has proposed to manage the unpredictability, and uncontrollability, of Oshawa area development and associated electrical load forecast by:

a. Annually updating its load forecast and adjusting rates, prospectively, for updated customer growth expectations, including updated forecast net new connection costs; and

b. a Net New Connection Cost Variance Account to capture unspent connection costs for return to ratepayers. (This variance treatment is proposed to be symmetrical, but OPUCN believes that the risk of slower than forecast growth is greater than the risk of higher than forecast growth.)

60. OPUCN would still carry the revenue risk of its load forecast within each test year, but through an annual adjustment mechanism OPUCN would avoid a significant and extended (5 year cumulative) revenue shortfall risk.

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[34] Transcript Volume 2, page 55, lines 5-24; Transcript Volume 3, page 119, line 26 - page 120, line 26.
[35] The adjustments to net new connection costs set out at Exhibit J2.4 page 6, in the range of $370,000 per year, would have a revenue requirement impact of approximately $80,000. The revenue shortfall for 1.5% vs. 3% growth would approximate $220,000 (approximately 780 customers @ approximately $280 each), for a net revenue shortfall of approximately $140,000 per year.

61. Second, OPUCN has proposed an annual adjustment to rates based on updated OEB published cost of capital parameters. This mechanism has been approved by the board in both the Enbridge Gas Distribution and Horizon Custom IR plans. It neutralizes risks regarding long term interest rate predictions that should not be borne by either the utility shareholder or ratepayers.

62. Third, OPUCN has proposed an annual rate adjustment for the working capital impacts of the cost of power. As with interest rates (i.e. cost of capital), OPUCN does not believe that either its shareholder or its customers should bear the risk of highly unpredictable Ontario power prices. (In requesting this annual adjustment, OPUCN has assumed a flat cost of power in the representative rates filed in support of its application.)

63. OPUCN has also proposed two one time adjustments to its pre-approved Custom IR plan rates:

a. an adjustment for final regional planning related capital costs (including contributions to Hydro One regional reinforcement costs); and

b. an end of term true up for variances in costs for plant relocations driven by third party requests.

Both of these cost categories are completely beyond OPUCN's control, and OPUCN does not believe that either its shareholder or its ratepayers should bear these cost risks.

64. The Board's direction is that in exchange for the certainty of having rates set in advance for 5 years, a distributor should commit to operating within those rates and managing its risks.[36] As noted above, OPUCN has adopted this proposition in respect of approximately 85% of its revenue requirement during the 2015 – 2019 period.

65. However, OPUCN does not believe that the Board's *RRFE* policy is intended to fix distributors, or ratepayers, with risks for material costs that cannot be

[36] EB-2012-0459, EGD 2014-2018 Rate Application, page 38.

predicted or controlled by the distributor. There is no incentive or equity rationale for such a proposition. Further, such an approach would ignore the legal responsibility of an economic regulator to set rates that allow the regulated utility a reasonable opportunity to earn a fair return on invested capital.

66. OPUCN believes that the 3 annual adjustments and 2 one time reconciliations that it has proposed provide an appropriate risk/reward allocation as between OPUCN's shareholder and ratepayers, as intended by the Board.

Incentives for Continuous Improvement

67. As noted above, the Board's *RRFE* policy focuses on an "outcomes based approach" to regulation.

68. 4th Generation IR and Annual Index rate setting both embed productivity factors to ensure that distributors are delivering "value for money" to ratepayers.

69. In its Custom IR proposal, OPUCN has addressed the "value for money" regulatory objective through;

   a. evidencing, through robust external and internal benchmarking, that its proposed plan period revenue requirement already embeds superior, and improving, cost and operational efficiency; and

   b. proposing two additional mechanisms to incent continuous improvement.

70. OPUCN's own statistical analysis[37] demonstrates that, among comparable Ontario LDCs:

   a. OPUCN currently has the lowest residential rates;

   b. OPUCN currently has among the lowest net OM&A per customer;

   c. OPUCN has the lowest net fixed assets per customer; and

   d. OPUCN has the highest customer per FTE ratio[38].

[37] Exhibit 1.0-Staff-1, pages 5-6; Exhibit 10, Tab C, pages 2 – 4 and 8-10.
[38] Exhibit 1, Tab C, page 33.

That is, OPUCN is already highly efficient, relative to its peers.

71. Considering its forecast costs, OPUCN also presented an analysis which demonstrates that it will remain highly efficient through, and at the end of, the proposed rate plan term[39]:

a. OPUCN's forecast 2019 OM&A per customer remains unchanged from its 2013 level;

b. OPUCN's forecast 2019 net fixed assets per customer remains lower than average comparable LDCs for 2013.

c. OPUCN's distribution revenue per customer is increasing over the plan period at just over half the rate of increase in OPUCN's overall revenue requirement over the period (2.5% compared to 4.7%)[40];

d. OPUCN's forecast OM&A cost increase is being held at approximately 2% per year, below the Conference Board of Canada inflation forecasts for the City of Oshawa, and in the face of a customer growth forecast of 3% per year[41];

e. FTE's at the end of the rate plan period are to be maintained at today's level, which in the face of forecast customer growth represents the avoidance of 6 FTEs[42].

72. These analyses demonstrate not only current superior efficiency and productivity, but efficiency and productivity that improves over the proposed rate plan term.

73. Heeding the Board's direction for external cost benchmarking, and the Board's preference for total factor productivity benchmarking, OPUCN retained Pacific Economics Group Research LLC (PEG) appraise OPUCN's forecasted total cost for the proposed rate plan term, using the Board's total factor productivity econometric benchmarking methodology.[43]

[39] Exhibit 1.0-Staff-1, pages 5-6; Exhibit 10, Tab C, pages 2-5 and 8–10.
[40] Exhibit 1, Tab C, page 22.
[41] Exhibit 1, Tab C, page 32.
[42] Exhibit 1, Tab C, page 33.
[43] Exhibit 10, Tab A.

74. PEG's analysis determined that OM&A and total factor productivity trends for OPUCN during the plan term are well above the average historical trends for Ontario electricity distributors [PEG Report, page 16]:

	OPUCN	**Ontario Distributor Averages**	
	2015-2019	**2003-2011**	**2003-2012**
OM&A	2.17%	0.51%	-0.40%
Capital	0.12%	0.01%	-0.26%
Total Factor	0.87%	0.19%	-0.33%

75. PEG's analysis also determined that OM&A and total factor productivity trends for OPUCN increase over the plan term [PEG Report, page 18]:

Year	**OM&A Productivity**	**Capital Productivity**	**Total Productivity**
2015	-2.0%	-3.4%	-2.9%
2016	1.1%	0.4%	0.6%
2017	3.2%	0.7%	1.6%
2018	3.7%	0.9%	1.9%
2019	4.9%	2.0%	3.0%

76. Board Staff submitted an interrogatory which requested a calculation of the "stretch factor" implicit in the productivity and efficiency embedded in OPUCN's cost forecasts for the period 2015 through 2019. PEG's analysis indicated an implicit stretch factor of 0.87%, which exceeds the default IRM methodology stretch factor by 0.66%.[44] PEG concluded in its interrogatory response that:

> *OPUCN's custom IR proposal uses rigorous external cost and productivity benchmarking to show that the cost forecasts offer customer good value and the prospect of continuous efficiency improvement*
>
> *....*
>
> *The Board can thus be satisfied that OPUCN's "utility performance" under the Custom IR rates proposed will continue to reflect strong cost efficiencies and quantifiable value to OPUCN's customers.*

77. NBM Engineering was retained to benchmark OPUCN's proposed capital investment associated with its system renewal program and its MS9 distribution

[44] Exhibit 10.0-Staff-44

station project.[45] NBM was not provided with OPUCN's cost forecasts, but rather was asked to develop its own cost forecasts independently, based on project descriptions provided by OPUCN.

78. Table 16 in OPUCN's *Distribution System Plan*[46] summarizes the benchmarking results. OPUCN's forecast project costs are lower than NBM's benchmark costs.

79. METSCO also produced a summary costing for the capital investments identified in the METSCO *Asset Condition Assessment Report and Asset Management Plan* for sustainment of OPUCN's fixed assets.[47] Again, comparison of OPUCN's proposed costs for the benchmarked projects indicates that OPUCN's forecast project costs are lower than METSCO's benchmark costs.[48]

80. In the result, the statistical analysis presented by OPUCN, and 3 external benchmarking studies, all demonstrates that the revenue requirement requested by OPUCN over the period 2015 through 2019, and the resulting Custom IR rates proposed, *"will continue to reflect strong cost efficiencies and quantifiable value to OPUCN's customers"*.

81. This conclusion supports the "outcomes based regulation" which is the principal underlying the Board's *RRFE* policy.

82. In addition to comprehensive benchmarking of its forecast costs which demonstrates that its proposed revenue requirement embeds superior and improving cost efficiency and productivity outcomes during the rate plan term, OPUCN is proposing two unique incentive mechanisms to encourage continuous improvement.

83. These proposed incentive mechanisms build on the incentive already inherent in a multi–year rate plan, which sets rates for the duration of the plan term and

[45] Exhibit 10, Tab B; Exhibit 10, Tab C, pages 4-6.
[46] Exhibit 2, Tab B, page 40.
[47] Exhibit 2, Tab B, Schedule 3, page 4.
[48] Exhibit 2, Tab B, page 41; Exhibit 10, Tab C, pages 7-8.

allows any incremental plan term efficiencies to accrue to the utility during the plan term.

84. The proposed mechanisms provide for the sharing between the utility and its customers of the benefits from sustainable O&M and, in particular, capital investment efficiencies and innovations that last longer than the 5 year term of a rate plan period, further supporting the “outcomes based regulation” approach underlying the *RRFE*.

85. OPUCN’s proposed Total Cost Efficiency Carryover Mechanism (TCECM) is detailed at Exhibit 10, Tab C, pages 12 through 14. An example of how the mechanism is proposed to work is provided in response to SEC interrogatory 10.0-SEC-46.

86. This is essentially the efficiency incentive mechanism that the Alberta PUC has recently approved for use in that province. By allowing OPUCN to carry over into each of the 2 years following the end of its 2015-2019 Custom IR plan term a portion of the benefits resulting from demonstrably sustainable efficiencies, OPUCN would be further incented to pursue such efficiencies, in particular closer to the end of the plan term (when the benefits that could be realized within the plan term are of a shorter duration).

87. OPUCN’s TCECM would operate by comparing achieved earnings to Board approved earnings during the plan term, and allowing OPUCN an incentive in the two years beyond the end of the plan term equal to half of the percentage by which actual earnings exceed Board approved earnings, to a maximum of 50 basis points, multiplied by its subsequent (2020 and 2021) test year revenue requirements.

88. During the course of the proceeding OPUCN has clarified its proposal as follows:

a. The calculation of actual earnings during the plan term would be weather normalized.[49]

b. Actual ROE would be calculated using standard utility accounting procedures, as detailed in the Board approved settlement in Horizon's recent Custom IR Application [EB-2014-0002].

c. OPUCN would accept the onus, and risk, to demonstrate that the efficiencies implemented, and the resulting savings claimed for credit under this incentive mechanism, provide sustainable value to customers beyond the end of the plan term.[50]

89. OPUCN continues to believe that its 5 year TCECM provides a stronger efficiency incentive than would limiting application of a carryover incentive to efficiencies realized in only the last the last 2 years of the proposed rate plan. However, should this prove to be more palatable to the Board, OPUCN agrees that this would still be a step forward in electricity regulation in Ontario.

90. OPUCN has also proposed an innovative Controllable Capital Investment Efficiency Incentive Mechanism (CCIEIM), modelled on an analogous approach to incent sustained capital cost reductions adopted by Office of Gas & Electricity Markets (Ofgem) in the UK. The proposed CCIEIM is detailed at Exhibit 10, Tab C, pages 15 through 19. An example of how the mechanism is proposed to work is provided in response to SEC interrogatory 10.0-SEC-47.

91. Under the proposed CCIEIM, OPUCN would be incented to find further efficiencies in rate base investments, where it can, by being allowed to earn back some portion (50%) of the return on the avoided rate base. Should further capital investment efficiencies be successfully incented, ratepayers enjoy 50% of the benefit, through a permanent reduction in rate base.

92. OPUCN has proposed to limit application of the CCIEIM to two well defined and readily monitored capital investment programs; its system renewal program (forecast at a capital cost over the rate plan term of $23.9 million) and its MS9 Distribution Station program (forecast at a capital cost over the rate plan term of

[49] Exhibit J1.4.
[50] Exhibit K1.2.

$16 million).[51] A proposed variance account would be used to track the difference between the costs embedded in approved rates for each of these investment programs and the costs actually incurred in carrying out the programs.

93. In proposing this incentive mechanism, OPUCN has accepted the onus to demonstrate that it has achieved the outcomes for the included projects, as detailed in its Distribution System Plan. Any deferred or otherwise not completed projects would be removed from the incentive calculation.

94. These two incentive mechanism proposals further respond to the Board's *RRFE* objective of incenting continuous cost efficiency and productivity improvements. As stated by OPUCN's President, Mr. Mahajan, in testimony[52], OPUCN invested the time and effort to develop and propose these two innovative incentive mechanisms in response to the Board's openness, as expressly stated in the *RRFE*, to consider efficiency carryover mechanisms and to develop incentives to encourage asset optimization and innovation.[53]

95. It has been noted in the course of this proceeding that OPUCN has <u>not</u> proposed an in year earnings sharing mechanism (ESM) for each year of its proposed plan term, such as has been adopted by the Board for EGD and Horizon in their respective Custom IR rate plans. There are a number of reasons for this[54]:

a. One of the functions of an ESM is to protect ratepayers from windfall utility earnings resulting from inflated cost forecasts or overly conservative load forecasts. OPUCN has provided comprehensive, robust and determinative cost benchmarking (internal and external) to demonstrate that its cost forecasts are anything but inflated. OPUCN's high growth load forecast presents more risk to OPUCN than it does to ratepayers.

b. ESMs blunt in period efficiency incentives, since to the extent that the utility does realize legitimate efficiencies during the plan term, it benefits from only a portion of those efficiencies.

[51] Exhibit J2.3.
[52] Transcript Volume 1, page 19, line 24, *et seq.*
[53] *RRFE Report*, page 61.
[54] Exhibit J2.4, page 2.

c. Rather, to incent efficiencies during the plan term, OPUCN has been instructed by the ECM approved in Alberta, and has proposed its TCECM, which has the advantage of incenting in period efficiencies without blunting the efficiency drivers that commend incentive regulation to begin with.

96. OPUCN can certainly operate with an ESM such as that adopted for EGD and Horizon. However, OPUCN believes that its proposed TCECM, combined with robust internal and external benchmarking of its costs, its aggressive load forecast, and the natural incentives embedded in incentive regulation to begin with, present a superior incentive "package" than would an ESM. OPUCN believes that, in the long run, its proposals better reward efficiencies realized, and offers superior benefits to both the shareholder and ratepayers.

Reporting & Evaluation

97. Exhibit 10, Tab E, details OPUCN's proposed annual reporting during the course of the requested Custom IR rate plan term. OPUCN would:

a. File load forecast related information (customer numbers, annual consumption, annual load), in support of its proposed annual rate adjustment for an updated load forecast.

b. Provide evidence regarding the progress of its system renewal capital investment program and its MS9 investment program, in support of its proposed CCIEIM.

c. File program level capital spending updates in accord with the Board directed investment categories underpinning OPUCN's comprehensive distribution system plan (i.e. system access, system renewal, system service and general plant), comparing actual to forecast spending in these investment categories and addressing the reasons for any material variance.

d. File in it annual rate adjustment application the information included in its RRR filings (as listed in the evidence).

e. File additional utility accounting information as agreed to by parties in the most recently approved Union Gas Limited and Enbridge Gas Distribution 5 year rate plan proceedings (as listed in OPUCN's evidence).

98. OPUCN has now also proposed metrics against which it is prepared to be evaluated during the course of its proposed Custom IR plan term.[55]

99. OPUCN has identified the two primary causes of historic system outages to be failure of porcelain insulator equipment and foreign interference (animal contact). Commencing in 2011 OPUCN instituted a program to replace porcelain insulators and install animal guards in certain portions of its system. This program has been effective in reducing outages from these two causes. However, these two issues remain the primary drivers of OPUCN's system outages.[56]

100. During its system renewal activities, planned on the basis of its Asset Condition Assessment and resulting Capital Investment Plan, OPUCN will include replacement of porcelain insulators and installation of animal guards in its system renewal work[57]. Thus further reduction in these outage causes should demonstrate the progress, and effectiveness, of OPUCN's system renewal program. This program represents approximately 50% ($12.5 million) of OPUCN's Capital Investment Plan during the proposed Custom IR plan period[58].

101. OPUCN also expects to be evaluated on the basis of its progress on other aspects of its Distribution System Plan and resulting Capital Investment Program. To support the tracking of OPUCN's execution of its Distribution System Plan, OPUCN has provided capital expenditure details, on a project by project basis, by investment category, at Exhibit 2, Tab B, Schedule 7, and Attachments A through I thereto.

102. OPUCN has proposed further evaluation during its Custom IR plan term of its continued operations and service quality. OPUCN has committed to maintaining both its current reported performance on each of the OEB Scorecard metrics,

[55] Exhibit J1.3.
[56] Transcript Volume 2, page 99, lines 9 *et seq.*; Exhibit 2, Tab B, page 29, Figure 5.
[57] Transcript Volume 3, page 162, lines 16-27.
[58] Transcript Volume 3, page 150, lines 17 *et seq.*

and maintaining OEB service quality requirements (SQRs) at least at the level achieved in 2014.

103. In support of these proposed metrics, OPUCN would file annually:

a. System outage data related to the two outage cause codes; Equipment Failures and Foreign Interference Outages.

b. Its reported OEB scorecard performance.

c. Its OEB service quality requirement (SQR) data.

Conclusion: Custom Application

104. OPUCN submits that it has produced a thoughtful, well developed and comprehensively evidenced Custom IR rate plan proposal. OPUCN has taken the time, and put in significant effort, to understand and respond to all of the elements of the Board's *RRFE*, and in particular of the Board's Custom IR rate setting mechanism, as articulated in the *RRFE Report* and the Custom IR application decisions issued by the Board to date.

105. OPUCN has presented comprehensive external benchmarking of its proposed costs, to demonstrate continuing and improving efficiencies over the plan term. OPUCN has also researched and developed proposals for 2 innovative incentive mechanisms focussing on longer term sustainable efficiencies which provide benefits for customers, beyond the end of the current rate plan term.

106. OPUCN asks that the Board consider this effort, and the resulting Custom IR proposal, in its entirety. As related in testimony, the proposal has been designed as a "package" of interrelated elements.

107. OPUCN believes that, in its totality, the Custom IR proposal presented in this application presents innovative steps forward to "outcome based regulation" of Ontario's electricity distribution sector, strikes an appropriate risk/reward balance between its shareholder and its customers, and provides benefits and value to both.

ISSUE 2: DISTRIBUTION SYSTEM PLAN AND CAPITAL EXPENDITURES

Distribution System Plan

108. In support of its Custom IR proposal, OPUCN has prepared and filed a comprehensive, robust, Distribution System Plan (DS Plan).[59]

109. The DS Plan presents OPUCN's capital investment plan for the Bridge Year 2014, and the test years 2015 through 2019. It also provides historical actual capital expenditures for the years 2010 through 2013 and the Bridge Year (2014), all as required by Chapter 5 of the Board's *Filing Requirements for Electricity Transmission and Distribution Applications* (March 28, 2013).

110. As this is OPUCN's first DS Plan, instead of providing information on OPUCN's performance in relation to previous operational or other objectives, the DS Plan reviews OPUCN's investment history and documents the impacts of this historical investment program on the current and planned asset management and investment strategy.

111. The DS Plan also documents OPUCN's asset management program, including the approach used by OPUCN to collect, tabulate, and assess information on physical assets, current and future system operating conditions, business needs and customer feedback, and explains how this information is used to plan, prioritize and optimize capital expenditures.

112. At Exhibit 2, Tab B, Schedule 5, OPUCN has set out the results of application of its Asset Investment Prioritization Tool (AIP), which was applied to the 103 projects identified in the Asset Condition Assessment and Asset Management Plan prepared by Metsco Energy Solutions [Exhibit2, Tab B, Schedule 3]. The AIP and its application are described at Exhibit 2, Tab B, pages 47-48.

113. Application of the AIP identified 1 "critical" project, 11 "very high priority" projects, and 89 "high priority projects". OPUCN has planned to implement all of these

[59] Exhibit 2, Tab B.

projects, in order to maintain reliable operation of its distribution system and its ability to serve its customers. There are 3 additional projects which, while of a “moderate” priority from an asset condition perspective, are required to meet OEB Long Term Load Transfer elimination direction or, in the case of the smart grid pilot, a Ministry of Energy mandate (thus addressing the “responsive to public policy” imperative for Custom IR plans pursuant to the *RRFE*).

114. The DS Plan also illustrates how OPUCN has met the OEB’s expectations for electricity distributor planning, as articulated in the *RRFE Report*. The DS Plan addresses:

a. Regional system planning considerations: The evidence describes OPUCN’s participation in regional planning discussions, to address anticipated transmission and capacity constraints in the GTA East Region and the interim and longer term solutions discussed. Regional planning related investments are a major component of OPUCN’s Capital Investment Plan during the proposed rate plan term.

b. Public policy goals: OPUCN engaged a third party consultant – UtiliWorks – to assess OPUCN’s present grid status and develop a *Smart Grid Roadmap and Financial Analysis* [Exhibit 2, Tab B, Schedule 4]. OPUCN has proposed a measured implementation of the results of that analysis through distribution system automation projects and development of an intelligent communication network to reduce distribution costs and outage occurrence and duration.[60]

c. Delivery of “value for money”: OPUCN’s System Renewal and System Service capital programs ensure the continued ability to reliably serve both present and future customers. OPUCN’s “smarter grid” and Outage Management System (OMS) proposals are supported by customer expressed preferences for reliability, power quality and outage restoration timing.

d. Benchmarking for reasonableness: OPUCN’s DS Plan is informed and supported by 4 external studies:

(i) Metsco Energy Solutions’ *Asset Condition Assessment Report and Asset Management Plan*, which documents the status of OPUCN’s distribution infrastructure and identifies critical and high priority asset investment requirements. [Exhibit 2, Tab B, Schedule 3]

[60] Exhibit 2, Tab B, pages 70-71; page 90, Table 41, rows 11-15.

(ii) NBM Engineering Inc.'s independent costing of OPUCN's proposed System Renewal Plan. [Exhibit 10, Tab B]

(iii) UtilityPULSE reports on customer surveys, the feedback from which supports OPUCN's proposal to invest in a "smarter" grid and Outage Management System and related system enhancements. [Exhibit 1, Tab D, Schedules 1 and 2]

(iv) The UtiliWorks *Smart Grid Roadmap and Financial Analysis* informing OPUCN's measured plan for a "smarter", more operationally efficient and effective grid. [Exhibit 2, Tab B, Schedule 4]

115. Based on the comprehensive evidence and analysis filed, OPUCN is requesting approval by the Board of the prudence of the Capital Investment Plan and associated budgets for the proposed rate plan period through 2019.

116. OPUCN submits that the effect of such approval now is that expenditures up to the requested budget levels would be accepted as prudent, and included in rate base when OPUCN commences its new rate-setting cycle (subject to proof that the expenditures were in fact made and the related projects were in fact completed and put into service). This position is supported by the discussion at page 20 of the *RRFE Report*. OPUCN expects that capital spending in excess of the amounts approved in this application would be subject to prudence review at the time of OPUCN's next cost of service application.

117. As part of its capital budget approval, OPUCN requests approval of the working capital proposal supported by the Lead/Lag Study prepared by Ernst & Young [Exhibit 2, Tab A, Schedule1], with the adjustments accepted by OPUCN and summarized in Exhibit J1.1, page 2. These adjustments arise from the very thorough (and very helpful) review of the lead/lag analysis undertaken by Mr. Aiken on behalf of Energy Probe, and results in an updated working capital allowance percentage of 10.02%.[61]

[61] Transcript Volume 4, page 3, lines 14-25.

118. OPUCN is also requesting that the Board approve for inclusion in its rate base the costs of capital contributions made to Hydro One on account of regional planning investments, at the time that those contributions are made.

119. OPUCN is aware that in the April 2, 2013 *Partial Decision and Order* in EB-2012-0064, the Hearing Panel determined, in the context of an application for an Incremental Capital Module, that Toronto Hydro's capital contributions in respect of the Bremner Station should be considered an intangible asset to be recognized in rate base when the assets contributed to are put into service.

120. However, OPUCN has also had reference to Article 410 of the Board's Account Procedures Handbook, which states as follows [emphasis added]:

> *Accounting for Contributions in Aid of Construction*
>
> *<u>Contributions paid by a distributor</u>*
>
> *In some cases distributors will incur expenditures for amounts paid to other distributors or transmitters for capital projects (i.e. for transmission upgrades or expansion projects).*
>
> *Distributors who incur such costs, should record the mounts in USoA Account 1609, Intangible Assets – Capital Contributions Paid. Accumulated amortization of intangible assets is recorded in Account 2120, Accumulated Amortization of Electric Utility Plant – Intangibles, and amortization expenses in account 5715, Amortization of Intangibles and other Electric Plant. <u>These amounts will typically be included in rate base at the next cost of service application</u>.*

No reference is made in the above excerpt to the consideration of whether the asset with respect to which capital contributions are required has been put into service.

121. Once OPUCN has made the capital contributions required by Hydro One, the execution of the related transmission project is out of OPUCN's control, though its capital will have been committed. OPUCN will have done everything that it can do. In the aforementioned Toronto Hydro decision, in considering that the "in

service" approach for rate basing capital could be more usefully referred to as the "used or useful" approach, the Hearing Panel stated[62]:

> *...in some cases, it may be that THESL's work has been completed on a project, but it is not yet "in service" as work which is the responsibility of other parties has not been completed. In these circumstances, the Board finds that THESL may consider the work to be completed and hence "useful", even if it is not yet being "used".*

122. OPUCN acknowledges that in the foregoing excerpt, the Hearing Panel was referring to work by THESL on THESL's assets, which were not yet in service because work on another party's related assets had yet to be completed.

123. In its proposed treatment of the requisite Hydro One regional planning contributions, OPUCN has followed its understanding of Article 410 of the Board's Accounting Procedures Handbook, as excerpted above. While OPUCN believes that this approach is appropriate, it will of course take the Board's guidance on the appropriate treatment of these amounts.

[62] EB-2012-0064, *Partial Decision and Order*, April 2, 2013, page 13, top.

ISSUE 3: OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS

124. OPUCN's planned level of OM&A expenditures for the 2015-2019 period is evidenced at Exhibit 4.

125. As discussed above, OPUCN's proposed OM&A budget has been demonstrated, through both internal statistical analysis and PEG's external benchmarking, to be appropriate, reflecting continued and improving efficiencies over the rate plan period.

126. OPUCN requests approval of its planned OM&A expenditures as updated (June, 2015, Exhibit K1.2).

ISSUE 4: FORECASTS

127. OPUCN has corrected its calculations of forecast "Other Revenue" at Exhibit J3.2, and the resulting reductions in other revenue forecast have been incorporated in the updated rate impacts provided in Exhibit J2.11, Correct (as filed July 8, 2015).

128. The main issue that has arisen during the course of this proceeding in respect of OPUCN's forecasts are related to its customer growth rate forecast.

129. OPUCN initially forecast an average customer growth rate over the proposed rate plan term of 3%. This growth rate is about twice the historical growth rate observed by OPUCN of approximately 1.4%. The drivers for the higher rate of customer growth forecast by OPUCN are summarized at Exhibit 1, Tab C, pages 4-5 and 24-27, and further discussed Exhibit 2, Tab B, pages 6-8.

130. In June, 2015, OPUCN updated its load forecast (Exhibit K1.2), reducing its forecast load growth for 2015 to 1.5%, based on year to date experience. However, the growth forecast for 2016 through 2019 has been maintained at 3%, for the reasons discussed in the evidence noted in the preceding paragraph and in oral testimony.

131. During examination by Board Staff, OPUCN was asked whether this updated forecast remained OPUCN's "best" forecast should the Board not allow annual updates as proposed by OPUCN. OPUCN's Mr. Martin answered "no". The reasons for that response were subsequently articulated by Mr. Martin,[63] and are further discussed in Exhibit J2.4 Page 5.

In summary, it is important to understand the risks inherent in a load forecast as dictated by the aggressive growth aspirations of the City of Oshawa, the Region of Durham, and local developers. Fair consideration of these risks provides

[63] Transcript Volume 2, page 58, lines 6 *et seq.*; page 99, line 13 *et seq.*

context for OPUCN's evidence on what its "best" load forecast is, and explains why the answer to that question must be context specific.

132. As stated in Exhibit J2.4, OPUCN's "best" load forecast remains as it has been updated as of June, 2015; 1.5% in 2015 and 3% per year thereafter for the balance of the plan term. This is the growth rate in 2016 through 2019 that OPUCN expects, based on the best available information from the relevant 3rd parties.

133. There is no mystery, however, to the fact that this aggressive load forecast presents significant risks for OPUCN. As discussed in Exhibit J2.4, while OPUCN is prepared to accept the in year risks of lower than the 3% forecast growth, it cannot afford to accept those risks for all years between now and 2020. This is precisely why OPUCN has proposed to update its load forecast annually, given the circumstances presented in its franchise territory; ambitious external growth plans to which OPUCN is mandated by its distribution licence to respond.

134. As articulated in Exhibit J2.4, should the Board decline to allow in period adjustment of OPUCN's load forecast, the risk posed by the "best", but nonetheless aggressive (on the part of the relevant 3rd parties), 3% growth forecast is more significant than OPUCN is able to accept.

135. It is in this context that OPUCN has indicated that, should no load forecast adjustment be permitted during the rate plan term, OPUCN would revert to a load forecast that more closely aligns to the historically observed rate of load growth in Oshawa; 1.5% per year, for each year of the proposed plan term.

136. In this event, OPUCN would also propose to reduce its forecast net new connection costs (to be in line with the reduced load forecast), as indicated on page 6 of Exhibit J2.4. The consequent reduction in revenue requirement over the plan term would total approximately $400,000.

137. If growth were to end up being higher than this adjusted forecast contemplates, net new connection costs would increase, but could be funded out of incremental revenues resulting from the higher number of customer connections.

138. Revenues above this increased level of net new connection costs under a higher than 1.5% growth scenario would accrue during the plan term to OPUCN's shareholder. This is not a result that OPUCN seeks or endorses.

139. OPUCN addresses the alternative proposal advanced by Board Staff during the oral portion of the hearing – one mid-term adjustment – later in this argument.

ISSUE 5: REVENUE REQUIREMENT

140. The elements of OPUCN's Base Revenue Requirements for 2015 through 2019 are addressed in Exhibit 6, at page 4.

141. OPUCN is not aware of any particular issue related to the accuracy of determination of its base revenue requirements for the proposed test years.

ISSUE 6: DEFERRAL AND VARIANCE ACCOUNTS

142. OPUCN is not seeking to clear, but is proposing to continue, the Group 1 and Group 2 accounts listed in tables 9-2 and 9-3 of Exhibit 9, with the exception of the Special Purpose Charge Variance Account (1521). OPUCN proposes to discontinue the Special Purpose Charge Variance Account, as discussed in Exhibit 9, at page 6.

143. OPUCN is seeking approval to maintain, but is not seeking to clear, the following existing accounts:

a. Tax Rate Changes Deferral Account

b. Pension Cost Differential Deferral Account

144. OPUCN is requesting approval of the following new deferral/variance accounts, all as detailed at Exhibit 1, Tab C:

a. 2015 Revenue Variance Account: in support of OPUCN's proposal for rates to be effective January 1, 2015, to allow for recovery over the balance of the proposed rate plan term of the revenue deficiency from January 2015 through the implementation of the rate order in this application.

b. Unbudgeted Regional Planning Investment Cost Variance Account: to track the variance between forecast and actual costs incurred by OPUCN in respect of regional planning related capital expenditure, for disposition at the end of the rate plan term.

c. Distribution Plant Relocation Cost Variance Account: to track the variance between forecast and actual costs incurred by OPUCN in respect of plant relocation in response to 3rd party requirements, for disposition at the end of the rate plan term.

d. Net New Connection Cost Variance Account: to track the variance between budgeted and actual net new connection costs, for disposition at the end of the rate plan term.

e. Rate Smoothing Deferral Account: in support of implementation by OPUCN of its proposed rate smoothing of 2015 and 2016 rate increases over the entire plan term.

f. CCIEIM Variance Account: to record that portion of the variance in capital cost between forecast and actual costs for execution of its system renewal program and its MS9 program, for disposition at the end of the rate plan term in accord with OPUCN's CCIEIM proposal, as warranted.

145. OPUCN also requests a new Depreciation Expense Deferral Account, which is described at Exhibit 1, Tab C, at pages 41-42. This account arises from the Settlement Agreement approved in OPUCN's 2012 cost of service rate proceeding (EB-2011-0073) and would record the additional depreciation from 2012 through 2014 of approximately $150,000.

146. OPUCN wishes to make two corrections to its evidence in respect of this request.

147. First, OPUCN wishes to clarify that it is seeking to dispose of the balance in this proposed deferral account, in accord with the 2012 settlement agreement. (OPUCN's oral evidence was that it was not seeking to dispose of any of its deferral or variance accounts.)

148. Second, OPUCN has found an error in its evidence in respect of this proposal. The evidence indicates that OPUCN has reduced its 2015 rate base to account for this additional depreciation. That has not in fact been done. OPUCN proposes to make this correction to its 2015 and forward rate base in its Draft Rate Order to be filed following the Board's decision.

ISSUE 7: COST ALLOCATION AND RATE DESIGN

149. OPUCN has allocated its forecast costs among rate classes using the same cost allocation methodology which it used for its 2012 Cost of Service application. No changes to this methodology have been implemented.

150. Small changes observed for OPUCN's revenue to cost ratios[64] are due to the change in customer mix resulting from high forecast residential growth and associated streetlighting connections growth rates.[65]

151. As detailed in Exhibit 8, pages 4-5, OPUCN is proposing to changes its fixed/variable charge proportion for the residential and General Service < 50kw rate classes by increasing the fixed charge in each case to the midpoint of between the current (2014) fixed charge and the ceiling for the fixed charge determined by the updated cost allocation study. The fixed component of OPUCN's charges for these rate classes are proportionately low compared to neighbouring LDCs.

152. On April 2, 2015, subsequent to OPUCN filing its application, the OEB released its Policy *A New Distribution Rate Design for Residential Electricity Customers* [EB-2012-0410], in which the Board indicates that distributors are to move to 100% fixed charges for residential distribution rates. The Board is also reviewing its rate design policy for other customer classes.

153. As indicated during oral testimony, OPUCN maintains its proposal to alter, for the purposes of rates to be approved in this proceeding, the fixed proportion of its residential and GS<50 rates. OPUCN will adopt the Board's new rate design policy when and in the manner directed by the Board, just as will other Ontario electricity distributors, independently of the proposed fixed/variable change for the rates applied for herein.

[64] Exhibit 1, Tab C, page 35, Table 17; Corrected for 2016 and 2017 at Exhibit 7.0-VECC-47.
[65] Exhibit 1, Tab C, page 35.

ISSUE 8: IMPLEMENTATION

Effective Date for Rates

154. OPUCN has filed a comprehensive Custom IR rate application. The Custom IR proposal advanced has been carefully considered, and the supporting documentation has been the product of a significant amount of time and effort. As noted at the outset of this argument, OPUCN has included a number of external studies/reports in support of its application. As also discussed above, OPUCN has carefully considered, and has attempted to respond to, all of the Board's expectations under the *RRFE* for rate setting in general, and for Custom IR rate applications in particular.

155. As related in OPUCN's letter to the Board dated December 23, 2014, requesting that its then current rates be declared interim pending the disposition of this application, that despite its diligent efforts (and, in some respects, because of them), the scale and scope of the work involved in presenting this comprehensive, 5 year application resulted in delayed filing.

156. Further discussion of the circumstances related to the delayed filing are detailed at Exhibit 1.0-SEC-5. OPUCN requests that the Board review those details in deliberating on the appropriateness of OPUCN's request for 2015 rates to be made effective January 1, 2015.

157. OPUCN appreciates that the Board has, in some prior decisions, not provided an effective date for rates earlier than the date on which the rate decision was made. However, the opposite has also been true.[66] OPUCN is not aware of any comprehensive discussion by the Board of the principles that it will apply in determine the effective date for rates relative to the timing of the filing of a rate application and the timing of the resulting rate decision.

[66] EB-2012-0459; EB-2013-0416/EB-2014-0247; EB-2012-0064.

158. Should the Board grant OPUCN's requested 2015 rates, but effective September 1st rather than January 1st, OPUCN would suffer a revenue shortfall of $1.8 million, and an annualized earnings shortfall of 345 basis points.[67]

159. OPUCN submits that, in the circumstances of this application, such a result would be penal, and unfair.

160. It has been suggested [1.0-CCC-7] that OPUCN's request is for "retroactive" rates. That is not the case.

161. Scott Hempling provides an instructive working definition of "retroactive ratemaking" in his book *Regulating Public Utility Performance*[68]:

> *To "correct" a pre-existing rate based on end-of-year results, the commission would have to order a change to previously approved rates, then apply that change to a past period. That is the definition of retroactive ratemaking.*

162. Professor Hempling explains, with reference to U.S. jurisprudence, the policy basis for the rule against retroactive ratemaking as follows:[69]

> *The rule "ensures predictability and stability of utility rates and generally prevents utility companies from recovering losses that stem from 'past company mismanagement or improper forecasting'".*

163. The OEB has expressed similar sentiments. In a 2006 decision which considered the topic in some detail, the majority of the Hearing Panel wrote:

> *When investors and consumers cannot be assured that final rates are indeed final, the resultant risks increases [sic] costs for everyone. In addition, intergenerational inequities arise, with today's consumers paying the costs of past events. In this case, it is not appropriate for either the utility or its ratepayers to bear the implications of a retroactive rate change. To burden the utility would be contrary to the regulatory compact.*

[67] Exhibit J3.4, page 1.
[68] Published by American Bar Association, Section of Environment, Energy and Resources, page 326.
[69] Ibid, page 327, citing *Archer Daniels Midland Co. v. Iowa*, 485 N.W.2d 465, 467 (Iowa 1992); *Citizens Utils. Co. v. Ill. Commerce Comm'n*, 529 N.W.2d 510, 515-17 (Ill. 1988).

To burden the ratepayers would be wrong, especially given the length of the retroactivity.[70]

164. Vice Chair Kaiser, a member of the hearing panel in that 2006 case, wrote a dissenting opinion, disagreeing with the majority on whether retroactive ratemaking was engaged as an issue, but not on the characterization of the rule against retroactive ratemaking. After citing judicial authority for the rule that *"…the Board must act prospectively, and may not award rates which will recover expenses incurred in the past and not recovered from rates established for past periods"*[71], Vice Chair Kaiser wrote:

> *The reason is that the regulatory compact assumes that between rate hearings, there will always be over earnings or under earnings but the utility must accept the consequences. It is not entitled to be reimbursed if it does not make its full allowed rate of return. On the other hand, the utility does not have to give money back to the ratepayers if it earns in excess of that amount. Rates are to be corrected at the time of the next hearing on a going forward basis. They are not made retroactive. This allows the utility to finance its operations on a predictable basis and provides finality to the proceedings.*[72]

165. Allowing OPUCN to recover sufficient revenue on account of 2015 costs to cover those costs and provide for a fair return of and on equity does not offend the policy against allowing a utility to revisit its forecasting or management decisions and thereby avoid historical losses, which policy informs the rule against "retroactive ratemaking".

166. Declaring rates interim, as the Board has done in this case, specifically contemplates that final rates for the period in question have yet to be set. Final rates, at some level, will have to be set for the period from January 1, 2015 to the effective date of the final rate order in this proceeding. OPUCN's request is that the Board set final rates for the period effective January 1, 2015 at a level

[70] EB-2005-0013/0031, Decision and Order, February 24, 2006, p.7.
[71] EB-2005-0013/0031, Decision and Order, February 24, 2006, p.17, citing *Northwestern Utilities Ltd. v. City of Edmonton*, [1979], 1 S.C.R. 684.
[72] EB-2005-0013/0031, Decision and Order, February 24, 2006, p.17.

sufficient to allow it to recover its costs and provide for a fair return of and on equity.

167. The revenue shortfall for the period during which rates were interim will be collected on a prospective basis (that is, on consumption during future billing periods), as opposed to recalculation of past bills by application of a revised rate to historical and already billed consumption. As noted by Vice Chair Kaiser in the 2006 decision noted above;

> *There is ample authority in the regulatory jurisprudence that credits going forward do not constitute retroactive ratemaking.* *This is particularly the case where it reflects a one time fixed amount adjustment to an overpayment that the tribunal finds unjust.*[73] [Emphasis added.]

168. In its evidence as filed on January 29, 2015 [Exhibit 1, Tab C, page 37], OPUCN proposed a 2015 Revenue Variance Account to capture the revenue deficiency that would result from a decision setting rates effective January 1, 2015. OPUCN has considered the impact on it customers of recovering this revenue deficiency, and has proposed to clear that variance account over a 4 year period. The impacts of this proposal on rates is illustrated at Exhibit J3.4. The last table on page 4 of this exhibit illustrates the minor impact on rates going forward that OPUCN's proposal entails.

[73] EB-2005-0013/0031, Decision and Order, February 24, 2006, p.21, citing *New York Water Service Corp. v. Public Service Commission*, 208 N.Y.S. 2d 587 (1960) and *ATCO Gas and Pipelines Ltd. v. Alberta Energy and Utilities Board* [2006] S.C.J. 4 at para. 137.

ADDITIONAL ISSUE: CONSIDERATION OF AN ALTERNATIVE PLAN

169. During the hearing 3 scenarios were put to OPUCN for consideration. These scenarios were:

   a. To comment on the applicability of the mechanisms agreed to by the parties to, and approved by the Board in, the Horizon settlement agreement. Those mechanisms are: i) an earnings sharing mechanism; ii) a capital expenditure variance account; and iii) an efficiency adjustment mechanism.

   b. To consider the merits of a mid-term rate review, as opposed to the annual rate adjustment review proposed by OPUCN.

   c. To provide a load forecast proposed in the event that no annual adjustments to OPUCN's rates during the 5 year Custom IR term are permitted.

   OPUCN responded to all three of these scenarios in Exhibit J2.4.

170. In considering these 3 scenarios, OPUCN also considered some of the other concerns explicitly or implicitly raised during the interrogatory and oral hearing phases of this process regarding; i) the number of annual rate adjustments proposed; ii) the scope and requirements of the annual rate adjustment process proposed; and iii) the timing for updating rates for 2016, given that a decision on OPUCN's application is not reasonably expected prior to August.

171. These considerations led OPUCN to develop an alternative approach to setting its rates for the 2015 through 2019 period, building on the proposition advanced by Staff of a one, mid-term review.

172. While OPUCN is not amending its "prayer for relief", OPUCN does believe that it would be able to implement an alternative approach along the lines suggested by Staff and developed in Exhibit J2.4. OPUCN believes that such an alternative would simplify the implementation of a 5 year rate plan for OPUCN, while preserving the essential risk/reward balance and value for money/efficiency incentives that it believes are inherent in its filed proposal. Staff's proposal could

be implemented by OPUCN with relatively few changes to the essential components of its application as filed.

173. Were the Board to adopt one, mid-term review point in determining OPUCN's rates for the 2015 through 2019 rate plan period, OPUCN would suggest (and could implement) the following approach:

a. The Board would set rates for each of the plan term years now, but subject to review of rates for 2018 and 2019 and adjustment, as appropriate. The review would occur in the second half of 2017. OPUCN would file, in April 2017, an application for review and (if appropriate) adjustment of 2018 and 2019 rates.

b. In respect of the annual adjustments and variance account treatments proposed by OPUCN in its application as filed, under this alternative approach OPUCN would propose as follows:

Currently Proposed Adjustment/Variance	**2015, 2016, 2017**	**2018, 2019**
Load Forecast	1.5% annual growth, with an ESM as adopted for Horizon (and Enbridge) to protect ratepayers in the event that growth accelerates.	3% annual growth, subject to review and adjustment as appropriate. Maintain ESM.
Net New Connection Costs	Adjust as indicated in table at J2.4, page 6, and if ESM adopted eliminate net new connection cost variance proposal.	Maintain forecast as filed, subject to review and adjustment as appropriate. Maintain ESM and eliminate variance proposal.
Cost of Capital	No change – annual update per November Board published parameters.	No change – annual update per November Board published parameters.
Cost of Power for the Purposes of Working Capital	Adjust based on trend analysis provided at Exhibit 2, Tab A, pages 45 *et seq.*	Adjust based on trend analysis, subject to review.

Currently Proposed Adjustment/Variance	2015, 2016, 2017	2018, 2019
Regional Planning Costs	Maintain current forecasts and variance account treatment (disposition at end of plan period) to protect both ratepayers and shareholder.	Maintain current forecasts and variance account treatment to (disposition at end of plan period) to protect both ratepayers and shareholder.
Third Party Requested Plant Relocation Costs	Maintain current forecasts and variance account treatment (disposition at end of plan period) to protect both ratepayers and shareholder.	Maintain current forecasts and variance account treatment (disposition at end of plan period) to protect both ratepayers and shareholder.

174. By way of elaboration on the foregoing parameters:

a. ***Load Forecast:*** The load forecast for 2015 has already been adjusted to 1.5% (June Update, Exhibit K1.5). For the reasons discussed at paragraphs 133-138 above, OPUCN would propose adjusting the load forecast for 2016 and 2017 to 1.5% as well. To preclude a windfall to OPUCN should growth materialize at a faster pace than the adjusted forecast, an Earnings Sharing Mechanism (ESM) such as that adopted in the Horizon proceeding could be implemented. OPUCN would revisit the current 3% load growth forecast for 2018 and 2019 in its mid-term filing, but for simplicity would suggest maintaining for the end of the rate plan any ESM implemented for the first part of the rate plan period.

b. ***Net New Connection Costs:*** As discussed at paragraph 139, above, if the load growth forecast is adjusted downwards for 2015, 2016 and 2017, the net new connection cost forecast is also appropriately adjusted downward, as indicated at page 6 of Exhibit J2.4. Given that incremental revenue arising from increases in load growth relative to forecast in these years would more than offset increases in net new connection costs necessitated by faster than forecast growth, if an ESM is implemented the variance treatment proposed for actual net new connection costs in order to protect ratepayers from paying for connection costs not in fact incurred could be eliminated. In 2018 and 2019 the net new connection cost forecast would be reviewed along with review of the load growth forecast.

c. ***Cost of Capital:*** Both Horizon and Enbridge have been afforded the ability, in their respective Custom IR plan approvals, to annually update cost of capital in accord with the Board's published parameters, as has been proposed by OPUCN. This is a mechanical exercise, and OPUCN would maintain its request for this annual adjustment for the reasons discussed at paragraph 61, above.

d. **Cost of Power for the Purposes of Working Capital:** In anticipation of an annual update of its forecast cost of power, OPUCN has kept its forecast for cost of power flat in the materials filed to date. In order to simplify the plan, if the Board were to eliminate annual updates in favour of one mid-term update, and given that it is now more than half way through 2015, OPUCN would be prepared to take the risk on a 3 year (2015 through 2017) cost of power forecast. In this event, OPUCN would replace its currently flat cost of power forecast with the cost of power indicated by the trend analysis provided in the prefiled evidence (Exhibit 2, Tab A, pages 45 *et seq.*), and revisit this forecast at the mid-term review for the years 2018 and 2019.

e. ***Regional Planning Costs and Third Party Requested Plant Relocation Costs:*** OPUCN would maintain its current proposal to track the variance in these two, externally driven and uncontrollable cost categories, and clear that variance at the end of the plan term, in order to protect both its shareholder and its customers from the exogenous risks inherent in these cost categories.

175. In addition to the foregoing modifications, OPUCN would:

a. Add a capital expenditure variance account in respect of its system renewal capital investment program. OPUCN believes that a more focussed version of the capital expenditure variance account adopted in the Horizon settlement, which in this plan would function to return to ratepayers amounts recovered on account of OPUCN's system renewal capital investment program elements not in fact implemented over the rate plan term, could provide useful protection to ratepayers and confidence to the Board. This more focussed approach could also work in tandem with, and support, OPUCN's proposed CCIEIM. As noted earlier in this argument [paragraph 94], any project included in the CCIEIM proposal but not in fact implemented during the plan term would be removed from the calculation of the CCIEIM. The costs already included in rates on account of such planned project would be accounted for, instead, in this System Renewal Capital Variance Account for return to ratepayers at the end of the rate plan term.

b. Maintain its proposed Total Cost Efficiency Carryover Mechanism (TCECM), but modify it to apply only to the last 2 years (2018 and 2019) of its rate plan period. While departing from the form of ECM recently approved in Alberta, which was the basis upon which OPUCN proposed its TCECM, focussing the TCECM on the last 2 years of the rate plan period would address concerns raised during the proceeding that the Alberta ECM model does not focus enough on incenting (or mitigating the natural disincentive for) end of plan term efficiencies and over-rewards efficiencies achieved early in the plan term and from which the utility benefits for longer during the plan term. OPUCN would continue to accept weather normalization of its TCECM calculations, and an onus to demonstrate sustainable efficiencies in years 2018 and 2019 meriting extension of an incentive reward into 2020 and 2021, all as reflected in OPUCN's June update (Exhibit K1.2).

OPUCN believes that an ESM, were one to be adopted, can work in tandem with its TCECM (including as modified to apply in the last 2 years of the rate plan period), as the former provides for the sharing of efficiencies within the plan term, and the latter would provide for the sharing of efficiencies realized in the last 2 years of the plan term beyond the end of the plan term.

c. Maintain its proposed CCIEIM capital investment incentive proposal in respect of its two large controllable capital programs (its system renewal program and MS9). As noted in a., above, a System Renewal Variance Account could work in tandem with the proposed CCIEIM. System renewal projects not completed during the plan term would be removed from the CCIEIM calculation, and accounted for in the System Renewal Variance Account for credit to ratepayers at the end of the plan term.

d. As indicated by Mr. Savage during oral testimony[74], it would also be appropriate to remove the costs and revenues associated with un-executed system renewal projects from any ESM or ECM implemented, as projects not executed (as opposed to executed in an alternative fashion) do not represent efficiencies.

[74] Transcript Volume 4, page 26, lines 9-22.

CONCLUSION

176. In conclusion, there is perhaps no better way to convey to the Board what OPUCN has sought to accomplish with this application than through the words used by Mr. Mahajan, OPUCN's President, at the opening of the oral portion of this hearing: [Transcript Volume 1, pages 13 to 23]:

> *"…we do appreciate the opportunity for the Board's panel's examination of what we truly believe is an innovative and creative custom IR proposal.*
>
> *….in developing our custom IR proposal, we paid attention to Board's expectations as described under the RRFE, and also based on our review of recent decisions on custom IR proposals of both gas and electricity distributors*
>
> *….based on the guidelines under the RRFE, we did a detailed asset condition assessment, and then, to get ready for the expected growth in Oshawa, really driven by the extension of Highway 407, the management team at OPUCN diligently worked on developing a comprehensive multi-year plan, as expected under the custom IR framework for capital expenditures*
>
> *…. we started with developing a bottom-up robust evidence of our forecast for both OM&A and capital investments. So in developing the OM&A we did not just look at simple inflationary or a simple formulaic percentage adjustment. It was really a comprehensive exercise of our work force and a scales gap review, retirements, work processes, to manage both existing objectives and new objectives, such as to enhance customer communications, and of course to prepare for and manage growth, which in Oshawa we certainly see a lot.*
>
> *….*
>
> *Our multi-year capital expenditure plan was driven off of an asset condition assessment, and our asset investment plan provides not only sustaining our service levels, but enhancing our service levels through leveraging off our existing smart-meter investments as an example by implementing an outage management system.*
>
> *….*
>
> *That will provide us tools to both reduce the outage restoration time and improve customer communications. And particularly when it matters most.*
>
> *…..*

OPUCN has significantly large multi-year investment requirements, as is in the evidence of our DSP. And this is associated with really planning for customer growth in our service territory with relatively certain timing and level of expenditures.

…..

What is not known is the exact amount of these and other third-party-driven capital expenditures for which we strongly believe that the ratepayer and the shareholder can and should be protected through annual adjustments, which we have proposed in our Exhibit 10, and update mechanisms proposed in our application.

….. once we developed these forecasts, we then benchmarked our existing and forecast costs to demonstrate that we already are, and we will continue to be, efficient. To demonstrate this continuous improvement we engaged PEG, Pacific Economics Group …. and provided them with our outcomes for the long-term plan which, amongst other outcomes, include a number of customers, peak demand, consumption, line length, average kilometre of line.

….. not only are we efficient today but, baked in our forecast, baked in our planning processes, in terms of how PEG calculates it with an established benchmarking methodology, we will remain efficient, and thanks, of course, to the attention paid to continuous improvement in the development of our plan

…. that's our interpretation of what the RRFE says when it talks about efficiency improvement and expectation under the RRFE for all of the three different streams of rate-setting processes.

….

But I do believe that the interpretation, which leads to a formulaic adjustment on top of a very comprehensive planning process, which bakes in efficiency as a culture, is not the right message and, quite frankly, it will be punitive to a distributor who is already efficient.

….

So to sum it up, I really believe that the benchmarking evidence is the right way of proving that a distributor is efficient or as efficient as possible, which is what the RRFE's focus is ...

…. now to up the ante for continuous improvement. Listening to what the Board's been saying in some of the decisions, and to share the risk and reward between the ratepayer and the shareholder beyond the proposed plan period, we explored the idea of developing incentive proposals. And

we have proposed two incentive proposals to stimulate innovation beyond what we already have in our culture

.... I know that this is a departure from the norm for all of us, certainly for Oshawa.

.... if and hopefully when they are implemented, they can and they will produce the desired results in incenting the right behavior, which ultimately truly benefits the customers for a sustained period of time, much beyond the plan period.

....

I would like to submit to the Panel that the team at OPUCN has put in a tremendous effort to provide you a comprehensive application that addresses all of the expectations from an applicant under the RRFE.

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:

GOWLING LAFLEUR HENDERSON LLP, per:
Ian A. Mondrow
Counsel to Oshawa PUC Networks Inc.