

**ONTARIO ENERGY BOARD**

**IN THE MATTER OF** an application made by Halton Hills Hydro Inc. with the Ontario Energy Board under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 (Schedule B), seeking approval for changes to its distribution rates to be effective May 1, 2018, the approval of a deferral and variance account, and the recovery of costs related to a pay equity settlement

**EB-2017-0045**

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**REPLY SUBMISSION**

**OF**

**HALTON HILLS HYDRO INC.**

**MARCH 21, 2018**

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**REPLY OF HALTON HILLS HYDRO INC.**

**OVERVIEW**

Halton Hills Hydro Inc. (“**HHHI**”) applied to the Ontario Energy Board (the “**OEB**”), pursuant to Section 78 of the *Ontario Energy Board Act, 1998*,<sup>1</sup> for the: (i) approval of distribution rates effective May 1, 2018; (ii) approval of a deferral and variance account to correct depreciation errors; and (iii) recovery of costs associated with a pay equity settlement (EB-2017-0045).

The most recent developments in this proceeding include the filing of submissions on March 14, 2018 (each a “**Submission**”), by OEB staff (“**Board Staff**”), the School Energy Coalition (“**SEC**”), and the Vulnerable Energy Consumers Coalition (“**VECC**”). HHHI has prepared this reply submission (the “**Reply**”) in response to the Submissions.

A summary of the key issues that are addressed in this Reply include:

- a) Pay Equity Settlement Agreement.** HHHI submits that the costs incurred in relation to the Pay Equity Settlement Agreement satisfy the requirements for a Z-Factor Application.
- b) Deferral and Variance Account for Depreciation.** HHHI submits that an error in the calculation of depreciation expenses has denied HHHI a fair return and that this error should be corrected through the establishment of a deferral and variance account.
- c) Price Cap Adjustment.** Board Staff and HHHI agree that a Price Cap adjustment of 1.2% with an effective date of May 1, 2018 is appropriate.

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<sup>1</sup> RSC 1998, c 15 (Sched B).

1       d) **Retail Transmission Service Rates.** Board Staff and HHHI agree that the Uniform  
2       Transmission Rates that were updated effective January 1, 2018, should be incorporated  
3       into the 2018 Rate Generator Model.

4       e) **Residential Rate Design.** Board Staff agrees that the proposed 2018 increase to the  
5       monthly fixed charge is calculated in accordance with the OEB's residential rate design  
6       policy.

7       f) **Deferral and Variance Accounts.** Board Staff and HHHI agree that the disposition of the  
8       Group 1 Deferral and Variance accounts is appropriate.

9       Each of these key issues are addressed in turn in this Reply.

1    **1.0    RECOVERY OF PAY EQUITY SETTLEMENT COSTS**

2    HHHI submits that the costs incurred in relation to the Pay Equity Settlement Agreement should  
3    be dealt with as a Z-Factor Event, as this event satisfies the requirements set out in the OEB’s  
4    *Filing Requirements for Electricity Rate Applications – 2017 Edition for 2018 Rate Applications*,  
5    July 20, 2017 (the “**Filing Requirements**”), and the *Report of the Board on 3<sup>rd</sup> Generation*  
6    *Incentive Regulation for Ontario’s Electricity Distributors*, July 14, 2008 (the “**3<sup>rd</sup> Gen Report**”).

7    Board Staff, SEC, and VECC take the position that the amounts payable pursuant to the Pay Equity  
8    Settlement Agreement were part of the ordinary course of business and should have been planned  
9    for by HHHI.<sup>2</sup> These arguments fail to recognize both the context of the Pay Equity Settlement  
10    Agreement and the actions of HHHI.

11    With respect to context, HHHI could not resolve the pay equity issues unilaterally, but instead had  
12    to negotiate with the Power Worker’s Union CUPE Local 1000 (the “**Union**”). This negotiation  
13    process began in September 2012 and the Pay Equity Settlement Agreement was not finalized and  
14    executed until February 2017 – a period of well over 4 years (the “**Negotiation Period**”).

15    During the Negotiation Period, HHHI had no certainty of when the process would be concluded  
16    or the amount that would ultimately be payable – the event was simply not within the control of  
17    HHHI. This was confirmed by the independent report<sup>3</sup> that HHHI provided to the Board as part of  
18    its IR responses in this proceeding (see Appendix F to the IR responses). Notwithstanding this

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<sup>2</sup> Board Staff Submission at 4; SEC Submission at 5; VECC Submission at 3.

<sup>3</sup> Gallagher McDowall Associates (February 9, 2018): *Report on OEB/SEC/VECC Interrogatories relating to Pay Equity Maintenance*, p. C-2.

1 uncertainty, it is inaccurate to portray HHHI as not having anticipated that certain amounts would  
2 be payable, as HHHI accrued \$107,000 for the year ended December 31, 2016 based on an estimate  
3 of the settlement amount and such costs were allocated to USoA 1572.<sup>4</sup>

4 Furthermore, the arguments of Board Staff, SEC, and VECC rely on hindsight and fail to recognize  
5 the practical process by which rates are approved. Specifically, HHHI began work on its last cost-  
6 of-service rebasing application (EB-2015-0074) approximately 30 months prior to the finalization  
7 of the Pay Equity Settlement Agreement.<sup>5</sup> Had HHHI included rough, quantitatively unsupportable  
8 estimates of future pay equity settlement costs in its rebasing application, the reaction of  
9 intervenors and Board Staff would have been entirely predictable – HHHI would have been  
10 strongly criticized by Board Staff and the intervenors. This is not mere speculation – even with the  
11 Pay Equity Settlement Agreement now executed, Board Staff currently challenges recovery in  
12 future years on the basis that “[t]here is no certainty that that (sic) costs will occur”.<sup>6</sup> To imagine  
13 the acceptance by Board Staff or intervenors of such costs prior to the Pay Equity Settlement  
14 Agreement having been settled is simply not believable.

15 The current hindsight-based challenges result in HHHI being left without a viable path forward at  
16 any point in time. As noted, had HHHI included a contingency amount in its last rebasing  
17 application, it would have been aggressively challenged as being uncertain, hypothetical and  
18 unsupportable; but now that it has brought forward a true crystallized cost, Board Staff and

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<sup>4</sup> HHHI Interrogatory Response to OEB Staff Question #12(a).

<sup>5</sup> HHHI Application for Approval of a Z-Factor Rate Rider for Recovery of Pay Equity Settlement Agreement, filed December 1, 2017 at Section 3.10.

<sup>6</sup> Board Staff Submission at 14.

1 intervenors are aggressively challenging on the basis that HHHI failed to assert the claim in  
2 advance. In an untenable position, HHHI chose the approach of certainty and should not be  
3 penalized for having selected what it considered the more prudent course.

4 With respect to procedure, VECC submits that HHHI fell short with respect to providing notice of  
5 the Z-Factor Event.<sup>7</sup> HHHI submits that notice was timely, as the Pay Equity Settlement  
6 Agreement was executed in February 2017 and HHHI provided notice to the OEB, on June 29,  
7 2017, of HHHI's intention to file a Z-Factor Application to recover the related costs.<sup>8</sup> Section  
8 3.2.8.1 of the Filing Requirements notes that failure to notify the OEB within 6 months of the event  
9 *may* result in disallowance of the claim, but HHHI submitted notice well within this time period.

10 Board Staff, SEC, and VECC challenge the materiality of the Z-Factor claim on the basis that the  
11 effects relate to a period of several years.<sup>9</sup> However, there is no requirement that a Z-Factor Event  
12 relate to a single year for the purposes of applying the materiality threshold. The materiality  
13 threshold merely categorizes electricity distributors on the basis of annual revenue requirement for  
14 the purpose of gauging the impact of a given event. To disallow aggregation of the effects of an  
15 event would require reading additional words into the requirements for a Z-Factor Application. In  
16 addition, aggregation is appropriate in this instance because the Pay Equity Settlement effects prior  
17 years, but the costs related to these prior years must be absorbed by HHHI in the current period.

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<sup>7</sup> VECC Submission at 6.

<sup>8</sup> HHHI Application for Approval of a Z-Factor Rate Rider for Recovery of Pay Equity Settlement Agreement, filed December 1, 2017 at Section 3.2.

<sup>9</sup> Board Staff Submission at 12; SEC Submission at 7; VECC Submission at 4.

1 HHHI submits that the amounts related to the Pay Equity Settlement are properly the subject of a  
2 Z-Factor Application. Such amounts are directly related to the Z-Factor Event and not covered by  
3 existing rates, thereby satisfying causation, as set out in the 3<sup>rd</sup> Gen Report.<sup>10</sup> Further, these  
4 amounts satisfy the materiality threshold (as addressed above) and were only determinable through  
5 bilateral negotiations with the Union, which was an event beyond the control of HHHI. Both SEC  
6 and VECC accept that the amounts in question were prudently incurred.<sup>11</sup>

## 7 **2.0 DEFERRAL AND VARIANCE ACCOUNT FOR DEPRECIATION**

8 HHHI submits that the appropriate calculation of the depreciation expense correction is \$339,392  
9 which, after taking into account the Regulated Return on Capital, results in an additional Net  
10 Revenue Requirement of \$330,259 (as shown in Table A3 of HHHI's original Application).

11 Board Staff, SEC, and VECC note that the onus is on the applicant to ensure that its application is  
12 complete and accurate.<sup>12</sup> HHHI does not dispute that care must be taken in preparing an  
13 application, but submits that the standard is not one of perfection. However, the arguments of  
14 Board Staff, SEC, and VECC amount to requiring perfection, which is unreasonable when one  
15 considers the substantive and procedural complexity of rebasing applications. HHHI took care in  
16 preparing a detailed application in EB-2015-0074, as it has also done in this proceeding, and to  
17 deny the correction on the basis that no error should have been made would lead to a minor  
18 calculation error resulting in a significant and punitive financial impact. Not only is this approach

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<sup>10</sup> Appendix: Filing Guidelines at p. v.

<sup>11</sup> SEC Submission at 6; VECC Submission at 5.

<sup>12</sup> Board Staff Submission at 18; SEC Submission at 3; VECC Submission at 7.



1 punitive, but it is inconsistent with the Board’s statutory objectives, which requires balancing: (a)  
2 consumer interests with respect to pricing, and cost effectiveness; and (b) the maintenance of a  
3 financially viable electricity industry.<sup>13</sup> This balancing has long been at the heart of the OEB’s  
4 jurisdiction with respect to rate-setting – “just and reasonable rates” must be fair to both consumers  
5 and the utility. SEC is dismissive of HHHI’s ability to earn a fair return through rates – stating that  
6 the fair return standard should merely provide “an opportunity over the long-run to recover its cost  
7 of capital”. Even by SEC’s own version of the fair return standard, if the depreciation error were  
8 not corrected, how would any Board decisions related to HHHI’s rates for the period from 2016 to  
9 2021 enabled HHHI to have a genuine opportunity to earn a fair return? As noted in Appendix F  
10 of HHHI’s IR responses, HHHI’s 2016 ROE was 6.76%, far below the Board-approved ROE for  
11 2016 of 9.19%. This, in HHHI’s submission, is an unusually low number for the first year of an  
12 IR term (i.e., one would expect the actual ROE to be much closer to the Board-approved figure).  
13 Although HHHI has not calculated its ROE for 2017 (pending the outcome of the audit), as the  
14 evidence indicates, disallowing recovery of the depreciation calculation error “will result in HHHI  
15 being perilously close to triggering ... a regulatory review every year until its next re-basing  
16 application. In other words, HHHI knows that at the beginning of its fiscal year, the understatement  
17 of depreciation puts HHHI very close to under-earning by 300 basis points.”<sup>14</sup> The impact to  
18 HHHI of the calculation error is significant and represents 3.03% of its annual revenue  
19 requirement.<sup>15</sup>

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<sup>13</sup> OEB Act, section 1(1), paragraphs 1 and 2.

<sup>14</sup> Depreciation DVA Application, p.2.

<sup>15</sup> See Table B1 (IRM Revised Rate Rider Calculation; Depreciation DVA Application).

1 SEC and VECC also take the position that correction of the depreciation error is inappropriate  
2 because EB-2015-0074 was resolved by way of a settlement agreement.<sup>16</sup> HHHI acknowledges  
3 that it is impossible to surmise what, if any, settlement may have been reached if the depreciation  
4 had been properly accounted for at that time. However, SEC's characterization of HHHI's current  
5 application as a re-opening of EB-2015-0074,<sup>17</sup> or that any variation would result in the complete  
6 failure of the settlement agreement,<sup>18</sup> amounts to histrionics. With respect to the former, it is not  
7 reasonable to assume that every settlement agreement precludes the correction of errors, as any  
8 such bar would almost certainly dissuade electricity distributors from entering into settlement  
9 agreements. The latter presumes that Board Staff and the intervenors would not agree to a  
10 settlement that included accurate costs (and more importantly, uncontentious depreciation costs),  
11 which is an unlikely assumption.

12 The OEB recently approved a similar correction in its Decision and Order in EB-2017-0215. In  
13 that proceeding, an error had been made with respect to the reference price for a purchased gas  
14 transportation variance account that, if left uncorrected, would have resulted in a significant credit  
15 to customers. The decision in EB-2017-0215 demonstrates that:

- 16 a) notwithstanding that an applicant must ensure its application is complete and accurate, an  
17 error is not a bar to correction; and

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<sup>16</sup> SEC Submission at 2; VECC Submission at 7.

<sup>17</sup> SEC Submission at 2.

<sup>18</sup> SEC Submission at 3.

1       b) retroactive ratemaking is not necessarily engaged with respect to corrections in a prior  
2       period.

3       With respect to SEC’s argument that there is no regulatory basis for correcting the depreciation  
4       error,<sup>19</sup> this is simply not true. The OEB Act does not place any preconditions on the bringing of  
5       an application (by a utility or anyone else for that matter) to set utility rates. Faced with the  
6       depreciation error, HHHI has a number of options available to it, including: (a) bringing a motion  
7       to review and vary the last rebasing decision and order (as noted by SEC<sup>20</sup>), with a request to  
8       abridge the time period for bringing a review based on the timing of discovery of the error; (b)  
9       requesting the establishment of a deferral and variance account to record error amounts, with a  
10      proposal for recovery; or (c) given the magnitude of the amounts relative to HHHI’s annual  
11      revenue requirement, bringing an early cost-of-service rebasing application. It is not HHHI’s  
12      preference to re-open its last rebasing decision, or bring an early rebasing application.  
13      Consequently, HHHI chose the second of these options, as being the most expedient for the utility,  
14      ratepayers and the Board. The DVA approach avoids the significant cost of a premature rebasing  
15      application.

16      Taking no action is not a viable option for HHHI, as the magnitude of the expense is simply too  
17      large for HHHI to ignore and absorb for the remainder of the IR term. Moreover, given the nature  
18      of the depreciation expense – it is not an expense that can be “managed” within HHHI’s cost  
19      envelope – the depreciation calculation error has a direct impact on the operation of HHHI that

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<sup>19</sup> SEC Submission at 1.

<sup>20</sup> SEC Submission at 2.

1 cannot be mitigated. Such an approach is particularly difficult considering that HHHI is a very  
2 efficient utility, recognized as one of only six Ontario local distribution companies to be allocated  
3 a stretch factor of 0%.<sup>21</sup> Neither customers nor the utility are served appropriately under the  
4 circumstances.

5 Board Staff recalculated the amounts set out in HHHI's "Table A1 – 2016 Approved Cost of  
6 Service vs. 2016 Correctly Calculated" and arrived at a depreciation error of approximately  
7 \$196,000 as opposed to the HHHI calculation of \$339,393.<sup>22</sup> HHHI has reviewed these  
8 calculations and can confirm that the original figure of \$339,393 was correctly calculated. The  
9 apparent discrepancy results from Board Staff not including the depreciation associated with  
10 capital additions during the 2016 Test Year (the "**2016 Capital Additions**"). However, the 2016  
11 Capital Additions clearly ought to be included.<sup>23</sup> Tables demonstrating the reconciliation of the  
12 Board Staff calculations with the HHHI calculation of \$339,393 have been circulated and posted  
13 with this Reply in a Microsoft Excel file titled "Halton\_Reply\_TableA1Excel\_20180321".

14 HHHI submits that establishing a new deferral and variance account to correct the depreciation  
15 error should be permitted because it will lead to the correct result, whereby rates will properly  
16 reflect the depreciation expense incurred by HHHI in providing service. In contrast, if the  
17 depreciation error is not corrected, then HHHI will be perilously close to having its earnings falling

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<sup>21</sup> Pacific Economics Group Research, LLC, "Empirical Research in Support of Incentive Rate-Setting: 2016 Benchmarking Update: Report to the Ontario Energy Board" (July 2017) at Table 5.

<sup>22</sup> Board Staff Submission at 23.

<sup>23</sup> For reference purposes, the simplest reference for the test year capital additions included in rate base per the Settlement Agreement can be found at slides 5 through 7 of HHHI's slide deck filed in EB-2015-0074 to assist with presentation of the Settlement Agreement in the EB-2015-0074 rebasing (on the Board's webdrawer).

1 outside of the +/- 300 point dead band. Such a result is not efficient for consumers, whereas the  
2 correction of the error by way of a deferral and variance account can restore economic balance.

3 **3.0 PRICE CAP ADJUSTMENT**

4 Board Staff submits that the distribution rates should be increased by 1.2%, effective May 1,  
5 2018.<sup>24</sup> This supports HHHI's application, which requested an adjustment based on the  
6 inflationary adjustment.<sup>25</sup> At the time of the application, HHHI estimated the inflationary  
7 adjustment to be 1.9%, but the OEB subsequently determined this amount to be 1.2% for Price  
8 Cap IR rate changes effective in 2018.

9 **4.0 RETAIL TRANSMISSION SERVICE RATES**

10 Board Staff submits that the Uniform Transmission Rates ("UTRs") that were updated effective  
11 January 1, 2018, should be incorporated into the 2018 Rate Generator Model.<sup>26</sup> HHHI supports  
12 this submission and had noted in its application (filed September 25, 2017) that adjustments to the  
13 UTRs were anticipated and that any such changes should be incorporated in the 2018 Rate  
14 Generator Model.<sup>27</sup>

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<sup>24</sup> Board Staff Submission at 27.

<sup>25</sup> HHHI Application at 4.

<sup>26</sup> Board Staff Submission at 28.

<sup>27</sup> HHHI Application at 4.

1 **5.0 RESIDENTIAL RATE DESIGN**

2 Board Staff submits that the proposed 2018 increase to the monthly fixed charge is calculated in  
3 accordance with the OEB's residential rate design policy.<sup>28</sup> As noted by Board Staff, the monthly  
4 fixed charge changes have been calculated without taking into account the impacts of the Z-Factor  
5 Application and proposed depreciation DVA.<sup>29</sup> Board Staff submits that if these recoveries are  
6 approved then the bill impacts should be revised.<sup>30</sup> HHHI agrees with Board Staff.

7 **6.0 DEFERRAL AND VARIANCE ACCOUNTS**

8 Board Staff supports the disposition of the Group 1 Deferral and Variance accounts,<sup>31</sup> as requested  
9 in HHHI's application.<sup>32</sup>

10 All of which is respectfully submitted.

11 **DATED** at Halton Hills, Ontario, this 21st day of March, 2018.

**HALTON HILLS HYDRO INC.**

  
Arthur A. Skidmore, President and CEO

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<sup>28</sup> Board Staff Submission at 30.

<sup>29</sup> Board Staff Submission at 30.

<sup>30</sup> Board Staff Submission at 30.

<sup>31</sup> Board Staff Submission at 33.

<sup>32</sup> HHHI Application at 7.