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Ontario

BY E-MAIL

April 25, 2019

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Hydro One Networks Inc.
Application for Rates
OEB File Number EB-2017-0049

Please find attached OEB staff's submission on the draft rate order filed by Hydro One Networks Inc.

Original Signed By

Martin Davies
Project Advisor, Rates
Major Applications

2018 - 2022 ELECTRICITY DISTRIBUTION RATES

Hydro One Networks Inc.

EB-2017-0049

ONTARIO ENERGY BOARD

STAFF SUBMISSION ON DRAFT RATE ORDER

April 25, 2019

INTRODUCTION

Hydro One Networks Inc. (Hydro One) filed a five-year Custom Incentive Regulation (Custom IR) application with the Ontario Energy Board (OEB) on March 31, 2017 with subsequent updates under section 78 of the *Ontario Energy Board Act, 1998,*[1] seeking approval for changes to its distribution rates, to be effective January 1, 2018 to December 31, 2022 (the application).

On April 5, 2019, Hydro One filed a draft rate order (DRO) pursuant to the Decision and Order (Decision) dated March 7, 2019.

The Decision found that the effective date of Hydro One's rate order would be May 1, 2018 with an implementation date of July 1, 2019.

OEB staff's comments on the DRO follow.

Capital Expenditure Reductions

Background

In the Decision, the OEB made the following findings regarding capital expenditure reductions:[2]

> The OEB will impose an overall reduction in the proposed total capital for the 5-year period of $300 million (from $3,573.3 million to $3,273.3 Million), representing an 8.4% reduction. …
>
> This $300 million reduction does not include pension-related reductions ($20 million in 2018) which are discussed under Issue 38 or reductions related to the HOAA ($3.6 million in 2018) which are discussed under Issue 42.
>
> The OEB will not break down this reduction by the areas identified under Issue 30, nor will the OEB dictate how this reduction is applied at the program and project level. Hydro One is in the best position to utilize its prioritization and optimization tools to accommodate this reduction. However, the OEB expects Hydro One to explicitly address the issues that are raised in this Decision and Order in determining how to accommodate this reduction. Also, as directed under the Historical Cost Performance section on page 74 of this Decision and Order, Hydro One is to report to the OEB the revised capital program as part of its first annual update rate application, and to provide a detailed status report as part of the next rebasing rate application. The OEB will not re-adjudicate the appropriateness of the quantum of the revised capital program. As an interim step, Hydro

[1] S.O. 1998, c.15 (Schedule B).
[2] p. 76.

> One is directed to propose a preliminary annual distribution of the capital reduction over the term of the Custom IR plan as part of the draft rate order process of this proceeding.

In its DRO, Hydro One stated the following regarding the implementation of this finding:[3]

> Hydro One's requested capital spending of $3,571 million has been reduced to $3,081 million to reflect the Decision through the implementation of: an overall capital reduction to the work program over the five-year test period; a reduction in pension and OPEB costs, part of which is the subject-matter of the Pension Appeal; a reduction to compensation costs of Hydro One's executive leadership team as proposed by Hydro One and accepted in the Decision; and reduction in capital associated with the proposed integration of the Acquired Utilities in 2021 and 2022, which was denied.

Discussion and Submission

OEB staff submits that the information provided by Hydro One in the DRO on the capital reduction is inadequate, as it is neither sufficiently complete nor clear enough to explain satisfactorily how Hydro One has complied with the direction provided by the OEB in the Decision. As such, this information is also inadequate to form a basis for comparisons and tracking of changes necessary for the detailed status report which is to be provided as part of the next rebasing application.

OEB staff notes, in support of this view, that in the DRO Hydro One has included two high level tables: "Table 3 – Proposed Capital Spending Summary ($millions)"; and "Table 4 – Proposed In-Service Capital Additions Summary ($millions)." There are no detailed explanations as to how these tables relate to each other, or any continuity schedules which would indicate exactly where the adjustments have been made. The key information provided in these two tables is summarized in the table prepared by OEB staff below:

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[3] p. 12 (footnotes removed).

Hydro One Capital Expenditures ($ millions)									
	Capital Spending Table 3					In-Service Additions Table 4			
	As Filed	Decision	Yearly Change	Total Change		As Filed	Decision	Yearly Change	Total Change
2018	624.5	564.5	60	60		631.5	627.8	3.7	3.7
2019	732.7	617.1	115.6	175.6		751.5	556.5	195	198.7
2020	695.6	655.3	40.3	215.9		744.8	676.8	68	266.7
2021	697.8	634.4	63.4	279.3		691.5	711.7	-20.2	246.5
2022	783	609.9	173.1	452.4		771	616.8	154.2	400.7
Total	3533.6	3081.2	452.4			3590.3	3189.6	400.7	

OEB staff further notes that the high level information provided by Hydro One in Tables 3 and 4, as summarized above, raises questions that are not answered in the DRO as to how Hydro One has complied with the Decision's mandated $300 million capital cut, exclusive of reductions related to pensions and the Hydro One Accountability Act (HOAA). The overall capital reduction arising from the cuts made by Hydro One is $452.4 million. Hydro One has not provided an explanation as to how this cut complies with the direction in the Decision and OEB staff submits that it should do so. The in-service additions total $400.7 million, a difference of over $50 million from the capital cuts over the five-year period and Hydro One has also not provided an explanation for this differential which OEB staff submits it should also do.

In the DRO, Hydro One included in its explanation of its approach to the capital reductions the following explanation:[4]

> Consistent with the OEB's findings, the capital reductions are focused mainly on the System Renewal category. The increase in System Service spending reflects development projects which are largely non-discretionary and are required to comply with the Distribution System Code (such as: feeder development in Leamington area to address increasing demand).

OEB staff notes that the System Renewal investments have been reduced by 33% over the five year period to address the OEB's mandated capital reduction, while the System Service investments have increased by 44% over the same time period. OEB staff observes that this increase in System Service investments would appear to represent the introduction of new evidence by Hydro One in the DRO phase of the proceeding which OEB staff submits is not appropriate as

[4] P. 13 (footnotes removed).

parties were not provided with an opportunity to test this evidence during the proceeding.

OEB staff also notes that Hydro One did not provide further explanations of the cuts and increases which were made and OEB staff submits that the above explanations are not sufficient. For instance, OEB staff believes that Hydro One should explain why it was not able to anticipate the increases related to the above-referenced feeder development in the Leamington area as this would appear to be the type of project that could have been anticipated at the time of the application.

OEB staff also submits that Hydro One should provide more details on the significant reduction in the System Renewal investments and how this reduction was effected. OEB staff believes that Hydro One should provide a discussion of the reliability impacts, if any, of the proposed cuts and how the cuts were undertaken to minimize any impacts on reliability. OEB staff is concerned that if there is a reliability impact of any significance, this could result in a large increase in proposed system renewal spending in the future.

OEB staff believes Hydro One should discuss these kinds of impacts in the context of the OEB's findings in the Decision on Issue 29, where the OEB stated that "Hydro One should attempt to reduce these fluctuations in future plans and also take that into consideration when revising the current plan to accommodate OEB-imposed reductions."[5]

OEB staff is also concerned that it is not clear from the evidence provided in the DRO how the reductions in capital spending have impacted depreciation and submits that these impacts should also be clearly indicated and explained.

OEB staff has additional concerns with respect to the other capital cuts mandated by the Decision. Hydro One stated in the DRO that the pension-related reduction to capital expenditures in 2018 is equal to $17.9 million, instead of the $20 million that was ordered, which reflects actual capital pension contributions made in that year.[6] OEB staff notes that it is not clear from the DRO how this

[5] p. 62.
[6] DRO, p. 12, Footnote 28.

reduction is included within the overall adjustment made to 2018 capital spending. OEB staff submits that Hydro One should also provide a clear explanation as to how the $17.9 million cut which has been made is compliant with the $20 million cut that was ordered by the OEB.

OEB staff also has some other concerns in this area that are discussed in the deferral account section of this submission. OEB staff submits that these concerns provide further reasons why a line-by-line break-out of the adjustments to capital spending that is linked to each of the findings in the Decision is necessary in order to determine that Hydro One has accurately implemented each reduction in capital spending as ordered by the OEB.

Working Capital Allowance

Background

Hydro One had stated in the application that its working capital allowance was 7.7% and this was reflected in the Decision.[7]

Discussion and Submission

OEB staff notes that in the DRO Hydro One is using a 7.9% working capital allowance.[8] OEB staff submits that Hydro One should explain why it is using the 7.9% allowance, instead of the 7.7% allowance that was discussed in the application and approved in the Decision.

Forgone Revenue Calculations

Background

In the Decision, the OEB made the following findings regarding forgone revenue calculations:[9]

> While the OEB is setting May 1, 2018 as the effective date for new rates for Hydro One, rates will not be implemented until July 1, 2019. This means that the incremental base

[7] p. 84.
[8] DRO, Exh. 1.2, p. 1.
[9] pp. 175-176.

> revenue requirement provided by this Decision from May 1, 2018 to June 30, 2019 (14 months) would normally be recovered from ratepayers during the concluding six months of 2019. This may require mitigation to ensure bill impacts are reasonable for all of Hydro One's customer classes.
>
> Hydro One shall provide, as part of the draft rate order (DRO) process, scenarios demonstrating the impacts of both the aforementioned recovery period and other scenarios with the recovery spread over longer periods of time. …
>
> In addition, in order to determine the starting point for Hydro One's first annual update application, as part of the rate order process the OEB will also approve base distribution rates for May 1, 2018, January 1, 2019 and January 1, 2020, if necessary, upon which any rate adjustments would apply. Hydro One shall include a proposal for the base distribution rates for all necessary years as part of the DRO process.

Discussion and Submission

OEB staff notes that Hydro One has provided in the DRO two rate impact/mitigation scenarios, based on a six month recovery period and an 18 month recovery period. The proposed tariff is based on the 18 month period. OEB staff notes, however, that Hydro One did not provide the rate impacts of the six month recovery period, or any discussion as to how the 18 month scenario was determined to be optimal. OEB staff submits that this information would be useful to parties and the OEB in assessing the appropriateness of the proposed 18 month mitigation period. OEB staff further submits that a more detailed explanation as to why the 18 month recovery period was chosen would also be helpful to the OEB in assessing Hydro One's proposal to extend the transition to fully fixed rates by one year as discussed in the DRO.[10]

OEB staff further notes that the Decision stated, as quoted above, that in order to determine the starting point for Hydro One's first annual update application, as part of the rate order process, the OEB would also approve base distribution rates for May 1, 2018, January 1, 2019 and January 1, 2020 if necessary, upon which any rate adjustments would apply. Hydro One was directed to include a proposal for the base distribution rates for all necessary years as part of the DRO process.

However, the only tariff Hydro One has included in the DRO is for July 1, 2019 implementation. Where 2020 rates are concerned, Hydro One states that "The

[10] DRO, p. 25.

proposed 2020 foregone revenue base rates to be approved as part of this DRO will be applied to the final 2020 base rates to be calculated in Hydro One's 2020 annual update application."[11] OEB staff does not believe that the information which Hydro One has provided in the DRO in this area meets the requirements of the Decision and submits that in its reply submission, Hydro One should clarify how it believes the DRO meets the requirements discussed above, or if it agrees that these requirements have not been met, to make any necessary modifications.

Deferral and Variance Accounts

Other Pension and Employee Benefits (OPEB) Costs

Background

The Decision established the deferral account requested by Hydro One to record the OPEB costs included in Hydro One's forecasts that can no longer be capitalized as a result of the ASU 2017-07 standard.[12] Hydro One was instructed to file details of the OPEB costs included in its Operating, Maintenance and Administration (OM&A) and capital forecasts that can no longer be capitalized as a result of the ASU 2017-07 standard. Hydro One filed a Draft Accounting Order for this deferral account as part of the DRO.[13]

Discussion and Submission

OEB staff has no concerns with the Draft Accounting Order, subject to some minor wording changes that it will discuss with Hydro One but not list here.

OEB staff notes that Hydro One was instructed to reduce its 2018 capital forecast to account for the amounts that had initially been capitalized but are now being tracked within this new deferral account. Hydro One has quantified this amount in

[11] DRO, pp. 28-29.
[12] p. 170.
[13] DRO, Exhibit 10.1.

the DRO as $13 million.[14] It is not clear to OEB staff that this amount has been removed from the 2018 capital spending forecast presented in the DRO.[15]

OEB staff submits that this is another reason why, as has been discussed previously in this submission, a line by line break-out of the adjustments to capital spending that is linked to each of the findings in the Decision is necessary in order to determine that Hydro One has accurately implemented each reduction in capital spending as ordered by the OEB.

Disposition Period

Background

Hydro One has assumed a disposition period for deferral and variance account balances (DVAs) of 18 months in the DRO which matches up with the forgone revenue recovery period. Hydro One had proposed that the DVAs would be disposed over a one-year period, which was referenced in the Decision,[16] although the OEB did not specifically opine upon it.

The Decision ordered Hydro One to return 50% of the $121.8 million Independent Electricity System Operator (IESO) credit to customers now and the remaining credit when balances are next disposed. Hydro One was also directed to calculate the revised balance with an updated interest projection to June 30, 2019.[17]

Discussion and Submission

OEB staff notes that in the DRO, Hydro One has revised the Deferral and Variance Account disposition amount to include 50% of the IESO credit and interest projected to June 30, 2019 as directed. OEB staff agrees with the revised disposition amount of a $54.5 million credit. OEB staff is of the view that while the Decision did not specifically opine on the disposition period, the implication is that the proposal from Hydro One was approved.

[14] DRO, p. 20 Table 8.
[15] *Ibid*, p. 13.
[16] p. 166.
[17] pp. 167-168.

OEB staff observes that Hydro One appears to be matching the DVA disposition period with the recovery period for forgone revenues. OEB staff is of the view that in the absence of a specific approval of a disposition period in the Decision, this matching may be reasonable depending on what decision the OEB ultimately reaches on the forgone revenue recovery period. OEB staff notes in this context, its concerns expressed earlier in this submission about the information Hydro One has provided in this regard.

However, OEB staff also notes that in the Decision,[18] the OEB stated with respect to the IESO credit that "A credit of this magnitude is unusual and the OEB finds that customers should benefit from a portion of this adjustment as soon as possible." OEB staff is concerned that Hydro One's proposal to return this amount over 18 months rather than the 12 months that had been referenced in the Decision is not in compliance with the finding that customers should benefit from a portion of this adjustment as soon as possible.

Implementation of the Tax Decisions

Background

In the Decision, the OEB required that Hydro One reflect the impact of the OEB's findings in the Tax Savings Determination decision and order,[19] which upheld the OEB's findings in the transmission revenue requirement proceeding decision and order,[20] on the revenue requirement in this proceeding (the tax decisions). The OEB further required that this information be provided in sufficient detail to demonstrate how the findings of the Tax Savings Determination[21] decision and order have been appropriately reflected in the DRO for this proceeding with all necessary supporting documentation.[22]

[18] p. 167.
[19] EB-2018-0269.
[20] EB-2016-0160.
[21] EB-2018-0269.
[22] p. 177.

Discussion and Submission

In the previous transmission proceeding from which the tax decisions had arisen,[23] the OEB had used a methodology which multiplied the 62% benefits follow costs allocation factor in favour of shareholders by the Grossed Up Regulatory Taxes for 2017 and 2018 respectively in order to arrive at the regulatory taxes included in the revenue requirement for each year. This resulted in $51 million and $55 million in regulatory taxes for 2017 and 2018 respectively.[24]

OEB staff notes that the grossed up regulatory tax balance that was used in that calculation for each year represented the regulatory taxes that would have been included in the revenue requirement had the tax benefits from the Initial Public Offering (IPO) been allocated 100% in favour of the shareholder. The calculation discussed in the above paragraph that was used to arrive at the final regulatory tax balance for both 2017 and 2018 was not contested and the resulting regulatory taxes were included in rates approved for the respective years.

Applying the same methodology used in the tax decisions results in a regulatory tax balance for the current proceeding as follows:

	2018	2019	2020	2021	2022
Grossed-up Regulatory Taxes (DRO Ex 1.5) **A**	$72	$76.4	$75.4	$77.1	$85.5
Allocation Factor (DRO, p. 21) **B**	63.8%	63.8%	63.8%	63.8%	63.8%
Regulatory Taxes using methodology from EB-2016-0160 **A x B**	$45.9	$48.7	$48.1	$49.2	$54.5
Regulatory Taxes proposed by Hydro One in the DRO (DRO, Ex 1.5)	$43.1	$50	$51.1	$54.5	$64.5
Difference	$2.8	($1.3)	($3.0)	($5.3)	($10.0)

It is not clear to OEB staff why Hydro One deviated from the methodology of calculating the final regulatory taxes after sharing of the tax benefits from the IPO that was used and not contested in the tax decisions. The revised methodology

[23] EB-2016-0160 *Decision and Order,* November 9, 2017.
[24] *Ibid,* p.14.

used by Hydro One in its DRO results in approximately $16.8 million more in regulatory taxes over the period 2018-2022. OEB staff notes that on an annual basis, this increment is material. Hydro One's distribution materiality threshold is $1 million.

OEB staff submits that the same methodology that was used in the tax decisions should be applied in this proceeding as well unless Hydro One can provide an acceptable explanation for the change.

Fixed and Volumetric Rates

Background

The OEB found that Hydro One's mitigation plan for the DGen rate class was reasonable.[25]

In the DRO, Hydro One stated that it had adopted the alternative approach to phasing-in the change to the fixed charge for the DGen class requested by OEB staff in its submission.[26]

Hydro One stated that for 2018 it proposed to move the DGen Revenue to Cost (R/C) ratio from 58% to 60%, which would bring the R/C ratio towards the OEB's approved range of 80-120%, while ensuring that the total bill impact for an average DGen customer does not exceed 10%. For 2019, Hydro One proposed moving the DGen R/C ratio to 63%, while also continuing to keep the total bill impact for a DGen customer below 10%. Similarly, for 2020, Hydro One proposed moving the R/C ratio to 78% while maintaining total bill increases below 10%.

Discussion and Submission

OEB staff has a concern with Hydro One's approach to this matter. OEB staff observes that in calculating 2019 and 2020 R/C ratios Hydro One has used 2018

[25] Decision, p. 16.
[26] DRO, p.26.

costs from the cost allocation model, scaled up to reflect the overall percentage increase in revenue requirement (the rate class maintains a constant percentage share of the total costs). Hydro One is also calculating the revenue at proposed prior year rates times forecasted current year volumes. Therefore, customer growth is reflected in the revenue component, but not the costs component.

OEB staff's concern is that the R/C ratio has still not reached the 80% bottom of the OEB acceptable range at the end of the three year period. OEB staff notes that because customer growth is being reflected in the revenue component, but not the cost component as discussed above, the projected R/C ratio for 2020 of 78% is likely overstated, meaning that Hydro One is further away from achieving the 80% bottom of the OEB acceptable range than this number would suggest.

Acquired Utilities

Background

Hydro One stated in the DRO that the revenue requirement associated with the rate base, incremental OM&A, incremental capital and working capital components for the Acquired Utilities had been removed in 2021 and 2022.[27]

OEB staff notes that SEC, supported by VECC,[28] expressed a concern that Hydro One had provided inadequate information and documentation in the DRO with respect specifically to the question of costs that should not be borne by legacy customers arising from the OEB's findings related to the Acquired Utilities.

Hydro One responded to SEC's concerns[29] by arguing that SEC's request is at odds with the OEB's findings in this proceeding and, as well, the information sought by SEC does not exist. As such, Hydro One stated that fulfilling SEC's request would necessitate the creation of new evidence, based on information that was not on the record in the proceeding which would in turn necessitate a further hearing to review and test the evidence put forward.

[27] DRO. p. 7.
[28] Letters dated April 8, 2019 and April 11, 2019.
[29] Letter dated April 10, 2019.

The OEB issued a letter in response to SEC's request,[30] which stated that the OEB would not require Hydro One to provide the material requested by SEC and VECC at this time. In reaching this conclusion, the OEB stated that as noted in the Decision,[31] the Acquired Utilities are small in comparison to the rest of Hydro One. In addition, Hydro One's proposed integration of the Acquired Utilities, which the OEB rejected, was only for the last two years of the term (2021, 2022). The OEB therefore concluded that it did not consider the magnitude and duration of any impact to legacy customers to be significant enough to incur the additional costs and time delays that would result from granting the requests of SEC and VECC.

Discussion and Submission

On the basis of the OEB letter discussed above, OEB staff accepts the material filed in the DRO by Hydro One on this matter as being adequate for the purposes of establishing a rate order in this proceeding. OEB staff anticipates that in its next rebasing application, Hydro One will provide material necessary to enable the OEB to conduct the detailed examination of cost allocation for the Acquired Utilities contemplated in the OEB's letter.

Specific Service Charges

Background

In the Decision, the OEB stated that it did not approve the proposed increase to the Meter Dispute Charge, as a charge of $290 would make it prohibitive for a customer to question a meter reading. As such, the OEB found that the charge was to remain at $30.[32]

Discussion and Submission

OEB staff notes that on Hydro One's January 1, 2017 tariff, this $30 charge is shown as "Meter dispute charge plus Measurement Canada fees (if meter found

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[30] Dated April 23, 2019.
[31] Decision, p. 24
[32] Decision, p. 149.

correct).[33] However, on the proposed July 1, 2019 tariff included in the DRO, this charge is described as “Meter Dispute Charge Measurement Canada (MC)” and is now “$30.00 plus MC fee.”[34]

OEB staff submits that Hydro One should clarify why the wording related to this charge has been changed in the proposed tariff and why it believes that this change is in compliance with the Decision.

Interim Rates

Background

OEB staff notes that the Panel declared Hydro One’s rates as interim effective January 1, 2018.[35] OEB staff further notes that the panel in the related seasonal rates proceeding directed Hydro One to file an updated report on the elimination of the seasonal class no later than three weeks after the issuance of the final rate order in the current proceeding.[36]

Discussion and Submission

OEB staff submits that as the seasonal rates matter was not considered in the current proceeding because of the separate process previously established, it would be appropriate for Hydro One’s rates to remain as interim until the seasonal rates proceeding has concluded.

Tariff of Rates and Charges

Background

Hydro One filed a 2019 Tariff of Rates and Charges as part of its DRO.

[33] Exh. H1-2-2, Attach. 1, p. 16 Filed: 2017-03-31.
[34] DRO, Exh 9.0, p.14.
[35] *Decision on Issues List, Interim Rates and Procedural Order No. 2*, December 1, 2017.
[36] EB-2016-0315, *Procedural Order No. 2*, April 17, 2019.

Discussion and Submission

OEB staff does not have any substantive concerns with the Tariff of Rates and Charges filed by Hydro One. OEB staff will discuss with Hydro One, but will not list here, any formatting changes to the proposed tariff that it believes are necessary in order for it to conform with the general approach to electricity distributor tariffs approved by the OEB. In the event that Hydro One has any concerns with any of OEB staff's proposed changes, it can set out those concerns in its reply submission.

- All of which is respectfully submitted-