Ontario Energy Board
Commission de l’énergie de l’Ontario

DECISION AND ORDER

EB-2014-0101

OSHAWA PUC NETWORKS INC.

Application for electricity distribution rates and other charges beginning January 1, 2015 and for each following year through to December 31, 2019.

BEFORE: **Allison Duff**
Presiding Member

Cathy Spoel
Member

Emad Elsayed
Member

November 12, 2015

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1 INTRODUCTION AND SUMMARY

This is a Decision of the Ontario Energy Board (OEB) on an application filed by Oshawa PUC Networks Inc. (Oshawa PUC) on January 29, 2015 for permission to charge certain distribution rates to its customers from 2015 to 2019.

Oshawa PUC owns and operates an electricity distribution system in Ontario, serving approximately 55,400 customers in the City of Oshawa and the Region of Durham. There are approximately 50,500 residential, 4,000 small commercial (general service < 50 kW) and 500 industrial (general service > 50kW) customers. The remainder are in the unmetered scattered load, street lighting and sentinel lighting customer categories.

The rates approved in this Decision are set based on the OEB's determination of the revenue required to cover the cost of operating and maintaining Oshawa PUC's distribution system at a level of service that meets the needs of its customers.

A few years ago, the OEB reviewed its approach to setting distribution rates for regulated distribution utilities in Ontario. The resulting policy was introduced in October 2012 in a Report of the OEB titled *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* (RRFE). The RRFE policy provides options for a distributor to apply for rates. The RRFE policy, as the title states, confirms a performance-based approach to regulation that supports the cost-effective planning and efficient operation of a distribution network. The OEB intends the policy to provide an appropriate alignment between a sustainable, financially viable electricity sector and the expectations of customers for reliable service at a reasonable price.

The RRFE provides that utilities may choose one of three rate-setting options. Oshawa PUC asked the OEB to approve its rates for five years using the Custom Incentive Rate-setting (Custom IR) option. A Custom IR is a minimum five-year rate plan that may for example, be a suitable choice for distributors with large and highly variable capital investment requirements.

The OEB finds that Oshawa PUC's application does not meet the all the expectations of the RRFE for a Custom IR. The deficiencies include the number and extent of the proposed annual adjustments and the absence of defined productivity targets and outcomes during the five-year term of the plan.

While there was no settlement among the parties prior to the hearing, during the course of the hearing, an alternative approach was proposed by the parties and agreed to by Oshawa PUC. Rather than annual adjustments, the proposal is to set rates for 2015, 2016 and 2017 now and allow for a mid-term review to update information and finalize rates for 2018 and 2019.

While the OEB does not encourage alternatives to an application to be proposed, evaluated and supported during the hearing process, in this case, it was a successful outcome. The OEB commends the parties for collectively working toward a solution that meets Oshawa PUC's business requirements.

The OEB approves the alternative approach agreed to by Oshawa PUC. The OEB finds that the evidence filed is comprehensive, and provides sufficient information to set rates for 2015, 2016 and 2017 on a final basis and rates for 2018 and 2019 on an interim basis. During 2017, the OEB will require Oshawa PUC to file a mid-term update of information to allow the OEB to finalize rates for 2018 and 2019.

2 THE PROCESS

In reaching its findings, the OEB was aided by the participation of five parties who each represented different groups of customers affected by the application; the Consumers Council of Canada, Energy Probe Research Foundation (Energy Probe), the Greater Oshawa Chamber of Commerce, the School Energy Coalition (SEC), and the Vulnerable Energy Consumers Coalition, collectively referred to as the intervenors. OEB staff was also a party and participated actively in the proceeding.

The OEB provided parties the opportunity to ask Oshawa PUC questions about its evidence in writing through interrogatories, and in person at a technical conference on May 21 and 22, 2015. A settlement conference was held from June 2 to 4, 2015 and all parties were invited to participate. No settlement was reached among the parties on any of the issues.

The OEB decided to proceed with an oral hearing, followed by written argument. The daily transcripts of the oral hearing, the evidence and written arguments are on the OEB's website www.ontarioenergyboard.ca under file number EB-2014-0101.

3 STRUCTURE OF THE DECISION

The OEB has organized this Decision into sections, aligned with the approved issues list, and numbered accordingly. Each section covers the OEB's findings and the reasons for approving or denying certain aspects of the application.

4 RENEWED REGULATORY FRAMEWORK ISSUES

4.1 Custom Application

The OEB evaluates applications for distribution rates under its Renewed Regulatory Framework for Electricity (RRFE). The policy framework provides a performance-based approach to regulation including the delivery of financial, operational and public policy outcomes while maintaining a focus on customer needs.

The RRFE affords distributors three rate-setting options, each of which is intended to accommodate varying capital and other requirements of distributors based on their current and forecast business conditions.

In selecting an option, Oshawa PUC considered its business challenges over the next five years. In particular, Oshawa PUC forecast significant customer growth in its service area – as much as three times the growth rate of the last decade – and was uncertain regarding the exact cost and timing of capital investments required to accommodate this growth. In particular, the extension of Highway 407 to the east of Toronto is expected to spur new housing development and require the relocation of sections of Oshawa PUC's existing electricity infrastructure. In addition, an increase in electricity demand will require a new transformer station to increase delivery capacity to new and existing Oshawa PUC customers.

Oshawa PUC also outlined the challenges it has faced since its last cost of service application in 2011. Oshawa PUC had its rates adjusted annually under Price Cap Incentive Regulation (Price Cap IR), before Custom IR was an option. With a Price Cap IR application, a mathematical formula determines the annual rate increase and there is no full cost of service review of the utility's rates.

Since its last cost of service hearing, Oshawa PUC had significant non-discretionary investments that materially decreased its net income. Although the OEB-approved return on equity (ROE) was 9.3% in 2012, Oshawa PUC's actual regulatory ROE was less than 6% in both 2013 and 2014. Oshawa PUC's evidence indicated that rates set applying the Price Cap IR option for 2015-2019, even after a full cost of service review for 2015, would not support the forecast level of capital spending required, a level two or three times its annual depreciation expense. To restore its ROE to levels within the range of the OEB's allowed level, while funding the forecast capital investments required, Oshawa PUC selected the Custom IR option.

In its Custom IR application, Oshawa PUC proposed a number of annual adjustments to manage the uncertainty of its capital plan as the timing and cost of some investments are dependent on third parties and beyond the utility's control. For example, Oshawa PUC proposed to update its load forecast and adjust rates prospectively each year from 2016 to 2019 for updated load growth and capital expenditure forecasts.

Intervenors and OEB staff questioned whether Oshawa PUC's capital plan was sufficiently variable and uncertain to warrant a Custom IR, and whether the annual adjustments were consistent with the RRFE and would add regulatory costs and processes.

As an alternative to setting rates for five years, OEB staff suggested a mid-term review in 2017 to establish rates for 2018 and 2019, by which time more information would be available on the timing of capital investments and new customers. Most intervenors were in favour of a mid-term review yet differed in the details, particularly with respect to which revenue requirement inputs would be set for the first three years and subject to update in the last two years.

In reply argument, Oshawa PUC defended its Custom IR application as the annual adjustments would address risks associated with 15% of its revenue requirement; risks it argued that neither the company could control nor should its customers bear. However, Oshawa PUC submitted that it could accept a pre-scoped, mid-term review and agreed that it might be a better approach in their current circumstances and one within which it could effectively operate. A mid-term review would also address the concerns regarding regulatory burden and frequency of adjustments raised by the parties.

Findings

The OEB finds that the application does not meet all expectations of a five-year Custom IR application under the OEB's RRFE policy. In referring to the Custom IR rate-setting method, the RRFE states:

> The OEB expects that a distributor that applies under this method will file robust evidence of its cost and revenue forecasts over a five year horizon, as well as detailed infrastructure investment plans over that same timeframe. In addition, 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[1].

[1] RRFE Report, page 19

A distributor should not file a Custom IR unless it is prepared to take on risks, and manage those risks, throughout the five-year term. The OEB finds that the application does not meet the expectations of the RRFE in a number of areas. The number and extent of the proposed annual adjustments does not demonstrate that Oshawa PUC can manage within the rates set for five years. To the contrary, the proposed annual adjustments are designed to correct the rates and decrease the risk by adjusting the forecasts given new revenue and cost information.

The OEB, however, disagrees with the argument put forward by OEB staff and the intervenors that a Price Cap IR rate plan would continue to be a good fit for the utility, with an Incremental or Advanced Capital Module to accommodate the timing uncertainty of its planned capital additions.

The capital spending that Oshawa PUC could not avoid in 2013 and 2014 compromised its ability to achieve the OEB's approved ROE. The evidence suggests that these investment needs will continue. In addition, Oshawa PUC indicated that the Advanced Capital Module was not an available option when it was preparing its application.

Oshawa PUC selected the Custom IR option, and the OEB will deal with that application and will not impose Price Cap IR with a capital module option for setting rates in 2015 to 2019. The OEB finds that the evidence filed by Oshawa PUC provides sufficient credible information to set final rates for a three-year period, and interim rates for a two-year period, subject to the directions set out in this Decision.

4.2 Annual Adjustments and a Mid-term Review

Oshawa PUC proposed annual rate adjustments to address the significant risks of forecast error in revenues and costs, despite its rigorous planning efforts. Of particular concern were events outside Oshawa PUC’s control, such as delayed or reduced growth in the community, or unexpected higher capital required for asset relocation in response to municipal, regional or third party requirements.

Annual adjustments were intended to protect both Oshawa PUC and its customers from these uncontrollable and unpredictable material risks, and to preclude reopening Oshawa PUC’s rates to full review during the five-year plan period. The proposed adjustments were:

- Updated actual and forecast costs for required relocation of distribution plant in response to 3rd party requests
- An updated load forecast and an associated update to net new customer connection costs to account for updated customer connection and volume forecasts

- Updated cost of capital applying OEB-approved cost of capital parameters for capital structure, return on equity and cost of debt
- Updated forecast working capital requirements based on updated cost of power forecasts.

In addition, Oshawa PUC proposed one-time adjustments for actual and forecast costs related to contributions to Hydro One Networks Inc. (Hydro One) for transmission upgrades, and unbudgeted distribution projects required as a result of regional planning. Oshawa PUC agreed that the OEB's policies regarding Z-factors and off-ramps would also apply.

The RRFE indicates that a distributor proposing to have its rates set under Custom IR must demonstrate its ability to manage its business within the rates set, realizing that actual costs and revenues will vary from forecast. Oshawa PUC argued that it had adopted the proposition in the RRFE, which requires a distributor to commit to operating within those rates and managing its risks in exchange for the certainty of having its rates set in advance for 5 years. However, it also argued that the RRFE was not intended to burden distributors, or ratepayers, with risks for material costs that cannot be predicted or controlled by the distributor. Oshawa PUC submitted that despite the annual adjustments, it still was assuming risk for more than 85% of its revenue requirement from 2015 to 2019 and the risks within each year.

OEB staff and intervenors opposed the numerous annual adjustments and related variance accounts proposed by Oshawa PUC. They argued that these adjustments were contrary to the spirit and intent of the RRFE, which is to demonstrate the ability to manage within the rates set. Furthermore, the foundation of the RRFE is that a distributor must pace investments and smooth its rates in order to provide predictability and stability for customers.

OEB staff proposed a mid-term rate review to replace the proposed annual adjustments. A mid-term review was supported by some of the intervenors and was accepted by Oshawa PUC as this approach would largely address the "regulatory burden" and "number of adjustments" concerns raised by the parties.

Oshawa PUC continued to request that the cost of capital and working capital allowance be adjusted each year. OEB staff and intervenors were generally in favour of the usual annual adjustments for cost of capital but varied in their support of annual adjustments to the cost of power component of the working capital allowance.

Findings

The OEB finds that the number and frequency of the proposed adjustments over the plan term is inconsistent with the risk management principles under the Custom IR model - to manage within rates set, given that actual costs and revenues will vary from forecast. It is the OEB's view that Oshawa PUC's annual adjustment proposal does not provide the appropriate allocation of risk between the distributor and its customers. It also reduces the incentive to seek efficiency improvements.

Oshawa PUC selected the Custom IR option given its large and variable capital plan. However, as a relatively small distributor, Oshawa PUC does not have the diversity or breadth in its customer base and underlying infrastructure to readily manage the risk through trade-offs, deferrals and reprioritization, implicitly required in a Custom IR application.

Oshawa PUC stated that "it is overly simplistic to assume that all types of forecasts are equal when it comes to ability to manage risk". The OEB agrees that not all risks are equal, but is reluctant to categorize and segregate risks for some Custom IR applicants.

The OEB finds the mid-term review to be a reasonable alternative for Oshawa PUC, as it allows for rate adjustments in 2018 and 2019, if warranted. In reply argument, Oshawa PUC indicated that it "has considered the increased risk resulting from one mid-term review / adjustment process, and is prepared to accept that risk if the Board concludes that such an approach better responds, in Oshawa PUC's circumstances, to the spirit and intent of the RRFE".

The OEB finds that a mid-term review is the best of available options to deal with the deficiencies associated with Oshawa PUC's application.

The mid-term review will have a narrow scope with a limited number of 2016 actual and forecast updates. The OEB directs Oshawa PUC to file a new application no later than July 1, 2017 including evidence of:

- customer connections and consumption
- capital expenditures by Oshawa PUC, net of contributions, resulting from:

  a) regional planning
  b) third party requests for plant relocations
  c) new customer connections

- cost and schedule of the MS9 substation project and the proposed Hydro One Enfield TS, as well as any related capital contributions to Hydro One by Oshawa PUC

- cost of capital
- working capital requirements based on an updated forecast for the cost of power
- comparisons of OEB-approved to actuals for 2015-2017
- comparisons of the approved forecasts for 2018 and 2019 that are used to set interim rates in this Decision and updated forecasts for 2018 and 2019, and
- comparisons of the interim rates for 2018 and 2019 set in this Decision and the rates that would flow from the updated forecasts Oshawa PUC provides.

The comparisons should provide information, including on financial performance, sufficient for the OEB to determine whether rate adjustments are warranted.

The OEB approves rates for 2015, 2016 and 2017 on a final basis, and rates for 2018 and 2019 on an interim basis, pending a mid-term application and proceeding. The annual proposed rates will be updated in the Draft Rate Order, consistent with the changes ordered by the OEB in this Decision. The OEB will hold a scoped written or oral hearing process in 2017 to adjust and finalize the interim rates set for 2018 and 2019 if the updated evidence indicates that an adjustment is warranted.

The OEB will not approve any annual adjustments for the cost of capital or the working capital allowance in 2016 and 2017. The OEB understands that other OEB decisions regarding Custom IR applications have allowed for the approval of annual, mechanistic adjustments for these parameters. However, with a mid-term review planned for 2017 and the potential for early rebasing associated with financial performance outside of the OEB's 300-basis point earnings deadband, the OEB does not find the additional time, effort and expense required by further annual adjustments to be justified.

4.3 Outcomes, Monitoring and Reporting

The RRFE promotes the achievement of outcomes for the benefit of existing and future customers. Under a performance-based approach, a distributor is expected to demonstrate continuous improvement in achieving the four outcomes: customer focus, operational effectiveness, public policy responsiveness and financial performance.

To facilitate performance monitoring, the OEB has established a scorecard based on the four outcomes. All Ontario electricity distributors are to report their scorecard metrics on an annual basis. The scorecard metrics are available on the OEB’s website for all customers to review and compare by distributor. In addition to the scorecard, distributors under Custom IR are expected to propose performance targets and measures specific to their own business.

Oshawa PUC proposed that its outcome performance metrics include the OEB’s scorecard, maintaining OEB service quality requirements at 2014 levels, and reducing outages caused by porcelain insulator equipment failures and foreign interference (animal contact).

Intervenors argued that the outcomes and performance reporting proposed by Oshawa PUC were not adequate. OEB staff submitted that there should be metrics to measure efficiencies in operations, such as unit cost performance for operations, maintenance and administration (OM&A) costs or capital project costs.

Findings

The OEB finds that the measurement of outcomes proposed by Oshawa PUC is insufficient. For example, there are no proposed outcomes or efficiency metrics related to OM&A to demonstrate continuous improvement, other than outages.

The OEB encourages Oshawa PUC to develop additional meaningful metrics and targets to demonstrate continuous improvement in its OM&A and capital programs, and requires Oshawa PUC to file a revised set of metrics and targets as part of its first rate application after the completion of the term of this plan. In the meantime, Oshawa PUC is directed to report annually on the metrics it has proposed (scorecard, service quality levels and outage reduction measures) on April 30 each year.

4.4 Incentive Mechanisms

Rates set under Custom IR provide an inherent incentive: a distributor can retain the benefit of savings achieved over the rate term, up to a limit.

Oshawa PUC proposed three incentive mechanisms:

1) The Controllable Capital Investment Efficiency Incentive Mechanism (CCIEIM) to incent Oshawa PUC 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 tracked and shared between Oshawa PUC and its customers.

2) The System Renewal Capital Variance Account to protect customers and provide confidence to the OEB for planned system renewal project elements that are recovered in rates yet not implemented over the rate term.

3) The Total Cost Efficiency Carryover Mechanism (TCECM) to incent efficiency initiatives late in the Custom IR rate term by allowing Oshawa PUC to track sustainable cost savings and receive the resulting benefit for two years after the rate term.

During the oral hearing, Oshawa PUC clarified its TCECM proposal as follows:

- actual earnings would be calculated on a weather-normalized basis
- actual ROE would be calculated with standard utility accounting procedures, consistent with Horizon Utilities Corporation's OEB-approved settlement proposal[2]
- Oshawa PUC would accept the onus, and risk, to demonstrate the efficiencies implemented and savings claimed beyond 2019
- the efficiency carryover would be determined in the latter years of the plan
- the incentive would only apply to the last two years of the rate plan.

Neither the intervenors nor OEB staff supported the CCIEIM incentive. They noted that while Oshawa PUC had researched other jurisdictions and developed an innovative proposal for the OEB's consideration, they argued that the capital cost forecasts lacked independent assessment and benchmarking. OEB staff submitted that the incentive was not necessary to incent efficiencies as avoiding unnecessary capital spending and finding efficiencies in capital programs should be part of the regular business of a responsible distributor.

The intervenors and OEB staff supported the System Renewal Capital Variance account as it would allow customers to receive a refund for costs included in rates, for any system renewal projects not implemented.

The intervenors and OEB staff did not support the TCECM incentive. They argued that it was too complex and that Oshawa PUC had not demonstrated the necessity and the budgeted costs to be used to determine "investment efficiency".

Findings

The OEB commends Oshawa PUC for its innovative approaches to incentive mechanisms. Oshawa PUC researched approaches used in other jurisdictions with an aim to import best practices into Ontario, to the extent that the goals and outcomes were aligned with the RRFE and the unique aspects of Oshawa PUC's five-year plan. However, insufficient evidence was provided for the OEB to understand the purpose and application of these incentives in other jurisdictions and to determine if adoption of similar mechanisms in Ontario is appropriate.

The OEB approves the System Renewal Capital Variance Account as proposed as it allows the rate impact of projects approved yet not implemented to be refunded to customers. The OEB recognizes that five years is a relatively long planning term, and specific system renewal projects, in particular, may change based on ongoing assessments of need and scheduling.

[2] EB-2014-0002

The OEB will not approve the CCIEIM as Oshawa PUC, like any distributor, should strive to find cost savings and provide its best forecast in the evidence supporting a proposed capital expenditure plan.

The OEB will also not approve the TCECM. The OEB is not convinced the proposed calculations would capture efficiency gains in 2018 and 2019, and also finds the proposed calculation to be overly complex. In general, the OEB prefers to avoid incentives that require new deferral and variance accounts, complicated accounting and subjective elements, as these can lead to protracted and complicated proceedings when the accounts are to be cleared.

4.5 Earnings Sharing Mechanism

An earnings sharing mechanism enables the sharing of any earnings above or below the OEB-approved return on equity. Oshawa PUC did not propose an earnings sharing mechanism, yet several parties submitted that earnings sharing is an important feature of other Custom IR applications. Parties indicated that an earning sharing mechanism had been approved as part of the Enbridge Gas Distribution Inc.[3] and Horizon Utilities Corporation[4] Custom IR applications whereby over earnings were shared equally, with no dead band between the distributor and its customers.

Oshawa PUC's position is that it can operate with an earnings sharing mechanism if so directed by the OEB, provided that it relates to the load forecast used by the OEB to set rates. In particular, Oshawa PUC proposed a load forecast growth rate of 1.5% for each of 2015, 2016 and 2017 if its annual adjustment proposal was not approved, a decrease from its original load forecast growth of 3.0%. The decrease was proposed to reduce Oshawa PUC's revenue risk if the City of Oshawa's growth plans did not materialize as predicted. An earning sharing mechanism would protect customers until the mid-term review should the 1.5% be approved, yet the predicted growth of 3.0% actually materializes.

Findings

The OEB will not impose an earning sharing mechanism. Oshawa PUC did not propose one in its application and it is not a requirement of the RRFE. The fact that other Custom IR applications and settlement proposals have included an earning sharing mechanism is not relevant to Oshawa PUC.

[3] EB-2012-0459
[4] EB-2014-0002

As Oshawa PUC's rates are not to be finalized for 2018 and 2019, and will be subject to a mid-term update and review, the opportunity for Oshawa PUC to over-earn throughout the five-year term has been reduced. The OEB finds this adequately balances the needs of the utility and those of its customers.

4.6 Benchmarking

The RRFE emphasizes the importance of benchmarking in Custom IR applications. The cost forecasts filed by Custom IR applicants must be supported by benchmarking to allow the OEB to assess the reasonableness of the distributor's forecast costs[5].

Oshawa PUC retained Pacific Economics Group LLC (PEG) to provide an independent assessment of Oshawa PUC's forecasted costs for 2015-2019 compared to an econometrically determined benchmark based on historical costs of other Ontario distributors.

Using the total cost model adopted by the OEB to determine stretch factors cohorts for Ontario distributors under incentive ratemaking, PEG estimated that Oshawa PUC's 2015 – 2019 cost forecasts were 11.7% below the historical benchmark on average. PEG's evidence is that Oshawa PUC's cost performance should gradually improve from a level commensurate with a Group III stretch factor in 2015 to those of a Group II stretch factor in later years of the plan[6].

PEG also calculated the productivity growth that was implicit in Oshawa PUC's forecast of operating and capital costs. PEG found that if this productivity was achieved, the productivity growth of operation, maintenance, and administration (OM&A) inputs would average 2.17% annually and the productivity of capital inputs would average 0.12% annually. The combined total factor productivity would average 0.87% annually. The potential OM&A and total factor productivity embedded in Oshawa PUC's forecasts were above average historical trends for Ontario distributors as calculated by PEG.

Oshawa PUC submitted that the benchmarking evidence provided in the PEG report provides an independent validation that its planned capital investments were efficient, fair and reasonable and its forecast OM&A costs would remain among the most cost efficient distributors in the Province.

Oshawa PUC also had independent third parties review its capital investment plans and costs. Oshawa PUC's Asset Condition Assessment and Investment Plans were

[5] RRFE Report, page 13
[6] The OEB groups electricity distributors into five categories based on their efficiency, with Group 1 the most, and Group 5 the least, efficient.

reviewed by METSCO Energy Solutions (METSCO) and its System Renewal costs and System Service projects were reviewed by NBM Engineering Inc. (NBM). In addition, Oshawa PUC engaged UtiliWorks to assess its present grid status. UtiliWorks provided a Smart Grid Roadmap and Financial Analysis which Oshawa PUC used as a guide to prioritizing projects.

For OM&A, Oshawa PUC filed its own comparative analysis, which demonstrates that it has the lowest residential rates; is among the lowest in net OM&A per customer; has the lowest net fixed assets per customer; and the highest customer per FTE ratio of comparable distributors in Ontario.

Oshawa PUC submitted that its OM&A budgets were externally benchmarked in the PEG study as highly efficient and delivering productivity well above the average historical trends for Ontario distributors.

Some parties submitted that PEG's analysis was not a true external benchmark as it compared historical periods to a future period, benchmarking Oshawa PUC against itself, and that the future period costs were not sufficiently certain to form a reliable basis for benchmarking.

They also argued that RRFE policy presumes that benchmarking to other electricity distributors or similar regulated businesses will be used as a basis to develop a Custom IR applicant's cost forecasts, yet Oshawa PUC used a bottom-up approach to forecast its costs, and then provided the information to PEG for benchmarking purposes.

Findings

The OEB agrees that PEG's analysis, while informative, cannot be viewed as an external benchmark, as it simply compared Oshawa PUC's year-over-year performance against its expected future performance. Oshawa PUC's budgets were not compared to those of other distributors which is the primary purpose of external benchmarking.

The OEB also finds that the third-party reviews by METSCO and NBM are beneficial in supporting Oshawa PUC's asset condition assessments and project cost estimates.

Oshawa PUC also filed comparisons of its historical performance to other Ontario distributors using the OEB's compiled yearbook information. Oshawa PUC compared favourably on metrics such as total cost per customer and FTE per customer, with costs lower than the average distributor. The OEB finds that despite the subsequent $25 million addition to the capital expenditure forecast, the comparisons were still favourable.

The OEB appreciates the effort that Oshawa PUC made in preparing and filing the cost and productivity analyses. However, the OEB finds that further external benchmarking analysis would be beneficial in supporting future applications, particularly in the areas of capital and OM&A costs.

5 DISTRIBUTION SYSTEM PLAN AND CAPITAL EXPENDITURES

In the RRFE Report, the OEB stressed the importance of capital investment and capital planning, requiring rate applications to be supported by an integrated five-year capital plan that includes consideration of regional infrastructure planning. The five-year time horizon allows distributors to pace and prioritize projects with a view to the impact on the total bill for customers[7].

Oshawa PUC submitted its Distribution System Plan (DSP) with its application to document its asset management process and capital expenditure plan in accordance with the OEB's *Filing Requirements for Electricity Distribution Rate Applications*, Chapter 5.

Oshawa PUC indicated that the plan details its asset management process, demonstrating the approach that Oshawa PUC uses to collect, tabulate and assess information on physical assets, current and future system operating conditions, business needs and customer feedback, and how this information is used to plan, prioritize and optimize planned capital expenditures. Oshawa PUC also stated that its DSP sets out and supports its proposed expenditures on its distribution system and (non-system) general plant over a 5 year planning period, including both capital investment amounts and asset-related maintenance expenditures.

The DSP also reviews Oshawa PUC's 5-year investment history and analyzes the impacts of this historical investment program on the current and planned asset management and investment strategy. Oshawa PUC's historical capital expenditures and forecast capital expenditures are set out in Table 1:

[7] RRFE pp. 10-31

TABLE 1 CAPITAL EXPENDITURES, HISTORICAL AND FORECAST 2010-2019

	Actual					Forecast				
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
System Access	1,447	8,913	2,899	4,042	3,764	8,995	4,140	3,550	3,435	3,455
($ millions)		516.0%	-67.5%	39.4%	-6.9%	139.0%	-54.0%	-14.3%	-3.2%	0.6%
System Renewal	4,637	7,039	7,162	5,971	7,098	5,943	4,932	4,472	4,761	4,851
($ millions)		51.8%	1.7%	-16.6%	18.9%	-16.3%	-17.0%	-9.3%	6.5%	1.9%
System Service	-	-	-	1,903	1,566	2,418	1,380	5,820	18,395	4,050
($ millions)					-17.7%	54.4%	-42.9%	321.7%	216.1%	-78.0%
General Plant	775	1,476	2,302	530	486	1,675	1,180	755	889	510
($ millions)		90.5%	56.0%	-77.0%	-8.3%	244.7%	-29.6%	-36.0%	17.7%	-42.6%
Total Gross Expenditure	6,859	17,428	12,363	12,446	12,914	19,031	11,632	14,597	27,480	12,866
($ millions)		154.1%	-29.1%	0.7%	3.8%	47.4%	-38.9%	25.5%	88.3%	-53.2%
Capital Contributions	- 2,173	- 931	- 1,271	- 1,699	- 2,258	- 4,911	- 1,455	- 1,075	- 1,095	- 1,105
Total Net Expenditure	**4,686**	**16,497**	**11,092**	**10,747**	**10,656**	**14,120**	**10,177**	**13,522**	**26,385**	**11,761**
($ millions)			-32.8%	-3.1%	-0.8%	32.5%	-27.9%	32.9%	95.1%	-55.4%
										10.4%

SOURCE: EB-2014-0101, JUNE 23, 2015 UPDATE

Findings

The OEB finds that Oshawa PUC's DSP generally meets the OEB's expectations for a consolidated DSP as envisaged by the RRFE. However, the corresponding asset condition assessment and capital investment plans raised a number of questions.

Oshawa PUC conceded in its reply argument that its Asset Investment Prioritization tool associated with its Capital Investment Plan is a "work in progress". The OEB agrees that the Capital Investment Plan requires improvements. The main area of concern is that the investment prioritization process resulted in the majority of the proposed capital projects being ranked equally in terms of priority. Of 103 projects identified over the 2015-2019 period, 89 were assigned a high priority and only 3 projects were identified as being less than "high priority". In explaining the "high priority" classification, Oshawa PUC described those projects as being more amenable to scheduling in consideration of additional factors, such as available resources, cost efficiencies, and rate smoothing.[8]

[8] Exhibit 2, Tab B, Schedule 5, p. 1

The OEB finds that these prioritization results are an indication that the tools used by Oshawa PUC lack the necessary refinement to classify the relative priority of the projects involved. It was suggested by some parties that Oshawa PUC should be required to work with intervenors and OEB staff to develop a meaningful set of metrics and targets to track the effectiveness of the DSP.

The OEB encourages Oshawa PUC to continue to refine its investment optimization and prioritization tools and to develop appropriate metrics to measure the efficiency of capital projects planning and execution. It is Oshawa PUC's responsibility to determine how this objective is accomplished. As mentioned earlier in this Decision, the OEB requires Oshawa PUC to file a revised set of metrics and targets as part of its first rate application after the completion of the term of this plan.

Oshawa PUC's proposed capital expenditures for the 2015 to 2019 period total approximately $75 million. The various components of these proposed expenditures are as follows:[9]

System Access (net of 3rd party contributions)	18.3%
System Renewal	32.9%
System Service	42.2%
General Plant	6.6%

According to Oshawa PUC, the System Access projects are triggered by third party requests or other obligations. They are generally high priority and beyond Oshawa PUC's control. The System Renewal projects mostly involve the replacement of aging equipment and/or refurbishment of distribution assets. The System Service projects are driven by transmission and/or distribution capacity constraints due to load growth along with enhanced system operations and efficiencies. The System Service component includes two major projects: a contribution to Hydro One's Enfield TS, and MS9 municipal station and related distribution feeders. The General Plant component includes tools, vehicles, building services and information systems support.

The OEB also has some concerns about the quality of the project cost estimates in Oshawa PUC's proposed capital program. These concerns include:

- a history of under-spending on capital compared to plan

[9] Appendix 2-AA, Exhibit 1.4, p.22, June 23, 2015 update

- lack of benchmarking that would identify efficiency improvement opportunities, as opposed to just developing an independent estimate
- lack of internal efficiency improvement targets based on lessons learned during the plan period
- significant change in the cost estimates for some capital programs during the course of the proceeding, particularly MS9 related expenditures which grew by over 60% and contributed to a 77% increase in the total system service expenditures.

In order to address these concerns, the various parties suggested a number of measures, including:

- imposing a bottom-line reduction to the proposed capital budget
- removing certain large projects from the capital budget.

The OEB will not impose a bottom-line capital budget reduction and will not remove any projects from the capital budget. The OEB approves Oshawa PUC's capital budget subject to the following conditions:

- Given the uncertainty regarding the cost and timing of the Hydro One Enfield TS contribution and the MS9 substation projects, these will be subject to review and update at the mid-term review in 2017 for the 2018 and 2019 test years. The treatment of any contributions made by Oshawa PUC to Hydro One are dealt with in the rate base section below.

- The OEB directs Oshawa PUC to report annually on the status of its capital program, including an analysis of variances from plan.

- The OEB directs Oshawa PUC to remove $400,000 per year from its capital budget in 2015 to 2017 for new connection costs to match the 1.5% customer growth forecast approved and make the appropriate rate base reductions in preparing the Draft Rate Order.

6 RATE BASE

The rate base used to determine the revenue requirement is defined as net fixed assets calculated as the average of the balances at the beginning and the end of each test year, plus a working capital allowance. The net fixed assets include those distribution assets (wires, poles, transformers, meters, buildings, etc) that are associated with activities that enable the distribution of electricity. In this proceeding, only the working capital allowance and capital contributions were disputed by the parties.

Findings

The OEB approves the rate base as filed by Oshawa PUC for 2015, 2016 and 2017, with the exceptions noted in subsections 6.1 and 6.2. The OEB also approves the rate base as filed for 2018 and 2019, subject to the findings in subsections 6.1 and 6.2, and on the understanding that the rate base for these last two years will be adjusted as necessary as part of the mid-term review.

6.1 Working Capital Allowance

Oshawa PUC engaged Ernst and Young LLP (E&Y) to undertake a Lead/Lag Study to determine the working capital allowance (WCA). The WCA represents the amount of cash required to operate a utility's business on a day-to-day basis, taking into consideration the time lag between when payments are made by the distributor for services, and when payments are received from its customers. It is commonly based on a calculation of the OM&A and cost of power expenses, and is included in a utility's rate base.

Based on E&Y's study, Oshawa PUC initially proposed a 13% WCA for 2015, but subsequently revised its proposal to 10.2%. The E&Y witness agreed that 10.2% was a more accurate calculation, and better reflected Oshawa PUC's working capital needs.

Energy Probe submitted that the service lag of 17.44 days embedded in the 10.2% WCA was overstated given Oshawa PUC billed its customers monthly. While Energy Probe did not call any evidence on the point, it submitted that the industry standard service lag should be the mathematical mid-point of the monthly service period or 15.22 days. Energy Probe estimated that utilizing a 15.22 day service lag reduced the WCA from 10.2% to approximately 9.37%.

In reply argument, Oshawa PUC agreed to the revised service lag of 15.22 days and a WCA of 9.37%.

Findings

The OEB approves the WCA of 9.37% for 2015 reflecting Oshawa PUC's actual costs. The OEB notes that WCA default rates are only to be applied in cases where a distributor had not prepared a lead/lag study of its own costs.

Oshawa PUC also proposed the working capital allowance be updated annually for the cost of power. The actual cost of power from the prior year would be used to calculate the WCA, adjusting the 9.37% beyond 2015. This issue is discussed in the Annual Adjustments section of this Decision. The OEB finds that no annual adjustments for the cost of power will be made to Oshawa PUC's rates in 2016 and 2017. The cost of power will be updated in the mid-term application and the WCA will be adjusted accordingly in order to finalize rates for 2018 and 2019.

6.2 Capital Contributions

Oshawa PUC's capital budget includes capital contributions to third parties. The largest capital contribution in the budget is $13.5 million to Hydro One Transmission for building the proposed Enfield TS which will provide benefits to Oshawa PUC and its customers.

The capital contributions are to be paid in 2015, 2017 and 2018 and the Enfield TS is expected to be in service in 2018. Oshawa PUC proposed to increase rate base by the capital contributions in the year the payments are made.

OEB staff and several intervenors submitted that capital contributions should not be added to rate base until the underlying asset goes into service. Parties argued that the capital contributions to Hydro One do not benefit Oshawa PUC's customers until the Enfield TS is in service. Instead of adding the contributions to rate base, the rate-making treatment should be the same as if Oshawa PUC were building the asset. Oshawa PUC should treat the contributions as construction work in progress (CWIP) until the asset goes into service, in accordance with Article 410 of the OEB's Accounting Procedures Handbook. Parties also cited the OEB's Partial Decision and Order in Phase 1 of Toronto Hydro-Electricity System Limited (Toronto Hydro) Incremental Capital Module decision[10] as precedent for this treatment of the capital contributions.

Oshawa PUC argued that the Article 4.10 of the Accounting Procedures Handbook makes no reference to whether the asset has been put into service.[11]

[10] EB-2012-0064, Toronto Hydro partial decision, p. 55
[11] OEB Accounting Procedures Handbook, p. 32

Findings

The OEB finds that the capital contributions to Hydro One should be treated as CWIP until the underlying assets are used and useful. Oshawa PUC should accrue interest on the contribution made adding the total costs to rate base when the planned asset goes into service, which is currently expected in 2018. This accounting treatment is consistent with the Toronto Hydro partial decision.[12]

If the actual payment dates or total amount of contributions change from forecast, this information should be available for the mid-term review in 2017 to align rates with actual costs and service availability. As a result, there will be no additions to rate base prior to 2018 associated with the Enfield TS, and the amount added to rate base will be reviewed at the mid-term review, prior to the asset going into service.

[12] EB-2012-0064, Toronto Hydro partial decision, p. 55

7 OPERATIONS, MAINTENANCE AND ADMINISTRATION EXPENSE

Operations, maintenance and administration (OM&A) costs are the largest component of Oshawa PUC's revenue requirement at about $12 million per year. OM&A includes employee compensation, corporate costs, customer service and operations costs. Operations costs include the day-to-day maintenance of the system such as vegetation management, and work requested by customers such as restoring service, repairing failed equipment or responding to specific customer requests.

In addition to OM&A costs, Oshawa PUC incurs depreciation and amortization expenses, payments in lieu of taxes and property taxes.

Oshawa PUC's evidence was that its proposed OM&A budget was necessary to meet public and employee safety objectives, comply with the Distribution System Code, environmental requirements, government direction and to maintain service quality and reliability at or above regulated performance levels.

Oshawa PUC's proposed OM&A costs for 2015 to 2019 compared to historical actual costs from 2011 to 2014 are shown in Table 2.

Table 2 Operations, Maintenance and Administration Costs

2011- 2019

	Actual				Forecast				
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Operations	749,243	1,167,906	919,397	1,374,416	1,288,019	1,484,147	1,593,497	1,579,144	1,410,513
($ millions)		55.9%	-21.3%	49.5%	-6.3%	15.2%	7.4%	-0.9%	-10.7%
5 years from 2014 to 2019									2.6%
Maintenance	1,048,680	1,094,190	1,313,715	1,096,733	1,346,279	1,375,515	1,405,469	1,436,077	1,467,354
($ millions)		4.3%	20.1%	-16.5%	22.8%	2.2%	2.2%	2.2%	2.2%
5 years from 2014 to 2019									33.8%
Billing and Collecting	2,358,686	2,398,127	2,462,960	2,464,873	2,653,062	2,715,401	2,780,102	2,846,477	2,914,572
($ millions)		1.7%	2.7%	0.1%	7.6%	2.3%	2.4%	2.4%	2.4%
5 years from 2014 to 2019									18.2%
Community Relations	973,010	1,004,587	1,092,298	1,131,482	1,161,723	1,309,846	1,337,732	1,366,218	1,395,314
($ millions)		3.2%	8.7%	3.6%	2.7%	12.8%	2.1%	2.1%	2.1%
5 years from 2014 to 2019									23.3%
Admin. & General	5,022,130	5,402,280	5,245,121	5,002,232	5,604,762	5,647,747	5,707,425	5,804,965	5,914,459
($ millions)		7.6%	-2.9%	-4.6%	12.0%	0.8%	1.1%	1.7%	1.9%
5 years from 2014 to 2019									18.2%
Total OM&A	10,151,749	11,067,090	11,033,491	11,069,736	12,053,845	12,532,656	12,824,225	13,032,881	13,102,212
($ millions)		9.0%	-0.3%	0.3%	8.9%	4.0%	2.3%	1.6%	0.5%
5 years from 2014 to 2019									18.4%

Source: EB-2014-0101, June 23, 2015 update

Table 2 shows an increase of 18% in total OM&A costs over the 5 year period. Oshawa PUC indicated in its application, the primary driver for the cumulative average growth rate in OM&A from 2014 to 2019 was the increase of 6 full-time equivalent employees (FTEs), from 75 to 81, to support the expected increase in customer connections. Forecast customer connections were expected to increase by more than 16% over the same period.

Oshawa PUC also stated that the OM&A per customer measure illustrated the embedded efficiencies within its forecast. Adjusting OM&A costs for inflation, and using IRM actual and assumed inflation rates, the OM&A per customer decreases by approximately $23 per customer (11.0%) in 2019 compared to the level approved in Oshawa PUC's last rebasing decision.[13] This OM&A per customer metric is based on the customer growth assumption of 3% per year from 2015 to 2019.

Intervenors and OEB staff submitted that the OEB should reduce OM&A costs with a particular focus on 2015, the first year of the five-year plan. Reasons put forward for reductions include a load growth lower than forecast, OM&A increases higher than inflation and no planning for staff vacancies.

Oshawa PUC argued that these submissions did not take into account that the 2014 actual expenditures are not a reflection of typical Oshawa PUC costs, as labour costs were lower due to high employee turnover and a number of employees who were on long-term disability for that year. Oshawa PUC argued that using 2014 actual OM&A as a basis for calculating an inflation-adjusted 2015 cost is, therefore, not a relevant or useful approach.

Oshawa PUC argued that its application is for 2.1% annual OM&A growth rate, as compared to the average Conference Board of Canada forecast inflation rate for the same period of 2.65%.

Oshawa PUC pointed out that it plans to have an increase of only one FTE between 2015 and 2019 and argued that OM&A cost per customer, even if the 1.5% forecast is used, is still well below the industry average.

Findings

Establishing an appropriate OM&A budget is critical in ensuring that Oshawa PUC has sufficient funds to operate a safe and reliable system, considering the customer bill impacts are just and reasonable.

[13] EB-2011-0073

In reviewing the OM&A budget, the OEB also considers Oshawa PUC's efforts to achieve efficiency gains, by doing more work with fewer resources, implementing innovation and demonstrating continuous improvement.

The OEB finds that Oshawa PUC's OM&A budget is reasonable. The forecast average OM&A per customer is relatively stable over the term of the plan. In addition, Table 3 indicates that with a 3% forecast growth in customers in 2018 and 2019, the average OM&A per customer is expected to decrease.

Table 3 - Operations, Maintenance and Administration Costs per Customer 2014-2019

	Actual 2014	Forecast 2015	2016	2017	2018	2019
OM&A Updated ($000)	11,070	12,054	12,533	12,824	13,033	13,102
Customer Numbers	54,670	55,499	56,331	57,176	58,034	58,904
Rate of Growth (%)	n/a	1.5%	1.5%	1.5%	1.5%	1.5%
OM&A/Customer ($)	$ 202	$ 217	$ 222	$ 224	$ 225	$ 222
Alternative Rate of Growth		1.5%	1.5%	1.5%	3.0%	3.0%
Customer Numbers	54,670	55,499	56,331	57,176	58,891	60,658
Alternative OM&A per Customer	$ 202	$ 217	$ 222	$ 224	$ 221	$ 216

Despite projected growth, Oshawa PUC proposes to increase OM&A at less than the forecast rate of inflation and does not propose to increase its overall staffing. The OEB finds that this demonstrates a commitment to achieving efficiencies.

The OEB agrees with Oshawa PUC that taking the 2014 actual expenditures in isolation, as a base, is inappropriate as it does not give a full picture of its situation. The OEB notes that as well as the staff vacancy issues, Oshawa PUC had also under-earned by more than 300 basis points during 2013 and 2014. Under those circumstances, it is not surprising that they made do with less in 2014. However, the OEB is concerned that this may not be sustainable over the next few years.

While the percentage increase from 2014 actual spending may appear relatively large, the dollar impact on rates is not particularly significant as Oshawa PUC's rates are lower than most other distributors.

7.1 Letter of Credit

Oshawa PUC has a $7.5 million letter of credit that it uses as prudential support for the Independent Electricity System Operator (IESO). The annual interest cost of the letter of credit is approximately $50,000. The function of such a deposit is prepayment of the distributor's cost of power. If the letter of credit were increased to preclude margin calls, then all power costs would effectively be prepaid, significantly increasing calculated working capital requirements.

Intervenors submitted that interest costs of $50,000 associated with the IESO letter of credit should not be included in OM&A expenses. It was submitted that the interest cost should be considered a short term debt expense in the cost of capital.

In addition, Energy Probe submitted that Oshawa PUC should increase its letter of credit with the IESO to reduce the number of margin calls. Oshawa PUC had 46 margin calls in 2012 and 33 in 2013. Energy Probe submitted that customers would be better off paying an additional $50,000 in interest costs for a higher letter of credit, thereby eliminating the need for margin calls. Energy Probe estimated a downward working capital allowance adjustment of 2.04% saving customers $200,000.

In reply argument, Oshawa PUC submitted that a higher letter of credit would tie up additional capital, which would be unavailable for other uses. With the significant ongoing capital investment requirements, such as the new municipal substation, the cost could be significant.

Oshawa PUC indicated that it currently has the financial capability to manage its account with the IESO under the current prudential arrangement and it should not be forced into a different financial arrangement that it cannot support and does not require.

Oshawa PUC argued that the letter of credit represents a cash deposit with the IESO. Such a deposit would be considered working capital and would likely eliminate most if not all the cost of power lead used in the calculation of the working capital allowance.

Findings

The annual interest cost on the letter of credit of $50,000 is not a material amount, regardless of whether it is treated as an OM&A expense or absorbed as a cost of short-term debt in the cost of capital.

The OEB will not direct Oshawa PUC to alter its financial arrangements with the IESO for the cost of power. There is no evidence that Oshawa PUC has acted imprudently in establishing the existing letter of credit. The OEB finds that specific financing decisions should be made by Oshawa PUC's management considering the opportunity cost of its available capital. As a result, there will be no changes to the working capital allowance or the cost of capital sections of this Decision.

8 CUSTOMER AND LOAD FORECASTS

To develop its load forecasts, Oshawa PUC used a multiple regression analysis to determine the relationship between the consumption of electricity and other factors such as the economy and inflation. Knowledge of extraordinary events were also used to adjust the load forecast from the regression analysis, such as population growth, weather normalization, the City of Oshawa's replacement of streetlights with LEDs and conservation and demand management.

To develop its customer forecast, Oshawa PUC used a model which predicted an annual growth rate of approximately 1.4% in total customer connections in 2015 to 2019. Oshawa PUC also took into account other factors that were expected to increase population forecast above normal growth levels, such as the extension of Highway 407, and increased its forecast by 1.6% for load growth, resulting in a total demand growth of 3% per year.

Oshawa PUC's application included a proposal to update its load forecast annually and adjust rates accordingly as the number and timing of customer additions were uncertain and outside of its control.

Oshawa PUC submitted that if the OEB did not approve annual adjustments to its demand growth forecast and adopted a mid-term review in 2017, the appropriate demand growth for 2016 and 2017 would be 1.5%, in line with its historical growth rate and the rate forecast for 2015.

Oshawa PUC indicated that a 3% average annual growth forecast is its "best" forecast for 2016 to 2019. Oshawa PUC relied upon discussions with the City of Oshawa, planners and developers to arrive at the 3% forecast in its application. However, given the uncertainties inherent in the 3% and that the range or potential rates based on external information was between 1% to 5%, the 1.5% was more appropriate in the absence of annual adjustments.

Parties supported the 1.5% growth rate for 2015 yet submitted the 3% growth rate for 2016 - 2019 should be approved. Parties indicated that Oshawa PUC described the 3% as the "best forecast" and the 1.5% ignored the significant evidence filed based on data from the city, region and developers. OEB staff submitted that the forecast of 1.5% per year was more reasonable than the 3% given historical trends.

In reply argument, Oshawa PUC clarified that the 3% was the forecast based on available information, yet it could not afford to take the risk associated with a 3% for 2016 and 2017 given the uncertainties and reliance on third parties. Assuming the mid-term review provided the opportunity to update the growth forecast, Oshawa PUC submitted the 3% was still appropriate for 2018 and 2019.

Findings

The OEB finds that using the proposed 1.5% growth forecast for each year until 2019 is inconsistent with Oshawa PUC's capital plan. Growth is clearly forecast for the City of Oshawa. All evidence is that the historical growth rate of 1.5% will be exceeded. Oshawa PUC filed an application to reflect that growth and to prepare its distribution infrastructure to accommodate that growth.

The OEB understands that Oshawa PUC growth is dependent upon third-party predictions, including the completion date of the Highway 407 extension. As of the date of this Decision, the extension is not complete and the forecast growth has not materialized. The pace of growth has been less than expected. While 3.0% was proposed in the application, that evidence was updated by Oshawa PUC during the oral hearing. The best available information was provided by Oshawa PUC in testimony. One reason that Oshawa PUC under-earned in 2012 and 2013 was that its target growth was over-ambitious. The OEB is reluctant to impose another load forecast that is higher than the most recent evidence.

The OEB approves an annual 1.5% growth rate for 2015, 2016 and 2017 and a 3.0% growth rate for 2018 and 2019. As a result, the load forecast will match the capital budget by the end of the planning term. Oshawa PUC has the opportunity to update the forecast growth rate for 2018 and 2019 based on actual results to date at the mid-term review. The OEB directs Oshawa PUC to revise its kWh calculation for 2015 - 2019 accordingly when preparing the draft rate order.

9 REVENUE REQUIREMENT

The revenue requirement is the total cost for a utility to provide energy service. It includes the cost of salaries, equipment, capital projects, depreciation, taxes, interest and a return on equity invested by shareholders. The revenue requirement is used to set rates for customers.

Parties and OEB staff did not take issue with the elements of the revenue requirement calculation, other than suggestions for reductions in OM&A and rate base, including working capital.

The OEB approves all aspects of the proposed revenue requirement calculation, unless otherwise indicated in this Decision. The OEB expects Oshawa PUC to revise the revenue requirement calculation to reflect the findings in this Decision as part of the draft rate order.

10 COST OF CAPITAL

Oshawa PUC applied the standard capital structure of 40% equity and 60% debt, of which 56% was long-term and 4% was short-term debt. For the return on equity and short term debt in 2015 - 2019, Oshawa PUC applied the rates in the *Cost of Capital Parameter Updates for 2015 Cost of Service Applications*, issued by the OEB on November 20, 2014 (the 2015 deemed rates).

For long-term debt to comprise 56%, Oshawa PUC applied its actual weighted average rate cost to the debt outstanding (funded debt) and the 2015 deemed long-term debt rate to any unfunded debt. Oshawa PUC's funded debt included notes payable to the parent company, Oshawa Power and Utilities Corporation and the Toronto Dominion Bank. Oshawa PUC anticipated issuing new debt during the plan term to which the deemed long-term debt rate would apply.

Energy Probe argued that there was sufficient evidence to show that Oshawa PUC has the ability to borrow at rates significantly below the deemed rate and submitted that the forecast rate applied to new issues should be its actual long-term debt rate.

In its reply submission, Oshawa PUC submitted that the deemed rate should be used for any new debt issues as there was no merit in attempting to forecast the long-term debt rate. The future rate would depend upon timing, amount, and term of a new debt issuance and be influenced by factors such as cash flow and financial market conditions. Oshawa PUC clarified that it was not expecting to seek additional funding until 2017; therefore, the differential between funded and deemed rates would not be a material amount.

Oshawa PUC also proposed the OEB allow annual updates to its cost of capital for recovery in rates, applying the OEB's deemed rates for 2016 - 2019. Most parties except Energy Probe supported an annual adjustment for cost of capital as the calculation was simple, mechanistic and had been granted to other electricity distributors.

Findings

The OEB approves the proposed cost of capital for 2015. After submissions were filed, the OEB issued the approved cost of capital parameters for 2016. The OEB directs Oshawa PUC to apply the 2016 cost of capital parameters to determine rates in 2016 – 2019. As indicated in the Annual Adjustment section of this Decision, the OEB will not approve annual adjustments to the cost of capital as final rates will be set for 2015 - 2017. Oshawa PUC will have the opportunity to update the cost of capital to incorporate the OEB deemed cost of capital parameters from 2017 to update rates in 2018 and 2019.

For long-term debt that comprises funded and unfunded components, the OEB finds it appropriate to apply the actual cost to the funded debt and the deemed rate to the unfunded debt. The OEB establishes deemed rates to apply when the underlying debt does not exist or is not funded in order to achieve the approved capital structure. To the extent funded debt exists, the corresponding actual rate should apply to the funded debt only.

For the purposes of setting rates for 2015 - 2019 in this Decision, the 2015 deemed return on equity, the deemed short-term debt rate and the weighted average long-term debt rate will apply to the 40%/60% capital structure.

11 DEFERRAL AND VARIANCE ACCOUNTS

Variance accounts track the difference between the forecast cost of a project or program, which has been included in rates, and the actual cost. If the actual cost is lower, then the extra money is refunded to customers. If the actual amount is higher, then the utility can request permission to recover the extra amounts through future rates.

In contrast, a deferral account tracks the cost of a project or program, which the utility could not forecast when the rates were set. When the costs are known, the utility can then request permission to recover the costs in future rates.

Oshawa PUC did not request disposition of any of its Deferral and Variance Accounts (DVAs) in Group 1 and Group 2 as the net balances were relatively small and volatile from year to year. However, Oshawa PUC indicated that it would seek annual disposition of Group 1 balances as necessary during 2015 - 2019 to comply with OEB policy[14].

As at December 2013, total DVA balances were a receivable to Oshawa PUC of $2,195,932. As of September 2014, the comparable total DVA balances were a net payable for Oshawa PUC of $345,848. Oshawa PUC indicated that the balances were driven by unusual movements in commodity costs and the global adjustment, which led to larger than normal swings in some DVA balances.

Oshawa PUC proposed to maintain two existing DVAs, the Tax Rate Changes and Pension Cost Differential Deferral Accounts and to discontinue the Special Purpose Charge Variance Account. Parties and OEB staff supported this proposal except Energy Probe which indicated that the Tax Rate Change account should be discontinued as changes to tax rates is a risk other businesses are required to bear.

Oshawa PUC also proposed seven new DVAs:

- 2015 Revenue Variance Account: to address the revenue difference between rates effective January 1, 2015 and the actual implementation date.

- Unbudgeted Regional Planning Investment Cost Variance Account to track the variance between forecast and actual costs incurred by Oshawa PUC due to regional planning related capital expenditures.

[14] Report of the Board on Electricity Distributors Deferral and Variance Account Review Initiative, EB-2008-0046, July 31, 2009 (EDDVAR).

- Distribution Plant Relocation Cost Variance Account to track the variance between forecast and actual costs incurred by Oshawa due to plant relocations in response to third-party requests.

- Net New Connection Cost Variance Account to track the variance between budgeted and actual net new connection costs.

- Rate Smoothing Deferral Account to support of implementation of the proposed rate smoothing of the 2015 and 2016 rate increases.

- 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.

- Depreciation Expense Deferral Account, arising from the approved Settlement Proposal in EB-2011-0073, to record additional depreciation from 2012-2014 of approximately $150,000.

Support for establishing the new DVA's from parties and OEB staff depended upon the OEB's decision regarding annual adjustments, incentive mechanisms, effective date for rates and risk mitigation proposals.

Only OEB staff submitted that Oshawa PUC should dispose of its Group 1 and 2 DVAs in accordance with OEB policy regarding disposition upon rebasing. If there were concerns regarding the volatility of commodity-related balances, OEB staff submitted that disposition could be made on an interim basis.

Findings

The OEB finds it appropriate to dispose of the Group 1 and 2 DVA balances as at December 31, 2014. OEB policy is to clear the DVA balances for Group 2 accounts when re-establishing rates. This is particularly important for distributors under Custom IR as the next rates case could be in five years, leading to long periods between costs being incurred and their recovery causing intergenerational issues. The policy applies whether the payment is to the utility or its customers. Group 1 accounts are cleared annually if the threshold defined in the EDDVAR is reached. The OEB accepts Oshawa PUC's assurance that it will seek disposition if the threshold is reached.

The OEB will approve continuation of the Tax Rate Changes and Pension Cost Differential Deferral Accounts and discontinuance of the Special Purpose Charge Variance Account as it is no longer needed.

The OEB will approve a new variance account to track system renewal capital projects costs as discussed in the Incentive Mechanisms section of this Decision.

Technically, the OEB implicitly approved the new Depreciation Expense Deferral Account, as part of the approval of the EB-2011-0073 settlement. No new depreciation-related entries should be made to this account in 2015 as the terms of the settlement proposal applied only to 2012-2014. The OEB agrees with Oshawa PUC that it is appropriate to reduce its 2015 rate base to account for the additional depreciation recorded.

The OEB will not approve the other six new DVAs as proposed.

With respect to the Rate Smoothing Deferral Account and the 2015 Revenue Variance Account, other findings elsewhere in this Decision make these accounts unnecessary.

With respect to the other four requested accounts, the OEB acknowledges that a five-year custom IR time horizon may present challenges and opportunities for distributors to manage. However, the five-year time period is set by the RRFE and all distributors with Custom IR rates are expected to plan and manage over that time frame. The OEB appreciates that changes from forecasts in the later years will require flexibility from the distributor, yet is not convinced that variance accounts are the appropriate ratemaking tool to address this issue.

12 COST ALLOCATION AND RATE DESIGN

Cost allocation and rate design are essential steps in determining appropriate rates for each customer class.

Appropriate cost allocation ensures that the distributor's cost of service is correctly apportioned to each customer class. The OEB has outlined its cost allocation policies in the OEB's reports of November 28, 2007: *Application of Cost Allocation for Electricity Distributors*, and March 31, 2011: *Review of Electricity Distribution Cost Allocation Policy*[15] (the Cost Allocation Reports).

Rates are also designed in accordance with OEB's policy to ensure the appropriate collection of costs from each customer class. While rate design is primarily concerned with the recovery of distribution costs, other rates are established to recover other types of costs such as the Retail Transmission Rates, Wholesale Market Service Rates and Retail Service Charges.

In the application, Oshawa PUC indicated that it had followed the OEB's requirements.

The results of a cost allocation study are typically presented in the form of revenue-to-cost ratios for each customer class. Oshawa PUC presented its cost allocation results and proposed revenue-to-cost ratios within the OEB's prescribed range for each rate class. A ratio lower than the OEB's range indicates a rate class is under-contributing, subsidized by other customer classes. A ratio greater than the OEB's range indicates the rate class is over-contributing and subsidizing other customer classes.

Oshawa PUC's application included a rate smoothing proposal to spread the 2015 increase over the five-year period of the plan. The proposal requires the establishment of a new deferral account and variable charge rate riders.

Findings

The OEB approves Oshawa PUC's proposed cost allocation and rate design for 2015 to 2019.

The OEB will not approve Oshawa PUC's proposed rate smoothing proposal or the related January 1, 2015 effective date. As discussed in the Implementation section of this Decision, the approved effective date for new 2015 rates is October 1, 2015, not January 1, 2015. With either date, the evidence indicates that rate smoothing between the effective and implementation date is not warranted as the bill impact to customers

[15] EB-2010-0219

would be less than 10% of total bill. In addition, incurring additional interest cost to customers in order to smooth rates from 2015-2019 is not justified.

The OEB notes that in its report, *A New Distribution Rate Design for Residential Electricity Customers* [16](EB-2012-0410) issued on April 2, 2015, the OEB confirmed that distribution rates for residential customers are to move to a fixed monthly distribution charge over a transition period starting in 2016. In its argument in chief, in reference to the Report, Oshawa PUC indicated that it would adopt the OEB's new rate design policy when and in the manner directed.[17] The Report allows for exceptions in certain circumstances.

The OEB finds that given the number of rate changes to be implemented on January 1, 2016 in accordance with this Decision, the OEB will not require Oshawa PUC to begin the transition to fully fixed residential rates until 2017.

Accordingly, the OEB expects that the draft rate orders submitted by Oshawa PUC for 2017, 2018 and 2019 will reflect the first three years of this transition to fully fixed residential rates. The OEB expects that the draft rate orders submitted by Oshawa PUC for 2017, 2018 and 2019 will contain a proposal for the transition to fixed residential rates. Oshawa PUC must also file a schedule for each of these years showing the anticipated year-over-year change to the fixed monthly service charge and a calculation of the combined bill impact of the changes arising from this Decision for a low-volume customer[18] in each year of the transition. If applicable, Oshawa PUC must show how it has considered mitigation for low volume customers consistent with approach outlined in section 2.8.13 of Chapter 2 of the OEB's *Filing Requirements for Electricity Distribution Rate Applications (2015 Edition)*.

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[16] EB-2012-0410
[17] Oshawa PUC argument in chief, July 15, 2015, p. 41
[18] A low-volume customer is a customer whose average consumption is the tenth percentile of monthly consumption for residential customers.

13 IMPLEMENTATION

Oshawa PUC proposed an effective date of January 1, 2015 for its new 2015 rates, the date its rates were declared interim by the OEB.

On December 23, 2014 Oshawa PUC notified the OEB of its intention to file a rate application in January 2015 and requested the OEB declare its current rates interim as of January 1, 2015. Oshawa PUC indicated that despite its best efforts, the filing was delayed due to the "scale and scope of an application involving 5 test years and a comprehensive Distribution System Plan…. inclusive of a number of supporting external review/reports commissioned at the end of 2013 and through 2014."

Oshawa PUC was not expected to file a cost of service application for 2015. However, Oshawa PUC indicated that it applied earlier as its earnings were eroding from the required capital expenditures since the last cost of service for 2012 rates. Reported results indicated that Oshawa PUC's ROE was more than 300 basis points below the OEB's approved ROE in 2013 and 2014, triggering an "off ramp" situation. Oshawa PUC claimed that its 2015 forecast, based on current rates, would lead to an ROE 800 basis points below the OEB approved rate.

Oshawa PUC submitted that the difference between the proposed January 1, 2015 effective date and actual implementation date for new rates could be smoothed over 5 years, resulting in reasonable and fair earnings for the utility while mitigating the impact on customers in 2015.

Oshawa PUC argued that should the OEB make its 2015 rates effective September 1, 2015 rather than January 1, 2015, it would suffer a revenue shortfall of $1.8 million, an annualized earnings shortfall of 345 basis points. Oshawa PUC submitted that this result would be unfair.

Some parties submitted that the effective date for rates should be the first day of the month following the decision while others submitted that it should be the same date as the rate order. Parties cited past OEB decisions in which the utility was not allowed to retrospectively recover amounts from a period when interim rates were in effect[19].

Parties also indicated the application was eight months late, given the OEB's timelines. Parties submitted that the type of application, the timing and the resources deployed to complete the filing were completely within Oshawa PUC's control.

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[19] OPG (EB-2013-0321), Sioux Lookout (EB-2012-0166), Hydro Hawkesbury (EB-2013-0139), Centre Wellington (EB-2012-0113) and Fort Frances (EB-2013-0130).

In reply submission, Oshawa PUC indicated that it appreciated its regulatory obligations to file complete and timely applications, and to properly manage its regulatory responsibilities. However, addressing these regulatory obligations were a primary reason for the late filing. Oshawa PUC submitted that the degree of thought, comprehensiveness, and response to the OEB's filing and evidentiary expectations mitigates, in the current circumstances, the timing shortfall.

Findings

The OEB will not approve Oshawa PUC's proposed effective date of January 1, 2015. This application had not been filed by that date.

The OEB approves an October 1, 2015 effective date for new 2015 rates. The OEB allows for an eight month regulatory process, between the date an application is filed and the date rates are proposed to be effective. This eight month period has been referenced in many OEB communications, in particular in its February 20, 2014 letter provided to distributors regarding suggested filing dates for setting new 2015 rates. As Oshawa PUC filed its application on January 29, 2015, its effective date will be October 1, 2015.

The implementation date for 2016 and 2015 rates will be January 1, 2016. For 2015 rates, Oshawa PUC must calculate a rate rider to be applied to 2016 rates that recovers the revenue that Oshawa PUC would have recovered in rates from October 1, 2015 to December 31, 2015 (consistent with the findings in this Decision). Oshawa shall file a schedule showing the calculation of the rate rider and its consistency with the 2015 draft rate order.

As indicated in the cost allocation and rate design section of this Decision, the OEB expects that the draft rate orders submitted by Oshawa PUC for 2017, 2018 and 2019 will contain a proposal for the transition to fully fixed residential rates. If applicable, Oshawa PUC must show how it has considered mitigation for low volume customers consistent with approach outlined in section 2.8.13 of Chapter 2 of the OEB's *Filing Requirements for Electricity Distribution Rate Applications (2015 Edition)*.

As noted earlier in this Decision, the rates for 2018 and 2019 are approved on an interim basis, and the rate order and tariff sheets for those years must indicate this status in the title of the document.

13.1 Error during Price Cap IR term 2012-2013

Oshawa PUC discovered and brought to the OEB's attention an error recorded for 2002 to 2005, overstating its length of kilometres of wire. The error was not detected when Oshawa PUC's rates were subject to a Price Cap IR adjustment in 2012 and 2013. As a result, Oshawa PUC had been placed in a higher efficiency cohort with a lower stretch factor in 2012 and 2013, and its rates were higher by approximately one tenth of one percent as a result. The error was corrected for the PEG benchmarking study filed in this proceeding.

SEC submitted that the OEB should order Oshawa PUC to refund the money to customer for the excess rates that were charged in 2012 and 2013. SEC submitted that the OEB's Essex Powerlines decision[20] in which the OEB indicated that it could impose financial or other consequences on a utility in situation where errors are the result of a utility's negligence. SEC estimated that $70,000 should be returned to customers.

Oshawa PUC submitted that no evidence was filed, or requested by SEC to determine the materiality of the over collection proposition. In addition, there is no evidence to indicate that Oshawa PUC had been negligent.

Findings

The OEB will not direct Oshawa PUC to calculate the amount potentially over-collected in rates during 2012 and 2013 as rates were final. The OEB finds that there is no evidence that the error resulted in a material amount of over-recovery.

[20] EB-2014-0301/0072

14 ORDER

THE OEB ORDERS THAT:

1. Oshawa PUC shall file with the OEB, and shall also forward to the intervenors, draft rate orders for 2015, 2016, 2017, 2018 and 2019, attaching a proposed Tariff of Rates and Charges for each year reflecting the OEB's findings in this Decision by November 23, 2015. The draft rate orders shall also include:
    - For each year, customer rate impacts resulting from the implementation of this Decision and supporting information showing the calculation of the rates
    - For each year, a completed version of the Revenue Requirement Work Form excel spreadsheet, which can be found on the OEB's website
    - For 2015, the calculation of the rate rider to be applied during 2016 to recover revenue that would have been recovered in rates from October 1, 2015 to December 31, 2015
    - For 2017, 2018 and 2019, a proposal for the first three years of the transition to fully fixed residential rates, with a schedule for each of these years showing the year-over-year change to the monthly fixed charge and the combined bill impact of the transition to fixed rates and other changes resulting from this Decision, for a low-volume customer as discussed in section 2.8.13 of Chapter 2 of the OEB's *Filing Requirements for Electricity Distribution Rate Applications (2015 Edition)*.
2. OEB staff shall file any comment on the draft rate order with the OEB, and forward the comment to Oshawa PUC and the intervenors, on or before November 30, 2015.
3. Any intervenor who wishes to file a comment on the draft rate order shall file the comment with the OEB, and forward the comment to Oshawa PUC, on or before December 4, 2015.
4. Oshawa PUC shall file with the OEB and forward to the intervenors responses to any comments on its draft rate order within 7 days of the date of the receipt of the comment.
5. Oshawa PUC shall file an application for adjustment and finalization of 2018 and 2019 revenue requirement and rates no later than July 1, 2017. The filing shall include the evidence listed in section 4.2 of this Decision, and any other evidence Oshawa PUC believes is necessary to support the application.

6. Oshawa PUC shall report annually on the following:
   - OEB scorecard
   - Service quality levels achieved
   - Outage reduction achieved as a result of the two measures proposed by Oshawa PUC
   - The status of Oshawa PUC's capital program, including an analysis of variances from plan.
7. Oshawa PUC shall file a revised set of metrics and target outcomes as part of its first rate application after the completion of the term of this rate-setting plan.
8. Oshawa PUC shall file a draft accounting order for the System Renewal Capital Variance Account to record costs for system renewal projects that are approved for recovery in rates but not implemented over the rate term.

All filings to the Board must quote the file number, EB-2014-0101, be made through the Board's web portal at https://www.pes.ontarioenergyboard.ca/eservice/, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at http://www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Harold Thiessen at harold.thiessen@ontarioenergyboard.ca and Board Counsel, Jennifer Lea at jennifer.lea@ontarionenergyboard.ca.

DATED at Toronto November 12, 2015

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary