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March 1, 2019

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Our Matter Number:

BY E-MAIL AND COURIER

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

Attention: Ms. Kirsten Walli, Board Secretary

Dear Sirs/Mesdames:

Halton Hills Hydro Inc. (EB-2018-0328: ICM Application)

We are counsel to Halton Hills Hydro Inc. ("HHHI"). In accordance with Procedural Order No. 1 in the above-noted proceeding (issued on January 16, 2019), please find attached the written reply submissions of HHHI. This cover letter and reply submission will be filed on RESS today, and delivered to intervenors via email copy.

Sincerely,

Richard J. King

c: Richard Lanni (OEB)
Jerry Wang (OEB)
Intervenors in EB-2018-0328

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (as amended) ("**OEB Act**");

AND IN THE MATTER OF an application by Halton Hills Hydro Inc. to the Ontario Energy Board for an Order or Orders approving or fixing just and reasonable rates and other charges for electricity distribution to be effective May 1, 2019.

REPLY SUBMISSIONS OF HALTON HILLS HYDRO INC.

A. Introduction

Halton Hills Hydro Inc. ("**HHHI**") makes these reply submissions in support of its application to the Ontario Energy Board (the "**Board**" or "**OEB**") to recover, through an incremental capital module ("**ICM**"): (a) the incremental revenue requirement associated with the construction of HHHI's new municipal transformer station ("**TS**"); and (b) the incremental annual operating, maintenance and administration ("**OM&A**") costs of $131,515 associated with the new TS.

In responding to Board Staff, the Vulnerable Energy Consumers Coalition ("**VECC**") and the School Energy Coalition ("**SEC**"), HHHI has focused these reply submissions on the two key issues at play in this proceeding, namely:

- whether the evidence on the record in this proceeding is sufficient to demonstrate that the TS cost was prudent; and

- whether HHHI should be entitled to the OM&A costs associated with the TS.

The other issues required to be evaluated in an ICM application (i.e., project need, utility means, and materiality) were not contested by Board Staff, VECC or SEC, so these reply submissions provide only a very brief summary of these issues. Further, we will not repeat the factual and regulatory background to the TS project – this has been fairly and accurately captured in the "Background" section of Board Staff's submission.[1]

[1] Board Staff Submission, pp. 2 to 4.

The TS project was a significant undertaking for HHHI – and its commissioning this spring represents the culmination of a very long process of study, assessment, government relations, engineering and design work, negotiations with Hydro One and TransCanada, and ultimately construction and commissioning. HHHI believes that, at all times, it has held its ratepayers' interests paramount – balancing the need for capacity and reliability with the need to minimize costs. Not the least of this was working with the provincial government for a regulatory amendment to avoid the cost of having to run a transmission line under Highway 401 in order to connect the proposed TS to the IESO-controlled grid. The existing regulatory regime effectively prevented HHHI from achieving such savings, so HHHI worked with the provincial government to make a regulation that permitted the TS' current configuration vis-à-vis the IESO-controlled grid. This effort was not easy – and the net result was to the sole benefit of ratepayers (in the form of a lower rate base) not HHHI. While this is what any responsible utility should do (i.e., make real efforts to achieve savings), HHHI reminds the Board of this because it is indicative of HHHI's efforts to carry out the TS project in a prudent and cost-effective manner.

B. ICM Requirements

HHHI submits that its requested ICM satisfies the eligibility criteria of materiality, need and prudence 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**").

Materiality

HHHI accepts the submissions of Board Staff as an accurate and fair characterization of this criterion.[2] HHHI takes no issue with Board Staff's recalculation of the materiality threshold.[3] SEC agrees with Board Staff that the TS project meets both the materiality threshold in the Board's ICM formula, and the project-specific materiality test in the ACM Report.[4] VECC also agrees that the TS project meets the materiality criteria.[5]

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[2] Board Staff Submission, pp. 3 to 5.

[3] Board Staff Submission, p. 4.

[4] SEC Submission, p. 2.

[5] VECC Submission, pp. 1 to 2.

Need/Means

HHHI accepts the submissions of Board Staff as an accurate and fair characterization of this criterion.[6] SEC agrees with Board Staff that the TS meets the need requirement, and further notes that: "The evidence does demonstrate that the new TS is required to provide additional capacity to serve the growing load in Halton Hills", and makes reference to the TS being referenced by the IESO as a preferred option in the IESO's Northwest Greater Toronto Area Integrated Regional Resource Plan.[7] VECC also agrees that the need/means test is met.[8]

Prudence

HHHI accepts the submissions of Board Staff as an accurate and fair characterization of this criterion, and Board Staff's recommendation that the new TS be deemed a distribution asset pursuant to section 84(a) of the OEB Act. Board Staff recommends that the OEB approve the incremental capital amount of $23,476,441, and Board Staff submits that HHHI has correctly calculated the incremental revenue requirement of the new TS to be $1,698,085.

SEC's submission on prudence is not related to the TS' location, configuration, or HHHI's selection of the TS from among the various alternatives considered by HHHI to meet the capacity need. SEC's concern appears to focus solely on the specific capital cost of $23,476,441. In SEC's view, there is insufficient evidence to support this amount. SEC points to two factors in particular that underpin its argument: First, SEC states that the capital amount being request is more than previous forecasts. Second, SEC states that there is no benchmarking analysis to facilitate a cost comparison to similar projects. For these reasons, SEC suggests that the Board defer its determination on prudence until HHHI's next rebasing, and either: (a) approve the ICM on an interim basis; or (b) create a variance account to capture the difference between what is included in the ICM and what is determined to be recoverable following the prudence review in HHHI's next rebasing application. VECC agrees with SEC's submissions and supports the variance account option.

HHHI disagrees entirely with the submissions of SEC and VECC that there is insufficient evidence on the record to support the capital cost of the TS. Specifically, HHHI points to the following evidence in this proceeding:

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[6] Board Staff Submission, pp. 5 to 6.

[7] SEC Submission, p. 2.

[8] VECC Submission, p. 2.

- *Competitive Procurement*: All major equipment, as well as consulting, engineering and construction services were purchased through competitive Request for Proposal ("**RFP**") processes. Invitations were extended to entities based on three factors: (a) consultant and design engineer recommendations; (b) prior experience with electricity distributors; and (c) industry reputation. Bids were evaluated based on a scoring matrix that included: (a) relevant experience; (b) ability to meet the technical requirements; (c) reputation; and (d) price. For major equipment bids, the evaluation process involved not only HHHI staff, but also an independent design engineer and a project consultant, with final approval by HHHI executives and the HHHI Board of Directors. Successful proponents were asked to find cost efficiencies wherever possible.[9]

- *Joint Purchasing of Major Equipment*: The two largest equipment purchases (power transformers and gas insulated switchgear) were purchased through a joint purchase agreement with another distributor that was also constructing a transformer station. This joint purchasing arrangement yielded a 1% savings on the cost of the transformers and a 3% savings on the cost of the switchgear. Together, this resulted in a cost savings of $74,504.32 for the TS project.[10]

- *Manufacturer-Direct Purchasing*: HHHI saved a further $22,000 by working directly with cable manufacturers to bypass a minimum order requirement and purchase the 230 kV cable required for the transmission connection.[11]

- *Benchmarking*: Similar sized stations recently built in Ontario have required similar amounts of capital. For instance, Hydro Ottawa built and completed the Terry Fox Municipal TS in 2013 for $22 million. The Terry Fox Municipal TS is also a 230 kV to 27.6 kV station with 100 MVA of capacity.[12]

- *Site Alternatives*: The evaluation of site options incorporated an economic component, related to the total cost for completion (design and build) of the TS. As stated in the evidence: "HHHI chose Option 2C as the least cost option …" in part because of "[c]ost savings compared to building a new transmission connection crossing the 401" and "cost savings related to land purchase." [13] HHHI estimates the incremental costs savings with

[9] Application and Evidence, pp. 7, 8 and 16.

[10] Application and Evidence, p. 16.

[11] Application and Evidence, pp. 16 to 17.

[12] Board Staff Submission, p. 8 and footnote 19.

[13] Application and Evidence, p. 14 to 15; and Staff IR-7.

locating at the current site (as compared to others) range from $1,744,000 to $14,365,000.[14]

- *Government Relations*: As noted above, the existing regulatory regime effectively prevented HHHI from locating and configuring its facility in a way that avoided tunnelling under Highway 401. In order to achieve the cost savings associated with avoidance of the tunnelling, HHHI had to approach and work with government to obtain several statutory exemptions. This process took some time, but ultimately resulted in O. Reg. 219/13, section 1 of which deals solely with the previously existing transmission line under Highway 401 (connecting the Halton Hills Generating Station ("**HHGS**") to the IESO-controlled grid). That regulation provided an exemption from sections 57(b), 71, 78, 80, 81 and 86 of the OEB Act.[15] To obtain the benefit of this exemption, HHHI had to work with the owners of the HHGS and enter into a connection agreement in a form satisfactory to the Ontario Energy Board.[16]

- *IESO Regional Plan*: The IESO's Northwest Greater Toronto Area Integrated Regional Resource Plan indicates that avoiding having to tunnel underground saved an estimated $2 million per feeder. Further, the IESO Working Group recommended the current location and configuration based on an economic analysis.[17]

- *Aligned with Previous Cost Estimates*: At its last rebasing in 2016, HHHI estimated the capital cost of the TS at $19 million. This was a relatively rough forecast – and as explained at the time, HHHI chose not to bring forward the TS project as an ACM at its last rebasing precisely because the "budgetary numbers were still very preliminary and not sufficiently robust for the inclusion in the [Distribution System Plan]." Further, that $19 million figure was in 2014 dollars which is the equivalent of $21,887,000 (in 2018 dollars). A subsequent independent consulting engineer's budget estimated the cost of the TS project at just over $25 million. So this is not a case of a project running over budget – quite the opposite. This is a case of a project managed in a cost-effective

[14] VECC IR-7.

[15] Application and Evidence, p. 5.

[16] See section 4.0.2.1(1) to (3) of O. Reg. 161/99, made by section 1 of O. Reg. 219/13. Also see VECC IR-4 and Appendix IRR-G.

[17] Application and Evidence, Appendix C, pp. 32 and 63 (of 79).

manner to ensure final costs were in line with cost estimates generated throughout the project's development.[18]

- *Board Oversight*: The TS Project not only involved diligent management to ensure its actual costs tracked budgetary estimates, but it was subject to constant oversight by the HHHI Board of Directors. From the beginning of 2014 through to the end of 2018, the TS was discussed as an agenda item at 25 HHHI Board of Directors meetings.[19]

HHHI submits that there is an abundance of evidence on the record with respect to the specific cost of the TS. It is not clear what else HHHI could provide the Board, quite frankly. HHHI sees no reason to defer the prudence determination to HHHI's next rebasing application. A further deferral is not necessary, and HHHI submits that the prolonged uncertainty associated with the recovery of these costs would not be fair to HHHI.

C. Recovery of OM&A

As noted, HHHI is requesting $131,515 per year in OM&A costs related to the ICM. HHHI acknowledges that incremental OM&A is not typically requested and granted in ICM applications. However, the Board has indicated in the recent Festival Hydro decision[20] that a distributor is not prevented from requesting OM&A costs in an ICM application.

In that case, Festival Hydro sought to recover $634,496 in additional costs as a result of reconciling its forecasted costs (approved in its 2013 ICM application to construct a new TS) with the actual costs it incurred (i.e., Festival Hydro sought to true-up its forecast and actuals associated with an earlier ICM). Of the $634,496 sought to be recovered, $244,815 consisted of incremental OM&A costs from prior years 2013 and 2014. Importantly, and unlike this application, Festival Hydro did not request deferral account treatment before these costs were incurred. As a result, the OEB ultimately found these costs out of period and non-recoverable from ratepayers on the grounds that the OEB did not have an opportunity in the ICM proceeding to consider cost recovery of incremental OM&A costs associated with the new TS (i.e., recovery would amount to retroactive ratemaking).

Based on the Festival Hydro case, HHHI is requesting recovery of the forecasted OM&A amount associated with the TS – and is doing so prior to such costs being incurred. In the alternative,

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[18] Staff IR-4, Staff IR-5, and Appendix IRR-B (which shows the budget and actual cost forecasts and expenditures from 2007 to 2019.

[19] Appendix IRR-J.

[20] EB-2014-0073, *Festival Hydro Distribution Rates 2015*, April 30, 2015.

HHHI requests the Board's approval to establish a deferral and variance account to track the OM&A costs through to HHHI's next rebasing application, for determination at that time.

HHHI believes that there are important reasons for allowing recovery of the OM&A costs associated with the TS.

First, there is no sound policy basis for denying OM&A for needed and prudent capital projects. The TS is a significant capital project – and a necessary one to ensure available capacity and reliability for HHHI's current and future customers. The TS asset will increase HHHI's 2016 Board-approved rate base by 38%.[21] If a utility needs to augment its system for supply or reliability reasons between re-basing applications, and that materially increases the utility's OM&A expenses, it is reasonable to expect the recovery of the resulting incremental OM&A expense.[22] HHHI submits that the Board's recognition in the Festival Hydro case that appropriate OM&A costs could be brought forward in ICM applications recognizes this principle.

Second, HHHI's existing OM&A budget is tight. In the past three years, OM&A expenses have exceeded its Board-approved amounts by:

- $117,843 (or 1.96%) for 2016
- $86,478 (or 1.44%) for 2017
- $68,172 (or 1.13%) for 2018[23]

The forecast for 2019 is materially worse, with an exceedance of $231,340 (or 3.85%) over HHHI's Board-approved OM&A. What is notable about the actual exceedances is the consistency of the numbers – which HHHI submits is indicative of the fact that there appears to be little room to "absorb" any other material OM&A costs. HHHI's OM&A spending is remarkably flat in recent years, suggesting that the "true" OM&A costs of the utility are in the $6.1 to $6.2 million range. Adding a further $131,515 in OM&A associated with the TS would more than double the exceedances, raising them to between 3.3% and 4.2% range (or 6% range for the budgeted 2019 number). This is difficult for HHHI to manage.

Third, HHHI is not in an overearning position. In fact, HHHI has consistently underearned (relative to the Board's deemed return on equity ("**ROE**")) in recent years. In 2015, 2016 and 2017, HHHI's actual ROE was 6.70%, 6.76% and 6.98%, which represents an underearning (on average) of 225 basis points.[24] Adding $131,515 in costs to the HHHI's operations will

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[21] Application and Evidence, Appendix B.

[22] Staff IR-1, part a.

[23] HHHI is forecasting an increased exceedance in 2019 (of 3.85%). See Staff IR-1, repeated at Board Staff Submission p. 9.

[24] Application and Evidence, p. 11. Also see Table 1 in Board Staff Submission, p.6.

perpetuate or exacerbate the underearning – for no good reason (and in fact, for very good reasons – planning for and ensuring adequate capacity in the medium- to long-term).

Fourth, HHHI is already efficient. HHHI is one of only six Ontario electricity distributors in Efficiency Group 1 in the annual Pacific Economics Group Report (commonly referred to as the PEG Report). The year 2019 marks the sixth consecutive year that HHHI has been in Group 1 for efficiency.[25] There is, simply put, no room in HHHI's OM&A cost envelope to absorb an additional 2.2% of OM&A expenses.[26]

Fifth, while the TS is being built to meet new incremental load (with additional revenues), that load will show up later – not in the initial years of the TS' operation (i.e., not until after the next rebasing anyways). In the next few years, the OM&A costs associated with the TS will be real, but there will be no offsetting revenues.[27]

Finally, HHHI disagrees with Board Staff's view that HHHI has enjoyed increased revenues as a result of its IRM applications, and those additional revenues will allow HHHI to absorb the incremental OM&A costs associated with the TS. In Table 3 of its submission, Board Staff has calculated a "Price Cap Index Adjusted OM&A" which adjusts HHHI's Board-approved rates by HHHI's annual price cap index ("**PCI**"). The Table shows HHHI's annual OM&A cost increasing from $6,007,592 (in 2016, its last rebasing year) to $6,288,125 (in 2019). Board Staff points to this to support its argument that "Halton Hills Hydro should be able to absorb increases in OM&A spending up to the amounts shown in Table 3 using the extra revenue generated by the increased distribution rates." With respect, this argument is without merit. The PCI adjustments are meant to account for inflation in the years between rebasing applications. It is based on real inflation factors – which reflect HHHI's real cost to purchase goods and services. The PCI adjustments do not result in "extra money" for HHHI to be spent on additional OM&A.

For these reasons, HHHI believes that it should be entitled to recover its incremental OM&A associated with the TS, and that there is no sound policy or rate-making basis for denying such recovery. The fact that OM&A recovery is not typically available in an ICM application is not an acceptable rationale for imposing unrecoverable but valid OM&A costs on a utility that is efficient, already constrained in its OM&A budget, and underearning. A utility should not be punished for properly planning and executing a needed, material capital project simply because the in-service date is between re-basing applications. The Board clearly indicated its willingness

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[25] Staff IR-1, part a.

[26] The figure 2.2% is simply the forecasted OM&A being requested ($131,515) as a percentage of the Board-approved OM&A.

[27] SEC IR-4.

to consider OM&A expenditures in ICM applications. HHHI submits that this case represents a proper test case for the issue. Unlike Festival Hydro, HHHI is bringing forward its request for OM&A recovery in the ICM application, so retroactivity is not an issue. HHHI's existing OM&A budget is already tight, HHHI is not in an overearning position, there is no sound basis for denying OM&A for needed and prudent capital projects, HHHI is among the most efficient distributors in the province, and no incremental revenues will offset the OM&A costs in the next couple of years. In HHHI's view, all of these reasons support the reasonableness of HHHI's request.

D. New Deferral and Variance Accounts

HHHI accepts the submissions of Board Staff on this issue and will utilize generic 1508 sub-accounts for approved ICM amounts (capital expenditures, depreciation expense, rate riders and carrying charges as listed in the ACM Report and the subsequent Filing Requirements).

If the Board approves HHHI's request to recover incremental OM&A associated with the TS, HHHI hereby requests a new 1508 sub-account to track such costs for true-up at HHHI's next rebasing application. If the Board instead defers a determination on the incremental OM&A issue, HHHI requests Board approval to establish a deferral and variance account to track incremental OM&A costs for determination at HHHI's next rebasing.

E. Summary

In summary, HHHI submits that it has met the materiality, need and prudence criteria for an ICM, and ought to be permitted to recover the incremental revenue requirement related to the construction of its new TS. Neither Board Staff nor the intervenors denied that the need and materiality criteria were satisfied.

Board Staff agrees that HHHI has met the prudence criterion, and recommends that the OEB Panel approve the incremental capital amount of $23,476,441, and the incremental revenue requirement of $1,698,085. Only SEC and VECC took issue with the prudence criterion, and even then, solely on the specific capital cost amount – on the basis of insufficient evidence. HHHI strongly disagrees with SEC and VECC on this point, for reasons beginning at page 3 of this reply submission. The record in this proceeding demonstrates that the planning, development and construction of the TS involved what the Board would typically require to demonstrate specific capital cost prudence: (a) competitive RFPs for major equipment purchases, engineering and design services, etc.; (b) benchmarking (namely, a similar TS constructed for a similar total cost); (c) opportune purchasing (via joint purchasing of major equipment and manufacturer-direct purchasing to achieve better pricing); and (d) diligent cost oversight (via incorporating economic considerations into the alternatives assessment, managing the project within budget estimates, and constant Board of Director oversight). It also involved innovative cost saving initiatives (via pursuing regulatory change) to save HHHI millions of dollars.

Further, HHHI submits that there are good reasons to allow HHHI to recover its incremental annual OM&A of $131,515 associated with the construction of the TS until its next rebasing application. These are set out in section C of this memorandum. HHHI urges the Board to consider the typical practice of treating requests to recover OM&A in ICM applications as an exception. In HHHI's view, this is misguided policy and unfair to utilities. If anything, the exception should work the other way – utilities that are inefficient, in an overearning position and coming in under-budget on their OM&A spending might be denied funding – but not utilities in HHHI's position. These capital investments are needed, and there are real costs associated with their operations and maintenance.

Finally, HHHI asks that the Board approve its request under section 84(a) of the OEB Act to deem the TS to be a distribution asset, and its request to approve any deferral and variance accounts necessary to give effect to its determinations herein.

ALL OF WHICH IS RESPECTFULLY SUBMITTED,
this 1st day of March, 2019, by its counsel,

OSLER, HOSKIN & HARCOURT LLP
Per: Richard J. King, Partner

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