2016 ELECTRICITY DISTRIBUTION RATES

Grimsby Power Inc.

EB-2015-0072

OEB STAFF SUBMISSION ON SETTLEMENT PROPOSAL

June 30, 2016

INTRODUCTION

On June 24, 2016, Grimsby Power Inc. (Grimsby Power) filed a settlement proposal with respect to its 2016 Cost of Service application seeking an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2016. The parties to the settlement proposal are Grimsby Power and the following approved intervenors in the proceeding: Niagara Peninsula Energy Inc. (NPEI), Energy Probe Research Foundation (Energy Probe), School Energy Coalition (SEC) and Vulnerable Energy Consumers Coalition (VECC). A fifth intervenor, Cogeco, attended the settlement conference for a portion of the first day, but did not participate.

The settlement proposal represents a partial settlement. The issues not settled and the proposed method of hearing the issues and the reasons are as follows:

- Operations, Maintenance and Administration (OM&A) – the Parties agree that this issue should be dealt with by way of an oral hearing due to the complexity of the components included in the OM&A;
- Effective Date of Rates - the Parties agree that this issue should be dealt with by way of an oral hearing due to the fact that Grimsby Power's requested effective date of May 1, 2016 is now past; and
- Payments in Lieu of Taxes (PILs - the Parties agree that the complex and technical nature of the disputed issue suggests it be dealt with by way of an oral hearing.

The following represents OEB staff's submission on the settlement proposal as filed.

Settlement Proposal

Ontario Energy Board (OEB) staff has reviewed the settlement proposal in the context of the objectives of the *Renewed Regulatory Framework for Electricity* (RRFE), other applicable OEB policies, relevant OEB decisions, and the OEB's statutory obligations. The RRFE is a rate-setting option developed for distributors in *Report of the Board - Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* issued on October 18, 2012. The Parties considered the issues and outcomes of the RRFE in the context of Grimsby Power's application.

OEB staff submits that the outcomes arising from the OEB's approval of the settlement proposal would adequately reflect the public interest and would result in just and reasonable rates for customers.

OEB staff submits that in reaching the partial settlement, the parties considered Grimsby Power's customer engagement and feedback, industry benchmarks and past reliability and service quality performance.

OEB staff submits that the settlement proposal reflects a reasonable evaluation of the distributor's planned outcomes in this proceeding, and reflects appropriate consideration of the relevant issues and provides sufficient resources to allow Grimsby Power to achieve its identified outcomes in the four incentive rate-setting years that will follow.

Notwithstanding the above, OEB staff provides further specific submissions on the following issues:

- Distribution System Plan (DSP)
- Cost allocation and rate design for the Embedded Distributor rate class
- The application of Retail Transmission Service Rates to the Embedded Distributor rate class
- Grimsby Power's response to its commitment in its EB-2011-0273 settlement agreement to conduct an objective study of the useful lives of its distribution assets

Distribution System Plan

OEB staff agrees with the parties that the DSP, as adjusted through the settlement agreement, combined with the resources made available to Grimsby Power in the test year under the terms of this settlement proposal, provide a proper foundation for Grimsby Power in the test year to continue to: (a) pursue continuous improvement in productivity; (b) maintain system reliability and service quality objectives; and (c) maintain reliable and safe operation of its distribution system.

OEB staff notes that the $200,000 (9%) reduction in gross capital expenditures (12% on a net basis) in the test year reflects the parties' agreed-upon estimate of

the actual capital investment level Grimsby Power will achieve relative to its plan, based on historical performance. OEB staff supports such an adjustment insofar as it aims to ensure rates recover the costs only of assets that are used or useful in the year.

Regarding asset condition, a key component of distribution system planning, Grimsby Power has described its process as follows:

> In place of a formal Asset Condition Assessment, Grimsby Power analyzed existing data to determine the required System Renewal Investments. Asset condition & demographic information is kept in a number of formats including paper based files, GIS, database (MS Access-Db) and spreadsheet (MS Excel-Sp) based. The data was recently consolidated into a single database where asset demographic data can be analyzed and correlated with available asset condition data. Asset condition data is manually reviewed to identify assets with high severity defects or in need of imminent replacement. GPI combines the condition data with the asset age on an asset-by-asset basis to establish an adjusted age which can be objectively compared to the typical useful lives and to determine replacement options.[1]

Although Grimsby Power's DSP identifies an opportunity to better organize its asset condition data and define condition standards that can be consistently translated to probability and outcome, no time limit was placed on this expectation. Rather, the activity was categorized as a subject of "continuous improvement".[2]

OEB staff supports Grimsby Power's commitment to continuous improvement in this area, but submits that a consistent, replicable and documented approach to its asset condition assessment is required sooner, rather than later, to provide more confidence in Grimsby Power's capital budgets.

[1] Response to IR 2-Staff-16 b)

[2] Exhibit 2, Appendix 2-A,Distribution System Plan, page 66

The settlement proposal in this case requires Grimsby Power to conduct an independent Asset Condition Assessment to be submitted with its next cost of service or custom IR application. The settlement provides that the cost of this Asset Condition Assessment will be included as part of the regulatory costs for recovery in the next cost of service or custom IR application. OEB staff submits that this requirement, as well as the expectation of recovery of costs in excess of its materiality threshold, is appropriate. OEB staff notes that a deferral account will be required to track these costs for review and potential disposition the next rebasing application.

Cost Allocation and Rate Design for the Embedded Distributor Rate Class

Grimsby Power serves NPEI as an embedded distributor through the Niagara West Transformer Station (NWTS), which had been previously jointly-owned by Niagara Power Inc. (the parent corporation to Grimsby Power Inc.) and Peninsula West Power Inc. (now owned by NPEI) and operated as Niagara West Transformation Corporation (NWTC). On December 6, 2012, the OEB approved the purchase of the 50% share owned by Peninsula West Power Inc. by Niagara Power Inc. Grimsby Power and NWTC were amalgamated through OEB proceeding EB-2014-0344 on March 26, 2015 and the NWTS was deemed to be a distribution asset.

Consideration of the cost allocation and rate design proposals for the NWTS were deferred from the amalgamation proceeding until this cost of service proceeding. Prior to amalgamation, NWTS charged NPEI an approved transmission rate for transformation service of $1.77 per kW. This rate was insufficient to recover a return on the transmission assets or its full long term debt cost[3]. In its EB-2014-0344 decision, the OEB approved continued recovery of the approved transmission rate as a distribution rate until Grimsby Power's next rebasing.

In its application, Grimsby Power had calculated its revenue requirement based on recovery of the applicable rate of return, including its full long term debt cost. Grimsby Power proposed to allocate 50% of the costs for the NWTS to NPEI, to

[3] EB-2014-0344 Application, par. 17

reflect the fact that the facility serves both Grimsby Power and NPEI, and its assertion that the costs to serve these entities did not vary with the customer's load. The total capacity of the NWTS assigned to NPEI is approximately 40%[4].

Grimsby Power proposed to recover these costs through a fully fixed rate of $44,159.75 per month. The impact to NPEI through these proposals and the addition of Retail Transmission Service Rates (RTSRs) was an increase of 159%[5].

The parties reached a settlement on cost allocation and rate design for the Embedded Distributor class which includes the following characteristics:

- 40% of the costs directly associated with NWTS are allocated to the Embedded Distributor by using the direct allocation method.
- rate base components related to general plant indirect costs are not included in the allocation
- revenue to cost ratio of 100%.
- fixed/variable revenue proportion of 50% fixed and 50% variable
- Embedded Distributor forecast is based upon the gross load (i.e. the sum of the actual 2015 demand supplied from the NWTS to NPEI plus the demand supplied to NPEI from embedded generation)
- revenue generated from the variable rate in any calendar year will be trued-up to a reflect a minimum threshold of 117,500kW per year

OEB staff supports the overall proposal and submits that each of the elements of the agreement with regard to Grimsby Power's Embedded Distributor class is reasonable. The allocation of 40% of direct costs to NPEI is reflective of its assigned capacity on the NWTS. This is consistent with the allocation of Hydro One costs to other embedded distributors based on non-coincident peak[6]. The use of a revenue-to-cost ratio of 100% both reflects the clearly defined set of costs and assets to be allocated to this customer (i.e. NPEI) as well as avoids cross subsidy between the ratepayers of NPEI and those of Grimsby Power.

[4] EB-2015-0072, Response to IR 7-Staff-42g)
[5] EB-2015-0072. Response to IR #8-NPEI-7
[6] EB-2015-0079, Exhibit 3.2

The fixed revenue proportion of 50% is significantly higher than the 18.7% total fixed revenues recovered by Hydro One from its Sub-Transmission rate class, the rate class into which the majority of Ontario embedded distributors fall. However, OEB staff notes that this fixed/variable proportion was negotiated and accepted by NPEI as the customer of Grimsby Power, and therefore submits that it could be seen to represent a reasonable result.

Under the proposal, the billing determinant for the volumetric charge shall be on the basis of gross load. OEB staff submits that gross load billing for transformation service is consistent with industry practice for customers with load displacement generation at 1MW or above, or 2MW or above for renewable generation[7]. The circuit supplying NPEI's service territory also connects a wind project with a peak capacity of 9.8MW, which began operation in June 2014. NPEI has calculated the average generation output for the facility to be approximately 3.5 MW[8]. While OEB staff acknowledges that the transformer station is deemed to be a distribution asset, its operation at transmission voltages provides a rationale, in OEB staff's view, for designing the charges consistent with transmission rate design.

One area of the settlement proposal that is not directly consistent with industry practice is the fact that the parties have proposed a mechanism by which revenues will be trued-up to reflect a minimum demand of 117,500 kW, or 84% of the forecast demand of 139,279 kW per year. The settlement proposal states that the true-up mechanism provides Grimsby Power with some certainty of revenue recovery in the face of possible reductions in demand supplied from the NWTS to the embedded distributor as a result of CDM programs, loss of customer load, impacts of generation below the 1MW and 2MW capacities and potential transfers of load by NPEI to other facilities.

In OEB staff's view, the core issue being addressed through the proposed rate design for the embedded distributor is the appropriate level of revenue risk that distributors should be expected to manage. The true-up mechanism clearly seems to relate to the distributor's wish to minimize the risk that its asset will be

[7] EB-2015-0079, Notes to Tariff of Rates and Charges
[8] EB-2015-0072, Exhibit 7, Appendix 7-B

stranded by actions of its customer, NPEI. The agreement aims to insulate Grimsby Power from the revenue risk from two different kinds of system changes – the penetration of conservation and demand management (including small embedded generation) and load transfers.

Generally, a transmission asset owner's stranding risk is managed through a provision of the transmission system code which entitles a transmitter to be compensated if its facilities are bypassed (ie, not used as a result of reductions in load by the implementation of other load-serving measures).

While it has been some time since the OEB has considered this matter in a policy document, a 2004 decision on a proceeding to review the transmission system code found that "reductions in load attributable to measures for energy conservation, energy efficiency, load management or use of cleaner energy sources should not be considered system bypass. Measures discouraging such activities, such as a transmitter imposing a minimum payment obligation to cover present loads, should be prohibited and where such measures are in existing agreements they should be unenforceable."[9]

In OEB staff's view, the parties' selection of 84% of the load forecast as the variable revenue floor for the embedded distributor does not appear to foreclose the opportunity for increased penetration of distributed generation or more CDM measures – at least not for the current rate plan. A peak demand reduction of 16% from current forecast would greatly exceed the 5-year CDM target for LDCs and would be unlikely to be achieved for the subset of NPEI customers served by this transmission facility. To achieve this, customers would have to reduce their peak load, which is forecast to be 11.6MW in the average month, by 1.8MW every month of the year[10]. Not only is it unclear whether the practical potential to reduce peak load by this amount in this customer set exists; it is also unlikely to be achieved in a relatively short timeframe since the penetration of CDM and small-scale generation will depend almost entirely on the individual planning decisions of independent load customers rather than NPEI. Accordingly, the selection of the revenue floor at a level below the current load forecast does not seem to run counter to the policy principle outlined in the OEB's policy decision

[9] RP-2002-0120, Phase 1: Policy Decision with Reasons, June 8, 2004, p52.
[10] 139,279 kW/12 = 11.6MW. 117,500kW/12 = 9.8MW

that CDM not be discouraged by minimum load expectations, since there appears to be sufficient opportunity for customers to engage in CDM activities before minimum cost thresholds would be triggered.

The second risk, regarding the risk of asset stranding from load transfer, raises a separate set of issues. Grimsby Power has not yet entered into a connection agreement with NPEI, despite the requirements of the Distribution System Code, s. 6.3.2[11]. OEB staff submits that the absence of such an agreement is a primary factor in the complexity of the rate design matters that have surfaced in this proposal. OEB staff anticipates that such an agreement would typically be the vehicle by which parties could address issues such as the threshold at which compensation is payable to an asset owner if load is less than forecast as a result of load transferred from one transformer station to another due to system reconfiguration. Nevertheless, in OEB staff's view, the agreement to true-up variable revenues below a certain threshold is similar in principle to the outcome that a bypass agreement may otherwise have achieved. This provides further support for the reasonableness of the rate proposal. OEB staff further notes that the settlement proposal includes a commitment by Grimsby Power and NPEI to execute a connection agreement. OEB staff would be supportive of any steps that ensure that execution of a connection agreement is a priority. Considering that this is a matter of compliance with the Distribution System Code, OEB staff submits that Grimsby Power should be required to notify the OEB that a connection agreement has been executed by an established deadline.

A further and more current initiative relevant to the rate design proposed in the settlement proposal is the OEB's ongoing consultation on Rate Design for Commercial and Industrial Electricity Customers (EB-2015-0043). This initiative is specifically evaluating issues such as the incorporation of load displacement generation, as well as the applicability of gross load billing. OEB staff notes that this initiative has not yet concluded and no new policy has yet been determined. Nevertheless, OEB staff submits that the approach contained in this settlement is a reasonable result that has been achieved through negotiation by the parties, including, importantly, the directly affected customer, who is a party to this settlement proposal.

[11] EB-2015-0072, response to IR 7-Staff-42

While the elements of this rate design proposal are, to OEB staff's knowledge, unique, OEB staff submits that the resolution is reasonable overall, and administrable through the Price Cap IR term. The rate proposal is directionally consistent with OEB's rate design initiatives that are beginning to contemplate a shift toward more costs being recovered on a fixed basis; there is evidence that the parties have attempted to strike a balance between the interests of the distributor and its customer.

OEB staff notes that the general policy principle behind rate regulation is that the recovery of a revenue requirement is not a guarantee, but rather a risk for which a regulated entity is compensated through its rate of return on equity. While this settlement proposal does increase the revenue certainty for the distributor for this rate class, it falls short of providing a revenue guarantee, thereby mitigating this policy concern.

Retail Transmission Service Rates (RTSRs) for the Embedded Distributor Rate Class

The NWTS is physically located within NPEI's service territory and NPEI is the market participant for this asset. As a result, even though Grimsby Power owns the transformer station, it does not yet charge retail transmission service rates to its customer; the customer settles these charges with the IESO instead.

In order to align the station ownership with settlement responsibilities, Grimsby Power proposes to complete the IESO market participant registration processes to transfer the market participant designation and wholesale metering from NPEI to Grimsby Power. At the date of transfer, and upon notification to the OEB, Grimsby Power proposes to apply the Retail Transmission Service Rates to the Embedded Distributor rate class. Grimsby Power has proposed, and the parties agree, that the OEB approve the RTSRs to the Embedded Distributor class for its tariff sheets in this proceeding, on the condition that these rates will become effective upon attainment of market participant status for this asset.

OEB staff has reviewed the calculation of the RTSRs, and submits that they have been appropriately calculated, on the assumption that the IESO will settle Network and Line Connection uniform transmission rates (UTRs) with Grimsby Power as the market participant for the NWTS. Transformation charges for

NWTS have been removed from the calculation, as these costs are now recovered through Grimsby Power's distribution rates.

OEB staff notes that the OEB has in the past approved tariff sheets that would become effective upon the achievement of certain conditions that may come into being subsequent to the issuance of the decision in question. For example, the OEB's Decision for Hydro One Remote Communities Inc. (EB-2012-0137) approved a tariff of rates and charges that included rates applicable to Grid-Connected Communities that were conditional upon the LDC attaining approval to include specific communities within its service territory.

OEB staff notes that, had the transfer of market participant status from NPEI to Grimsby Power taken place upon the transfer to 100% ownership of the NWTS in 2012, the added complexity of conditional tariff sheets would not be an issue in this proceeding. OEB staff nevertheless agrees that this matter warrants prompt resolution, since, in the event that the OEB did not approve these rates in this proceeding, Grimsby Power would be unable to calculate RTSR s for this new rate class for the remainder of its IRM period. Under these circumstances OEB staff submits that, provided that Grimsby Power can sufficiently demonstrate its attainment of market participant status, the approval of a conditional RTSR contained in Grimsby Power's Embedded Distributor rate class tariff sheet is a reasonable approach to ensuring that these costs can be passed through to its customers in an equitable and timely manner, while avoiding an unnecessary and largely administrative OEB approval process at a later date. Grimsby Power will retain the responsibility for billing its customers accurately and in accordance with the conditions clearly indicated on its tariff sheet.

Grimsby Power's Response to its Commitment in EB-2011-0273

Grimsby Power's settlement agreement in its EB-2011-0273 contained a commitment to perform an objective study of the useful lives of its distribution assets, to be filed with its next cost of service application, as follows:

> 4.3 Is the proposed level of depreciation/amortization expense for the test year appropriate?
> …the Parties agree Grimsby Power will change the useful lives of assets to those represented by the Typical Useful Life as detailed in the study prepared by Kinectrics for the Board and released by the Board on July 8, 2010,

> and adjust depreciation for 2011 and 2012 accordingly. … Grimsby Power will also perform an objective study of the useful lives of its distribution assets using its resources, or will retain a consultant to perform such a study, and agrees to file that study no later than with its next Cost of Service application.

The settlement proposal was accepted by the OEB.

In its evidence regarding directions from previous proceedings, Grimsby Power identified this commitment. However, it stated that it had not conducted such a study[12]. Grimsby Power relied upon the Kinectrics Typical Useful Lives (TUL) in calculating its depreciation and amortization expense in this application.

In response to Interrogatory 1-Staff-8, Grimsby Power stated that it had not notified the OEB or Intervenors of its intent to forego the study. It noted that other utilities had adopted the Kinectrics TUL for the purposes of calculating depreciation and amortization expense, and that, in its view, conducting an independent study did not provide value for Grimsby Power customers. The response also noted that Grimsby Power had made a legal commitment to perform the study and that it would do so if requested by intervenors or the OEB.

The Parties have accepted the use of the Kinectrics TUL underpinning the calculation of depreciation and amortization expense in this application. OEB staff takes no issue with Grimsby Power's depreciation and amortization expense as calculated. OEB staff agrees that the OEB has accepted the use of the Kinectrics TUL in numerous applications[13], although this methodology is not required. As noted in the Filing Requirements:

> The Kinectrics Report provides information that the OEB expects distributors will consider as they develop asset service lives to be included in their cost of service applications. However, while the Kinectrics Report contains a range of useful lives for assets, distributors must ensure that these ranges (and the specific useful lives selected within the ranges) are appropriate to their circumstances when preparing an application, and must provide explanations

[12] EB-2015-0072, Exhibit 1, p. 100

[13] EB-2011-0123; EB-2011-0054; EB-2011-0073

for any proposed useful lives that are not within the ranges contained in the Kinectrics Report.[14]

While OEB staff supports the use of the Kinectrics TUL as an accepted methodology for calculating depreciation and amortization expense, and agrees that avoiding the expense of a third-party depreciation study may be in the best interests of Grimsby Power's ratepayers, OEB staff is concerned with Grimsby Power's failure to comply with the agreement in its settlement proposal with intervenors as approved by the OEB.

OEB staff submits that an appropriate remedy under these circumstances would have been for Grimsby Power to consult with the other parties to the settlement agreement regarding its plans and to apply to the OEB for a Motion to vary the decision in EB-2011-0273. Such an approach has been accepted by the OEB in the past.[15]

OEB staff considers the depreciation expense included in revenue requirement based on the Kinectrics TUL, as contained within the settlement proposal, to be reasonable. OEB staff also notes that, just as with the last settlement, there are several forward-looking commitments made in this settlement proposal – to conduct an asset condition study, execute a connection agreement and complete the market participant registration process. OEB staff submits that the OEB panel may wish to provide specific direction to Grimsby Power in its decision that would require it to comply with its commitment to each of these three undertakings. While such expectations would apply whether specifically articulated or not, additional orders may help to reinforce with the applicant the significance of its compliance obligations.

All of which is respectfully submitted

[14] Filing Requirements for Electricity Distribution Rate Applications – 2015 Edition for 2016 Rate Applications, July 16, 2015. p. 40
[15] EB-2016-0147