EB-2018-0016

Ontario Energy Board

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B, as amended;
AND IN THE MATTER OF an Application by Alectra Utilities Corporation to the Ontario Energy Board for an Order or Order approving or fixing just and reasonable rates and other service charges for the distribution of electricity as of January 1, 2019.

Submission of

Energy Probe Research Foundation

December 17, 2018

Introduction

In Procedural Order No.3 the OEB ordered allowed parties to the proceeding to make written submissions on all remaining issues by December 17, 2018. This is the submission of Energy Probe. As the remaining issues all deal with Alectra's application for OEB approval to fund costs of certain capital projects through Incremental Capital Module ("ICM") rate riders, Energy Probe will first provide brief comments on the evolution of ICM criteria and then deal with specific projects for which Alectra has applied to the OEB for approval of ICM rate riders.

The ICM Criteria

At the start of incentive regulation (originally called performance-based regulation or PBR) of electricity distributors by the OEB, there was no provision for a rider that would fund capital expenditures. Initially the method used by the OEB was referred to as Comprehensive PBR to indicate that both capital and OM&A were to be set by a rate setting I-X Price Cap formula that took into account inflation "I" and productivity "X". Distributors were expected to fund all their capital expenditures through rates produced by the application of the formula.

This seemed to work reasonably well for a few years until the legendary Ice Storm caused some distributors to incur large and unexpected capital expenditures to replace damaged facilities. In response to this the OEB put in place a method, the ICM, that would allow distributors to deal with such large and unexpected expenditures in the future by funding them through rate riders to be charged to ratepayers. Over the years since the ICM was introduced, as a result of demands from distributors, the criteria for projects that would be accepted for ICM treatment has changed several times. These changes came about through OEB reports or OEB decisions in specific cases. It seems to Energy Probe that each change further opened the door to what projects were acceptable for ICM treatment. In this application Alectra is pushing against the door with some of its projects and the OEB should consider the consequences if it opens the door further, not only on Alectra ratepayers but also on the ratepayers of other electricity distributors, which could use this decision as a precedent in future applications. In consideration of the evidence in this case, the OEB should keep in mind statements it made in recent past.

The Board is of the view that projects proposed for incremental capital funding during the IR term must be discrete projects, and not part of typical annual capital programs. This would apply to both ACMs and ICMs going forward.[1]

[1] EB-2014-0219, *Report of the Board New Policy Options for the Funding of Capital Investments: The Advanced Capital Module,* September 18, 2014, page 13

In addition, the OEB finds that a discrete project is not simply one that is distinguishable or defined at a new location - or all capital would be eligible. ICM projects do need to be different in kind from those that are carried out through typical base capital programs. Otherwise, the OEB would need to scrutinize all capital projects for optimization, not just the ICM projects.[2]

Application for Approval of ICM Projects by Alectra

Alectra Utilities is seeking OEB approval for ICM rate riders to fund three capital projects in the Powerstream Rate Zone ("PRZ") and two capital projects in the Enersource Rate Zone ("ERZ"). The three projects in the PRZ are the $5.5 million Bathurst Road Widening Relocation, the $2.1 million Barrie Transformer Station Support Work and the $13.3 million York Region Rapid Transit. The two capital projects in the ERZ are the $3.2 million Rometown Project and the $7.5 million Leaking Transformers Project.

In support of the five projects Alectra filed evidence of a Means Test by rate zone as it did in its EB-2017-0024 application. Energy Probe notes that the OEB in that decision found it would be more appropriate for the Means Test to be assessed for the distributor and not by rate zone.

The OEB finds that Alectra Utilities has passed the Means Test. Alectra Utilities provided evidence with respect to the earnings by rate zone. The OEB finds this is acceptable for assessing the earnings the year prior to merger, i.e. 2016. This test is, however, established to determine if a distributor requires funding in advance of the next rebasing. Earnings are therefore more appropriately assessed for the distributor, not the rate zone.[3]

<u>$5.5 Million PRZ Bathurst Road Widening Relocation ICM</u>

Alectra is planning to relocate its facilities along 6 km of Bathurst Road to accommodate road widening by York Region[4]. This is a mandatory project and Energy Probe has no concerns with its scope or current cost estimate. The only question is whether Alectra ratepayers should pay an incremental rider to fund this project. Energy Probe believes that when one takes into account the entire annual capital budget and the total annual revenues of Alectra Utilities this project can be funded by the company without the need to charge ratepayers and incremental rider.

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[2] EB-2017-0024 Decision, April 6, 2018, Page 27
[3] EB-2017-0024 Decision, April 6, 2018, Page 27
[4] Exhibit 2, Tab 3, Schedule 10, Page 20

$2.1 Million PRZ Barrie Transformer Station Metering and Feeder Relocation ICM

Alectra is planning to relocate its metering and feeders to accommodate the changes to the Barrie Transformer Station by Hydro One[5]. According to the evidence, this is a project mandated by the IESO, and Energy Probe has no concerns with its scope or current cost estimate. The only question is whether Alectra ratepayers should pay an incremental rider to fund this project. Energy Probe believes that when one takes into account the capital budget and revenues of Alectra Utilities this project can be funded by the company without the need to charge ratepayers and incremental rider.

$13.3 Million PRZ York Region Rapid Transit ICM

Alectra is planning to relocate some of its facilities to accommodate the construction of a York Region Rapid Transit project[6]. Energy Probe accepts the need for the project but has concerns about the amount Alectra has requested to be funded through an incremental rider to be paid by its ratepayers.

One of the widely accepted principles of regulation of utilities is that regulated utility rates should not be used to subsidize unregulated affiliates or businesses. The OEB has adhered to that principle since the creation of the OEB in 1960. In this particular case PRZ ratepayers are being asked to subsidize the costs of construction of a transit project owned by the York Region Rapid Transit Corporation ("YRRTC"). Specifically, PRZ ratepayers are to be charged approximately 50% of the costs of relocation of Alectra's facilities to accommodate construction of busways by YRRTC. The reason for this according to Alectra's evidence and testimony is that the Public Service Works on Highways Act ("PSWHA") requires Alectra to charge its ratepayers for that portion of the cost. Let's look at what the PSWHA actually says.[7]

Notice to operating corporation to take up works

2 (1) Where in the course of constructing, reconstructing, changing, altering or improving a highway it becomes necessary to take up, remove or change the location of appliances or works placed on or under the highway by the operating corporation, the road authority may by notice in writing served personally or by registered mail require the operating corporation, without prejudice to their respective rights under section 3, so to do on or before the date specified in the notice. R.S.O. 1990, c. P.49, s. 2 (1).

Apportionment of costs of taking up

(2) The road authority and the operating corporation may agree upon the apportionment of the cost of labour employed in such taking up, removal or change, but, subject to section 3, in default of agreement such cost shall be apportioned equally between the road authority and the operating corporation, and all other costs of the work shall be borne by the operating corporation. R.S.O. 1990, c. P.49, s. 2 (2).

[5] Exhibit 2, Tab 3, Schedule 10, Page 19
[6] Exhibit 2, Tab 3, Schedule 10, Page 18
[7] Exhibit K1.8, page 5

As can be seen, there is no requirement to pay 50% but rather the Act says that the parties may agree on the apportionment of costs and only in default of agreement the costs shall be apportioned equally. From the evidence on the record, it appears that Alectra may not have negotiated the best deal for the costs of relocation.

The PSWHA deals with interactions between a party it calls "the road authority" and a party it calls "the operating corporation". This is how they are defined in the act.

"operating corporation" means a municipal corporation or commission or a company or individual operating or using a telephone or telegraph service, or transmitting, distributing or supplying electricity or artificial or natural gas for light, heat or power; ("exploitant")

"road authority" means the Ministry of Transportation, a municipal corporation, board, commission, or other body having control of the construction, improvement, alteration, maintenance and repair of a highway and responsible therefor. ("office de la voirie") R.S.O. 1990, c. P.49, s. 1; 1998, c. 15, Sched. E, s. 30.

Alectra is a company distributing electricity and is therefore clearly an "operating corporation" as defined by the PSWHA. The situation is not so clear regarding YRRTC. Is YRRTC a "road authority" as defined by PSWHA? Alectra witnesses claim that it is but that does not necessarily make it so. YRRTC is a corporation building rapid transit busways along certain roads and highways in York Region. Busways are restricted access roads that will be only used by YRRTC owned vehicles. The public will not be allowed to use these busways. The fact that some of these busways are adjacent to roads does not make them roads. The busways are clearly not roads and YRRTC is therefore not a "road authority". YRRTC is just another user of space along roads, no different than Enbridge Gas, Bell Telephone or Rogers Cable, or Alectra Utilities itself. It does not possess any greater rights than any of these other users.

If YRRTC is not a "road authority" under the PSWHA, why has it been allowed to pretend to be a road authority in its interactions with Alectra and Alectra's predecessors for so long? The reason may lie in the governance and ownership of Alectra and YRRTC.

Alectra is owned by Mississauga (27.90%), Vaughan (20.84%), Hamilton (18.15%), Markham (15.72%), Barrie (9.43%), St. Catharines (4.85%), and OMERS Infrastructure (3.10%). YRRTC is owned by York Region (100%). Markham and Vaughn are the largest municipalities in York region and therefore have significant ownership of YRRTC.

Regarding governance, the mayors of Markham and Vaughn are on the boards of directors of Alectra [8] and YYRTC[9]. In fact, the Mayor of Markham is Chair of the Board of YYRTC.

It is likely that the close governance and ownership relationship between Alectra and YRRTC has effectively prevented Alectra from challenging YRRTC's pretense that it is a "road authority" under PSWHA. Why would YRRTC want to pretend that it is a "road authority"? The answer is clear. As a road authority under PSWHA, YRRTC gets to recover approximately 50% of the costs of relocation of facilities owned by an "operating corporation". If it were not a road authority, YRRTC would be forced to negotiate for the sharing of costs of relocation with Alectra and would likely be forced to pay far more than 50% of such costs. For example, if YRRTC was an affiliate of Alectra, the OEB's Affiliate Relationships Code for Electricity Distributors and Transmitters ("ARC") would not allow Alectra to recover any costs from its ratepayers since relocation would be a service provided to an affiliate. In that situation Alectra could, with the support of the OEB, force YRRTC to pay a much greater share of relocation costs, possibly even 100%.

OEB's Affiliate Relationships Code for Electric Utilities, specifies how much a utility is required to charge an affiliate for the provision of services, in this case the relocation of utility's facilities to accommodate the business of the affiliate. The following two clauses would apply.

2.3.3.6 Where a reasonably competitive market exists for a service, product, resource or use of asset, a utility shall charge no less than the greater of (i) the market price of the service, product, resource or use of asset and (ii) the utility's fully allocated cost to provide service, product, resource or use of asset, when selling that service, product, resource or use of asset to an affiliate. [10]

2.3.4.2 Where a reasonably competitive market does not exist for a service, product, resource or use of asset that a utility sells to an affiliate, the utility shall charge no less than its fully-allocated cost to provide that service, product, resource or use of asset. The fully-allocated cost shall include a return on the utility's invested capital. The return on invested capital shall be no less than the utility's approved weighted average cost of capital. [11]

[8] Exhibit K1.8, page 3
[9] Exhibit K1.8, page 2
[10] Exhibit K1.8, page 9
[11] Exhibit K1.8, page 10

In either case, whether a competitive market for relocation exists or does not exist, according to the ARC Alectra would have to charge YRRTC for a much higher portion of the cost of relocation than under the PSWHA.

Alectra and YRRTC seem to have a very close relationship through their common owners and the boards of directors but that may not make them affiliates. The following definition of "affiliate" is provided in the ARC.[12]

"affiliate", with respect to a corporation, has the same meaning as in the Business Corporations Act (Ontario);

The Business Corporations Act (Ontario)[13] referred to by the Affiliate Code provides the following definition of "affiliate" in its definitions.

"affiliate" means an affiliated body corporate within the meaning of subsection (4); ("membre du même groupe")
Subsection (4) provides a more useful definition.

Affiliated body corporate
(4) For the purposes of this Act, one body corporate shall be deemed to be affiliated with another body corporate if, but only if, one of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person. R.S.O. 1990, c. B.16, s. 1 (4).

According to the above definition Alectra and YRRTC are not affiliates. However, even though they are not affiliates, Alectra and YRRTC have a close ownership and governance relationship. Alectra is owned by a group of municipalities and OMERS while YRRTC is owned by York Region. However, two of the municipalities that have substantial ownership in Alectra, Markham and Vaughn, also have a substantial ownership of York Region. The mayors of both municipalities sit on the boards of directors of both Alectra and YRRTC and the Mayor of Markham is the Chair of YRRTC. It is hard to believe that the two municipalities do not have significant influence over the operations of Alectra and YRRTC or that transactions between Alectra and YRRTC are at arm's length. In fact there is evidence that they are not at arm's length. There is no contract between Alectra and YRRTC for the sharing of relocation costs[14]. The transactions between them are through purchase orders with no evidence of an upper limit on spending.

[12] Exhibit K1.8, page 8
[13] The Business Corporations Act (Ontario), R.S.O. 190, Chapter B16
[14] Tr. Page 56

In summary, YRRTC is not a road authority as defined by the PWSHA so that act does not apply to the transactions between Alectra and YRRTC. Although Alectra and YRRTC are not affiliates as defined by the Affiliate Relationship Code, for all practical purposes Alectra and YRRTC are behaving as affiliates and the OEB should not treat them as independent companies operating in an arm's length relationship. Under the PSWHA Alectra was proposing to pay approximately 50% of the costs of relocation. Under the ARC it would not pay anything or very little because YRRTC would have to pay for most of the cost. Energy Probe suggests the OEB should direct Alectra to pay no more than 25% of the costs of relocation as compromise between these two extremes. It would also send a strong message to YRRTC that it should do a better job of controlling its costs. Energy Probe submits that appropriate amount that the OEB should approve for funding through an ICM rider for this project is $6.7 million.

<u>$7.5 Million ERZ Leaking Transformer Project ICM</u>

The $7. Million Leaking Transformer Project[15] is not an unexpected large leak from a major transformer. It is the replacement of 1,221 transformers of various sizes and types that were known for some time to be leaking or contained PCB oil[16]. According to Alectra's evidence, from 2013 to 2017 Enersource replaced 2,680 transformers that were identified to be leaking oil or contained PCBs. Alectra has provided no engineering evidence why it now needs to speed up this program. It seems to Energy Probe that the only reason the replacement program is being speeded up is to deliberately increase the annual expenditure in order to qualify for the ICM treatment. This appears to be an attempt to game the system and OEB should reject it. Another reason to reject the request for funding through an incremental rider is that this project is part of a typical annual capital program.

<u>$3.2 Million ERZ Rometown Replacement Project ICM</u>

This is a request for an ICM rate rider to fund the $3.2 million replacement of wood poles in the Rometown neighbourhood in Mississauga[17]. Enersource, like a majority of distributors regulated by the OEB, replaces deteriorated wood poles on a regular basis through ongoing programs. According to Alectra's evidence it initially intended to do only a partial replacement in the Rometown area, because that was all that was necessary at this time. Then it decided to replace all poles. Alectra claims that it made this decision to double the size of the project because of public input. As in the Leaking

[15] Exhibit D, Tab 4, Schedule 11, Page 12
[16] Exhibit D, Tab 4, Schedule 11, Page 16
[17] Exhibit D, Tab 4, Schedule 11, Page 14

Transformer project it seems to Energy Probe that Alectra has deliberately increased the size and cost of this project to qualify it for funding through the ICM rate rider. On that basis, the OEB should reject Alectra's request for an incremental rider to fund this project. Moreover, it is part of a typical capital program, and when one takes into account the total capital budget and annual revenues of Alectra Utilities this project can be funded by the company without the need to charge ratepayers and incremental rider.

Conclusion

For reasons given above, Energy Probe submits that the OEB should not approve Alectra's application for ICM riders for the Leaking Transformers Project, the Rometown Project, the Bathurst Road Widening Relocation Project and the Barrie Transformer Metering and Feeder Relocation Project. For the York Region Rapid Transit Project, Energy Probe submits that the OEB should approve Alectra's application for an ICM rider but reduce the amount to be recovered from ratepayers.

Respectfully submitted, December 17, 2018,

Original signed by

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