EB-2015-0003

PowerStream Inc.

Application for electricity distribution rates for the period from January 1, 2016 to December 31, 2020.

ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")

ARGUMENT

January 15, 2016

POWERSTREAM INC.
2016-2020 RATES APPLICATION

EB-2015-0003

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A- INTRODUCTION

PowerStream Inc. (“PowerStream”) filed a custom incentive rate application on May 22, 2015 for approval of electricity distribution rates to be effective during the five year period from January 1, 2016 to December 31, 2020.

In the Decision on Threshold Question and Procedural Order No. 5, dated October 6, 2015, the Board found that the potential cost savings due to a merger were outside the scope of this proceeding. In particular, the Board stated at pages 6-7 that:

> *The OEB does not consider that it should treat PowerStream’s pre-consolidation rates application any differently than pre-consolidation rates applications for other utilities that occur further in advance of consolidation, such as the recent Horizon Custom IR application.*

Energy Probe Research Foundation ("Energy Probe") submits that if potential cost savings are out of scope and that costs need to be treated on a fictitious standalone basis, then the Ontario Energy Board ("Board") has to treat the entire application on a standalone basis. This also means that this application is comparable to standalone applications by other distributors that filed Custom IR applications.

Further, if the Board determines that the application fails as a Custom IR application and approves rates for some period less than the five years requested by PowerStream, then the rate setting methodology beyond the years set by the Board in this proceeding should be subject to the Board's policies in effect at that time.

The Renewed Regulatory Framework for Electricity Distributors ("RRFE") has evolved through the Board's Decisions in a number of Board Decisions, most notably in the Horizon Utilities case (EB-2014-0002), the Hydro Ottawa case (EB-2015-0004), the Hydro One Distribution case (EB-2013-0416/EB-2014-0247) and Toronto Hydro Distribution (EB-2015-0116). Energy Probe submits that the settlement proposals that were accepted and lauded by the Board have made improvements to the RRFE and the decisions by the Board have more clearly defined what is not a Custom IR. On a

standalone basis, the PowerStream application has to meet the same standards as approved by the Board in these other applications.

In the submissions that follow, Energy Probe will quote from the Board in these decisions to highlight the improvements and clarifications made to the RRFE as a result of negotiations between intervenors and distributors and through Board decisions that have enhanced outcomes over and above those contemplated in the RRFE. Energy Probe submits that these enhancements, which will be noted in the following submissions, should be applied to the current PowerStream application.

Energy Probe's submission is that the application filed by PowerStream is not a Custom IR. It is further submitted that the Board should approve rates only for a two or three year period and that there should be significant reductions in both capital and OM&A expenditures from those forecast by PowerStream.

B - SUBMISSIONS

The submissions that follow generally follow the issues list, as well as including general submissions under each of main issues.

1.0 CUSTOM APPLICATION

Energy Probe submits that the Board should not accept the application as filed as a Custom IR application. It is submitted that the PowerStream application is a "custom cost of service" application.

Energy Probe submits that there is no doubt that the PowerStream application is a custom cost of service application. The rates for which PowerStream is asking approval are all based on the exact same costs and forecasts as a cost of service application. In fact, PowerStream has indicated that the approach they have taken is based on having a revenue requirement calculation for each of the five years that is based on the exact same principles as a cost of service (Tr. Vol. 1, page 51). Mr. Macdonald was quite clear that the rates in this application were based on the cost of service for each of the five years (Tr. Vol. 1, pages 51-52):

> *MR. SHEPHERD: No, no, sorry. I'm not going to let you get off this one. For any of the years, are you asking for an amount in rates that is different from your forecast cost of service? Because I'm going to ask you to show me, if you say you are.*
> *MR. MACDONALD: No.*
> *MR. SHEPHERD: So every year you're asking for your cost of service, yes?*

MR. MACDONALD: Yes.

Energy Probe submits that PowerStream has interpreted the Board's Custom IR option, referred to in the RRFE report as "custom index" to include custom cost of service. Energy Probe submits that the Board should not accept this interpretation. The RRFE report set out three rate setting methods and all of them are described as incentive rate-making, not cost of service. Energy Probe further notes that the Board found that Custom IR does not include custom cost of service in the EB-2013-0416/EB-2014-0247 Decision dated March 12, 2015 for Hydro One Networks Inc. ("HONI"). Energy Probe submits that the Board should be consistent and make the same determination in this proceeding.

As the Board indicated in the HONI decision (page 14):

> *"the OEB continues to believe that multi-year incentive rate-setting, with its emphasis on results, is the most effective way to incent behaviour similar to that seen in commercially-oriented, consumer market-driven companies.* ***Incentive rate-setting differs from cost of service rate-setting in that it relies less on a utility's internal cost, output, and service quality to establish rates, and more on benchmarks of cost, output, and service quality that are external to the utility revealing superior performance and encouraging best practice****. The decoupling of rates from the utility's own costs simulates a competitive market environment and is more compatible with an outcomes-based approach to regulation."* (emphasis added)

The Board clearly distinguishes between multi-year incentive rate setting and cost of service rate setting. Custom IR is an incentive rate making mechanism. Everything provided by PowerStream in this application is based on a cost of service approach. Energy Probe submits that not only is the PowerStream application not a Custom IR, it is also, by the Board's own definition, not an incentive rate application.

In the alternative, Energy Probe submits that the Board should approve rates for PowerStream for only 2016 and 2017, with an option for 2018 rates. The option for 2018 rates would be determined by whether or not PowerStream has merged with other distributors in 2016. If PowerStream were to be part of a merger in 2016, then Energy Probe submits that while the OM&A and capital expenditures forecast for 2016 and 2017 would still likely be relevant, it is not likely that the same could be said for 2018.

If OM&A expenses are indexed to inflation, customer growth and productivity, then Energy Probe would have less concerns with the OM&A component of the revenue requirement for 2018. Energy Probe's main concern with 2018 under a merger scenario is the capital expenditure plan. Energy Probe submits that one of the first priorities of a

new merged entity would be to prioritize, or re-prioritize its capital expenditures and to find economies of scale wherever possible, including such things as increased bulk purchasing power and better contractor pricing for larger capital projects.

Energy Probe further submits that given the higher level of uncertainly on OM&A and capital expenditures as a result of the potential merger, there is even more need for the Board to provide ratepayers with adequate protection similar to that it approved for Horizon Utilities in EB-2014-0002. In that Decision and Order dated December 11, 2014 the Board found (page 3):

> *"... 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."*

On a standalone basis - even though this standalone basis is likely to be as fictitious as PowerStream's forecasts - Energy Probe submits that the PowerStream ratepayers deserve equal protection as the ratepayers of Horizon have received from the negotiated settlement between intervenors and the distributor, and found by the Board to satisfy the RRFE's objective that benefits of efficiency improvements would be shared with customers.

The RRFE is not just about distributors ensuring the ratepayers receive value for money. Energy Probe submits that the RRFE is also about the Board ensuring that these ratepayers receive value for money through the appropriate and consistent regulation of the distributors.

Energy Probe submits that the Board should implement the same mechanisms as it approved for Horizon and for Hydro Ottawa. In particular, these are the Earnings Sharing Mechanism, the Efficiency Adjustment Mechanism and the Capital Investment Variance Account as described in EB-2014-0002 Settlement Proposal dated September 22, 2014 (pages 29 - 35). Each of these mechanisms provides a measure of protection for ratepayers and enhances the RRFE objectives as well providing incentives for PowerStream to maintain or improve its operational effectiveness and to seek further productivity improvements, just as the Board said it would for Horizon.

1.1 Has PowerStream responded appropriately to all relevant OEB directions from previous proceedings, including commitments from prior settlement agreements?

PowerStream indicated that it had no outstanding directives from the OEB and Energy Probe accepts this submission.

1.2 What actions should the OEB require PowerStream to take at or near the end of the 5-year rate term (e.g. rebasing, plan assessment, measurement of customer satisfaction)?

Assuming the Board approves the Custom IR application, and on a standalone basis, the Board should require PowerStream to file for rates under one of the mechanisms available to it under the RRFE. The Board should also require PowerStream to file a separate assessment of its plan with a comprehensive review of all variances from plan for both OM&A and capital expenditures. The Board should also require PowerStream to file evidence of the increase in the value to customers for the money spent and as approved by the Board.

If the Board were to find that the application does not meet the standards and requirements of a Custom IR, then Energy Probe submits that at the end of any period for which the Board does set rates as part of this application, then PowerStream should be deemed to be under 4th Generation IRM for the remainder of the five year period, as is the Board policy.

1.3 Do any of PowerStream's proposed rates require rate smoothing or mitigation?

Based on the submissions found elsewhere in this argument, Energy Probe notes that the increase will be significantly less than that proposed by PowerStream. In that circumstance, no rate smoothing or mitigation is required.

2.0 OUTCOMES AND INCENTIVES

Energy Probe submits that the PowerStream proposal is deficient with respect to outcome-based regulation as described in the RRFE. The proposal includes limited potential for continuous improvement and lacks any externally imposed improvement incentives. In addition, the proposal includes limited, if any, cost and productivity benchmarking support that demonstrates continuous improvement. In fact, the proposal results in reduced productivity, as discussed under Issue 2.2 below. Finally, the proposal fails to demonstrate value to customers commensurate with the forecasted spending and resulting costs for customers.

2.1 Does PowerStream's Custom IR Application promote and incent acceptable outcomes for existing and future customers (including for example, cost control, system reliability, service quality, and bill impacts)?

Absolutely not.

As indicated under Issue 2.4 below, PowerStream has provided no evidence to support that the proposals result in acceptable outcomes for existing and future customers. Nor has PowerStream provided any metrics to measure the value to customers beyond the standard metrics.

Further, as indicated under Issue 3.2 (capital expenditures) and Issue 3.6 (OM&A), PowerStream has failed to include any externally imposed productivity measures that would incent acceptable outcomes for customers.

2.2 Does the Custom IR Application adequately incorporate and reflect the four outcomes identified in the RRFE Report: customer focus, operational effectiveness, public policy responsiveness and financial performance?

No. As noted in the submissions related to Issue 2.3 below, the PowerStream has not incorporated anything that would result in the outcomes identified in the RRFE Report.

PowerStream has not included any external productivity or efficiency improvements or targets beyond what is already incorporated by their historical activity. Energy Probe notes that the Board found the same deficiency in the Hydro One Distribution (EB-2013-0416/EB-2014-0247) Decision dated March 12, 2015.

PowerStream has indicated that their application is based on a cost of service approach (Tr. Vol. 1, pages 51-52) to calculate the revenue requirement for each year. This approach is not consistent with incentive regulation. As noted earlier, the Board discussed this difference in the HONI decision quoted under Issue 1.0 above.

2.3 Does the Custom IR Application adequately account for productivity and efficiency gains in its forecasts? Does the Custom IR Application adequately include expectations for productivity and efficiency gains relative to benchmarks that are external to the company (such as the Pacific Economics Group Research, LLC)?

No. In fact, the PowerStream evidence supports a worsening of operational effectiveness from the current levels. This leads to less value for customers for their money.

PowerStream has failed to incorporate any efficiency incentives or externally imposed incentives in its cost of service application. As such, Energy Probe submits that the four outcomes identified in the RRFE report cannot be met by PowerStream. This is abundantly clear with respect to customer focus in the lack of value for money from customers and any methodology to measure it. Operational effectiveness should reflect continuous improvement.

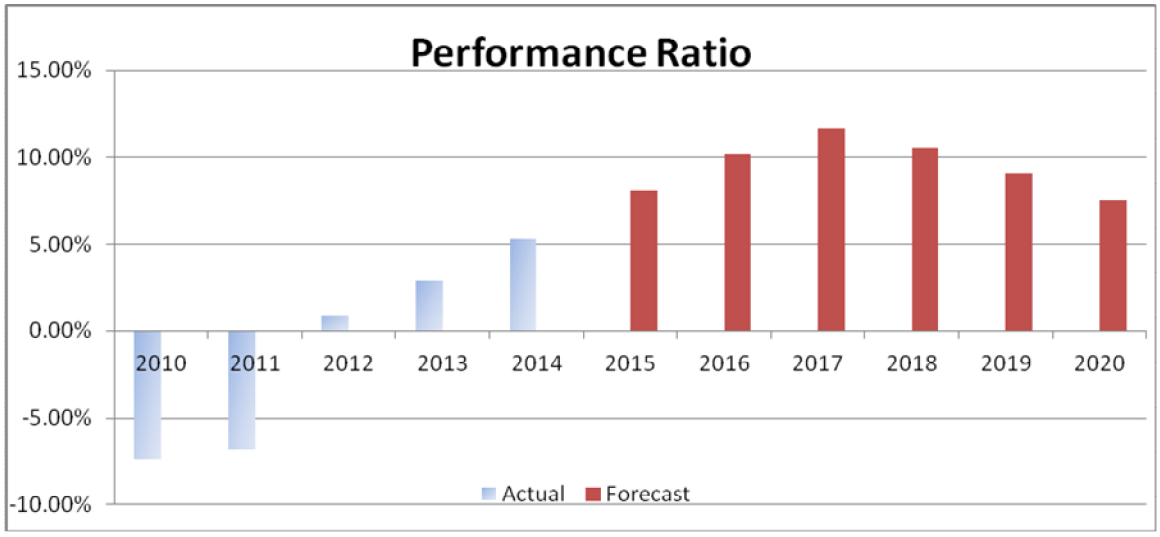
However, based on their own evidence, PowerStream is forecasting a decline in efficiencies for at least part of the five year horizon. This is illustrated in the response to Undertaking J1.3. This undertaking response provides the predicted, actual and forecast costs using the PEG methodology that has been adopted by the Board for determining the efficiency cohorts for distributors. The undertaking response reflects a number of corrections identified by PowerStream and the use of MIFRS for all the years shown, so that the figures are comparable across all years.

The following table takes the predicted total costs and actual total costs (including forecasts for 2015 through 2020) from Table J1.3 and calculates the performance ratio which shows the percentage that the actual costs are below or above the predicted costs.

	Predicted	Actual	Performance
Year	Total Costs	Total Costs	Ratio
2010	212,561	196,831	-7.40%
2011	218,280	203,553	-6.75%
2012	216,915	218,815	0.88%
2013	219,646	225,894	2.84%
2014	229,949	242,112	5.29%
2015	230,353	249,034	8.11%
2016	240,043	264,462	10.17%
2017	251,065	280,334	11.66%
2018	265,448	293,366	10.52%
2019	280,878	306,453	9.11%
2020	296,877	319,225	7.53%

This table clearly shows that PowerStream has been moving in the wrong direction. In 2010 the distributor was 7.40% below the predicted level of costs, while by 2014 this had changed to 5.29% above the predicted cost. This trend towards declining performance is forecast to continue through at least 2017 before slight improvements have been forecast. In fact, as shown in the above table and illustrated in the follow chart, PowerStream is forecasting that it will slip to more than 10% above the predicted costs in each of 2016 through 2018, with slight improvements in 2019 and 2020. However, the 2020 predicted

level is still worse than the actual figure for 2014. This implies a movement for PowerStream from Group III (within +/- 10% of the predicted cost) to Group IV (10% to 25% higher than predicted costs) for stretch factor assignments using the PEG methodology.



Rather than demonstrating continuous improvement in productivity and cost performance, as required by the RRFE, PowerStream is forecasting a decline.

Energy Probe notes that the decline in the Performance Ratio is forecast for the first several years in the five year horizon, with the forecasted improvements taking place further out in the timeframe. Energy Probe submits that the level of uncertainty surrounding forecasts increases the further out the forecast goes. Mr. Macdonald echoed this sentiment (Tr. Vol. 1, page 119) when he said that *"... to do a custom IR application and forecast five years is a little daunting. So there's a lot of uncertainty in a month or a year, let alone five years..."*. In other words, the certainty surrounding the decrease in the performance ratio in the next few years is higher than the projected improvement in the ratio further out in time.

PowerStream has indicated that it is important to distinguish between the accuracy with which the PEG model can be used to benchmark the cost of a distributor operating under usual circumstances to that used to assess the costs of a distributor facing unusual business conditions such as those faced by PowerStream.

Energy Probe notes that PowerStream has relied entirely on the PEG model as their benchmarking evidence (Tr. Vol. 1, pages 54-55 & 58-59). At the same time, PowerStream has questioned the validity of the PEG benchmarking given their unusual circumstances.

Energy Probe submits that there is no evidence in the proceeding to suggest that the cost pressures faced by PowerStream are unusual from those faced by other distributors. Cost for such things as transformer stations, new billing systems and plant replacement are not unusual. They are, in fact, typical expenditures by all distributors and are part of business as usual.

Energy Probe submits that the Board should approve an Efficiency Adjustment Mechanism as it has for both Horizon Utilities and Hydro Ottawa. This mechanism would apply if PowerStream, as forecast above, is placed in a lower efficiency cohort, as compared to its current cohort in any year during the term of the plan. The operation of the mechanism is described in detail in the EB-2014-0002 Settlement Agreement of September 22, 2014 on page 31. This efficiency adjustment provides a proxy stretch factor if PowerStream's efficiency ranking falls during the IR term. This mechanism aligns the interest of the distributor with the interests of its customers. PowerStream is incented to at least maintain its current efficiency level and customers are protected from a drop in the efficiency level.

2.4 Does the Custom IR Application adequately provide value to the customer (such as the X-Factor, Y-Factor and a shared earnings mechanism)?

No. PowerStream has not proposed any externally based productivity factor or stretch factor in its application for either OM&A or capital. No earnings sharing mechanism has been proposed.

The RRFE is supposed to be a comprehensive performance-based approach to regulation that is based on the achievement of outcomes that ensure the Ontario electricity system provides value for money for customers. In short, the RRFE places a greater emphasis on providing value for money.

Energy Probe submits that PowerStream has not only failed to provide any substantive evidence of value to customers as part of its application, but they have also failed to provide any meaningful metrics by which to evaluate the value delivered to customers in the future as a result of the proposed spending. The onus is on the distributor to provide such evidence and metrics and PowerStream has failed to meet this onus.

Energy Probe submits that the Board should impose an asymmetric earnings sharing mechanism for PowerStream based on the same one approved for Horizon. This should be implemented regardless of whether the Board sets rates for a five year period or a two or three year period This ratepayer protection and sharing of benefits is a key component

and outcome of the RRFE. If the Board were to only set rates for one year, then Energy Probe submits that an earnings sharing mechanism would not be required.

2.5 Does the Application adequately plan and prioritize capital expenditures?

No. This issue is dealt with under Issue 3.2 below.

2.6 Is the monitoring and reporting of performance proposed by PowerStream adequate to demonstrate whether the planned outcomes are achieved?

No. Energy Probe submits that the Board should direct PowerStream to convene a working group with intervenors to develop a comprehensive list of performance reporting metrics that could be implemented during the current period for which rates are approved and for any future application.

2.7 Are PowerStream's proposed off-ramps and annual adjustments appropriate? Has PowerStream demonstrated adequately its ability and commitment to manage within any rates set via this proceeding, given that actual costs and revenues will vary from those forecast?

No. Energy Probe notes that the proposed annual adjustments have been listed in the Board Staff Submission dated January 13, 2016 on pages 21 and 22 and will not repeat them here.

Energy Probe submits that there should not be adjustment to rate base associated with the cost of power impact on the working capital allowance. This is because PowerStream did not file a lead lag study, even though they did engage a third party to do a preliminary review of the percentage that would come out of a full study. PowerStream should be expected to live with the current forecast of the working capital allowance, just as it will be expected to live with the OM&A, revenue and capital additions forecasts.

3.0 REVENUE REQUIREMENT

The Energy Probe submissions in this section are made on the basis that if the Board were to somehow determine that the PowerStream application is an acceptable Custom IR application, or in the event that the Board determines that it is not an acceptable Custom IR application, but will set rates for some shorter period, as it did with Hydro One Distribution (EB-2013-0416/EB-2014-0247), then the following submissions should be taken into account for the relevant years.

3.1 Is the rate base component of the revenue requirement, including the working capital allowance, for 2016 – 2020 as set out in the Custom IR Application appropriate?

Energy Probe submits that the rate base component of the revenue requirement is not appropriate and is too high.

The rate base component of the revenue requirement is made up of three parts: capital expenditures forecast for 2015 through 2020, capital expenditures included in the 2016 opening rate base and the working capital allowance ("WCA").

Energy Probe's submissions with respect to the level of capital expenditures for 2015 through 2020 are provided under Issue 3.2 below.

Energy Probe notes that PowerStream has included $3.2 million in the opening rate base for 2016 for land that is not forecast to be used or useful until the new Vaughan transformer station (TS#4) is placed into service (Section III, Tab 3, Schedule 1, BOMA-9). This station is not forecast to be in service until the spring of 2017 (Exhibit G, Tab 2, page 4).

Energy Probe submits that this land should not be included in rate base until the transformer station that is being built on it is put into service. This is not different than not putting the costs associated with the foundation of the transformation station into service until the project is energized and provides a service, and hence, value to customers. Energy Probe similarly notes that if HONI had bought the land and built the transformer station and then sold it to PowerStream, the land component of the cost, along with the rest of the costs would not be included in rate base until it was purchased by PowerStream and the asset entered into service.

With respect to the WCA, PowerStream has proposed to use the Board's default value of 7.5% in each of 2016 through 2020. This is based on a preliminary analysis of the changes in the WVA percentage undertaken by Navigant (Exhibit K1.4), but when the values appeared to be close to the 7.5% default level, PowerStream decided not to proceed with a full study (Tr. Vol. 1, page 157). PowerStream explained that the 7.5% was close to the 7.65% average for 2016 through 2020, if 9.05% was used for 2016 (prior to moving to monthly billing) and 7.3% for the remaining years (Tr. Vol. 1, pages 158-160). Energy Probe submits that this rationale is sufficient to use 7.5% for the entire 2016 through 2020 period.

However, Energy Probe submits that the Board should direct PowerStream to conduct a lead/lag study by the end of the Custom IR period, of whatever period the Board sets rates for PowerStream in this proceeding. This will allow the Board and other parties to review the impact of the new CIS system to see if it has delivered any benefits and value to customers with respect to improved cash flow.

A second issue with respect to the WCA is the level of OM&A expenses to which the percentage of 7.5% is applied. A review of the RRWF's provided for 2016 through 2020 the Application Update of August 21, 2015, shows that the OM&A expenses used in the calculation of the working capital component of rate base (Rate Base and Working Capital Sheet) is equal to the sum of the OM&A expenses and property taxes (Revenue Requirement sheet). Energy Probe notes that this is not appropriate, as the OM&A figures include amounts for fully allocated depreciation.

As shown in the response to G-Energy Probe-14, different portions of the fully allocated depreciation expense associated with vehicle depreciation, tools depreciation and stores depreciation are allocated to OM&A. The dollar values are provided in the response to TCQ#14 and range from more than $820,000 in 2016 to just under $970,000 in 2020.

Energy Probe submits that these amounts should be removed from the OM&A expenses used to calculated the working capital component of rate base. This is because these are depreciation expenses and do not reflect actual payments, and thus do not affect cash flow. Since the working capital allowance is an allowance based on cash flow needs, depreciation expenses should not be included in the calculation. Energy Probe notes that over the last number of years the Board and distributors have acknowledged the need to remove the fully allocated depreciation expense included in the OM&A forecast for use in the WCA calculation. Energy Probe submits that the Board should direct PowerStream to remove this expense in the calculation.

3.2 Are the Distribution System Plan, capital programmes and related expenditures, associated with the revenue requirement for 2016 – 2020, as set out in the Custom IR Application, appropriate and is the rationale for planning and prioritizing appropriate and adequately explained and supported, considering:
i. customer feedback and preferences;
ii. productivity and sharing of benefits:
iii. benchmarking of costs;
iv. end-of-life criteria, health index, data governance, and the overall relationship of each planning component;
v. reliability and service quality;
vi. impact on distribution rates;

vii. trade-offs with OM&A spending;
viii. government-mandated obligations; and
ix. the applicant's objectives?

No. Energy Probe submits that the PowerStream forecast is deficient for a number of reasons. PowerStream has a history of under spending on its capital plan; no third party independent review of the capital plan was done; PowerStream proposes to replace assets in quantities that are in exceed of the asset condition assessment results; the pacing of the proposed work is not reasonable given past actual projects; some of the general plant spending may not need to occur as proposed because of the potential merger; the CIS spending is uncertain; and the capital budget has been overestimated.

Energy Probe has had the opportunity to review the detailed and comprehensive capital expenditure related submissions of the Association of Major Power Consumers ("AMPCO") and fully supports those submissions and will not repeat them here. Energy Probe shares the same areas of concern with respect to the proposed spending as does AMPCO.

The net impact of the AMPCO proposals is a reduction in the annual capital expenditures of about 20% or $25 million per year. Energy Probe notes that the Board Staff submissions result in a similar, albeit slightly lower, reduction in capital expenditures of about 15% or $19 million per year.

While the approaches taken by Board Staff and AMPCO are not the same, the end result is similar, with a reduction of 15% to 20% in annual capital expenditures in 2016 through 2020. Energy Probe submits that a result in this range would be appropriate and should be approved by the Board.

Energy Probe re-iterates its submission for the need for an asymmetric capital variance account for ratepayer protection. Given PowerStream's propensity to over forecast and under spend, the cumulative impact over a three to five year period could be a substantial level of costs being paid for by ratepayers that fail to materialize. Customers do not receive any value for money not spent, but paid for anyways. Ratepayers demand that the Board ensure that they do not pay for anything for which they receive no value.

Energy Probe is also making a submission related to the bridge year capital expenditures. Expenditures forecast for the bridge year, but not closed to rate base have a significant impact on rate base in 2016 and subsequent years. Unlike capital expenditures in the test years, the rate impacts of any under spending in 2015 has a full year impact on rates in

the 2016 test year and can have a impact on the rate base for all of the 2016 through 2020 years.

As shown in the response to II-s-Staff-34 in Section B, Tab 2, Schedule 1, the June year-to-date capital expenditures represented only about 38% of the planned expenditures in the bridge year. Energy Probe submits that asymmetrical capital variance account should also be applied to any under spending in the 2015 bridge year. Again, there is no value to customers of paying rates for expenditures that have not happened.

3.3 Is the capital structure and cost of capital component of the revenue requirement for 2016 – 2020 as set out in the Application appropriate?

Energy Probe submits that the Board should direct PowerStream to update its cost of short term debt and return on equity to match the figures set by the Board for 2016 rates in its October 15, 2015 letter on the Cost of Capital Parameter Updates for 2016 Applications.

PowerStream proposes that these rates be updated annually during the Custom IR period, including 2016 (Exhibit K, Tab 1). Energy Probe submits that the Board should adopt this proposal. It is consistent with the methodology approved by the Board for Horizon Utilities in EB-2014-0002, which was also a Custom IR proceeding.

However, if the Board were to approve a shorter period for rates than the five years in the PowerStream application, then Energy Probe submits that the cost of capital parameters should not be updated on annual basis and should be fixed at the current Board approved rates for 2016 rate applications. Again, PowerStream should be incented to live within the current parameters.

PowerStream also proposes to update the cost of long term debt on an annual basis under the Custom IR proposal. Again, Energy Probe supports this proposal, as it is consistent with that approved for Horizon Utilities in EB-2014-0002. The same exception to this update would be applicable if the Board approved rates for a shorter period of time.

However, Energy Probe does not support the use of the Board's deemed long term debt rate as the rate to be used for new debt issuances, as proposed by PowerStream (Exhibit K, Tab 1). Energy Probe submits that the Board should direct PowerStream to use a market based rate for new debt issuances, since it is an active participant in that market and has several debt instruments from third party sources that in aggregate account for nearly two-thirds of its total long term debt.

As shown in Exhibit K-1-2 in the table labelled Long-Term Debt Weighted Debt Cost - Test Year 2016, PowerStream is forecasting the issuance of a 10 year bond for $45 million on January 1, 2016. PowerStream has used a place holder of 4.50% for this debt and proposes to replace it with the Board's deemed long term debt rate issued in the October 15, 2015 letter.

Energy Probe submits that this is not appropriate given the evidence in this proceeding. In Exhibit K, Tab 1, PowerStream notes that it was able to issue an unsecured 10 year debenture in the amount of $150 million in November, 2014 at a rate of 3.239%. Further, in the response to II-Energy Probe-21, PowerStream indicated that the forecasted rate of 4.5% was based on an all-in interest rate for a 30 year bond in the range of 4.0% to 4.2% that existed in August/September 2014. The same response indicates that the November, 2014 issuance rate of 3.239% was based on a 10 year Government of Canada rate of 2.004% and an issue spread of 123.5 basis points.

As noted above, PowerStream has forecast the use of a 10 year bond for the 2016 issuance, the same term of the bond issued in 2014. In the response to II-Energy Probe-21, PowerStream indicated that the all-in rate as of August 2015 from BMO for a 10 year term was in the range of 2.76% to 2.81%. Even more recent information is available, based on the Board's October 15, 2015 Cost of Capital Parameters letter. As shown in that letter, the average 10 year Government of Canada bond rate for September 2015 was 1.48%. Adding the issue spread of 123.5 basis points would result in a 10 year bond rate of 2.715%. A review of the Bank of Canada website reveals that the December 2015 average yield on 10 year Government of Canada bonds was 1.46%. The current rate available from Infrastructure Ontario in the first week of January, 2016 is 2.6% for a ten year loan. Given all of the recent information available, Energy Probe submits that a realistic forecast for the January 1, 2016 10 year debt cost is in the range of 2.6% to 2.8%.

Using 2.7% for the $45 million issuance, the weighted average long term debt rate for 2016 would decrease from 3.96% (Exhibit K-1-2, page 3) to 3.82% and reduce the 2016 revenue requirement by approximately $800,000.

Energy Probe submits that the Board should direct PowerStream to use a debt rate of 2.7% for the $45 million issuance forecast for 2016 as this represents a reasonable and current forecast of the debt.

3.4 Is the depreciation component of the revenue requirement for 2016 – 2020 as set out in the Application appropriate?

Energy Probe submits that the depreciation methodology used by PowerStream is not appropriate and results in ratepayers overpaying during the IRM term and then paying a second time upon rebasing.

PowerStream has forecast the depreciation expense using the half year rule. However, on an actual basis, PowerStream starts recording depreciation expense in the month that an asset is placed into service (J-Energy Probe-40). The Board approved this difference between forecast and actual methodologies in EB-2012-0161. The results provided in Table J-EP-40-1 show the results of this decision. In 2013 and 2014, ratepayers paid more than $1 million rates for an expense that did not happen. To add insult to injury, because the depreciation expense was lower than forecast due to the different methodologies used, ratepayers, have already paid more than 1 million more than they should have, will now be paying the $1 million to PowerStream a second time, through the higher rate base that results from the lower depreciation expense.

As shown in the response to J-EP-40, over the 2012 through 2014 period, the average difference between the half year forecast methodology and the in-service month methodology used for actual expenditures is about $475,000 a year. In particular, in each year shown, the actual expense is lower than the forecast expense. This is not an unexpected result, since many projects built throughout the year are placed into service in the second half of the year.

The impact of this systematic difference between expenses due solely to the different methodologies used for forecasting and actual purposes is two-fold. First, the depreciation expense based on the half year methodology is biased and is higher than what can be reasonably expected to occur on an actual basis using the month in-service methodology. Second, because the actual depreciation expense is lower than the forecast, the remaining rate base is higher. When it comes time to rebase, this higher rate base results in higher rates for customers.

Customers are, in fact, paying for this depreciation expense more than twice. First they pay an expense that is clearly higher than the real forecast. Second, because the difference remains in rate base, they will have to pay the same amount through the depreciation expense in the future, following rebasing. Third, in addition to paying for the rate base difference a second time, ratepayers also have to pay for a return on capital on the difference.

Energy Probe submits that the Board should recognize the injustice to ratepayers of its past decision on this matter and not repeat it again. The Board should direct PowerStream to reduce the depreciation expense in each of 2016 through 2020 by

$475,000 to reflect the average over forecast in 2012 through 2014 that is due solely to the different methodologies used for forecasting and actual purposes. This will reduce cost to ratepayers by nearly $2.5 million in the 2016 through 2020 period and will ensure that they do not pay this $2.5 million and then see that same $2.5 million sitting in rate base in 2021 when it is time to rebase. Ratepayers are willing to pay the appropriate depreciation expense, but they are not willing to pay it twice.

Energy Probe compares this systematic bias to the calculation of fixed revenues from ratepayers in the following example. Revenues from fixed charges should be calculated by multiplying the monthly fixed charge by 12 and then by the average number of customers. This average number of customers is either the number of customers at the midpoint of the year, or the even more accurate average of the number of customers each month. The fixed revenue forecast would be biased if the monthly fixed charge times 12 was multiplied by the number of year-end customers. The Board can be assured that if that was the case, the distributors would be complaining, with justification, that the revenue forecast using the year-end methodology over stated the actual revenues in a systematic and biased way. With respect to the systematic and biased way that the depreciation expense is being forecast, relative to the actual expense, ratepayers are complaining equally as loud and expect the Board to fix this bias.

Finally, any changes to the level of capital expenditures would need to be reflected in a draft rate order with adequate detail to show the resulting changes in the depreciation expense.

3.5 Is the taxes / PILs component of the revenue requirement for 2016 – 2020 as set out in the Application appropriate?

Energy Probe submits that the PILs methodology used by PowerStream is appropriate given the corrections and changes made through the interrogatory process. These changes are noted on page 1 of Section V, Tab 1, Schedule 1. Energy Probe submits that these changes are appropriate and should be accepted by the Board.

Any changes to the level of PILs resulting from other changes made by the Board to the application will need to be reflected in a draft rate order with adequate detail to show the changes.

3.6 Are the OM&A programmes and related components of the revenue requirement for 2016 – 2020 as set out in the Custom IR Application appropriate and is the rationale for planning choices appropriate and adequately explained and supported considering:

i. customer feedback and preferences;
ii. productivity and sharing of benefits;
iii. benchmarking of costs;
iii. reliability and service quality;
v. impact on distribution rates;
iv. trade-offs with capital spending;
vii. government-mandated obligations; and
viii. the applicant's objectives?

Energy Probe submits that the Board should not approve the OM&A forecasts as proposed by PowerStream. The Board should approve an OM&A budget for 2016 and then adjust this budget by a formula that mimics incentive regulation and not a cost of service approach for the years beyond 2016.

Energy Probe submits that in order to be compliant with the objectives in the RRFE, the OM&A budget should be adjusted for 2017 and subsequent years by a formula that reflects forecasted inflation, customer growth and continuous improvement in productivity and cost performance (operational effectiveness). Energy Probe submits that a good proxy for this continuous improvement is the stretch factor based on the cohort that PowerStream is currently in.

Energy Probe submits that the Board should approve an adjustment factor to the 2016 base OM&A of 2.0%. This figure reflects the Board's 2016 inflation forecast of 2.1%, PowerStream's estimate of the impact of its customer growth on OM&A costs of 0.2% (JTC 1.1, Table 2), offset by the stretch factor of 0.3%.

This will provide an incentive for PowerStream to achieve further efficiency gains. This is critical to the outcomes based approach of the RRFE. In their current application, PowerStream has not included any additional efficiency gains in their 2016 through 2020 forecasts over and above that which has been obtained from past measures.

In addition to the 2.0% increase in 2017, Energy Probe submits that the Board should allow an incremental increase to reflect the movement to monthly billing. PowerStream has estimated this cost increase to be $3.696 million in 2017 (JTC 1.1, Table 3).

Included in this figure is a reduction of only $184,000 to reflect the movement of some customers to e-billing, thus reducing the postage increase of $2,089,500. These figures are shown in Table A-1 in Exhibit A, Tab 1, Schedule 1. This represents less than 9% of customers moving to e-billing. Energy Probe submits that this is too small and that PowerStream should be able to achieve significantly better results. Energy Probe submits

that the Board should allow the increase in OM&A of $3 million for the move the monthly billing. This will incent PowerStream to get more customers to switch to e-billing and reduce the costs associated with the move to monthly billing.

With respect to the other net incremental costs shown in Table of JTC 1.1, Energy Probe notes that all of the individual changes in 2017 through 2020 for such things as vegetation management and risk management are below PowerStream's materiality threshold of $771,000 (Exhibit G, Tab 2, page 1). As such, Energy Probe submits that PowerStream should be able to manage the immaterial impacts as part of the increase in OM&A based on the 2.0% escalator.

As for the base OM&A for 2016, Energy Probe submits that the Board should approve an OM&A budget of $87.0 million, a reduction from the $96.216 million proposed by PowerStream of just over $9 million.

Energy Probe has estimated this figure by applying an escalator for 2015 and 2016 to an adjusted actual level of OM&A expenditures for 2014, the last year for which actual data is available.

Actual OM&A expenses in 2014 were $85.454 million (Exhibit J, Tab 1, Table 1). However, this amount included $1.392 million for training costs associated with the new CIS system which PowerStream acknowledged were one-time costs (Exhibit J, Tab 1, page 3 & Tr. Vol. 2, pages 42-43). Removing this one-time costs results in an adjusted actual expense in 2014 of $84.062 million.

As calculated above, Energy Probe submits that the escalator, inclusive of inflation, customer growth and productivity gains, for 2016 is 2.0%. Using the same approach for 2015, the total escalator is 1.5%. The only difference in the components of the total escalator for 2015 as compared to 2016 is that the inflation rate is lower, at 1.6%. This is the rate that the Board determined was applicable to 2015 IRM applications, just as the 2.1% is the rate applicable to 2016 IRM applications.

Applying the total escalators of 1.5% and 2.1%, respectively, for 2015 and 2016 to the adjusted actual 2014 OM&A expense of $84.062 million yields a 2016 figure of $87.0 million. Energy Probe submits that this is an appropriate increase in OM&A for the two year period between 2014 and 2016. This increase is already significantly higher than the 1.5% increase between 2012 of $82.792 (Appendix 2-JA) and the adjusted actual for 2014. Even if the one-time costs for CIS related training are not removed from the 2014 actual expense, the increase in 2014 over 2012 is only 3.2%, still less than the proposed increase of 3.5% between 2014 and 2016.

As shown in Table 3 of JTC 1.1, PowerStream has forecast net new incremental costs in 2016 of $1.2 million. Again, however, none of the individual components of the net increase is material. The largest increase - $0.614 million for vegetation management - is less than the materiality threshold of $0.771 million. Further, Energy Probe agrees with the Board Staff assessment that PowerStream has failed to provide a detailed analysis of the changes proposed for vegetation management and has not provided any analysis of the net value benefits to customers. As such, Energy Probe agrees with Board Staff that the allowed vegetation management program costs should be reflective of the 2014 cost level, indexed by the escalator.

3.7 Is the compensation strategy for 2016 – 2020 appropriate and does it result in reasonable compensation costs?

Energy Probe has dealt with this subcomponent of the OM&A costs as part of the envelope approached under Issue 3.6 above.

3.8 Are the proposed other operating revenues for 2016 – 2020 appropriate?

No.

Energy Probe submits that there are three issues that need to be considered with respect to other operating revenues. These issues are the revenue forecasts for water/sewer billing, the gain on the disposition of property and rental income the Barrie building.

With respect to revenues associated with water/sewer billing for the cities of Markham and Vaughan, Energy Probe submits that the Board should direct PowerStream to undertake a fully allocated costing study for this service.

PowerStream has forecast revenues for these services based on a 3% increase to the current contract that expired at the end of 2015 (IV-VECC-30). Revenues for the 2016 through 2020 period are in the range of $2.6 million to $3.0 million per year (Application, Section II, Appendix 2-N).

However, this cost does not reflect any updates to reflect the replacement of the old billing system and its replacement with the new billing system at a substantial increase in cost. This new CIS system is used for the water/sewer billing.

PowerStream has indicated that the need for the new CIS system was driven by the requirement for updated electricity billing functionality (IV-VECC-30) and that there was not additional functionality purchased for water/sewer billing.

However, under cross examination, PowerStream noted that the CIS system that was replaced was about 30 years old and had experienced a couple of failures (Tr. Vol. 2, pages 75-76). Mr. Macdonald agreed that the old system would have had to been replaced even in the absence of any updated billing functionality.

Based on the evidence in this proceeding, Energy Probe submits that it is clear that some of the costs associated with new CIS system should be allocated to the costs for water/sewer billing.

Since PowerStream has not included or done any analysis of the changes in the cost of billing due to the new CIS system (Tr. Vol. 2, page 78) as part of this application, Energy Probe submits that the Board should direct PowerStream to do an independent third party fully allocated cost study to determine the costs attributable to water/sewer billing based on the costs approved in this proceeding. Energy Probe further submits that the Board should establish a variance account to the track the difference between these fully allocated costs and the revenues from water/sewer billing for future disposition to customers.

The second issue is related to the forecast for account 4355, gain on disposition of utility and other property. PowerStream has not forecast any revenue in this account, despite having actual revenue in both 2013 and 2014. Account 4362, loss on disposition of utility and other property, is forecast as a loss of $1,300,000 in each of 2016 through 2020.

Account 4355 is mainly made up of the sale of vehicles and meters (I-Energy Probe-28). For the first six months of 2015, PowerStream shows a gain of $115,171 in account 4355 and a loss of $631,126 in account 4362. (I-SEC-3, Exhibit B, Tab 1, Schedule 5).

Based on the year-to-date June 2015 actuals, Energy Probe submits that the losses forecast for account 4362 of $1.3 million are appropriate, as they are approximately double the first six months of 2015. However, Energy Probe submits that the gain in account 4355 of $0 is not reasonable. Using the same approach as account 4362, Energy Probe submits that the Board should increase the forecast to $230,000 for each year, based on the same double of the June 2015 figure as is reasonable for account 4362.

The third issue related to rent from the Barrie building. In Appendix A to Exhibit G, Tab 2, PowerStream provided a number of project investment summaries. One of these

projects identified is a renovation to the Barrie building. The forecasted costs include capital expenditures of $1.56 million in 2014 and $3.15 million in 2015. The Project Summary Report provided in support of this plan indicates that the renovations will allow the leasing of space which will allow for the partial recovery of the lease hold improvements to the building as a result of better space utilization.

PowerStream has not included any rental/lease revenue in its forecast of other revenues in 2016 through 2019. As indicated in the response to G-VECC-19 (Section III, Tab 1, Schedule 1), PowerStream will have available 7,000 square feet for potential lease and that it was believed that the space would lease for $8.00 to $10.00 per square foot. Based on the midpoint estimate of $9.00 per square foot, Energy Probe submits that the Board should direct PowerStream to include an additional $63,000 per year to account for this leasing revenue. It is not appropriate, in the view of Energy Probe, to include the entire costs of the leasehold improvements in rate base and in the revenue requirement, while at the same time not including the forecasted revenues generated by leasing the excess space created by the improvements.

4.0 LOAD FORECAST, COST ALLOCATION AND RATE DESIGN

4.1 Is the load forecast, including the application of CDM savings and setting of the savings references for the LRAMVA appropriate?

Energy Probe has reviewed the submissions of the Vulnerable Energy Consumers Coalition ("VECC") and Board Staff with respect to the customer and load forecasts.

PowerStream has used individual rate class models to forecast customer/connections and consumption. Energy Probe submits this methodology, as it allows for different explanatory variables to be used that impact on different rate classes. It also enables common explanatory variables, such as degree days, used for more than one rate class to reflect the rate class specific impact on consumption rather than imposing a relationship between total consumption and the explanatory variable.

Energy Probe has no concerns with the consumption forecast, other than that for the street lighting class. Energy Probe agrees with the submissions of VECC with respect to that forecast and supports the submission that the average annual usage per connection (pre-LED conversion) used should 727 kWh, the average annual usage per connection over the 2012 to 2014 period.

Energy Probe has no concerns with the manual CDM adjustments made to the forecast.

With respect to the residential customer forecast (and the resulting impact it has on other forecasts that use the residential customer forecast as an explanatory variable), Energy Probe shares the concerns expressed by VECC in their submissions and supports the recommendation of VECC to increase the forecast growth rate for the Residential class to the historical value of 2.2%.

4.2 Are the proposed billing determinants appropriate?

See the submissions under Issue 4.1 above.

4.3 Are the inputs to the cost allocation model appropriate?

Energy Probe has reviewed the submissions of VECC on this issue and support those submissions.

4.4 Are the costs appropriately allocated?

Energy Probe has reviewed the submissions of VECC on this issue and support those submissions.

4.5 Are the revenue-to-cost ratios for all rate classes over the 2016 – 2020 period appropriate?

PowerStream proposes to move the revenue to cost ratios for all customer classes that are outside of the Board's target policy ranges to the top/bottom of the range. This results in a revenue shortfall in total for each of the years. This revenue shortfall is proposed to be eliminated by allocating the shortfall to all customer classes with ratios below 100%.

Energy Probe supports the PowerStream proposal with respect to the movement of the ratios to the Board ranges for those currently outside of the range and the allocation of the resulting revenue shortfall to those classes that are below 100%.

However, Energy Probe does not agree with the allocation of this revenue shortfall as proposed by PowerStream. PowerStream proposes to allocate the revenue shortfall to the classes below 100% on a pro-rata basis (Tr. Vol. 3, page 173). This results in a change in the revenue to cost ratios for those customer classes below 100% that is the same for all of those affected rate classes. Energy Probe is not sure whether the change in the revenue to cost ratio would be the same absolute percentage or the same proportion to the percentage. In either case, however, those rate classes closer to 100% to begin with are

moved closer to 100% than those rate classes that are farther below 100% to begin with. This result is neither fair nor reasonable.

Energy Probe submits that the Board should approve a stepwise approach to adjusting the revenue to cost ratios for those rate classes that are below 100% in order to recover the appropriate amount of the revenue shortfall. In particular, the shortfall should first be allocated to the class whose ratio is the lowest until that ratio equals the ratio for the class with the second lowest ratio. Then both ratios would be increased, if there is still a shortfall, in tandem to the next lowest ratio, and so on. This ensures that the classes that are being subsidized the most are the ones that move closer to 100%. This result is more appropriate than the PowerStream proposal.

4.6 Are PowerStream's proposed charges for street lighting appropriate?

Energy Probe makes no submissions on this issue.

4.7 Are the proposed fixed and variable charges for all rate classes over the 2016 – 2020 period appropriate?

Energy Probe submits that with respect to the residential class, PowerStream is following the Board's policy, with one exception. It is Energy Probe's understanding that PowerStream is proposing a one year delay to 2017 to the beginning of the shift towards a 100% fixed charge. This delay will help mitigate the rate impacts for residential customers in 2016. PowerStream has also indicated that it will still be able to achieve the move to 100% fixed charges by 2020. Energy Probe supports this proposal and submits that the Board should approve it.

4.8 Are the proposed LV Rates appropriate?

Energy Probe supports the submissions of VECC related to this issue.

4.9 Are the proposed Retail Transmission Service Rates appropriate?

Energy Probe supports the submissions of VECC related to this issue.

4.10 Are the proposed specific service charges for miscellaneous services over the 2016 – 2020 period reasonable?

Energy Probe submits that this cannot be determined for the years beyond 2016. Energy Probe notes that the Board has initiated a Review of Miscellaneous Rates and Charges

(EB-2015-0304). For 2016 there are no changes to the proposed rates and Energy Probe submits that this is acceptable.

Energy Probe submits that if the Board determines that new rates and charges are appropriate, it should institute them as soon as possible, including during a Custom IR rate period. Any impact on revenues from these changes in rates and charges should be tracked in a variance account for clearance to ratepayers at a future time.

If there is an increase in the rates or charges, as would be expected given that the level of current rates were based on labour and material costs from nearly a decade ago, ratepayers should not continue to subsidize these costs through their delivery rates and this subsidization should be eliminated as soon as possible.

4.11 Are the proposed line losses over the 2016 – 2020 period appropriate?

Energy Probe accepts the line losses as proposed by PowerStream.

5.0 DEFERRAL AND VARIANCE ACCOUNTS

5.1 Should the existing deferral and variance accounts proposed for continuation be continued?

Energy Probe submits that the existing deferral and variance accounts proposed for continuation are appropriate. However, as noted in the response to N-Energy Probe-51, PowerStream has indicated that the two accounts listed in the response are no longer active and the residual balances have been included for disposition in this application. Energy Probe submits that these two accounts should be closed.

5.2 Should the OEB approve any new deferral or variance accounts?

Throughout this submission, Energy Probe has argued for the inclusion of a number of variance accounts. Energy Probe submits that the Board should approve these accounts, as they all provide value to customers through protection from forecast bias and the ability to share in savings over and above those forecast to be achieved. This has a significant value to customers and has been recognized by the Board in a number of other Custom IR applications. Energy Probe submits that these accounts represent a significant improvement to the RRFE and should continue to be adopted by the Board.

PowerStream has requested an account to capture the net book value of meters removed from service in compliance with the Board's May 21, 2014 Distribution System Code

amendment requiring all GS > 50 kW customers to have meters capable of recording time-of-use consumption. Energy Probe supports the addition of this account, provided that the net book value of such assets have been removed from rate base at the end of 2015. In other words, the net book value should be included in the requested account and not in the 2016 rate base.

5.3 Are the balances and the proposed methods for disposing of the balances in the existing deferral and variance accounts, appropriate (such as Account 1508)?

Energy Probe submits that the proposed methods for disposing of the balances in the existing deferral and variance accounts is appropriate. However, there are three adjustments that should be made to the balances originally submitted by PowerStream.

The first adjustment is related to the interest rate used through to the end of 2015. Based on the response to N-Energy Probe-50, and the use of the Board approved interest rate of 1.10% effective April 1, 2015 through to the end of 2015, the amount to be disposed of should change from $10,680,800 to $10,633,000 for the accounts shown in Table N-EP-50-1.

The second adjustment relates to the ICM true-up amount. PowerStream originally proposed the recovery of $288,985 (Exhibit G, Tab 2b, page 4) from customers. However, as shown in the response to G-Energy Probe-15c, PowerStream has adjusted the ICM true-up calculation to use unreduced CCA, consistent with the 2014 ICM Workforms. Based on that change, the balance is now a refund to customers of $22,097. PowerStream indicated in the interrogatory response that they would update the balances to be disposed of to reflect this change. Energy Probe submits that this change is appropriate and should be reflected in the final balances.

The third adjustment relates to the balance in account 1568 (LRAMVA). Energy Probe has reviewed the submissions of VECC with respect to this account and support those submissions.

C - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe worked with other intervenors in this proceeding to ensure complete coverage of the issues with a minimum of duplication. As an example, Energy Probe did not do any cross-examination in this proceeding. This was because other intervenors, notably the School Energy Coalition, took the lead with respect to overall issue of whether the application meets the standards for a Custom IR application. It also reflects Energy

Probe's view that spending any time dealing with the fictitious forecasts in this proceeding would have been a waste of time for all parties concerned.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

January 15, 2016

Randy Aiken
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