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BY EMAIL

January 22, 2016

Ontario Energy Board
P.O. Box 2319
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2300 Yonge Street
Toronto ON M4P 1E4
Kirsten.Walli@ontarioenergyboard.ca

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Niagara Peninsula Energy Inc. (Niagara Peninsula Energy)
2016 Price Cap IR Distribution Rate Application and
Application to dispose of balance in LRAMVA
OEB Staff Submission
OEB File No. EB-2015-0090 and EB-2015-0328

On November 27, 2015, the OEB issued a letter indicating that Niagara Peninsula Energy's EB-2015-0090 and EB-2015-0328 hearings would be combined. In accordance with Procedural Order #1 in EB-2015-0090 and the letter noted above, please find attached OEB staff's submission related to the above noted proceedings. NPEI and all intervenors have been copied on this filing.

Niagara Peninsula Energy's reply submission, if it intends to file one, is due by February 12, 2016.

Yours truly,

Stephen Vetsis
Advisor, Electricity Rates and Prices

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2016 ELECTRICITY DISTRIBUTION RATES

Niagara Peninsula Energy Inc.

EB-2015-0090
and
EB-2015-0328

January 22, 2016

OEB Staff Submission
Niagara Peninsula Energy Inc.
2016 Price Cap IR Distribution Rate Application and Application to Dispose of LRAMVA Balance
EB-2015-0090 and EB-2015-0328

Introduction

Niagara Peninsula Energy Inc. (Niagara Peninsula Energy) filed an application with the Ontario Energy Board (OEB) on September 28, 2015, seeking approval for changes to the rates that Niagara Peninsula Energy charges for electricity distribution, to be effective May 1, 2016. The Application was based on the Price Cap IR option of the 2016 Incentive Regulation Mechanism (IRM).

On November 16, 2015, Niagara Peninsula Energy filed a second application to dispose of balances in the Lost Revenue Adjustment Mechanism Variance Account (LRAMVA). In a letter issued on November 27, 2015, the OEB decided that it will hold a combined hearing for the applications filed by Niagara Peninsula Energy.

The purpose of this document is to provide the OEB with the submissions of OEB staff based on its review of the evidence submitted by Niagara Peninsula Energy in each of the two filed applications (collectively referred to as the Application). With the exception of the specific issues identified below, OEB staff takes no issue with Niagara Peninsula Energy's proposals. OEB staff supports Niagara Peninsula Energy's LRAMVA claim as filed.

Working Capital Allowance

In the decision for Niagara Peninsula Energy's most recent cost of service application[1] the OEB directed Niagara Peninsula Energy to conduct a lead/lag study and file it with its next incentive rate-setting application. Niagara Peninsula Energy's 2015 rates were approved on an interim basis, to be made final when the OEB made its determination on the appropriate working capital needs following the review of the lead/lag study.

[1] Decision and Order, EB-2014-0096.

Niagara Peninsula filed a lead/lag study with the Application. Following the review of interrogatories posed by OEB staff and intervenors, Niagara Peninsula Energy filed an updated lead/lag study in support of a working capital requirement of 12.61% of the forecast cost of power and OM&A expenses.

OEB staff submits that the OEB should approve a working capital requirement equal to 8.67% of the forecast cost of power and OM&A expenses. This submission is based on proposed changes that are detailed below. Detailed calculations are shown in Appendix A.

Determination of Lead/Lag Days for Payments in Lieu of Taxes (PILs)

Niagara Peninsula Energy's study indicated an expense lead of -562.72 days for PILs. In response to interrogatories, Niagara Peninsula Energy reported that this is due to a current credit balance of about $700,000 it has with the Ministry of Finance for PILs. Niagara Peninsula Energy noted that it has made no PILs during the period of the lead/lag study or in the 2015 test year. Niagara Peninsula Energy estimated that it will have a credit balance with the Ministry of Finance for the next five years. As a result of the negative expense lead, Niagara Peninsula Energy's study derived a net lag of 627.5 days[2] for PILs which equated to a $280k working capital requirement on an estimated $163k PILs. Niagara Peninsula Energy stated that its expense lead for PILs would be 36.22 days if it was not in a credit position.

OEB staff submits that Niagara Peninsula Energy's derivation of the working capital requirements for its PILs is counter-intuitive and unreasonable. In essence, the calculation is requiring additional working capital funding in order for Niagara Peninsula Energy to pay PILs that it has already paid. OEB staff submits that the OEB should deem an expense lead of 36.22 days for Niagara Peninsula Energy's PILs which reflects a scenario where the credit is ignored. This would have the net result of reducing the working capital factor from 12.61% to 12.45%.

[2] A net lag of 627.5 days for PILs is calculated by subtracting the revenue lag of 64.75 days with the PILs expense lead of -562.75, 64.75 – (-562.75) = 627.5 days. This calculation is in Table 13 of Niagara Peninsula Energy's lead/lag study.

OM&A Expense Lead

Niagara Peninsula Energy's revised lead/lag study showed an OM&A expense lead of -1.73 days. The negative expense lead was mainly due to the weighted contribution of annual prepaid expenses. This is illustrated in Table 1 where the weighted lead for annual prepaid expenses is -19.16 days despite that fact that annual prepaid expenses only comprise 6.55% of the total weighting of OM&A costs. Annual prepaid expenses include software maintenance, insurance and membership fees, as well as regulatory expenses relating to Niagara Peninsula Energy's 2015 cost of service rate application.

Table 1 – Calculation of Proposed OM&A Expense Lead[3]

OM&A Expense Lead Based on the period May 2014-April 2015				
	Expense Lead (days)	Amount ($)	Weighting Factor	Weighted Lead
Payroll & Benefits	9.64	9,827,474	58.69%	5.66
Annual Prepaids	-292.67	1,096,430	6.55%	-19.16
Quarterly Prepaids	-31.44	458,258	2.74%	-0.86
Monthly Prepaids	-13.00	78,934	0.47%	-0.06
Bi-weekly Prepaids	-6.76	503,000	3.00%	-0.20
OM&A Expense Lead	45.18	4,780,842	28.55%	12.90
TOTAL	**-94.30**	**16,744,938**	**100.00%**	**-1.73**

The study calculated an expense lead of -292.67 days for annual prepaid expenses and applied a one-year service period to annual prepaid costs and a five-year service period to the regulatory costs. The total annual prepaid expenses for the study period were $1,068,514 in prepaid expenses and $139,576 in regulatory expenses. When calculating the weighted lead for annual prepaid expenses, Niagara Peninsula Energy only included $28k, or one fifth, of the total regulatory costs that were paid in the period.

OEB staff submits that the five-year service period applied to the regulatory costs is inappropriate for the nature of those costs. First, this results in overstating the expense lead for annual prepaid expenses. Furthermore, the services provided by legal and consultant costs in preparation for a cost of service application only provide benefit while that cost of service application is being heard by the OEB. Once rates have been

[3] Reproduced from Table 11 of the updated lead lag study filed by Niagara Peninsula Energy with its responses to interrogatories on December 18, 2015.

approved, no further service is being provided. While regulatory costs may be amortized over five years when designing rates that does not mean that regulatory expenses provide a service over that period.

Based on this information OEB staff submits that the OEB should, at minimum, impose an expense lead of 4.27 days for OM&A expenses. This is achieved by applying an expense lead of -182.5 days to the full amount of annual prepaid expenses without amortizing regulatory expenses. Details of the calculation are shown in Appendix A. The impact of this change is to reduce the working capital factor by 17 basis points.

However, OEB staff also submits that even 4.27 days may still be too low when compared to the studies of other LDCs. Table 2 below shows the OM&A expense lags from several recent studies filed with the OEB. OEB staff is not aware of any other lead lag study that has proposed a negative OM&A expense lead, as Niagara Peninsula Energy has done. Given that payroll costs constitute a major element of OM&A expenses, it is counterintuitive that NPEI should have an expense lead that is significantly different from other utilities. OEB staff submits that Niagara Peninsula Energy has not provided any evidence to indicate why its circumstances would be unique from other Ontario distributors. In staff's view, the OEB could instead impose the current minimum OM&A expense lead days observed from the sample below (7.3), or the average of the OM&A expense leads of previous studies (16.3), if it found that this alternative were warranted.

Table 2 - Summary of OM&A expense leads for other Ontario distributors

Distributor Name	Case Number	OM&A Expense Lead (Days)
Entegrus Powerlines Inc.	EB-2015-0061	20.17
North Bay Hydro Distribution Ltd.	EB-2014-0099	15.97
Oshawa PUC Inc.	EB-2014-0101	13.80
London Hydro	EB-2012-0146	15.08
Hydro Ottawa	EB-2011-0054	11.28
Toronto Hydro	EB-2014-0116	33.86
Veridian	EB-2013-0174	12.81
Horizon	EB-2014-0002	7.30

Derivation of Collections Lag

The revised study calculated a collections lag of 29.24 days. This was calculated using monthly accounts receivable amounts grouped by how long the amounts have been outstanding. Niagara Peninsula Energy then averaged the monthly balance in each group as a means for weighting the lags in each group. This derivation is shown in Table 3 below.

Table 3 – Weighting of accounts receivable grouped by age[4]

Month	1-30 Days	31-60 Days	61-90 Days	91-180 days	> 181 days	Total (Outstanding)
May	6,052,545.01	244,868.59	108,429.73	254,831.01	476,036.00	7,136,710.35
June	8,561,465.88	252,692.70	124,493.61	207,210.89	558,392.11	9,704,255.19
July	9,481,342.98	180,487.51	115,456.54	223,519.81	580,209.12	10,581,015.96
August	11,549,573.50	160,574.59	79,181.71	211,999.45	597,107.69	12,598,436.95
September	9,215,239.51	187,091.87	63,307.47	188,523.35	611,962.59	10,266,124.79
October	9,873,109.55	169,768.87	106,764.71	157,288.76	293,429.25	10,600,361.15
November	10,130,498.43	344,256.65	67,057.82	162,291.39	318,530.16	11,022,634.44
December	9,893,622.68	258,462.10	98,673.21	192,363.79	350,721.80	10,793,843.59
January	10,010,446.59	198,785.63	120,477.50	195,541.57	380,523.18	10,905,774.48
February	11,802,516.72	188,469.32	72,608.01	164,948.71	405,557.38	12,634,100.14
March	11,317,436.43	235,915.85	75,021.08	128,949.00	420,488.90	12,177,811.25
April	8,664,997.36	224,229.67	87,528.10	121,607.45	462,617.32	9,560,979.91
TOTAL	**116,552,794.66**	**2,645,603.34**	**1,118,999.49**	**2,209,075.17**	**5,455,575.50**	**127,982,048.17**
# months	**12**	**12**	**12**	**12**	**12**	**12**
Average	**9,712,733**	**220,467**	**93,250**	**184,090**	**454,631**	**10,665,171**

In response to interrogatories, Niagara Peninsula Energy indicated that bad debts are written off in journal entries posted once a year. When asked how the data in Table 3 had been corrected for bad debt, Niagara Peninsula Energy stated that the data in the 'greater than 181 days' category is adjusted for the removal of bad debts in the October 2014 entry of the table above.

In response to interrogatories, Niagara Peninsula Energy calculated the collections lag using smaller time periods (shown in Table 4 below). OEB staff notes that Niagara Peninsula Energy has applied a mid-point of 5.5 days to the 'current 20-30' aging category in Table 4. This mid-point should likely be 25.5 days. OEB staff's calculations have taken this correction in to account.

[4] Reproduced from Niagara Peninsula Energy's response to OEB staff interrogatory #2c).

Table 4 – Derivation of proposed OM&A collection lag[5]

Aging Categories	Mid Point	Average A/R $	Weight	Collection Lag
Current 0-19	9.5	$ 9,457,387	88.68%	8.42
Current 20-30	5.5	$ 255,346	2.39%	0.13
Overdue 31-60	45.5	$ 220,467	2.07%	0.94
Overdue 61-90	75.5	$ 93,250	0.87%	0.66
Overdue 91-180	135.5	$ 184,090	1.73%	2.34
Overdue > 181	273	$ 454,631	4.26%	11.64
		10,665,170.68	100.00%	24.13

OEB staff submits that additional detail provided in Table 4 should be used instead of the 30 day groups proposed by Niagara Peninsula Energy in the lead/lag study. This adjustment provides a better basis for revenue-weighting the calculated lag.

Furthermore, OEB staff submits that Niagara Peninsula Energy's collections lag is overstated because the average accounts receivable balance for the 'greater than 181 days' group includes bad debt in all but one month of the source data. Niagara Peninsula Energy reported an average bad debt of $273,604.[6] If the average accounts receivable for the greater than 181 days group is decreased by the average bad debt, the collections lag is reduced to 17.6 days. This results in an overall reduction in the working capital factor of 361 basis points.

Conclusion

In summary, OEB staff has proposed the following changes to the derivation of Niagara Peninsula Energy's working capital allowance:

1) Applying an expense lead of 36.22 days for PILs expenses; a 16 basis point reduction in the working capital factor
2) Applying an expense lead of 4.27 days to OM&A expenses, a 17 basis point reduction to the working capital factor
3) The removal of bad debt from the weighted accounts receivable balances which reduces the collections lag to 17.6 days; a 361 basis point reduction in the working capital factor.

[5] Reproduced from Niagara Peninsula Energy's response to OEB staff interrogatory #2b).
[6] Cost Allocation Model, Draft Rate Order, EB-2014-0096, May 21, 2015.

The overall impact of all the changes combined would result in a decrease of the working capital allowance from the 12.61% to 8.67% of the cost of power and OM&A expenses. The overall changes proposed by OEB staff would result in a decrease of about $380,000 to Niagara Peninsula Energy's proposed revenue requirement, a material change based on the materiality threshold of $146,874[7] established in its last cost of service application.

[7] EB-2014-0096, Application – Exhibit 1, Tab 5, Schedule 1, September 23, 2014.

Appendix A

The following table shows the derivation of the working capital requirement of 8.67% supported by OEB staff. This table is a reproduction of table 13 from the study filed by Niagara Peninsula Energy. The proposed changes to the parameters are highlighted in all tables provided in this Appendix.

Table 5 – Calculation of OEB staff proposed working capital factor

Budget Item Description	Revenue Lag Days	Expense Lead Days	Net Lag (Lead) Days	WCA Factor	Test Year Expenses ($)	WCA ($)	WCA (%)
Cost of Power	52.59	29.59	23	6.30%	$ 144,149,669	$ 9,083,404	
Retailer Expenses	52.59	37.94	14.65	4.01%	$ 2,417,005	$ 97,011	
OM&A Expenses	52.59	4.27	48.32	13.24%	$ 16,424,995	$ 2,174,399	
Interest on Long Term Debt	52.59	4.38	48.21	13.21%	$ 2,345,596	$ 309,811	
PILs	52.59	36.22	16.37	4.48%	$ 163,430	$ 7,330	
Debt Retirement Charges	52.59	28.26	24.33	6.67%	$ 8,456,444	$ 563,686	
Sub-Total					$ 173,957,139	$ 12,235,641	7.62%
HST (Receivables)			-10.45	-2.86%	-$ 22,603,800.00	-$ 647,149.89	
HST (Expenses			43.63	11.95%	$ 19,499,180	$ 2,330,820	
Total (Inc. HST)					**$ 170,852,519**	**$ 13,919,311**	**8.67%**

The expense lead for OM&A expenses is derived by applying an expense lead of -182.5 days to annual prepaids and including the full amount, unamortized amount of billed regulatory expenses incurred in the study period. This is summarized in the reproduction of table 11 from the study shown below.

Table 6 – Calculation of Weighted OM&A Expense Lead

	Expense Lead (days)	Amount ($)	Weighting Factor	Weighted Lead
Payroll & Benefits	9.64	$ 9,827,474	58.69%	5.66
Annual Prepaids	-182.5	$ 1,208,091	7.21%	-13.17
Quarterly Prepaids	-31.44	$ 458,258	2.74%	-0.86
Monthly Prepaids	-13	$ 78,934	0.47%	-0.06
Bi-weekly Prepaids	-6.76	$ 503,000	3.00%	-0.20
OM&A Expense Lead	45.18	$ 4,780,842	28.55%	12.90
Total		$ 16,856,599	100.67%	4.27

The change to the revenue lag is calculated by removing bad debt from the derivation of collections lag. Bad debt was assumed to be $273,604 which reflects three-year average reported in the cost allocation model filed with Niagara Peninsula Energy's draft rate order in its last cost of service application, EB-2014-0096. This amount was bad debt was subtracted from the average accounts receivable for the "Overdue > 181"

aging category in the table provided in response to interrogatory Staff-2b). The calculation is reproduced below.

Table 7 – Derivation of Collection Lag with removal of Bad Debt

Aging Categories	Mid Point	Average A/R $	Weight	Collection Lag
Current 0-19	9.5	$ 9,457,387	88.68%	8.42
Current 20-30	25.5	$ 255,346	2.39%	0.61
Overdue 31-60	45.5	$ 220,467	2.07%	0.94
Overdue 61-90	75.5	$ 93,250	0.87%	0.66
Overdue 91-180	135.5	$ 184,090	1.73%	2.34
Overdue > 181	272.5	$ 181,027	1.70%	4.63
TOTAL		$ 10,391,567	97.43%	17.60

The new collections lag is applied to derive the overall revenue lag of 52.59 shown in the table below.

Table 8 – OEB staff proposed Revenue Lag Days

Service Lag	15.21
Billing Lag	17.98
Collection Lag	17.6
Payment Processing and Bank Float Lag	1.8
TOTAL	52.59