July 24, 2015

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

RE: EB-2014-0101 – Oshawa PUC Networks – Custom Rate Application – 2015-2019 – Final Argument of the Consumers Council of Canada

Please find, attached, the Final Argument of the Consumers Council of Canada in the above-referenced proceeding.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC: Phil Martin, OPUCN
Ian Mondrow, Gowlings
All intervenors
Ken Whitehurst, Consumers Council of Canada

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

DISTRIBUTION RATES FOR OSHAWA PUC NETWORKS INC. 2015-2019

EB-2014-0101

July 24, 2015

I. INTRODUCTION:

On January 29, 2015, Oshawa PUC Networks Inc. ("OPUCN") applied to the Ontario Energy Board ("Board") for approval of rates for a five-year period commencing January 1, 2015. The Application was made pursuant to the *Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach*, dated October 18, 2012 ("RRFE Report"). Specifically, OPUCN is applying for approval of the Custom Incentive Regulation ("Custom IR") option as set out in the RRFE Report.

On June 2 and 3 OPUCN and the intervenors participated in a Settlement Conference. None of the issues were settled. An oral hearing was held over four days during the period June 30 to July 9. OPUCN filed its Argument-in-Chief (AIC) on July 15, 2015. Board Staff filed its Submission on July 17, 2015.

This is the Final Argumen of the Consumers Council of Canada ("Council") regarding OPUCN's Application. The Council has worked throughout this process with the other intervenors. We have exchanged views and had extensive discussions regarding final positions on the issues. The Council has benefited from these discussions. Accordingly, the Council will not address each and every issue, as we realize others will be covering off points that we agree with. To the extent possible we will set out our support on positions advocated by others. These submissions will first address the issues related to the overall 5-year Custom IR rate plan proposal and whether OPUCN's proposed framework is both consistent with the RRFE, and represents an approach to rate-setting that should be approved by the Board. The Council will then deal with the broad categories of issues included in the Board's approved issues list. The submissions will be set out in the following sections:

1. Custom IR Application
2. Distribution System Plan and Capital Expenditures

3. Operations, Maintenance and Administration Costs
4. Forecasts
5. Revenue Requirement
6. Deferral and Variance Accounts
7. Cost Allocation and Rate Design
8. Rate Implementation

1. CUSTOM IR APPLICATION:

Relief Requested:

Under the RRFE local distribution companies ("LDCs") have three rate-setting options. These are the 4th Generation IR, the Annual IR index and the Custom IR. Through this Application OPUCN is seeking approval of a Custom IR.

The specific relief that OPUCN is seeking from the Board was set out in its Application. The key components of OPUCN's proposals are:

- Final rates effective January 1, 2015 to recover its forecast revenue requirement;

- A new variance account to capture the difference between revenue at OPUCN's current rates and the revenue that would have been collected had OPUNC's rates, as proposed, would have been in place on January 1, 2015 and a rate rider to recovery the balance in the account;

- Distribution Rates for each of the years 2016-2019 determined in accordance with OPUCN's forecast cost of service for each of those years;

- A rate smoothing mechanism and deferral account to facilitate the rates smoothing;

- An annual rate adjustment process to set final rates for each of the years to reflect a number of adjustments:

    i. Updated actual and forecast costs for required contributions to Hydro One Network Inc.'s ("HON") transmission upgrades to serve OPUCN's service territory and updated actual and forecast distribution system capital expenditures required as a result of regional planning activities;

    ii. Updated actual and forecast costs for required relocation of OPUCN distribution costs in response to 3rd party requests;

iii. Updated customer connection and volume forecasts and updated actual and forecast net new connection costs;

iv. Updated cost of capital based on the Board's annual approved cost of capital parameters (capital structure, return on equity and debt);

v. Updated working capital amounts based on annual cost of power forecasts;

vi. Z-factor relief;

- Three new variance accounts to facilitate updated connection costs, third party driven relocations and unbudgeted regional planning projects;

- An off-ramp that would be triggered when normalized earnings vary by 300 basis points above or below the approved ROE;

- Two efficiency incentive mechanisms;

- A new deferral account to facilitate the implementation of one of the proposed new efficiency incentive mechanisms;

- A new deferral account to adjust accumulated depreciation for a change in depreciation rates resulting from an independent study;

- Continuation of the Tax Rate Changes Deferral Account and the Pension Cost Differential Deferral Account; (Ex. 1/TB/pp. 1-4)

In assessing this Application, the Council submits that it is imperative for the Board to determine what rate-setting model is most appropriate for OPUCN and its ratepayers. Consistency with the Board's established rate-setting policies is important, but what is even more important from the Council's perspective is that the Board ensures the rate-setting model, and its various elements, result in just and reasonable rates for OPUCN's customers.

<u>Context</u>:

When the Board established the rate-setting options for electric LDCs in its RRFE Report it set out a number of expectations and requirements regarding the Custom IR approach that are relevant to its consideration of OPUC's Application. From the Council's perspective the following key comments from the RRFE Report are the most relevant:

1. Performance based regulation decouples the price (the distribution rate) that a distributor charges from its cost. This is deliberate and is designed to

incent the behaviours described by the Board in 2000. This approach provides the opportunity for distributors to earn, and potentially exceed, the allowed rate of return on equity. It is not necessary, nor would it be appropriate for rate base to be recalibrated annually (p. 11, emphasis added);

2. The Board will require consistent, meaningful and timely reporting to the Board to monitor utility performance and determine if the expected outcomes are being achieved (p. 11);

3. The Custom IR method may be appropriate for distributors with significantly large variable investment multi-year or highly variable investment commitments with relatively certain timing and level of associated expenditures (p. 14, emphasis added);

4. In the Custom IR method, rates are set based on a five-year forecast of a distributor's revenue requirement and sales volumes (p. 18); and

5. 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 time horizon, as well as detailed infrastructure investment plans over that same time frame. In addition, the Board expects a distributor's application under Custom IR to demonstrate its ability to manage within the rates set, given that the actual costs and revenues will vary from forecast (p. 19, emphasis added)

Since the RRFE was issued there have been two Custom IR plans approved by the Board. Toronto Hydro-Electric System Limited ("THESL") has applied under the Custom IR approach for rates for the period 2015-2019. The Board's Decision in that case is still pending. The application by Horizon Utilities Inc. ("Horizon") was the subject of a settlement negotiation process, which ultimately resulted in a Settlement Proposal between Horizon and its intervenors. That Settlement Proposal was approved by the Board on September 30, 2014. Hydro One Networks Inc. ("HON") applied to the Board for approval of a 5-year plan on December 19, 2013. The Board rejected HON's proposals on the basis that it did not consider HON's "Custom Cost of Service" application to be sufficiently aligned with the objectives of the RRFE policy. The Board determined that HON's approach lacked the RRFE features designed to achieve a central policy objective of measuring performance and providing incentives for continuous improvement. The Board approved rates for HON for three years using a cost of service methodology (Decision with Reasons, EB-2014-0247, dated March 12, 2015, pp. 8-9).

In its Decision regarding Horizon's application the Board made a number of observations that are, in the Council's view, relevant to this Application.

> The Board finds that there are several features in the Settlement

> Agreement which satisfy the RRFE's objective that benefits of efficiency improvements would be shared with customers. The proposed earnings sharing mechanism and the Capital Expenditure Variance Account are examples of such features. The "efficiency adjustment" concept and the proposed reduction in Horizon's submitted Operating, Maintenance and Administration (OMA) also provide incentives for Horizon to maintain or improve its operational effectiveness and to seek further productivity improvements (Decision with Reasons, EB-2014-0002, p. 3).

Although this is a utility-specific application, applicable to OPUCN, the Council submits that the Board's Decision in this case will serve as an important precedent for future applications. The RRFE Report sets out the Board's expectations and requirements for the three rate-setting models, but the LDC applications that the Board has received to date under the Custom IR approach have been very different. The Council accepts that certain aspects of an application may differ under a "custom" approach to address LDC-specific circumstances, but to the extent possible there should be some consistency among the various rate models. The Council submits that going forward the Board should provide more detailed guidance regarding the essential components of a Custom IR plan. This will assist the LDCs in terms of assessing which rate option best suits their circumstances, and in developing a plan that aligns with the Board's intentions with respect to the RRFE.

The Council submits that in the future consistency should be applied, to the extent possible, in the following areas (recognizing that an LDC may be able to justify a different approach for certain components of an application):

1. The treatment of cost of capital;
2. The type of benchmarking required and the application of benchmarking;
3. The annual adjustment process and the reporting requirements;
4. Z-factor relief;
5. Off-ramps;
6. The inclusion and design of an earnings sharing mechanism;
7. The derivation of capital and OM&A forecasts;
8. The design and application of any efficiency carry-over mechanisms;
9. The design and scope of deferral and variance accounts; and
10. Metrics to provide an ongoing assessment of capital spending.

The Council recognizes that each LDC may have individual circumstances that may merit different types of relief in a Custom IR plan. The Council is also of the view, however, that in order to better streamline the regulatory process and create stability for the LDCs and their customers, consistency should be encouraged by the Board. In the absence of consistency the Board's regulatory processes could become more cumbersome and costly. Substantially different rate plans, and plan elements for LDCs across the Province could increase regulatory burden and create disparities as to how each LDC is regulated.

OPUCN's Proposal:

OPUCN has proposed a rate-setting approach that it views as compliant with the RRFE, and supports an "outcomes based approach" to setting rates for the period 2015 though 2019 (AIC, pp. 13-14). OPUCN has identified that the main driver for its application for approval of Custom IR rate plan is its large multi-year capital investment requirements. The large capital investments are required to address the following:

1. Expected 3% annual average growth in customer connections and aggregate customer demand levels over the 2015-2019 plan period. These drivers require significant investment in both system expansion (i.e. new customer connection infrastructure) and system reinforcement (I.e. a new distribution station and upstream transmission capacity investment in order for OPUCN to continue to provide reliable electricity distribution service; and

2. Significant capital expenditures for relocation of distribution assets to accommodate the infrastructure being developed to respond to the growth in population and business activity in Oshawa, particularly across the north end of the City due to the extension through Oshawa of the 407 ETR highway. (Ex. 1/TC/p. 5)

It is OPUCN's position is that the Custom IR approach is intended to address the revenue needs of distributors with significantly large multi-year or highly variable investment commitments that exceed historical levels. Given these spending requirements OPUCN does not believe it is in a position to choose either the 4th Generation IR or the Annual Index rate setting option (AIC, p. 7).

The rate proposals result in significant increases for residential consumers in each year of the plan. These rate impacts are also highly uncertain as the rate plan proposes a number of annual adjustments that will impact rates throughout the plan. The rate increases could ultimately be higher. It is clear that OPUCN does believe that it has proposed a rate plan that adheres to the RRFE. The Company has good intentions and has prepared useful and extremely comprehensive evidence in support of its proposals. However, the Council does not believe the rate plan proposal is consistent with the RRFE and meets the Board's expectations. In addition, the Board needs to consider whether the costs of preparing this plan and maintaining it through the 5-year term outweigh the benefits.

From the Council's perspective OPUCN's proposed rate-setting plan should not be approved by the Board. It is does not meet the requirements of the RRFE and is not an appropriate approach to setting just and reasonable rates. The Council has the following concerns regarding OPUCN's plan and will address these concerns in detail in the sections below:

1. The Custom IR plan is not an "incentive" plan and should be more properly characterized as a multi-year cost service plan with mechanisms that allow for an annual rebasing of rates;

2. The plan is inconsistent with the RRFE as it does not require OPUCN "to manage within the rates set, given that the actual costs and revenues will vary from forecast";

3. The plan does not provide for any mechanisms that would allow the sharing of expected efficiency gains with ratepayers up front or after the fact;

4. The plan is not supported by external benchmarking in terms of assessing whether the proposed cost levels are appropriate;

5. The proposed plan is unnecessarily complex and would require an extensive and costly annual adjustment process. This is counter to the Board's objective of facilitating regulatory efficiency;

6. OPUCN has not developed a set of meaningful metrics and targets that could be used to assess its performance, specifically with respect to the execution of its capital plan throughout the plan term or a sufficient plan for reporting; and

7. The two proposed efficiency mechanisms should be rejected on the basis that they are potentially complicated and there is no evidence that they are required in order to incent productivity.

The Council will address each of these concerns below.

1. <u>The Proposal Is Not An Incentive Plan</u>

OPUCN's proposed Custom IR plan has not been crafted in such a way to incent the utility to seek out efficiency gains. What OPUCN has really proposed is a five-year cost of service approach to rate-making. Not only is it a five-year cost of service plan, it also incorporates a level of resetting rates each year (which would not necessarily be the case for a multi-year cost of service application). The Council submits that it is more aligned the traditional annual cost of service approach.

OPUC's proposal sets rates for 2015, but beyond 2015, it incorporates a rate adjustment process. As set out above, that rate adjustment process involves making adjustments for customer connection and volume forecasts, contributions to HON for transmission upgrades, distribution capital required as a result of regional planning, relocation costs driven by third party requests, cost of capital parameters, and working capital. There is also a request for Z-factor relief for material cost increases or decreases linked to unexpected, non-routine events. Z-factor relief could be related to a number of different circumstances.

What would not be adjusted each year is the OM&A forecast or the more predictable level of capital. In effect, what OPUCN has proposed is an approach that takes the risk out of forecasting. If many of the items that comprise the revenue are trued up or adjusted each year OPUCN's overall risk will go down. If that is the case, there should, from the Council's perspective, be a change in the capital structure to reflect the overall risk reduction. OPUCN has not proposed such an adjustment.

From the Council's perspective the plan, with all of its elements, is not consistent with the Board's RRFE to create a model that strengthen efficiency incentives. If a multitude of the cost categories and the load forecast are pass-through items where are the incentives to be productive? Where is the incentive to reduce costs, when the plan is continually adjusted along the way?

2. <u>No Commitment To Manage Within The Rates</u>:

As noted above, the RRFE explicitly states that with respect to the Custom IR approach LDCs will be required "to manage within the rates set, given that the actual costs and revenues will vary from forecast". This is not the case under the proposal advanced by OPUCN. OPUCN's proposal is to make adjustments to the rates each year. This will be through a process that could be costly and cumbersome. What this does is reduce OPUCN's own risk and create rate instability for its customers. Proposed rate increases have been set out in the evidence, but those rate increases will be adjusted each year depending upon the impacts of the annual adjustments.

OPUCN has indicated throughout the proceeding that it faces uncertainties with respect to the impacts of the 407, and how that will impact its load, its growth and relocations beyond its control. The Council accepts that these challenges are real. The Council recognizes as well that many LDCs face similar challenges. Either the LDC lives within the 4th Generation model, with an opportunity to apply for an incremental capital mechanism or it adopts the Custom Plan approach that requires them to set forecasts and live by those forecasts. Those are the options that the Board has advanced. They have advanced those models presumably to ensure that the LDCs are driven to find efficiencies, benefit from those efficiencies and share those benefits with their customers. The Board may, in the future, consider other alternative approaches that may be better suited to OPUCN's situation, but to date the Board has not done that.

3. <u>No Sharing Of Benefits With Ratepayers</u>:

The Council has consistently supported the inclusion of an earnings sharing mechanism ("ESM") in the context of any incentive rate-setting plan. An ESM is a tool which provides benefit sharing between ratepayers and shareholders if the company earns more than its allowed return. Although OPUCN has not proposed an ESM it acknowledged that it could certainly operate with an ESM such as that

adopted for Horizon or EGD. OPUCN added that it believes its proposed TCECM, combined with 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 package than would an ESM (AIC, p. 26). The Council disagrees.

An ESM is an important ratepayer protection mechanism that has been consistently approved by the Board. Both Enbridge Gas Distribution Inc. and Union Gas Limited have ESMs place with their multi-year IRM plans. The Board also approved an ESM for Horizon. The ESM acts as a performance incentive, while at the same time allows ratepayers to share in any efficiencies achieved. In addition, in the absence of independent budget assessments it protects against over-forecasting.

As noted below, the Council does not support the Total Cost Efficiency Carryover mechanism ("TCECM"), nor does it agree that OPUCN has included sufficient incentives in it plan. If the Board does approve a Custom IR approach for OPUCN an ESM should be an integral part of that plan.

Productivity factors and stretch factors should be also be an integral part of any IR plan. OPUCN has not included these elements in it proposed plan. If the Board approves a Custom IR approach it will be important to ensure that productivity and a stretch factor be included. This will ensure that benefits to ratepayers are embedded in the plan.

4. Not Supported By Meaningful External Benchmarking:

OPUCN developed its budgets on a cost of service basis (Ex. 1/TC/p. 17). It then presented those budgets and the resulting rates to PEG. The PEG analysis cannot be viewed as an external benchmark, as it simply compared OPUCN's year over year performance against its expected future performance. OPUCN's budgets were not compared to the budgets of other LDCs which it the primary purpose of external benchmarking. From the Council's perspective PEG's analysis clearly does not constitute meaningful external benchmarking as envisioned by the RRFE.

5. The Proposal Is Unnecessarily Complex

OPUCN has proposed an annual adjustment process. From the Council's perspective OPUCN has proposed a process that will be costly, onerous (for both OPUCN and the Board), and complicated. In addition, the inclusion of a large number of deferral and variance account adds to the complexity.

Under its proposal the following would be reviewed each year:

i. Updated actual and forecast costs for HON contributions;
ii. Updated actual and forecast costs driven by regional planning;
iii. Updated actual and forecast costs for 3rd party-driven relocations;
iv. Updated customer connection and volume forecasts;

v. Updated actual and forecast net new connection costs;
vi. Updated cost of capital parameters;
vii. Updated forecast of working capital to reflect the cost of power; and
viii. Any Z-factor applications;

While the cost of capital adjustments and the working capital changes would be mechanistic the other components would not. The actual amounts and forecast costs would have to be tested by the Board and intervenors. That process should be subject to Notice (setting out the proposed rate impacts) and could extend over a several month period. It would really amount to a cost of service rebasing where a significant amount of the revenue requirement would be revisited. The Council notes that in the RRFE the Board it would not be appropriate to recalibrate rate base every year. This proposal appears to be inconsistent with that.

Board Staff has proposed that if the Board approves a Custom IR plan for OPUCN, that it require a mid-term review instead of the annual adjustment approach proposed by OPUCN. This would be to set rates for 2018 and 2019 based on updated information. Although this would be more practical than the annual review process that OPUCN is proposing, we do not believe a mid-term review is in the spirit of the Board's proposed Custom IR option. From the Council's perspective this would amount to a rebasing of the rates.

If the Board chooses this option on the basis that OPUCN faces some unique challenges, it will be important that the scope of this review be carefully defined.

6. No Meaningful Metrics or Reporting

OPUCN has not developed a comprehensive set of meaningful metrics and targets that could be used to assess its performance throughout the plan term.

Under OPUCN's proposal it would it would file annually its results on the Board's scorecard metrics and service quality indicators. In addition, during the oral stage of the proceeding it proposed two new metrics related to porcelain insulator equipment failures and foreign interference through animal contact. It appears from the evidence however that these two metrics relate to capital spending that occurred prior to 2015 (Ex. 2-B, pp. 29 and 68).

If the Board approves a Custom IR approach, OPUCN should be required to work with Board Staff and intervenors to develop meaningful unit cost metrics the measure the efficiency of it capital program. The Board should also consider a generic approach to developing such metrics going forward.

7. The Two Proposed Efficiency Mechanisms Should Be Rejected

OPUCN has proposed two "efficiency mechanisms" to incent general efficiency initiatives late in the plan term and to incent cost control with respect to controllable capital investments.

The Total Cost Efficiency Carryover Mechanism (TCECM) is designed to incent general efficiency initiatives throughout the Custom IR Plan period, including late in the plan period, by allowing the utility to capture resulting cost savings for a short period of time following the end of the rate plan period. This incentive takes an average of the difference in each year of the plan between the actual ROE and the Board approved ROE. If that average difference in ROE is positive, OPUCN is entitled to recover in rates in each of the next 2 years, following the end of the Custom IR Plan an ECM "rate rider" equal to 50% of that difference, up to a maximum of 50 basis points. (Ex.10/TC/p. 14)

The Council does not support the TCECM for several reasons:

1. The use of ROE should not be used as the measure of efficiencies gained. The ROE can vary for a number of reasons in any given year. The Board's allowed ROE provides distributors with the opportunity to earn a commercial-based rate of return, it is not a guarantee. To the extent that productivity gains improve the distributor's ability to meet or exceed the allowed ROE is already a reward to the utility;

2. The Council questions both the material value of the productivity efficiencies that will be found in the last 2 years of the plan as well as the sustainability of the productivity given the great uncertainty of OPUCN's investment plans for those years as discussed in other sections of the Council's argument;

3. OPUCN states that the "proposal is simple to calculate and apply, and the incentive thereby provided for incremental efficiency is supported by statistical and independent third party validation of the continuing efficiency already embedded in OPUCN's Custom IR Plan period cost forecasts, as detailed above and fully evidenced in the balance of this application (and in particular in OPUCN's comprehensive Distribution System Plan filed as Exhibit 2, Tab B)." (Ex.10/TC/p. 14). The Council disagrees with this statement. The review would be very onerous and subjective.

4. The Council also notes that the Board has expressed its intent to engage stakeholders regarding additional regulatory mechanisms that would form part of the RRFE, including among other things, efficiency carry-over mechanisms. If the Board develops such mechanisms it will be important that they are meaningful and applied in a consistent manner across the various rate plans.

OPUCN also designed the Controllable Capital Investment Efficiency Incentive Mechanism ("CCIEIM") to incent it to control the costs of its controllable capital investment programs by allowing revenue requirement impacts of variances

between forecast and actual capital investment for these programs to be shared between OPUCN and its ratepayers (Ex. 10/TC/p. 15).

The Council does not support this incentive mechanism for several reasons:

1. There is no need for additional incentives or rewards to discourage overspending. Keeping the costs as low as possible should be the continual goal of the utility as it implements each capital program;

2. There is no supported benchmarking to the forecast costs of other distributors, so there is no way of knowing if OPUCN's costs are overestimated;

3. Determining if projects have been completed to plan, the effect of changes in scope for projects, as well as whether the results achieve what was intended will all factor into the validity of the comparison of actual to forecast costs. This will severely limit the usefulness of this incentive.

<u>Alternatives To OPUCN's Proposal</u>:

The Council submits that the Board has a number of alternatives if it determines that OPUCN's proposed 5-year custom approach is not appropriate. Those alternatives include: the application of the Board's price cap IR; or acceptance of a 5-year custom approach with amendments that would make the plan more consistent with the expectations of the Board regarding the RRFE and better balance the interests of OPUCN's ratepayers and shareholders.

A. <u>4th Generation IRM:</u>

OPUCN is a relatively low-cost utility operating in an area with that is characterized not only and a growth area, but an area where the growth is related to the development of densely populated sub-divisions. There are approximately 55,000 customers currently in OPUCN's service territory.

Given these characteristics and the fact that putting together a Custom IR application is a major undertaking the Council continues to question why OPUCN chose this approach. The Council submits that from its perspective the Custom IR option was meant for large LDCs with, as the Board has said, "significantly large or multi-year or highly variable investment commitments with relatively certain timing and level of associated expenditures" (RRFE, p. 14). OPUCN has some expected large capital projects, but the timing of those projects is uncertain.

OPUCN has repeatedly claimed that given its forecast capital spending requirements rates derived under the 4th Generation IR approach would be

"unjust, unreasonable and unlawful" as it would be unable to earn a fair return (AIC, p. 6). OPUCN has also indicated that if rates were determined under 4th Generation IRM, it would necessarily be close to triggering the 300 basis points off-ramp in 2016 and 2017, and would trigger it in 2018 and 2019 (Ex. J2.8).

This may not be the case, and as pointed out by Board Staff, LDCs are given an opportunity to earn the allowed ROE, but it is not guaranteed (Board Staff Submissions, p. 8). If OPUCN's rates were determined under the 4th Generation IR option, it would be incented to look for efficiencies and reconsider the pace at which it rolled out its distribution system plan. The Board should not conclude that OPUCN's returns will necessarily be inferior under a 4th Generation option.

The 4th Generation IRM approach is relatively simple, involves mechanistic annual adjustments, and does allow for relief with respect to capital requirements that arise during the plan. The Incremental Capital Module and the Advanced Capital Module may well provide the relief OPUCN requires to deal with its expected (and unexpected) capital requirements.

The Board must determine this case on its own merits. However, what is important to note that OPUC spent a considerable amount of time, effort and cost to put together its Application. The regulatory costs associated with this Application will exceed $1.2 million (Appendix 2-M). In addition, if OPUCN's proposals are accepted the annual adjustment process will be costly. It would involve annually updating the load forecast and adjusting rates for customer growth and new connection costs. There would also be adjustments for cost of capital and the impacts of the new cost of power on working capital. In addition, rates would be adjusted for regional planning related capital costs. (AIC, pp. 17-18). All of this would be subject to some form of discovery process, hearing (written or oral) and a readjustment of rates to reflect the Board's decision. So for OPUCN and the Board the Custom IR process has been, and would continue to be, incredibly complex and costly. Is this how the Board envisioned the Custom IR approach, especially for the smaller LDCs? Approval of OPUCN's approach as currently structured may well signal to other LDCs that all of this cost and complexity is required.

The Council submits that the Board should set OPUCN's rates on the basis of the 4th Generation IR model as defined by the RRFE. Rates should be rebased in 2015 (subject to some proposed adjustments to OM&A and Capital set out below). Thereafter, OPUCN should be subject to the approved annual adjustment process. OPUCN will have access to the ICM or ACM throughout the term plan. The Council believes that these mechanisms should provide the necessary relief OPUCN is seeking with respect to its capital requirements.

B. <u>Custom IR – With Amendments to OPUCN's Proposal</u>

If the Board determines that OPUCN's rates should be based on a Custom approach, the Council submits that a number of critical changes are required to ensure the plan is better reflects a form of incentive rate-setting. These changes are at a minimum:

1. The load forecast should be left at 3% as on OPUCN's evidence that is its best forecast available;

2. The OM&A levels for 2015 should be set on the basis of a formula that embeds productivity and stretch factor in the forecast;

3. Capital expenditures should be reduced to account for expected incremental productivity and efficiency improvements. They should also be subject to an asymmetrical variance account to ensure that ratepayers are protected from any under-spending;

4. There should be no rate smoothing unless the Board's criteria for rate mitigation (10% bill impact) is met;

5. The number of deferral and variance accounts should be reduced to reflect the revised structure of the plan;

6. There should be an asymmetrical earnings sharing mechanism consistent with the ESM approved for Horizon;

7. OPCUN should be required to develop, in conjunction with intervenors and Board Staff, meaningful metrics and targets related to its capital plan and more comprehensive reporting

2. DISTRIBUTION SYSTEM PLAN AND CAPITAL EXPENDITURES:

Capital Expenditures

What is clear with respect to OPUCN's capital plan is that there is no embedded productivity. The Council submits that once the DSP was completed and the forecast of capital prepared, OPUCN should have made adjustments to reflect productivity. Otherwise, the budgets are simply cost of service budgets. For this reason the Council submits that the Board should make adjustments to its base year capital plan to account for productivity (if it is requiring a price cap approach). If the Board approves a form of Custom IR the Council urges the Board to reduce the budget in each year to reflect expected productivity and to encourage OPUCN to consider the pacing of its investments.

OPUCN has proposed an extensive capital expenditure plan over the course of the rate plan from 2015 to 2019. OPUCN states that, "in 2015-2019, the key drivers for OPUCN capital investments are the acceleration of customer connections in Oshawa

(~ 3% annual); associated increases in residential and commercial load growth (kW) of approximately 3% on average per year; and the continuation of grid modernization to move towards a "smarter grid" that will enhance system resilience and reliability and improve customer value and satisfaction." (Ex. 2/TA/p.7).

In the evidence and throughout the proceeding OPUCN explains that the customer connections and load growth forecast are the utility's best forecasts, but they are not certain. Because of this uncertainty regarding the two the main drivers of the capital expenditure plan over 2015 – 2019, the Council believes there are reductions that should be made to the plan to better pace and plan with bill impacts in mind.
Also, approximately one third of OPUCN's 2015 - 2019 capital expenditures are what have been defined as non-controllable capital expenditures. These expenditures, particularly those for 2018 and 2019 are not certain and are sufficiently unpredictable that their inclusion in the overall plan should be re-assessed.

The Council will provide specific submissions regarding both System Access and System Services expenditures.

1. OPUCN has included in its forecast approximately $1M in Hwy 407 expansion that is not receiving a contribution (Chapter 2, Run 4 Appendix 2-AA). OPUCN stated it had not received an update to the 407 expansion plans. The official position is that development is still on track to complete Phase 1 by December, 2015, however, in OPUCN's estimation development is behind the plan by between 3 and 6 months (IR 3.0-Staff-18 Ex 3/p. 26).

2. Mr. Labricciosa stated "again, the work that relates to that million is while they are working in that area we will install our infrastructure at the same time. So inasmuch that they're still staying on schedule, we are going to do our work. If they happen to slip off schedule, then we would not go in early or ahead of them. We would wait until they get to that greenfield and breakthrough and put ours in at the same time." (Tr. Vol. 3, p. 38). The Council recommends that the $1M as mentioned above not be included in the 2015 budget and be reassessed regarding whether it is necessary at all after a review of customer connections and the utility's other capital work commitments in future years.

3. The service expansion contributions illustrated an historical average of approximately 70% /year (Chapter 2 Run 4 Appendix 2-AA). The Council recommends that this percentage should be used for the 2015 -2019 forecasts of contributions. Mr. Savage stated, "So I am just pointing that out to show that the percentage -- the historical percentages you see here, you can't necessarily take them as an indicator -- -- of the future ones and of the actual ones. Many of those that showed 70 percent in history, when we did the initial evaluation, probably would have been about 50, 55 percent." (OH/Vol3/p38). The Council recommends that the 70% would be a better

forecast as it is consistent with historical levels.

4. With respect to the Durham Region and City of Oshawa plant relocation costs OPUCN stated, "additional or upgraded plant for <u>future</u> system and customer needs is at OPUCN's cost and is planned in accord with standard distribution system planning practices and overall cost efficiencies." (Ex2/TB/p. 77). The Council asked, "How do you decide whether that is cost-effective or not?" MR. LABRICCIOSA stated " … I would say coming back afterwards, in general, I don't think we would do it on a one by one basis, but we look at it and say coming back ten years later to do the work while the roadway is already completed and the boulevards are landscaped to try to get into the area and put the infrastructure in, comes at a very heavy price, in terms of restoration costs. So while the trench is open it would make sense to minimize the future cut and future restoration costs." (OH/Vol3/p 42-43). The Council questions whether this infrastructure is required in the absence of a specific current customer needs. These expenditures are, in our view premature. Decreasing the amount of additional or upgraded plant for future system and customer needs would decrease the Durham Region / City of Oshawa plant relocation costs by $1 – 2M over the plan.

5. OPUCN is seeking $13.5 million for capital contributions that it will have to make to HON for the building of its Enfield TS. This is the largest capital project included in OPUCN's DSP. There is a great deal of uncertainty with respect to the timing and the overall cost of the project. In an updated letter from HON regarding the Enfield TS it states, "The in-service date of the proposed new station will be determined after a connection request has been made by the relevant LDCs and a firm need has been established after the 2015 actual summer peak loads. As such, the local planning study team recognized and agreed that, where possible, distribution load transfers to help balance the forecasted load at Wilson TS and Thornton TS may be required in the interim prior to the proposed TS coming into service and that affected LDCs develop a timeline to implement any required load transfers. This also includes the review of available feeder capacity utilization at Thornton TS, in order to make efficient and cost effective use of available facility capacity. This interim solution may require additional LDC investments, which at this time is unknown."(TC2.9/p4). The Council questions whether or not this project should be included in the capital forecast given this uncertainty. OPUCN is forecasting three capital contributions to HON in 2015, 2017 and 2018 related to the project. From the Council's perspective the regulatory principle that assets are included in rate base once they are used and useful, must be upheld. The capital contributions should not enter OPUCN's rate base until the transmission station is used and useful, even though OPUCN may pay contributions in prior years. The contributions should be held in CWIP until they are added to rate base. If the Board approves a Custom IR approach then the

contributions should be added to rate base until 2018 assuming the project is in service. If the Board approves a 4th Generation index the timing and the cost of the project can be considered through an ICM.

6. The MS9 distribution voltage transformer station is included in OPUCN's DSP as needed infrastructure to connect the new Enfield TS. The cost is $14.5 million including the cost of related feeders. With such uncertainty regarding the likelihood of the Enfield TS coming into service before 2019 or beyond, the Council recommends that the MS9 project be deleted from the capital expenditure plan.

In summary, making the adjustments that the Council has suggested will work towards smoothing investments, incenting productivity and ensuring project priorities match system needs in the face of the numerous uncertainties including load growth, customer connections and 3rd party implementation of major capital projects.

Asymmetrical Capital Variance Account:

The Council is supportive an asymmetrical variance account to record the difference between the approved in-service amounts and actual, if the actual amounts are less than the proposed in-service amounts. This approach is consistent with the variance account approved by the Board in the Horizon case and in the most recent HON transmission Decision.

Working Capital:

Oshawa originally filed for a working capital allowance ("WCA") of 13%, based on the lead/lag study filed by Ernst & Young (Ex2/TA/S1). OPUCN updated the WCA calculation to reflect a number of corrections and changes that resulted from the interrogatory process and through the technical conference (Ex. K1.2 Table2/p2/update June23/15). These changes result in a reduction of the WCA percentage from 13.0% to 10.9%.

The Council has reviewed the submission of Energy Probe and supports its further adjustments in the calculation of the WCA percentage. These adjustments include:

1. Replacing the service lag suggested by OPUCN of 17.44 days with the industry standard figure of 15.22 days. This reduces the WCA percentage from 10.02% to approximately 9.37%.

2. Eliminating or significantly reducing the use of margin calls. As explained by Mr. Martin, OPUCN has a $7.5 million line of credit that it uses as a prudential

for the IESO and that this letter of credit has an annual cost of about $50,000 (TC/Vol.1/p122-123). Mr. Martin further indicated that OPUCN would need a letter of credit in the range of $10 to $12 million to eliminate the margin calls and that the annual incremental cost of higher letter of credit would be in the neighbourhood of $50,000 (TC/Vol.1/p123-124). The Council agrees with Energy Probe that ratepayers would be better off paying for a higher letter of credit that would eliminate the need for margin calls. This would change the cost of power expense lead that reflects the higher letter of credit to 32.91 days.

Incorporating the numerous corrections that OPUCN agreed to through the interrogatory, undertaking and cross examination processes as mentioned above, as well as reflecting the correct figure for the service lag (15.22 days) and the cost of power expense lead that reflects a higher letter of credit (32.91 days) as described in Energy Probe's submission results in a WCA percentage of 7.33%. The Council agrees that this is the appropriate WCA percentage for OPUCN.

3. OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS:

OPUCN's forecasts for OM&A Costs for the five-year term are: $12.053 million (2015), $12.532 million (2016), $12.824 million (2017), $13.032 (2018) and $13.103 (2019)

The Council has reviewed the submissions of the School Energy Coalition (SEC), Board Staff and Energy Probe regarding OM&A. They have all set out a number of reasons why OPUCN's forecasts for OM&A are too high. SEC points to consistent underspending relative to Board amounts, staffing issues, and the fact that no efficiencies are built into the budget. These are all valid reasons to reduce the OM&A amounts. The Council supports the approach advanced by Energy Probe to index OM&A over the term of the plan. This is consistent with the approach approved by the Board with respect to Horizon and consistent with a number of other IR applications. This approach ensures that an up front productivity factor is included in the plan.

4. FORECASTS:

The Council submits that the Board should rely on OPUCN's own evidence regarding its load forecast. On June 23 the updated evidence confirmed a 3% increase in load. During the proceeding OPUCN indicated that it continued to believe that the 3% annual growth rate was its best forecast (J2.4).

5. REVENUE REQUIREMENT:

The Council has no direct submissions to make regarding the calculation of the revenue requirement.

6. DEFERRAL AND VARIANCE ACCOUNTS:

The Council has made various submissions regarding deferral and variance accounts throughout this argument.

7. COST ALLOCATION AND RATE DESIGN:

The Council is not taking issue with any of OPUCN's proposals regarding cost allocation and rate design.

8. RATE IMPLEMENTATION:

OPUCN is seeking to recover the revenue requirement associated with 2015 assuming rates were in place January 1, 2015. The current practice at the Board for LDCs that are seeking January 1 rates is to require an April filing. In July 2013 OPUCN wrote to the Board advising of its intention to file a Custom IR Application for rates effective January 1, 2015. That Application was not filed until January 29, 2015. On December 30, 2014, the Board approved OPUCN's application for interim rates effective January 1, 2015.

The Council recognizes that if the Board deems it appropriate, given interim rates are in place, OPUCN's effective date could be January 1, 2015. This does not constitute retroactive rate-making. The Board does, at times approve retrospective rates, when an applicant's request is sufficiently justified. This was done in the most recent HON Distribution proceeding because HON filed in a timely manner and any delays were not the result of its actions. The Board, however, is not required to go back to January 1 to set rates simply because it has declared the rates interim. The Board made this clear in its interim rate order.

OPUCN indicated that despite its diligent efforts the scale and scope of the work involved in presenting the 5-year application resulted in the delayed filing. In addition, OPUCN has argued that an effective date other than January 1 would be "penal and unfair" (AIC, pp. 42-43). The Council disagrees.

This was a live issue in the most recent Ontario Power Generation Inc. ("OPG") payment amounts application. OPG made an argument that the Board was required to set rates effective January 1 on the basis that declaring rates interim required it. In addition, OPG argued that unless the Board did so it would be violating the "fair

return standard". In that case, the delay in filing was due to OPG's own decisions, and was not the result of external circumstances.

In that case the Board enunciated its general practice of making rates final at the conclusion of a proceeding:

> The Board's general practice with respect to the effective date of its orders is that the final rate becomes effective at the conclusion of the proceeding. This practice is predicated on a forecast test year which establishes rates going forward, not retrospectively. Going forward, the utility knows how much money it has available to spend and the ratepayer knows how much it is going to cost to use electricity in order to make consumption decisions. The forecast test year enables both the utility and the ratepayer to make informed decisions based on approved rates. The forecast test year is a pillar in rate setting and the Board's practice must be respected (Decision with Reasons, EB-2013-0321, p. 221)

OPUCN should not be granted an effective date of January 1, 2015, simply because the preparation involved in filing a Custom IR application was onerous and complex. OPUCN was aware of the Board's filing requirements. If the circumstances were beyond its control, the relief might be granted, but that is not the case.

The Council also has concerns about the practical effect of a January 1, 2015, effective date. OPUCN would be collecting amounts from customers on the basis that although they paid rates from January 1 on, those rates should have been higher. The Council believes that to the extent possible this scenario should be avoided. The Council supports an effective date that aligns with the date of the final rate order.

III. CONCLUSION:

The Council does not believe that OPUCN has sufficiently demonstrated the need to set rates on the basis of a Custom IR approach. Furthermore, OPUCN has not demonstrated that its specific Custom IR proposal is an appropriate approach to rate-setting that is both consistent with the RRFE and in the best interests of its ratepayers. The Council submits that the Board should reject the application as proposed and order OPUCN's rates be established on the basis of the 4th Generation IRM. The 4th Generation approach will incent OPUCN to look for efficiencies either through cost reductions or by reconsidering the pace of its proposed capital programs. To the extent non-controllable projects arise OPUCN will have access to the ICM and ACM modules.

If the Board determines that OPUCN's rates should be determined based on a custom approach, the Council has set out how above what amendments would be required. Those amendments would better align a custom approach with the expectations and requirements of the RRFE.

III. COSTS:

The Council requests that it be awarded 100% of its reasonably incurred costs incurred in connection with this proceeding. The Council submits that it has participated responsibly throughout this proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED