2017 ELECTRICITY DISTRIBUTION RATES

Brantford Power Inc.

EB-2016-0058

OEB STAFF SUBMISSION ON SETTLEMENT PROPOSAL

November 11, 2016

INTRODUCTION

On November 3, 2016, Brantford Power Inc. (Brantford Power) filed a settlement proposal with respect to its 2017 Cost of Service application seeking an order approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2017. The parties to the settlement proposal are Brantford Power and the following approved intervenors in the proceeding: Energy Probe Research Foundation (Energy Probe), School Energy Coalition (SEC) and Vulnerable Energy Consumers Coalition (VECC).

The settlement proposal represents a full settlement.

The following is Ontario Energy Board (OEB) staff's submission on the settlement proposal as filed.

Settlement Proposal

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.

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 settlement, the parties considered Brantford 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 Brantford Power to achieve its identified outcomes in the four incentive rate-setting years that will follow.

OEB staff further submits that the explanation and rationale provided by the parties is adequate to support the settlement proposal.

OEB staff has reviewed the models and draft tariff sheets that have been submitted in support of the Settlement Proposal, and submits that they accurately reflect the Settlement Proposal. OEB staff notes that certain formatting errors are contained in the draft tariff sheets. OEB staff submits that, should the OEB decide to accept the Settlement Proposal as filed, these formatting issues can be resolved in a final rate order.

OEB staff provides further specific submissions on the following issues:

- The treatment of potential capital spending variances in 2016 and 2017
- Cost of long term debt

Capital Spending Variance

OEB staff agrees with the parties that the Distribution System Plan, as adjusted through the Settlement Proposal, combined with the resources made available to Brantford Power in the test year under the terms of this Settlement Proposal, provide a proper foundation for Brantford 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.

Brantford Power's May 4, 2016 application included a proposal to purchase and refurbish an existing building to consolidate its operations which are currently housed in three separate rental locations. At the time of the application, Brantford Power anticipated that the purchase, refurbishment and relocation to the new building would be complete by December 31, 2016. Brantford Power's proposed 2017 revenue requirement included the impact of the acquisition of the land and building. Subsequently, Brantford Power determined that the acquisition was not proceeding at a pace that would accommodate its proposed timeline. In response to interrogatory 2-Staff-7, Brantford Power withdrew its request and adjusted its application to remove the $966k revenue requirement impact[1] of the proposed facility. Brantford Power indicated that it would apply for an Incremental Capital Module (ICM) when the facility relocation is complete.

[1] EB-2016-0058 Revenue Requirement Workform, 20161103, Sheet 10.

In this case, all parties agreed that Brantford Power had undertaken a rigorous approach to its asset condition assessment and developed a well-supported Distribution System Plan. However, for the purposes of settlement, the parties have agreed to two adjustments. The first of these is a reduction in Brantford Power's proposed capital expenditures of 10% to reflect its historical level of execution as compared to its budget. The reduction is limited to expenditures not related to Brantford Power's System Integration Plan. Brantford Power has calculated the 10% reduction in its remaining capital expenditures to be $323k[2]. This results in a settlement for 2017 total capital expenditures of $3,828,988.

Parties have also agreed that any underspending compared to the agreed level of in-service additions in 2016 and 2017 will be added to the threshold calculation in the event that Brantford Power files an ICM application prior to its next cost of service application[3], thus reducing the amount of potential ICM capital available to Brantford Power at that time by an amount corresponding to the underspent amounts. This calculation would be asymmetrical, applying only to amounts of underspending, with no adjustment if Brantford Power should spend more than its approved in-service additions in either year.

OEB staff notes that this mechanism is a slight departure from the normal approach to a cost of service application, within which the OEB approves rates designed to recover forecast test year costs. Distributors are expected to manage within the approved spending envelope during the IRM term, subject to certain prescribed formulaic adjustments, without subsequent true-ups. It is also a slight departure from the approach to the eligible incremental capital calculation under the ICM policy.

OEB staff submits that Brantford Power's proposal to file an ICM application during the IRM period presents an opportunity to ensure that its ratepayers are held whole in the event that capital projects are delayed, and that the solution contained in the Settlement Proposal ensures that the proposed ICM calculation does not double-count revenue requirement amounts.

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[2] EB-2016-0058 Settlement Proposal, p. 14.
[3] EB-2016-0058 Settlement Proposal , p. 17.

Brantford Power's application indicated some evidence of under-spending in prior years, and OEB staff notes that the OEB has approved other mechanisms in the past to track actual capital spending, such as a variance account[4]. OEB staff has no concerns with this provision of the settlement agreement because of Brantford Power's specific circumstances.

Cost of Long Term Debt

The Settlement Proposal incorporates a weighted average cost of long term debt of 4.29%. Brantford Power's Long Term Debt Cost includes a promissory note with the City of Brantford at a rate of 4.20%. Brantford Power's application was filed on the basis of the cost of capital parameters in effect for 2016, which included a deemed cost of long term debt of 4.54%. On October 27, 2016, the OEB issued its cost of capital parameters for cost of service applications with rates effective in 2017, which incorporate a deemed long term debt rate of 3.72%.

Parties have expressed concerns with the promissory note, as it "has no prepayment options and provides for the unilateral rights of renewal by the City of Brantford every five years in perpetuity, with the interest rate formula set at prime plus 1.5%"[5]. Nonetheless, parties have accepted the weighted debt cost rate of 4.29% as calculated by Brantford Power for the purposes of settlement.

OEB policy as outlined in the Cost of Capital Report (Report) establishes the long term debt rate applicable to affiliate debt as follows:

> For affiliate debt (i.e., debt held by an affiliated party as defined by the Ontario *Business Corporations Act, 1990*) with a fixed rate, the deemed long-term debt rate <u>at the time of issuance</u> will be used as a ceiling on the rate allowed for that debt.[6]

The promissory note with the City of Brantford was last renewed on December 16, 2015 at the rate of 4.20%. The previous rate was 5.87%. The OEB's cost of

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[44] EB-2014-0116 Toronto Hydro Decision and Order, p. 52

[5] EB-2016-0058,Settlement Proposal, p. 22.

[6] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, p. 53.

capital parameters for 2016 rate applications, issued on October 15, 2015, established a deemed long term debt rate for 2016 applications of 4.54%. The renewed rate on Brantford Power's promissory note is below that ceiling.

OEB staff notes that, while the OEB's cost of capital policy contemplates and provides for distributors' use of affiliate debt, the Report also expresses the expectation that the policy would evolve over time. In the near term, however, distributors should ensure that the applied-for rate and terms are prudent and comparable to a market-based agreement and rate on arms-length commercial terms. The Report states that:

> The Board is of the view that electricity distribution utilities should be motivated to make rational decisions for commercial "arms-length" debt arrangements, even with shareholders or affiliates.
>
> In general, the Board is of the view that the onus is on the electricity distribution utility to forecast the amount and cost of new or renewed long-term debt. The electricity distribution utility also bears the burden of establishing the need for and prudence of the amount and cost of long-term debt, both embedded and new[7].

OEB staff acknowledges the intervenors' concerns that the terms of the promissory note appear to be to the advantage of the City of Brantford and are inconsistent with those generally available through a market-based agreement. However, OEB staff notes that, while there may be valid reasons to replace the affiliate debt with third-party debt at a lower rate, there may be conditions in Brantford Power's arrangements with the City of Brantford that are also advantageous to the borrower.

OEB staff submits that the renegotiation of affiliate debt is a decision for the distributor and its shareholder. While there are instances where distributors have replaced affiliate debt with third party debt, there are other instances where the affiliate debt remains in place, with the amounts recovered in rates consistent with the OEB policy described above. OEB staff submits that the OEB may wish to encourage Brantford Power to examine this debt arrangement to determine if

[7] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, p. 53.

the benefits to its ratepayers are sufficient to outweigh the disadvantageous conditions, and to provide sufficient justification in its next cost of service application.

OEB staff notes that the parties have agreed to accept the updated rate of 4.20% for the promissory note and Brantford Power's overall weighted average cost of long term debt as calculated of 4.29%. OEB staff notes that the rate for the promissory note was established at a time when the OEB's deemed long-term debt rate was 4.54%. OEB staff also notes that the promissory note carries a fixed term of five years (although it appears that the shareholder has the ability to extend the term of the note). Given these facts, and subject to OEB staff's comments above about a further examination of Brantford Power's debt arrangements in the future, OEB staff is of the view that this is a reasonable outcome. OEB staff notes that this item is one part of a broader agreement that OEB staff finds reasonable. Therefore, OEB staff does not have any concerns with the proposed weighted average cost of long-term debt for the purposes of settlement.

All of which is respectfully submitted