Ontario

Ontario Energy Board
Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2016-0356

HYDRO ONE SAULT STE. MARIE LLP

Application for electricity transmission revenue requirement effective January 1, 2017

BEFORE: Allison Duff
Presiding Member

Christine Long
Vice Chair and Member

Michael Janigan
Member

September 28, 2017

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1 INTRODUCTION AND SUMMARY

Great Lakes Power Transmission LP (GLPT, now Hydro One Sault Ste. Marie LP or Hydro One SSM) filed an application with the Ontario Energy Board (OEB) on December 23, 2016, seeking approval for changes to its electricity transmission revenue requirement, to be effective January 1, 2017.

The OEB sets rates for rate-regulated electricity transmitters in Ontario by setting a revenue requirement for each transmitter. These individual revenue requirements are incorporated into the Uniform Transmission Rates (UTRs) that recover the revenue requirements uniformly from ratepayers across the province. The 2016 UTRs currently in place were declared interim[1] until the 2017 UTRs are approved.

The OEB approved GLPT's 2016 revenue requirement of $40,565,936[2], which included a previously approved deferral and variance account recovery of $787,816.

On October 13, 2016, the OEB approved an application by Hydro One Inc. to purchase all of the issued and outstanding voting securities of GLPT's general partner, Great Lakes Power Transmission Inc. (the MAADs decision).[3] The OEB accepted Hydro One Inc.'s proposal to defer rebasing of the new company, Hydro One SSM, for a ten-year period. Hydro One SSM was permitted to continue with GLPT's existing revenue requirement and to bring forward a subsequent rate application, proposing a revenue cap index framework for the deferral period.

In this application, Hydro One SSM has proposed a revenue cap index for 2017, which results in a 1.9% increase or a proposed base revenue requirement of $40,533,904. Hydro One SSM also proposes to recover a net deferral and variance account balance of $975,219, resulting in a revenue requirement of $41,509,123 to be recovered through the 2017 UTRs effective January 1, 2017.

The OEB denies the application. The OEB finds the application is deficient as it does not meet the guidance provided in the MAADs decision and the OEB's 2016 *Filing Requirements for Electricity Transmission Applications* (Transmission Filing Requirements). Hydro One SSM's approved 2016 revenue requirement and charge determinants will remain in effect in 2017.

[1] EB-2016-0160 November 24, 2016 Oral Hearing Transcript, page 4, lines 12 & 13
[2] EB-2015-0337
[3] EB-2016-0050 October 13, 2016 Decision and Order, pages 24 and 25

2 THE PROCESS

Hydro One SSM's application was filed on December 23, 2016 under section 78 of the *Ontario Energy Board Act, 1998,* S.O. 1998, c. 15, (Schedule B) and under the OEB's Transmission Filing Requirements. Hydro One SSM requested approval for changes to its electricity transmission revenue requirement to be effective January 1, 2017.

The OEB issued a Notice of Hearing on February 28, 2017. The Association of Major Power Consumers in Ontario (AMPCO), School Energy Coalition (SEC) and the Vulnerable Energy Consumers Coalition (VECC) applied for intervenor status and cost award eligibility. No objections were received and the OEB approved the requests. OEB staff also participated actively in the proceeding. This proceeding was conducted by way of a written hearing.

The OEB provided parties the opportunity to ask Hydro One SSM questions about its evidence through written interrogatories. The OEB issued Procedural Order No. 1 on March 29, 2017, setting dates for the delivery of interrogatories to Hydro One SSM and for the delivery of Hydro One SSM's responses. The OEB issued Procedural Order No. 2 on May 26, 2017, in which it set dates for the argument-in-chief from Hydro One SSM and submissions from OEB staff and intervenors. A date for a reply submission from Hydro One SSM was also set.

Hydro One SSM, OEB staff, and the intervenors addressed five key areas in submissions. Those areas are set out in the next section of this Decision.

The evidence in this case can be found on the OEB's website, www.oeb.ca under File Number EB-2016-0356.

3 DECISION ON THE ISSUES

3.1 Proposed Revenue Cap Index Framework

Hydro One SSM proposed a revenue cap increase of 1.9% to its approved 2016 base revenue requirement. Hydro One SSM calculated its proposed increase using the same price cap adjustment (inflation minus productivity and stretch factors) applicable to Ontario's electricity distributors filing an Incentive Regulation Mechanism (IRM) application. Hydro One SSM proposed an inflation factor of 1.9%, a productivity factor of 0% and a stretch factor of 0%.

Findings

Hydro One SSM is one of the first transmitters to apply to the OEB for a revenue cap index increase.

The OEB's *Handbook to Electricity Distributor and Transmitter Consolidations* (Consolidation Handbook) provided guidance to consolidating utilities. The OEB clarified that while the Consolidation Handbook is applicable to both electricity distributors and transmitters, most of the OEB's policies and prior OEB decisions have related to distributors. Transmitters were instructed to consider the intent of the Consolidation Handbook and make appropriate modifications as needed.

The Consolidation Handbook set out that three rate setting options for distributors under the OEB's *Renewed Regulatory Framework for Electricity Distributors* (which, since the issuance of the Handbook for Utility Rate Applications on October 13, 2016 is referred to as the *Renewed Regulatory Framework*, or RRF) were applicable to consolidating distributors during a deferred rebasing period. Under the RRF, the OEB indicated that customer interests would be protected through rigorous performance reporting and monitoring[4] and that customers would share in the benefits derived from distributors' performance incentives. This was to be accomplished through the productivity and stretch factors which were deducted from inflation in the price cap index formula.[5]

The Transmission Filing Requirements continued the emphasis on the RRF's principles, which were rearticulated in the October 13, 2016 Handbook for Utility Rate Applications, indicating that a revenue cap index was an incentive-based and indexed adjustment to

[4] RRF, p.11
[5] RRF Table 1, p.13

revenue requirement for transmitters, analogous to the Price Cap for distributors described in the RRF. The Transmission Filing Requirements included the expectation for the development of an index, as well as productivity and stretch commitments. The OEB invited transmitters to propose and substantiate the appropriate method and commitments for these elements.[6] The summary chart included in the Transmission Filing Requirements described the purpose of productivity and stretch factors as the "Sharing of benefits" for a revenue cap index.[7]

Finally, the OEB's MAADs decision provided guidance to Hydro One SSM specifically, indicating that a separate rate application with a revenue cap index could be brought forward. As guidance, the decision stated that the application would be expected to incorporate the components of the incentive-based revenue cap index set out in the Transmission Filing Requirements as described above.

The OEB finds that an essential component of an incentive-based revenue cap index is missing in this application - the sharing of benefits with customers. This sharing is to be achieved through productivity and stretch factors that reduce the inflationary increase sought by the applicant.

These key reductions are not simply ancillary add-ons to the calculation of the inflationary increment but are an integral part of the incentive-based framework. A revenue cap index that is simplified to just the inflation factor should not be the default option if the utility does not provide transmitter-specific measurements. There is insufficient evidence for the OEB to accept Hydro One SSM's submission that the productivity and stretch factors should be 0%, as zero has a value and meaning in an incentive-based framework.

As a result, the OEB concludes that Hydro One SSM's proposed revenue cap framework cannot be approved. The OEB assesses the individual components of Hydro One SSM's proposed revenue cap index framework in the following sections.

3.1.1 Inflation Factor

Hydro One SSM applied an inflation factor of 1.9%, consistent with the inflation factor approved by the OEB for distributors in 2017. No party objected to Hydro One SSM's proposal.

[6] Transmission Filing Requirements, sec. 2.0 at p.1
[7] Ibid at Sec. 2.0 p.5

OEB staff, AMPCO, and SEC suggested that Hydro One SSM should consider the appropriate weighting of inputs in its future revenue requirement applications. VECC submitted it was reasonable to use the inflation factor of distributors as an interim approach.

Hydro One SSM submitted that until transmission-specific proposals for annual adjustments are available, it is reasonable to update the inflation factor on an annual basis using the OEB's posted factor for distributors.

Findings

The OEB does not approve the proposed 1.9% inflation factor for Hydro One SSM. The OEB finds Hydro One SSM's proposed use of 1.9% would have been acceptable if Hydro One SSM's proposed approach to the revenue cap index were being approved in this proceeding, as the inflation factor does not depart from the inflation factor used for distributors. The Transmission Filing Requirements indicate that rate applications should provide an explanation for any departure from the inflation calculation for distributors.

The inflation factor of 1.9% for distributors was based on a two-factor input price index that used component weights of 30% for labour and 70% for non-labour[8]. The OEB agrees that evidence regarding the appropriate input weights should be included in any subsequent rate application by Hydro One SSM.

3.1.2 Productivity Factor

Hydro One SSM proposed to use the OEB-approved productivity factor of 0%, as established for distributors in 2017. No party objected to Hydro One SSM's proposal.

OEB staff, AMPCO, and SEC agreed that a Total Factor Productivity (TFP) study should be completed by Hydro One Transmission for its 2019 Revenue Requirement Application. VECC submitted that it was reasonable to apply the distributor productivity factor of 0% as an interim approach.

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[8] *Report of the Board: Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* (the Rate Setting and Benchmarking Report) EB-2010-0379, Issued November 21, 2013 and as corrected on December 4, 2013

Hydro One SSM noted that Hydro One Transmission will be undertaking a TFP study in connection with its 2019 Revenue Requirement Application. The results of that TFP study are expected to be available to Hydro One SSM.

Findings

While distributors and transmitters may share a significant number of the same inputs, there is no evidence that the 0% productivity factor used in the price cap adjustment for distributors is equally applicable to transmitters. The historical record shows that the OEB set the 0% productivity factor for distributors in its Rate Setting and Benchmarking Report[9]. The OEB based the 0% on a TFP analysis that considered the impact of IFRS, smart meters and CDM program costs on distributor input data collected over 10 years.

The OEB cannot find that the 0% productivity factor for distributors should be applicable to Hydro One SSM in 2017 without better evidence of its applicability to transmitters. Such evidence was not provided in this application.

3.1.3 Stretch Factor

Hydro One SSM proposed a stretch factor of 0% for 2017. Hydro One SSM indicated that it plans to adopt the stretch factor that Hydro One Transmission proposes in its 2019 revenue requirement application. Until then, Hydro One SSM submitted that implementation of a stretch factor would be "counter-intuitive" to the OEB's consolidation policy. In any event, Hydro One SSM filed a benchmarking report by First Quartile Consulting (1QC) and submitted that the report supported a 0% stretch factor.

Parties disagreed with this approach. OEB staff and VECC supported a stretch factor of 0.30%, while AMPCO and SEC believed that stretch factors of 0.45% and 0.60% respectively, were appropriate.

Parties submitted that the 1QC benchmarking report did not justify the placement of Hydro One SSM in the highest performing cohort with an associated 0% stretch factor. Furthermore, AMPCO and SEC both submitted that the 1QC report accounted for Hydro One SSM's OM&A costs only, and did not include capital spending comparisons. AMPCO submitted that as a result, the 1QC report was not a total cost benchmarking study. SEC also noted that OM&A accounted for no more than 28% of Hydro One SSM's annual revenue requirement in each year since 2012.

[9] *Ibid.*, at page 17

In its reply submission, Hydro One SSM maintained that the proposed stretch factor of 0% was appropriate and its approach was consistent with the Transmission Filing Requirements. These requirements state "that a transition period may better accommodate the gradual entrenchment of RRFE objectives and principles in transmission rate-setting over time. Therefore, where a transmitter is filing based on cost of service or the Revenue Cap index, if benchmarking evidence is not currently available, the transmitter must file in its application a strategy to acquire such evidence for its subsequent application."[10]

While Hydro One SSM did not support the inclusion of any stretch factor, it asserted that it should not be allocated a stretch factor representative of the worst performers in the industry, as SEC and AMPCO suggested. Hydro One SSM submitted that the 1QC report shows consistently better than average performance in the upper quartiles, than the results of the comparable companies.

Findings

The OEB finds that a stretch factor is a required component of a revenue cap index which enables customers to share the benefits of continuous improvement. The OEB will not approve an incentive-based rate increase in 2017 without a stretch factor, pending the 2019 operational integration with Hydro One Transmission.

Hydro One SSM's reply argument indicated "the implementation of a stretch factor, during the critical first two years of integration, is counter intuitive to the Board's consolidation policy" such that transaction costs of the integration could be offset with any achieved savings. However, Hydro One SSM also submits that it will operate on a stand-alone basis in 2017, and that it doesn't anticipate savings from integration in the first two years of the proposed revenue cap framework. The OEB finds it difficult to reconcile these seemingly contradictory assertions by Hydro One SSM.

The OEB agrees with Hydro One SSM that the inclusion of a stretch factor would reduce the achieved cost savings available to the acquiring utility. However, if a utility does not want to share any benefits with its customers, it should not apply for an incentive-based increase in revenue.

While the operational integration is expected to result in "longer term operational synergies and savings", the OEB found insufficient efficiencies in evidence applicable to

[10] February 11, 2016 *Filing Requirements for Electricity Transmission Applications*, Chapter 2 page 2.

2017. The requirement for continuous improvement should not be delayed until the company's operational integration process is complete.

The OEB also finds the benchmarking evidence insufficient to support the submission that Hydro One SSM is in the top cohort of efficiency. As VECC indicated, a 0% stretch factor is applicable to a distributor with actual costs 25% or more below predicted costs. In addition, the evidence was based on OM&A results only and not a total factor productivity study. The OEB acknowledges that the Transmission Filing Requirements allow for a transition period to file benchmarking evidence or a strategy for acquiring benchmarking evidence. However, as evidence was filed, the OEB must base its decision on the evidence on the record.

Hydro One SSM suggests that it is not cost effective or timely to acquire such evidence prior to operational integration with Hydro One Transmission in 2019, and that the Hydro One stretch factor will simply be adopted at that time. If that is Hydro One SSM's position, then it may be difficult to justify a revenue cap-based incentive ratemaking increase until 2019.

3.2 Performance Reporting and Monitoring

Hydro One SSM stated that it is aligning itself with the principles of the RRF through the development and integration of a balanced scorecard. Hydro One SSM submitted that it has historically developed annual key performance indicators (KPIs) for business performance measurement and is committed to continuous improvement in performance to maximize value for the ratepayer. Hydro One SSM stated that the evolution of a balanced scorecard will further enhance its performance management and ensure that the objectives and goals of the company are being managed to create additional value for the ratepayer.

Hydro One SSM stated that it has incorporated two primary elements of the RRF policy: a proposed scorecard to measure performance; and enhanced reporting on customer engagement.

OEB staff submitted that Hydro One SSM's scorecard was incomplete. OEB staff and AMPCO stated that Hydro One SSM should re-submit a proposal in its 2018 application, including performance measure metrics, targets for the performance outcomes, and timelines for implementation.

VECC submitted that the OEB should only accept Hydro One SSM's proposed scorecard as appropriate for 2017, subject to additional data being provided as part of its 2018 revenue requirement application.

Hydro One SSM stated that it will be undergoing significant operational changes in preparation for its integration into Hydro One Transmission, which may impact the results of its proposed performance measures. However, Hydro One SSM advised that it will provide the results of its proposed scorecard for 2016 and for completed quarters in 2017 in its 2018 application.

Findings

The OEB finds the proposed scorecard for 2017 is incomplete.

As the Transmission Filing Requirements indicate, the scorecard is an integral and expected element of the new revenue cap index model for transmitters. While there has been some progress in identifying potential enhancements to performance outcomes, Hydro One SSM falls short of the OEB expectations for performance measure metrics, each with specific performance outcomes and implementation timelines. And while a scorecard submitted after 2019 may reflect future operational changes, the current application must comply with the scorecard requirements in 2017, the year in which rate increase is proposed.

3.3 Asset Management Plan and Other Commitments

Hydro One SSM stated that it is not currently in a position to provide a detailed and comprehensive asset management plan or a transmission system plan (TSP). However, Hydro One SSM had made a commitment in its approved settlement proposal[11] to provide a comprehensive asset management plan as part of its next rate application.

OEB staff submitted that it would be reasonable for Hydro One SSM to file a more enhanced TSP, including an asset management plan, in accordance with Transmission Filing Requirements and aligned with the Hydro One TSP that will be filed in 2019.

AMPCO submitted that Hydro One SSM should have filed information on its asset management approach and spending levels for the two-year period prior to

[11] EB-2014-0238, OEB-approved settlement proposal, at p.11

consolidation. These steps should have been completed in order to meet the commitment in the approved settlement proposal[12]. In addition, Hydro One SSM should have also indicated how its assets will be managed in the short term.

In reply submission, Hydro One SSM agreed that in the future, it will file either:

- A transmitter-specific TSP which will meet the OEB's specifications; or
- Hydro One Transmission's TSP, to be filed with its 2019 revenue requirement application, which will address the asset needs of Hydro One SSM.

Findings

The OEB notes that Hydro One SSM has outstanding commitments from the OEB-approved settlement proposal including studies, plans and measures that were to be filed as part of its next rates application. The OEB appreciates that those commitments were made prior to purchase of its shares by Hydro One Inc., yet a revenue cap index application is a rates application within the meaning of the settlement proposal. It is the OEB's expectation that when it approves a settlement proposal, the parties will fulfill the commitments contained therein.

3.4 Deferral and Variance Accounts (DVA)

Hydro One SSM requested approval of certain DVA account balances as of December 31, 2016 and disposition in 2017. In total, Hydro One SSM requested approval to recover a net debit balance of $975,219, which included $787,816 relating to Account 1595, Disposition and Recovery/Refund of Regulatory Balances.

In addition, Hydro One SSM proposed to establish a forgone revenue deferral account, to capture differences between revenue earned by Hydro One SSM under the interim UTRs set at the 2016 UTR level and the revenues that would have been received under the approved final 2017 UTRs.

Findings

In the December 18, 2014 Decision and Order[13], the OEB approved recovery of $787,816 in each of 2015, 2016 and 2017 to clear deferral and variance account balances totaling $2,363,488 to the end of 2014. Hydro One SSM's 2016 approved revenue requirement and charge determinants include the $787,816. Given the 2016

[12] EB-2014-0238
[13] EB-2014-0238

charge determinants will remain in place for 2017, another $787,816 will be collected in 2017, consistent with the OEB's previous decision.

The OEB does not approve for disposition the additional balance of $187,403[14] recorded in the DVAs as at December 31, 2016 as the application to adjust the revenue requirement is denied.

The OEB does not approve the Forgone Revenue Deferral Account. As the 2017 revenue requirement will not change from the 2016 OEB approved revenue requirement, no forgone revenue will be generated.

All other DVA accounts will remain open and continue to accrue interest, as applicable, pending future review and approval by the OEB.

3.5 Effective Date of Rates

Hydro One SSM proposed an effective date of January 1, 2017 to recover the proposed 2017 revenue requirement.

Findings

As the revenue cap index application is denied, no effective date decision is required. Hydro One SSM's 2016 approved revenue requirement and charge determinants will remain in effect for 2017.

[14] The $187,403 debit balance is the requested $975,219 debit balance as at December 31, 2016 less the $787,816 debit balance approved for disposition.

4 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. AMPCO, SEC, and VECC shall file with the OEB and forward to Hydro One SSM their respective cost claims no later than 7 days from the date of issuance of this Decision and Order. Cost claims must be prepared in accordance with the *OEB's Practice Direction on Cost Awards*.

2. Hydro One SSM shall file with the OEB and forward to intervenors any objections to the claimed costs within 14 days from the date of issuance of this Decision and Order.

3. AMPCO, SEC, and VECC shall file with the OEB and forward to Hydro One SSM any response to any objections to the cost claims within 21 days from the date of issuance of this Decision and Order.

4. Hydro One SSM shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

All filings to the OEB must quote the file number, EB-2016-0356 and be made electronically in searchable/unrestricted PDF format through the OEB's web portal at https://www.pes.ontarioenergyboard.ca/eservice/. Two paper copies must also be filed. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at https://www.oeb.ca/industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

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

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Fiona O'Connell at Fiona.OConnell@oeb.ca and OEB Counsel, James Sidlofsky, at James.Sidlofsky@oeb.ca.

ADDRESS

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4
Attention: Board Secretary

E-mail: BoardSec@oeb.ca
Tel: 1-888-632-6273 (Toll free)
Fax: 416-440-7656

DATED at Toronto, **September 28, 2017**

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary