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**BY E-MAIL**

January 25, 2018

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street, 27<sup>th</sup> Floor  
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Hydro Hawkesbury Inc. (Hydro Hawkesbury)  
2018 Distribution Rates Application  
Ontario Energy Board File Number: EB-2017-0048  
Submission on Settlement Proposal**

In accordance with Procedural Order No. 1, please find attached OEB staff's submission on the filed settlement proposal for Hydro Hawkesbury's 2018 distribution rate application.

Hydro Hawkesbury and all intervenors have been copied on this filing.

Yours truly,

*Original Signed By*

Birgit Armstrong  
Project Advisor, Major Applications

Attach.

# **2018 ELECTRICITY DISTRIBUTION RATES**

**Hydro Hawkesbury Inc.**

**EB-2017-0048**

**OEB STAFF SUBMISSION ON SETTLEMENT  
PROPOSAL**

**January 25, 2018**

## INTRODUCTION

Hydro Hawkesbury Inc. (Hydro Hawkesbury) filed a complete application with the Ontario Energy Board (OEB) on July 12, 2017 under section 78 of the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that Hydro Hawkesbury charges for electricity distribution, to be effective January 1, 2018.

A community meeting was held as part of the proceeding on September 18, 2017. OEB staff and Hydro Hawkesbury made presentations at the meeting. A summary of the community meeting was posted to the record of the proceeding.

The comments during the community meeting focused on clarifying the rate increase related to distribution costs of \$0.15 per month for a typical residential customer; the rate impact of a new transformer station going into service in 2017; the need for infrastructure renewal; and time of use pricing. OEB staff took comments regarding infrastructure renewal into consideration in reviewing Hydro Hawkesbury's application to ensure that Hydro Hawkesbury's capital programs were at appropriate levels to ensure reliability. Overall, there were positive comments regarding Hydro Hawkesbury's capital spending as well as its overall pricing in comparison with other utilities in Ontario.

The OEB issued an approved issues list for this proceeding on November 21, 2017. A settlement conference was held on November 22, 2017 and Hydro Hawkesbury filed a settlement proposal setting out an agreement among all the parties to the proceeding on January 8, 2018. The parties to the settlement proposal are Hydro Hawkesbury and the approved intervenors in the proceeding: the School Energy Coalition (SEC) and the Vulnerable Energy Consumers Coalition (VECC) (the Parties).

The settlement proposal represents a complete settlement of the issues in this proceeding. For a typical residential customer with monthly consumption of 750 kWh, the total bill impacts under the filed settlement proposal will be a decrease of \$17.29 per month - a percentage decrease of about 18.26% - as a result of a number of rate riders crediting funds back to the rate payers (discussed below).

This submission is based on the status of the record as of the filing of the settlement proposal and reflects observations which arise from OEB staff's review of the evidence and the settlement proposal. It is intended to assist the OEB in deciding upon Hydro Hawkesbury's application and the settlement proposal.

## Settlement Proposal

OEB staff has reviewed the settlement proposal in the context of the objectives of the OEB's *Handbook for Utility Rate Applications*<sup>1</sup> and the *Renewed Regulatory Framework* (RRF); 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 Hydro Hawkesbury'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 appropriate consideration of the relevant issues. It also ensures there are sufficient resources to allow Hydro Hawkesbury 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 are adequate to support the settlement proposal and that the outcomes arising from the OEB's approval of the issues as settled in manner described in the settlement proposal would adequately reflect the public interest and would result in just and reasonable rates for customers.

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 finds it necessary to make submissions on the following areas in order to assist the OEB in its consideration of the settlement proposal:

- Rate Base and Capital Additions
- Transformer Station Refund
- Distribution System Plan
- Operations, Maintenance and Administration (OM&A)

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<sup>1</sup> Issued October 13, 2016

## Rate Base and Capital Additions

In the settlement proposal, the Parties agreed to treat proposed capital expenditures equal to capital additions.

OEB staff notes that the Parties have agreed to reduce Hydro Hawkesbury's 2018 opening rate base by \$5,000, for a 2018 opening rate base of \$7,890,599, to adjust for actual capital expenditures in the 2018 test year. The Parties agreed to Hydro Hawkesbury's proposed 2018 capital expenditures of \$175,830 as filed, but agreed to include capital contributions of \$10,000 related to the expected development of a new subdivision. The resulting 2018 test year closing rate base is \$8,056,429.

In its 2017 fixed assets, Hydro Hawkesbury also included a capital addition of \$3.5 million for an 110kV transformer station (110kV TS), which was energized in May of 2017. OEB staff notes that Hydro Hawkesbury identified the need for the 110 kV TS upgrade as early as 2012<sup>2</sup>. At that time Hydro Hawkesbury's estimated budget for the upgrade was substantially lower at \$1.5 million.

The available evidence suggests that a key factor for the delays and cost overruns was the mismanagement of the project by a third party, retained in 2012<sup>3</sup>. As part of Hydro Hawkesbury's last rebasing application,<sup>4</sup> the forecasted capital expenditures of \$1.5 million for the 110kV TS was approved and included in rate base for the 2014 test year. That same year Hydro Hawkesbury hired General Electric (GE) to assist with the commissioning of the new transformer. While reviewing the engineering report and requirements, GE noted that major equipment and other cost elements for the 110 kV project needed to be added to the original estimate. These included missing costs related to: a control building and panels; the demolition of the old building; replacement of the original oil catch basin with a new design; telecommunications provisions with Hydro One; and the creation of a commission/authorization plan. In addition, the estimate for labour, material and engineering costs needed to be updated significantly following the re-design, in order to meet the requirements from Hydro One, the Independent Electricity System Operator and the Ministry of Energy. Those costs had not been fully addressed in the original estimate<sup>5</sup>. As part of this settlement proposal, the parties agreed to include the sum of \$3.5 million of capital additions in 2017 for the 110kV TS.

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<sup>2</sup> Part of an ICM application, EB-2011-0173.

<sup>3</sup> Application, EB-2017-0048, Exhibit 2, p. 3-9

<sup>4</sup> EB-2013-0139

<sup>5</sup> *ibid*

OEB staff supports the settlement proposal regarding the addition of \$3.5 million to rate base in 2017 because it is satisfied based on the evidence on the record that the original estimate was grossly deficient and that much of that is due to the lack of effective project management by a third party. That said, OEB staff would encourage Hydro Hawkesbury to conduct an *ex-post* analysis of Hydro Hawkesbury's policies and procedures for the development, procurement and management of external engineering services.

OEB staff agrees with the Parties that the level of capital in the test year is appropriate for the projects planned by Hydro Hawkesbury in the test year, and when compared to historical actuals. OEB staff also agrees with the Parties that the level of capital in the test year provides adequate capital resources to allow Hydro Hawkesbury to continue pursuing improvement in productivity and service quality objectives; to achieve operational efficiencies; and to maintain reliable and safe operation of its distribution system.

### **Transformer Station Refund**

In its application and the settlement proposal, Hydro Hawkesbury acknowledged that the delays related to the 110kV TS resulted in an over-collection through base rates and caused Hydro Hawkesbury to over-earn during the past IRM period, as shown in the table below. The delay in putting the 110kV TS into service combined with underspending of its approved OM&A budget (discussed below) during the IRM period caused this over-earning.

<b>Return on Equity<sup>6</sup></b>				
		<b>2014</b>	<b>2015</b>	<b>2016</b>
Deemed		9.36%	9.36%	9.36%
Actual		12.48%	19.72%	17.63%

This issue was first addressed during Hydro Hawkesbury's IRM application for 2016 rates.<sup>7</sup> In its decision, the OEB found that the Price Cap IR increase of 2.1% would be granted on an interim basis. In making this finding, the OEB restricted the interim status only to the portion of Hydro Hawkesbury's rates related to the 2016 increase. The remainder of its base rates was considered final.<sup>8</sup>

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<sup>6</sup> Interrogatory response, 1-Staff-5, p. 1

<sup>7</sup> Decision and Rate Order, EB-2015-0077, p. 3-5

<sup>8</sup> *ibid*

As part of Hydro Hawkesbury's 2017 IRM proceeding<sup>9</sup>, the OEB disallowed the price cap adjustment due to this issue and approved 2017 rates on an interim basis. The OEB noted that it would consider the circumstances underpinning Hydro Hawkesbury's over-earning, and any proposal for redressing the situation, in a future proceeding.

In the current proceeding, as a remedy, the Parties agreed to refund the equivalent of the revenue requirement that related to the 110kV TS asset included in the 2014 rate base at a value of \$1.5 million (the amount initially budgeted for the 110kV TS), which was collected over the last four years. Hydro Hawkesbury has calculated a revenue requirement equivalent of \$305,798 for the period from January 1, 2014 to December 31, 2017, to be disposed through a credit rate rider. This amount is incremental to the forgone revenue resulting from the OEB's decision on Hydro Hawkesbury's 2017 IRM application. The Parties agreed to a one year disposition period and have agreed to make rates final.

OEB staff supports the Parties' proposal and takes no issue with the quantum of the refund or the disposition period. OEB staff notes that the substantial rate decrease for Hydro Hawkesbury's customers in the 2018 test year is due to this rate rider.

### **Distribution System Plan**

A consolidated distribution system plan (DSP) was prepared by Acumen Engineering Solutions International Inc. (AESI). As part of the executive summary, AESI asserted that the DSP was prepared in accordance with the OEB's *Filing Requirements for Electricity Transmission and Distribution Applications*, Chapter 5, dated March 28, 2013.<sup>10</sup>

Hydro Hawkesbury notes that its DSP is an integrated document that supports the cost-effective planning and operation of its distribution network, which is efficient, reliable, and sustainable and provides value for its customers. It further noted that the DSP documents the practices, policies, and processes that are in place to ensure that investment decision cost-effectively support Hydro Hawkesbury's desired outcomes and provide value to its customers.

It is OEB staff's view that Hydro Hawkesbury's DSP continues to lack a number of key parameters, such as the basis for asset management process workflows; the asset

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<sup>9</sup> Decision and Rate Order, EB-2016-0079, p. 3-5

<sup>10</sup> Application, Distribution System Plan, p. 57, Executive Summary, p. 5

replacement prioritization process; and clear identification of planning outcomes, specific productivity initiatives or DSP metrics.

OEB staff submits that, as evidenced by the significant overspend on the recently completed 110kV TS expansion work; complete reliance on outsourced engineering and construction professionals; and a lack of solid contractor management skills, the utility is vulnerable to material oversights on the part of third parties, whose technical capabilities, knowledge, and diligence the utility is not in a position to gauge. While the forecasted capital expenditures do not appear to include any planned projects of comparable complexity, OEB staff has some reservations as to the utility's ability to effectively address any potential unforeseen circumstances (particularly given the modest capital budgets) and/or effectively implement any forthcoming (along with existing) OEB guidance in the areas of asset management.

Hydro Hawkesbury remains a top-ranked Ontario utility in Pacific Economics Group's (PEG) efficiency rankings. However, OEB staff submits that the current proceeding represents the downside to the drive to achieve cost efficiency as an objective in and of itself, without due regard for quality, expertise and good corporate and strategic governance. The PEG report is a very effective tool for assessing total productivity but does not provide a complete picture of performance.

The settlement proposal stipulates that Hydro Hawkesbury will carry out an independent asset condition assessment of its system, which will be filed as part of its next cost of service rebasing application. In response to interrogatories, Hydro Hawkesbury had noted that it "viewed the DSP framework [as] a living document"<sup>11</sup> and plans to develop many of the currently missing components in the coming years. In light of that objective, OEB staff supports the Parties' agreement to complete a full asset condition assessment, which should inform and continue to improve Hydro Hawkesbury's ongoing development of its DSP.

OEB staff submits that the filing of a more detailed asset condition assessment by Hydro Hawkesbury as part of its next rebasing application will help inform pacing and prioritization decisions in the future. As part of Hydro Hawkesbury's ongoing development of the DSP, OEB staff would also encourage Hydro Hawkesbury to ensure that in future DSP filings it improves its management of external contractors as part of its continued work on improving its capital management processes.

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<sup>11</sup> Responses to Interrogatory, 2-Staff-28, p. 81



## **OM&A**

As part of this settlement proposal, the Parties agreed to reduce OM&A by \$35,000 to \$1,175,114, which results in a 4.2% increase over the last OEB approved OM&A budget. That is an average increase of just over 1% per year. The Parties agreed that the proposed OM&A budget is appropriate.

OEB staff takes no issue with the agreed upon OM&A budget.

As stated in the application and the settlement proposal, Hydro Hawkesbury is transitioning from retaining its own linemen on staff to engaging external contractors to manage 100% of its capital and OM&A activities. Hydro Hawkesbury does not anticipate a significant impact to OM&A due to this transition. As this time, Hydro Hawkesbury has an understanding with an external contractor, however, no service agreement has been formalized to date. As part of this settlement proposal, the Parties agreed that Hydro Hawkesbury would formalize a service agreement with its primary contractor, Sproule Inc., within one year. Hydro Hawkesbury agreed to file a copy of that agreement with the OEB to confirm compliance with the terms of this settlement proposal.

OEB staff notes that the lack of solid contractor management skills or a formalized agreement leaves the utility vulnerable. OEB staff supports the need for a formal arrangement and submits that a service agreement should ensure stability and consistency related to expected operational expenditures. In addition to OEB staff's recommendation on managing capital projects, OEB staff also encourages Hydro Hawkesbury to continue to work to improve its management processes and establish policies to improve its management of external contractors as they relate to its day-to-day operational needs.

All of which is respectfully submitted