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BY E-MAIL

December 17, 2018

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

Dear Ms. Walli:

Re: Alectra Utilities Corporation (Alectra Utilities)
2019 Distribution Rate Application
OEB Staff Submission
OEB File No. EB-2018-0016

In accordance with Procedural Order No. 3, please find attached OEB staff's submission. This document is also being forwarded to the parties of the case.

Yours truly,

Original Signed By

Donald Lau
Project Advisor – Rates Major Applications

Encl.

2019 ELECTRICITY DISTRIBUTION RATES

Alectra Utilities Corporation

EB-2018-0016

OEB STAFF SUBMISSION

December 17, 2018

Introduction

Alectra Utilities Corporation (Alectra Utilities) filed a complete application with the Ontario Energy Board (OEB) on June 7, 2018 under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the rates that Alectra Utilities charges for electricity distribution, effective January 1, 2019.

On November 8, 2018, the OEB issued Procedural Order No.3 (PO3), which provided for an oral hearing on two issues (i) the York Region Rapid Transit (YRRT) Incremental Capital Module (ICM) project and (ii) the Earnings Sharing Mechanism (ESM) for the Horizon Rate Zone (Horizon RZ). The OEB further established procedural steps for parties to file submissions on all issues. Submissions for issues not eligible for cost awards have already been filed.[1]

At the oral hearing on December 5, 2018, intervenors and Alectra Utilities (collectively referred to as parties) reached a tentative settlement to defer the ESM for Horizon RZ until Alectra Utilities' 2020 rate application. This included the interaction between the change in capitalization policy for the Horizon RZ and the ESM calculation. The parties believed this approach will promote regulatory efficiency since the OEB, in PO3, deferred review of the balances and disposition of the deferral accounts related to the change in capitalization policy for the Brampton and Enersource RZs. On December 6, 2018, the OEB accepted the settlement proposal of the intervenors and Alectra Utilities.

As a result, this submission addresses Alectra Utilities' request for ICM funding for projects in the Enersource and PowerStream RZs.

Incremental Capital Modules Requested

Alectra Utilities has applied for ICM funding for five projects.

Two projects are for the Enersource RZ totaling $10.7 million in capital additions and a resulting revenue requirement of $885,346.

[1] IRM applications (excluding ICM and capitalization policy change) and Custom IR update (excluding earnings sharing mechanism and capitalization policy change)

Table 1 – Proposed Enersource ICM Projects

Project Description	Capital Expenditures
Leaking Transformer Replacement Project	$7,500,000
Rometown	$3,200,000
System Renewal	**$10,700,000**
Total Enersource RZ Incremental Capital Funding	**$10,700,000**

Alectra Utilities attributed its need for increased capital for the Enersource RZ over that provided for in the 2013 cost of service application[2] primarily to address reliability levels, and environmental and safety risks.[3] OEB staff notes that the Enersource RZ received incremental funding in the amount of $10.8 million as part of its ICM request for 2018 rates.

The Leaking Transformer Replacement project is part of a multi-year initiative to replace a backlog of transformers that were found to be leaking or containing PCB contaminated oil. The OEB previously approved funding for this project in Alectra Utilities' 2018 IRM application.[4]

The Rometown project is intended to renew the distribution infrastructure in a specific area south of the Queen Elizabeth Highway and east of Dixie Road (i.e. Rometown). Alectra Utilities indicates that the area shows poor conditions of overhead assets, existence of leaning poles, porcelain insulators (which are prone to cracking and deterioration leading to failures and pole fires), and transformers showing signs of oil leaks.

The other three ICM projects are for the PowerStream RZ. These three projects total $20.9 million in capital additions and a resulting revenue requirement of $1,508,566.

[2] EB-2012-0033
[3] IRR ERZ-Staff-82(a)
[4] EB-2017-0024

Table 2 – Proposed PowerStream ICM Projects

Project Description	Capital Expenditures
Road Authority YRRT Yonge St	$13,272,246
Bathurst Ave from Hwy 7 to Teston Road	$5,500,000
System Access	**$18,772,246**
Barrie TS Upgrade- Metering and Feeder Relocation	$2,100,000
System Service	**$2,100,000**
Total PowerStream Rate Zone Incremental Capital Funding	**$20,872,246**

The YRRT project is part of a multi-year project to relocate overhead and underground distribution assets to accommodate the York Region Rapid Transit Corporation's (YRRTC) Bus Rapid Transit (BRT) developments. Alectra Utilities is obligated to relocate its distribution plant to facilitate transportation infrastructure developments by applicable road authorities in accordance with the Public Service Works on Highways Act (PSWHA) and recovers capital contributions related to 50% of expenditures of labour costs. The OEB previously approved funding for this project in Alectra Utilities' 2018 IRM application.

The Bathurst Ave road widening project relates to the relocation of approximately 6 km of overhead and underground distribution system assets as a result of the Regional Municipality of York widening Bathurst Street from Highway 7 to Teston Road. Similar to the YRRT project, Alectra Utilities is obligated under the PSWHA to relocate its distribution assets.

The Barrie Transmission Station (TS) upgrade project relates to the relocation of six feeders and the corresponding wholesale revenue metering equipment as a result of Hydro One Networks (Hydro One) undertaking a station rebuild in 2019. The existing feeder integration at Barrie TS cannot be accommodated with the upgraded station, since Hydro One will be moving the station egress westward.

Requirements for ICM Funding

The ICM is a mechanism available to electricity distributors whose rates are established under the Price Cap IR regime as described in Section 3.3.2 of the *Filing Requirements*.[5] The ICM is intended to address the treatment of a distributor's capital

[5] Ontario Energy Board *Filing Requirements For Electricity Distribution Rate Applications – 2018 Edition for 2019 Rate Applications- Chapter 3 Incentive Rate-Setting Applications*, July 12, 2018 ("IRM Filing

investment needs that arise during the rate-setting plan which are incremental to a materiality threshold. The ICM is available for discretionary and non-discretionary projects, as well as for capital projects not included in the distributor's previously filed Distribution System Plan (DSP). It is not limited to extraordinary or unanticipated investments.

In order to qualify for ICM funding, a request must satisfy the eligibility criteria of (i) materiality, (ii) need and (iii) prudence, as set out in section 4.1.5 of the *Report of the Board - New Policy Options for the Funding of Capital Investments: The Advanced Capital Module* (the ACM Report).[6] Changes to the materiality threshold were made in the *Report of the OEB on New Policy Options for the Funding of Capital Investments: Supplemental Report* (the Supplemental Report).[7]

The ACM Report explains materiality as follows:

> A capital budget will be deemed to be material, and as such reflect eligible projects, if it exceeds the OEB-defined materiality threshold. Any incremental capital amounts approved for recovery must fit within the total eligible incremental capital amount (as defined in this ACM Report) and must clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.
>
> Minor expenditures in comparison to the overall capital budget should be considered ineligible for ACM or ICM treatment. A certain degree of project expenditure over and above the OEB-defined threshold calculation is expected to be absorbed within the total capital budget.

The ACM Report describes need as follows:

> The distributor must pass the Means Test (as defined in the ACM Report).
>
> Amounts must be based on discrete projects, and should be directly related to the claimed driver.

Requirements")
[6] EB-2014-0219, September 18, 2014
[7] EB-2014-0219, January 22, 2016

> The amounts must be clearly outside of the base upon which the rates were derived.

The ACM Report describes prudence as follows:

> The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

This submission will examine the OEB-defined materiality threshold and the Means Test initially as they are common to all ICM projects. OEB staff will then address the remaining criteria for each ICM project as they are project specific.

OEB-defined Materiality Threshold

An ICM is available to distributors during the Price Cap IR years for capital investment needs that are incremental to the OEB's materiality threshold. The ICM materiality threshold is outlined in the Supplemental Report and in Chapter 3 of the Filing Requirements for Distribution Rate Application.[8] It represents a distributor's financial capacities underpinned by existing rates, including growth and a 10% dead band. The equation used to calculate the materiality threshold is as follows:

$$Threshold\ Value\ (\%) = \left(1 + \left[\left(\frac{RB}{d}\right) \times (g + PCI \times (1+g))\right]\right) \times \left((1+g) \times (1+PCI)\right)^{n-1} + X\%$$

Where: n = number of years since cost of service rebasing
RB = Rate Base included in base rates ($)
d = depreciation expense included in base rates ($)
g = distribution revenue change from load growth (%)
PCI = price cap index

Alectra Utilities utilized a price cap index of 0.9% as a placeholder in its initial filing until the price cap index for 2019 was available. This was based on inflation of 1.20% less a productivity factor of 0.00% and a stretch factor of 0.30%. For purposes of this submission, OEB staff has updated the price cap index applied in Alectra Utilities' ICM

[8] Filing Requirements for Electricity Distribution Rate Applications – 2018 Edition for 2019 Rate Applications (Chapter 3 – Incentive Rate-Setting Applications), July 12, 2018, Page 26

Model for the Enersource RZ and PowerStream RZ for 2019 to 1.20%. This is based on inflation factor of 1.50% as announced by the OEB[9] for 2019 applications, and a stretch factor of 0.30%.

The OEB expects a distributor to manage within a capital expenditure level equal to the product of the depreciation expense included in base rates and the materiality threshold value, before being eligible to apply to recover incremental amounts. Taking into account the inflation factor for 2019 of 1.50% the materiality threshold for the Enersource RZ and PowerStream RZ are as follows.

- Enersource RZ has a materiality threshold value of 130.6%. Depreciation included in Enersource Hydro's last cost of service rates in 2013 was $28.7 million;[10] meaning only forecasted capital above $37.5 million is eligible for the ICM (130.6% x $28.7 million)
- PowerStream RZ has a materiality threshold value of 153%. Depreciation included in PowerStream's last cost of service rates in 2017 was $52.3 million;[11] meaning only forecasted capital above $80.0 million is eligible for the ICM (153% x $52.3 million)

Alectra Utilities has presented a total capital budget for 2019 of $74.3 million for the Enersource RZ[12] and $102.1 million for the PowerStream RZ.[13] The available ICM amounts above the materiality threshold are therefore $36.8 million ($74.3 million - $37.5 million) for the Enersource RZ and $22.1 million ($102.1 million - $80.0 million) for the PowerStream RZ.

With respect to the ICM materiality threshold, OEB staff does not take issue with Alectra Utilities' calculations for the ICM materiality threshold based on the OEB's ICM formula and the total requested amounts for the Enersource and PowerStream RZ are within the available ICM amounts above the materiality threshold.

[9] Issued November 23, 2018
[10] EB-2018-0016, Alectra_Attach44_ICM Model_ERZ_r2_20180622, June 22, 2018
[11] EB-2018-0016, Alectra_Attach29_ICM Model PRZ_r2_20180622, June 22, 2018
[12] EB-2018-0016, Application, Exhibit 2, Tab 4, Schedule 11, Page 12
[13] EB-2018-0016, Application, Exhibit 2, Tab 3, Schedule 10, Page 15

Means Test

Under the ICM Means Test[14], if a distributor's regulated return on equity (ROE) exceeds 300 basis points above the deemed ROE embedded in the distributor's rates, then the funding for any incremental capital project will not be allowed.

Alectra Utilities filed its first annual Reporting and Record-Keeping Requirements on a consolidated basis on April 30, 2018. To calculate a consolidated deemed ROE, Alectra Utilities used the weighted average of the OEB-approved rate base amounts for each rate zone from the most recent OEB-approved rebasing application for each of the predecessor companies. OEB staff submits that Alectra Utilities' calculation is reasonable. Alectra Utilities submitted evidence to show that its 2017 ROE was calculated to be 8.43%. This is 47 basis points below a calculated deemed ROE for Alectra Utilities of 8.90%[15], thereby passing the ICM Means Test.

Eligibility of Individual Projects

This section addresses each ICM project individually for the remaining criteria under materiality, need, and prudence.

Materiality

In addition to the ICM materiality threshold calculation discussed above, the OEB also considers a project-specific materiality threshold. The ACM Report states that specific projects must clearly have a significant influence on the operation of the distributor; otherwise, they should be dealt with at rebasing.[16]

With respect to the project-specific materiality threshold, the OEB's 2018 Decision[17] on Alectra Utilities' ICM proposals adopted the same approach as the Toronto Hydro decision and found that the basis for a project-specific materiality threshold should be the proposed capital budget of Alectra Utilities as a whole. The OEB noted that it would consider whether each capital project proposed for an ICM is significant with respect to Alectra Utilities' total capital budget. In the 2018 Decision on Alectra Utilities' ICM proposal, the OEB was guided by the words "significant influence on the operation of the distributor" and "minor expenditure in comparison to the overall capital budget" in

[14] EB-2014-0219, Report of the Board – New Policy Options for the Funding of Capital Investments: The Advance Capital Module, September 18, 2014, p.15
[15] EB-2018-0016, Interrogatory Responses, ERZ-Staff-80
[16] EB-2014-0219, September 18, 2014, Section 4.1.5
[17] EB-2017-0024, Decision and Order, Page 25

assessing the materiality of each project.[18] Guided by this wording, OEB staff has made submissions on the materiality of each project.

OEB staff notes that for 2019, Alectra Utilities' overall capital budget for all rate zones is $257.3M.[19]

Need

In addition to the Means Test discussed above, the OEB also considers if the ICM project is a discrete project and if the applied for amounts are outside base rates. The OEB will make a determination on whether projects are discrete on a case-by-case basis but expect that the ICM project is not part of typical annual capital programs.[20] OEB staff has made submissions on each ICM project on whether the project can be reasonably included in existing capital programs and whether the applied for amounts were included in the current base rates.

Prudence

The OEB expects comprehensive evidence including a description of the proposed capital projects, expected in-service dates, and their costs. Justification that a project is prudent can be provided by showing that the proposed option is the most cost-effective option for ratepayers. OEB staff has made submissions on each ICM project based on the proposed options and the prudence of the recommended option.

Enersource ICM project - Rometown

Materiality

Based on Alectra Utilities overall capital budget, the Rometown ICM represents 1.4% of the total capital budget. OEB staff submits that the project is not a minor expenditure in comparison to the overall capital budget.

Need

OEB staff submits that the Rometown ICM expenditure is not a "discrete project". The asset replacement activities comprising this ICM are indistinguishable from asset replacements covered under ongoing multi-year Enersource RZ base capital programs.

[18] EB-2017-0024, Decision and Order, Page 26
[19] EB-2018-0016, Exhibit 2, Tab 4, Schedule 11, Page 13
[20] EB-2014-0219, Report of the Board – New Policy Options for the Funding of Capital Investments: The Advance Capital Module, September 18, 2014, p.13

The Rometown ICM is not a discrete project in and of itself, but its parts have been merged to create a proposed project. Asset replacement activities that would normally be categorized as typical program expenditures, such as replacement of overhead pole lines, transformers, insulators etc. have been bundled into a neighbourhood portfolio and classified as a project. The OEB found in last year's decision that "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."[21]

OEB staff submits that the Rometown ICM can be viewed as to be already included in base rates. Although the exact project name was not identified under the program Overhead Distribution Sustainment, OEB staff notes that there are in excess of 20 projects listed[22] in the previous rebasing application that are of a similar nature to the proposed Rometown ICM and the differences are minor. This project should be prioritized within the Overhead Distribution Sustainment program.

It is important to note that the OEB approved an Overhead Distribution Sustainment Program totalling $2.7 million for overhead system renewal (this includes $1.2 million for pole replacement and $1.5 million for overhead equipment replacement) as part of Enersource's last rebasing application.[23] The business case for that program identified that part of the project description is to fund the "replacement of sections of the overhead system over parts of the City…" The justification for the program identifies that this program is needed to replace equipment that reaches end of life or becomes hazardous, and that as "part of these overhead rebuild projects the replacement of poles, primary and secondary conductors, down guys, brackets, cross arms and insulators along with transformers are all replaced so that the system is brand new."[24]

In its current application, with respect to Rometown, Alectra Utilities notes that:

> [t]his project targets a defined system area with known substandard assets, based on identified system renewal needs and seeks to bring the existing substandard overhead system to present day standards. This differs from Alectra's more limited annual Pole Replacement Program which aims to replace individual poles throughout the RZ based on identified hazards and poor

[21] EB-2017-0024, Decision and Order, revised April 6, 2018, p.27
[22] EB-2012-0033, Exhibit 2, Tab 2, Schedule 2, Appendix 2, Page 25
[23] EB-2018-0016, Application, Attachment 46, Page 1
[24] EB-2012-0033, Exhibit 2, Tab 2, Schedule 2, Appendix 2, Page 27

condition. The Rometown project not only includes the replacement of poles, but also the replacement of substandard overhead system configuration with porcelain or known hazardous polymer insulators, replacement of damaged grounds, incorporates animal contact protection and provides improved clearance for enhanced safety.[25]

OEB staff submits that this project is a grouping of asset replacements, which can be done under system renewal programs. Although there are synergies to renew a geographical area altogether instead of asset by asset, Alectra Utilities already has a similar program to address such projects. OEB staff submits that the Rometown ICM does not satisfy the Need criteria as it is not a discrete project and the Enersource RZ's Overhead Distribution Sustainment base capital program covers these types of projects.

Prudence

Alectra Utilities provided a business case summary for the project that identifies the drivers, cost, expected in-service date and the various options considered. In response to an OEB staff interrogatory[26], Alectra Utilities noted that since 2014, the Enersource RZ has increased the frequency and detail of its inspections, reviewing outage data more rigorously, as well as striving to implement additional analytical methods to guide the pacing of asset replacements. To supplement and enhance the overhead system inspection, Alectra Utilities conducted additional testing of wood poles, utilizing the resistograph technology, which commenced in 2015.[27]

Alectra Utilities indicates that the primary driver of the need in the Rometown area is the condition of the assets. OEB staff notes that in response to ERZ-Staff-87, Alectra Utilities indicates it has experienced several outages in the area as a result of the deteriorated overhead system assets (emphasis added). However, in response to ERZ-Staff-89, it is noted that the primary driver for the renewal of the overhead system is the deteriorated and substandard condition of the assets in the area and not historical reliability performance (emphasis added). Alectra Utilities provides outage history due to equipment failure in the Rometown area as seen below.[28]

[25] EB-2018-0016, Application, Attachment 46, Page 1
[26] EB-2018-0016, Interrogatory Responses, ERZ-Staff-87
[27] EB-2018-0016, Interrogatory Responses, ERZ-Staff-87(b), Page 2
[28] EB-2018-0016, Interrogatory Responses, ERZ-Staff-89(c), Page 3

Table 2 - Outage History Due to Equipment Failure

Year	Cause Code	Num. of Outages	Num. of Customer Minutes	Customers Impacted
2011	Overhead (including poles)	0	0	0
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0
2012	Overhead (including poles)	0	0	0
	Switches	0	0	0
	Insulators	2	1,565	1,565
	Transformers	0	0	0
	Switchgears	0	0	0
2013	Overhead (including poles)	0	0	0
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0
2014	Overhead (including poles)	1	1,586	13
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0
2015	Overhead (including poles)	3	3,251	37
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0
2016	Overhead (including poles)	0	0	0
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0
2017	Overhead (including poles)	0	0	0
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0
2018 (Jan-July)	Overhead (including poles)	0	0	0
	Switches	0	0	0
	Insulators	0	0	0
	Transformers	0	0	0
	Switchgears	0	0	0

OEB staff submits that the filed evidence does not demonstrate urgency of the need driving these expenditures, and does not explain why they could not be deferred or

paced over an extended timeline by replacing individual worst-condition structures in these areas under the ongoing base capital Overhead Distribution Renewal and Sustainment program.

For the reasons set out above, OEB staff does not support the proposed Rometown ICM.

Enersource ICM Project - Leaking Transformer Replacement

Materiality

Based on Alectra Utilities overall capital budget, the Leaking Transformer Replacement ICM project represents 3.0% of the total capital budget. OEB staff submits that the project is not a minor expenditure in comparison to the overall capital budget.

Need

Alectra Utilities has applied for an ICM to complete a multi-year project to replace a backlog of transformers that were found to be leaking or containing PCB oil. This project is the second part of a project approved by the OEB on Alectra Utilities' 2018 IRM application[29] where the OEB approved ICM funding of $8.45 million for the 2018 "scope" of the project. The scope of the 2019 leaking transformer project is slated to replace the remaining backlog of 571 leaking transformers.

The OEB's decision in the 2018 application found that there is such a material change to the program from 2013 in that the 2018 program and its costs were neither "typical" nor "ongoing" from the normal transformer refurbishment and replacement program and cost levels as reflected in the revenue requirement approved by the OEB for 2013 rates. Subject to the Price Cap IR adjustment in subsequent years, "normal" levels of transformer refurbishment and replacement continue to be recovered in approved distribution rates. The OEB also stated that it expected that this project will evolve to be a typical ongoing capital program and may not be eligible for any additional incremental funding in subsequent years.[30]

OEB staff is guided by the OEB's finding that it expected that this project will evolve to be a typical ongoing program. OEB staff does not support the quantum requested of the proposed Leaking Transformer ICM expenditure for 2019. OEB staff will not re-argue the need for this type of project, however, the request for further funding for this type of

[29] EB-2017-0024
[30] EB-2017-0024, Decision and Order, Page 58

project must be questioned based on the intent of the OEB's ICM supplemental funding option.

OEB staff provides the following discussion based on the OEB's policies with respect to rate-setting approaches and the need for and use of the ICM/ACM capital funding options. Under traditional annual cost of service regulation, forecasted capital and operating costs, and the net book value (NBV) of in-service assets for the rate year are updated to derive the revenue requirement for that year, and the rates to recover it based on the forecasted demand (number of customers, kWh, kW). The costs of a capital expenditure, whether for a program or a specific project would be included in its entirety. However, the rate base would also be adjusted to include not just new in-service assets, but also to reflect reduction of existing assets' NBV and removal of assets at end-of-life or for other reasons, such as failure. There would be increases for new costs, but also reductions to reflect aging of existing assets. Under traditional cost of service approaches, this would be repeated on an annual basis, and the approved rates would be "just and reasonable" to recover the necessary and prudent costs.

However, filing annual cost of service applications has disadvantages and is not practical. It is resource-intensive with respect to people, time and costs. Beginning in 1999, the OEB adopted forms of Incentive Regulation (Mechanisms) (IRM) and has been using them in electricity and natural gas distribution, and most recently in the regulation of OPG's Prescribed Hydroelectric Payment Amounts.

Under this approach, the revenue requirement and rates are not "rebased", but instead are formulaically adjusted for the main drivers affecting operating and capital costs from year-to-year. It is expected that the rates adjusted would be able to fund ongoing "normal" operating and capital expenses incurred to serve demand.[31] Further, with the reduced regulatory oversight, and incentives to earn above the approved return of equity[32], the utility's management has greater flexibility to manage its costs to serve demand. IRM is thus based on an expectation of relatively stable operating costs and capital investments during the rate term between rebasing applications.

[31] While growth, such as new customers, are not explicitly addressed (under the price cap approach), it is presumed that rates which are compensatory to serve existing demand subject to the "inflation less productivity" adjustment are also compensatory for serving new (added) demand. Costs to serve new customers and demand are recovered by the revenues from the rates paid by new demand

[32] Subject to an earnings sharing mechanisms to cap overearnings to prevent excessive windfall profits

While the level and timing of expenditures and the ability to manage them may hold most of the time, it was recognized during the consultations for 3rd Generation IRM that there could be instances of periodic lumpy investments that could necessitate some incremental capital funding.

The OEB accepted the concept of the ICM.[33]

A key consideration of the adoption of the ICM was to provide a mechanism that would provide funding for necessary and material lumpy investments during the IRM term while still remaining under the formulaic IRM rate adjustment. The alternative was for the firm to apply for early rebasing to accommodate the "bump" in the capital expenditure. Further, the availability of the ICM still allowed the firm to plan for the capital expenditure when it was needed, and not advance or defer the project to coincide with a rebasing application.

The ICM policy has been applied since that time. There have been around 20 applications for incremental capital funding since 2010. The OEB has also evolved the ICM policy, including the introduction of the similar ACM in 2014 and 2016,[34] and the Rate Handbook has affirmed the availability of the ICM/ACM or analogous capital funding mechanisms under IRM plans for all Ontario energy sectors.

This leads to another approach to analyze the reasonableness of Alectra Utilities' 2019 ICM for its leaking transformer replacement. Until the ICM approach was introduced in 2008, the only option available for seeking funding for a material "lumpy" investment during the price cap term was off-ramping early to rebase rates through a cost-of-service approach. The ICM and now ACM allow for the utility to remain under its rate-adjustment plan while still getting necessary funding when it is needed. In other words, the ICM, as part of a price cap application, is a proxy for an early rebasing, albeit in a limited scope (only the identified ICM or ACM qualifying projects are considered). Except for the costs for this (these) project(s), rate base, OM&A expenses, depreciation, taxes and cost of capital are not updated.

Extending the comparison further, it is considered that the sum of the ICM rate riders, calculated to recover the incremental annual revenue requirement of the qualifying

[33] Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, (EB-2007-0673), September 17, 2008
[34] Report of the Board – New Policy Options for the Funding of Capital Investments: Supplemental Report, January 22, 2016

capital projects, and the price cap IR-adjusted base distribution rates, would approximate what would be rebased rates if the utility had instead rebased.[35]

This has an important implication. If Alectra Utilities had rebased in 2018, and had reflected the leaking transformer replacement program in its rate base and revenue requirement and recovered through approved rates, then it would be presumed to be funded through rates going forward, and the further program costs in 2019 would not be eligible for ICM treatment. Since the ICM rate rider, combined with Price Cap IR-adjusted rates is a proxy for rebased rates, then the same premise applies here. By the continuation of the 2018 ICM rate rider into 2019 (and beyond, until Alectra Utilities next rebases its rates), the program is funded through rates. This is presumably reasoning for the OEB panel's findings in the 2018 decision (i.e., as noted previously, **the OEB expects that this project will evolve to be a typical ongoing capital program and may not be eligible for any additional incremental funding in subsequent years**. (Emphasis added)[36]

During the IR years, depreciation expense is the return of originally invested capital that is available for re-investment in the replacement assets when the original assets reach end-of-life. On that theoretical basis, a utility should be able to fund most investments in future capital, whether for replacement or growth with no adverse impact on financial metrics.[37]

The incremental revenue requirement for the leaking transformer program approved in 2018 includes a return of (invested) capital, commonly referred to as depreciation expense, such that the original capital is fully recovered over the life of the asset. Thus

[35] This is not the only example of this concept of the role that capital-related rate riders play. The OEB's policy with respect to smart meter funding and cost recover, as documented in two reports (Guideline G-2008-0002: Smart Meter Funding and Cost Recovery, October 22, 2008 and Guideline G-2011-0001: Smart Meter Funding and Cost Recovery – Final Disposition, December 15, 2011), associated models, and OEB decisions on nearly one hundred applications have also recognized how the smart meter rate riders function as proxies for recovering the associated revenue requirement as these were deployed and entered service in accordance with government regulations. Specifically the Smart Meter Incremental Revenue Requirement Rate Rider (SMIRR) allowed for recovery of the incremental revenue requirement of approved smart meter costs until rebasing, when the utility applied for smart meter cost recovery in an IRM application. In a recent case, regarding Whitby Hydro (EB-2017-0085/EB-2017-0292), the OEB accepted a settlement proposal between the utility and OEB staff whereby distribution rates were adjusted by decreasing the capital-related revenue requirement being recovered for stranded conventional meters and added the SMIRR. This gave a proxy for "rebased" rates to avoid a costly rebasing application as the utility was investigating a merger with another utility.
[36] Decision and Order EB-2017-0024, April 5, 2018, p. 58
[37] Report of the OEB - New Policy Options for the Funding of Capital Investments: Supplemental Report, Page 9

the 2018 ICM rate riders are already recovering part of the transformers replaced in 2018. If the rate riders were being updated to reflect that recovery (i.e., adjust the average net book value, and recalculate application return on capital and taxes), the rate riders would reduce over time. However, the policy and practice is not to adjust the rate riders, just as base rates are not adjusted between rebasing applications. It is assumed that, except for the rate adjustment mechanism (inflation less expected productivity), additions and removals, and changes in demand (primarily growth) can be managed by the utility and will largely "balance".

Not adjusting the ICM rate riders for the recovery of depreciation expense in 2018 presumes that this returned capital is available for redeployment. If it was instead being returned to lenders and shareholders, then it would be appropriate to reduce the revenue requirement and the associated ICM rate riders. So, then, where could this depreciation expense be redeployed? An obvious candidate is to use it as available capital to fund (in part) the continuation of the leaky transformer replacement in 2019. Alectra does not require the amount of the 2019 program to be funded through a new rate rider, since it has capital available from the depreciation expense recovered for the 2018 program.

OEB staff notes that the requested 2019 program costs of $7.50 million[38] is smaller than the approved 2018 costs of $8.45 million, so the depreciation expense recovered – and to be recovered on a going forward basis – is also larger for the 2018 program than it is for the 2019. OEB staff also notes that Alectra has submitted that replacements in 2019 should complete the backlog.[39] In this sense, what is being funded through the 2018 ICM and any 2019 ICM, if approved, should not become a new normal level; Alectra Utilities should largely move back to transformer replacements as funded through base rates and adjusted for inflation less productivity, until the next rebasing.

OEB staff's application of the above considerations yields the recommendation that the proposed Leaking Transformer Replacement Project not be approved by the OEB as proposed by Alectra Utilities.

Prudence

In recent years, Alectra Utilities has increased the frequency and level of detail captured in its annual distribution system inspections to better assess the condition of its in-service distribution assets. As a result of this, environmental concerns related to leaking

[38] EB-2017-0024, Annual Update, Exhibit 2/Tab 4/Schedule 11/pp. 16-17, June 7, 2018
[39] *Ibid.*

transformers were identified when Alectra Utilities modified its transformer condition assessment methodology. OEB staff submits that the benefits of the program were established and accepted by the OEB last year. Continuation and completion of this program is in the public interest.

PowerStream ICM Project - York Region Rapid Transit

Materiality

Based on Alectra Utilities overall capital budget, the YRRT ICM Project represents 5.1% of the total capital budget. OEB staff submits that the project is not a minor expenditure in comparison to the overall capital budget.

Need

OEB staff submits that the YRRT project is a discrete project and outside the base upon which rates were derived. Alectra Utilities stated that it is obligated to relocate its distribution plant to facilitate transportation infrastructure developments by applicable road authorities in accordance with the PSWHA. YRRT's BRT developments were undertaken to meet the transportation needs resulting from projected population growth in York Region and Alectra Utilities has been relocating overhead and underground distribution assets in the PowerStream RZ to accommodate the YRRT. This project is a multi-year project and ICM funding for 2018 was previously approved by the OEB in Alectra Utilities' 2018 rate application.[40]

In PowerStream's last cost of service, the decision on capital budget stated that "PowerStream suggested that any reduction to its capital spending program was inappropriate, but that a reduction of $23.22 million was feasible, except that an additional $20.00 million may be needed for York Region Rapid Transit project."[41] During the oral hearing for this application, Alectra Utilities stated that the five year road authority budget is approximately $38.7 million and compared to a full listing of actual and forecasted projects for the same time period accounts to about $32.3 million, or a remaining budget of $6.4 million.[42] Given that PowerStream identified that additional funding may be required in its last cost of service application and comparing the project cost to the remaining budget and the overall budget, it is reasonable to conclude that the YRRT was not included in base rates.

[40] EB-2017-0024
[41] EB-2015-0003, Decision and Order, August 4, 2016, p.14
[42] EB-2018-0016, Oral Hearing Transcript, December 5, 2018, p.85

Prudence

This project is a coordinated effort between the YRRTC and Alectra Utilities with the YRRTC overseeing the design, project schedule, and sequence of work. The forecasted net capital cost of the project increased from $30.8 million to $37.7 million since Alectra Utilities' last rate application. Alectra Utilities explained that this was due to changes in design scope such as joint trench installations and deeper burial depths of underground assets. These changes in design were also non-standard to the PowerStream RZ, which required the resourcing of construction contractors. In addition, there were changes to the sequence of construction to accommodate the construction of transportation infrastructure and telecommunication companies. Alectra Utilities also provided relocation unit costing information that range from $1.6-$2.0 million/km.[43]

OEB staff submits that compared to similar relocation projects Alectra Utilities has completed in the past, and taking into consideration the complexities of coordination and design changes for a project of this magnitude, the total capital cost is within reason. However, OEB staff notes that much of the cost increase from the last rate application appear to be solely caused by the YRRTC. In response to a BOMA interrogatory[44], Alectra Utilities showed that Alectra Utilities and YRRTC were able to reach an agreement for a different apportionment of cost responsibilities based on specific YRRTC requests.[45] OEB staff submits that the OEB should encourage Alectra Utilities, moving forward, to negotiate similar cost sharing responsibilities for scope changes, especially those that are outside Alectra Utilities' control.

OEB staff submits that the proposed YRRT ICM is reasonable.

PowerStream ICM Project - Bathurst Street Road Widening

Materiality

Based on Alectra Utilities' overall capital budget, the Bathurst Street Road Widening ICM Project represents 2.1% of the total capital budget. OEB staff submits that the project is not a minor expenditure in comparison to the overall capital budget.

Need

OEB staff submits that the Bathurst Street Road Widening project is a discrete project and outside the base upon which rates were derived. Alectra Utilities stated that it is

[43] EB-2018-0016, Response to Board Staff Interrogatories, September 17, 2018 (PRZ-Staff-64)
[44] EB-2018-0016, Alectra IRR BOMA 20180917, September 17, 2018 (BOMA-6)
[45] EB-2018-0016, Responses to Building Owners and Managers Association of Greater Toronto Interrogatories, September 17, 2018 (BOMA-6)

obligated to relocate its distribution plant to facilitate transportation infrastructure developments by applicable road authorities in accordance with the PSWHA. Road widening on Bathurst Street was required to accommodate growth in the Richmond Hill and Vaughan regions and Alectra Utilities was required to relocate overhead and underground distribution assets to accommodate the road widening. In PowerStream's last DSP it had forecasted $5.7 million for road authority work in 2019.[46] The total capital cost of this project is $5.5 million. OEB staff submits that this project is almost the entire budgeted road authority work amount for 2019 and should be considered discrete and not included in base rates.

Prudence

Alectra Utilities provided alternative options that were considered including maintaining status quo, which would violate the PSWHA or placing the entire overhead system underground, which would provide protection from external factors but at an increased cost of $25-$35 million. Based on customer engagement, Alectra Utilities found the preference of customers was to maintain the existing configuration of the overhead and underground system. Alectra Utilities also provided relocation unit costs in response to staff interrogatories that range from $1.6-$2.0 million/km.[47]

OEB staff notes that the options presented by Alectra Utilities were not helpful in assessing prudence. An option of violating the PSWHA and an option that is five to seven times more expensive do not appear to provide customers with reasonable alternatives. However, the total project cost before capital contributions is $7.5 million to relocate 6kms of line. This project has a unit cost of $1.25 million/km. OEB staff submits that compared to similar relocation projects Alectra Utilities has completed in the past, this project is below historical actual unit costs and within reason. When assessing prudence, it is preferable to have reasonable alternatives for comparison, but in this case, in the absence of that, Alectra Utilities has still shown that the recommended option is a reasonable proposal with a reasonable cost.

Barrie TS Feeder Relocation

Materiality

Based on Alectra Utilities overall capital budget, the Barrie TS Feeder Relocation Project represents 0.8% of the total capital budget. OEB staff submits that the project is

[46] EB-2015-0003, Rate Proposal Exhibit G – Tab 2 – 5.4.5 Justifying Capital Expenditure, February 24, 2015, p. 3

[47] EB-2018-0016, Response to Board Staff Interrogatories, September 17, 2018 (PRZ-Staff-64)

not a significant capital cost in comparison to the overall capital budget. In the OEB's decision on Alectra Utilities' 2018 ICM requests[48], the OEB did not approve funding for a number of ICM requests based on the project costs in comparison to the overall capital budget as they were determined to be insignificant compared to the overall capital budget forecast for the 2018 year. For example, the Lake/John Area Overhead Rebuild project at a cost of $0.93 million and the Station Switchgear Replacement – 8th line MS323 project at a cost of $1.39 million were both not considered a significant capital cost in comparison to the overall capital budget. In OEB staff's view, the Barrie TS Feeder Relocation project is comparable at $2.1M and 0.8% of capital budget.

Need

OEB staff submits that the Barrie TS Feeder Relocation project is a discrete project and outside the base upon which rates were derived. The Barrie TS station rebuild was identified as part of the South Georgian Bay/Muskoka regional planning led by the Independent Electricity System Operator. Hydro One identified the need to rebuild Barrie TS in 2015 and the feeder relocation was not included in PowerStream's DSP. OEB staff submits that this project is an outcome of regional planning and is a discrete project not included in reoccurring capital programs.

However, as noted previously, the total capital cost of this project is small relative to Alectra Utilities total capital budget and should be managed within that envelope.

In addition, while the amount of this project is relatively small, disallowing it would also have the effect of reducing the amount to be approved as part of the total incremental capital available for this rate zone for 2019. OEB staff notes that the eligible incremental capital for the PowerStream RZ is $22.1 million and the requested incremental capital funding is $20.8 million. In the adoption of the "discrete" project criterion, the OEB expects that when applying for an ICM a utility is not proposing to use the entire eligible incremental capital envelope available for a particular year.[49] The total proposed incremental funding is close (within 10%) of the entire eligible incremental capital envelope.

[48] EB-2017-0024

[49] EB-2014-0219, Report of the Board – New Policy Options for the Funding of Capital Investments: The Advance Capital Module, September 18, 2014, p.14

Prudence

Alectra Utilities has presented options of either using station bus metering or utility feeder metering in addition to relocating the necessary feeders. Alectra Utilities has compared the two options and recommended the more economical solution of utility feeder metering. OEB staff submits that Alectra Utilities has chosen the most cost-effective option but as stated in the materiality section, Alectra Utilities should be able to manage this project within its existing capital budget.

OEB staff submits that the proposed Barrie TS Feeder Relocation ICM should not be approved as it could be managed within Alectra Utilities existing capital budget.

Effective Date

In the Oral Hearing on December 6, 2018, the OEB stated that it would be helpful for the parties to provide submissions on the effective date of the ICMs. OEB staff notes the application was filed on-time and there were minimal delays by the applicant. OEB staff submits that the effective date for the ICMs should be January 1, 2019. However, in the event that the foregone revenue rate rider results in a fixed rate rider that rounds to zero at the second decimal place or a volumetric rate rider that rounds to zero at the fourth decimal place, in one or more rate classes, Alectra Utilities should forgo the foregone revenue for the following reason.

OEB staff notes that the calculated ICM rate rider will be collected until the next cost of service, which in this case is longer than the typical IRM period. As noted earlier, ICM riders are not adjusted during non-rebasing years to update for components such as net book value. The asset's "rate base" is essentially frozen in time and the utility is in theory over collecting on its return and potentially PILs. This longer period should allow Alectra Utilities to recover the required funding even if Alectra Utilities forgoes the foregone revenue.

All of which is respectfully submitted