

## **VULNERABLE ENERGY CONSUMERS COALITION (VECC) INTERROGATORIES**

### **M1-VECC-1**

**Reference:** Exhibit M1, Pages 41-45

#### **Interrogatory:**

Please clarify – is PEG suggesting that Hydro One increase its proposed asymmetrical 98% CISVA band to an asymmetrical band of 95%?

**Response to VECC-1:** The following response was provided by PEG.

Please see the response to LPMA-4 (Exhibit L1/Tab 3/Schedule 4) for details of PEG's proposed sharing mechanism.

**M1-VECC-2**

**References:** Exhibit M1, Page 45

**Preamble:**

At the reference below the author makes the following statement:

Hydro One should, in our view, be permitted to keep a share of the value of any capex underspends. This would strengthen the Company's incentive to contain capex (but also its incentive to exaggerate its capex needs). We believe that the Company should be permitted to keep 5% of the value of capex underspends.

**Interrogatory:**

- a) Since there is both an incentive to contain actually capital spending, but also an offsetting incentive to exaggerate capital budgets, what evidence do the authors have that there is a net benefit to the proposal? Specifically, what evidence do the authors have to refute the hypothesis that the net result of a scheme - in which ratepayers pay for 5% of non-built (fictitious) capital - is negative?
- b) If it is true and there is an incentive to exaggerate capex needs can one then presume that the capital expenditure forecasts presented by the Hydro One in this application are inherently too high? If so (or if not) how would that be determined?

**Response to VECC-2:** The following response was provided by PEG.

- a) PEG believes that there can be net benefits from sharing capex underspends with utilities. Incentives to contain capex would be strengthened. Capex savings could lower rates at the next rebasing.

There are some protections for customers. For example, sharing with customers is possible for underspends but not overspends. Commissions have some ability to appraise capex proposals. The OEB, for example, has requested transmission and distribution system plans and has disallowed sizable portions of some recent capex proposals by utilities. Schemes to qualify for extra revenue by needlessly bunching capex can be recognized, through the analysis of historical spending and through testing of 5-year system plans. The OEB can also monitor the tendency of a utility to spend less than its capex proposal, particularly at the time of subsequent periodic applications to rebase rates.

Precedents for such sharing provisions in the regulation of other utilities shed light on their potential merit. PEG has not undertaken a comprehensive survey of approved cost tracker sharing provisions but is aware of several examples. Most notably, this type of incentive mechanism has been approved for capex in jurisdictions that include California, Britain, and British Columbia.

- In BC, at least 5 certificates of public convenience and necessity have been approved for gas and electric utilities which allow the utility to share in capex variances.
- In California, funding mechanisms for build outs of gas and electric automated metering infrastructure have on several occasions included provisions for the utility to share capex variances.
- In Britain, utilities may share in both underspends and overspends of *total* expenditures (aka “totex”) relative to approved amounts. Given VECC’s evident concern about utility exaggerations, it is notable that the utility’s share of expenditure variances is tied to how reasonable the utility’s expenditure forecast is deemed to be by Ofgem. This provision is part of Ofgem’s complicated information quality incentive.

Details of some capital tracker sharing mechanisms can be found in the table below. Sharing mechanisms have also been approved in North America for energy (e.g., generation fuel) procurement and other operating revenues. For example, Portland General Electric receives or pays 90% of the variances outside of a dead band so long as the recovery does not cause the company’s ROE to vary by more than 100 basis points from the allowed ROE. Similar mechanisms were approved for utilities in Missouri, New York, and Washington. It should also be noted that many multiyear rate plans have been approved over the years in which utilities keep the benefits of all capex underspends or share them only through an earnings sharing mechanism.

- b) Despite Hydro One’s incentive to exaggerate its capex requirements it has not necessarily done so. PEG is an expert on incentive regulation and can speak with some authority on the Company’s incentive to exaggerate its capex requirements. However, we were not retained to review the Company’s capex proposal and do not have an opinion on whether it is reasonable.

Regulators in other jurisdictions (e.g., Australia and Britain) use econometric benchmarking and engineering models and retain engineering consultants to appraise utility capex proposals. An econometric capex benchmarking model could include as a variable the share of utility assets exceeding the average service life.

Table VECC-2

**Details of Incentivized Capital Cost Trackers**

<b>Jurisdiction</b>	<b>Company Name</b>	<b>Services</b>	<b>Eligible Investments</b>	<b>Special Treatment of Cost Variances</b>	<b>Case Reference</b>
BC	Terasen Gas (now FortisBC Energy)	Gas	Customer Care Enhancement Project	Customers receive/absorb 100% of variances within 10% of cap; Savings or costs beyond deadband split evenly between customers and company	Order C-1-10
BC	Terasen Gas Vancouver Island (now FortisBC Energy)	Gas	Gas pipeline lateral from Squamish to Whistler	Customers receive/absorb 100% of variances within 10% of cap; Savings or costs beyond deadband split evenly between customers and company	Orders G-53-06, and G-76-06
BC	Terasen Gas Whistler (now FortisBC Energy)	Gas	Conversion of Whistler Gas system from propane to methane, meter/regulating station	Customers receive/absorb 100% of variances within 10% of cap; Savings or costs beyond deadband completely at company's risk	Order G-53-06
BC	BC Gas (now FortisBC Energy)	Gas	Southern Crossing Pipeline Project	Customers receive/absorb 100% of variances within 10% of cap; Savings or costs beyond deadband completely at company's risk.	Order G-51-99
BC	FortisBC	Bundled power service	Big White Supply Project	Customers receive/absorb 100% of variances within 10% of cap; Savings or costs beyond deadband completely at company's risk	Order C-17-06
CA	San Diego Gas & Electric	Power and Gas Distribution	Advanced metering infrastructure ("AMI")	No deadband. Asymmetrical mechanism wherein 90% of the first \$50 million over the cap and 10% of first \$50 million under the cap allocated to shareholders (No prudence review required)	Decision 07-04-043 (April 2007)
CA	Southern California Edison	Power Distribution	Deployment of AMI	No deadband. Asymmetrical Mechanism wherein 90% of first \$100 million over the cap charged to customers (No prudence review required)	Decision 08-09-039 (September 2008)
CA	Southern California Gas	Gas	AMI	Overrun sharing mechanism: Up to \$50 million to be paid by shareholders, calculated as 50% of first \$100 million over total cost; Underrun sharing mechanism: Up to \$10 million to be received by shareholders, calculated as 10% of first \$100 million under total cost.	Decision 10-04-027 (April 2010)

**M1-VECC-3**

**Reference:** Exhibit M1, page 42

**Preamble:**

At the reference below the author make the following statement:

The need for the OEB to sign off on multiyear total capex proposals greatly complicates Custom IR proceedings and is one of the reasons why the Board now requires and reviews transmission business plans - a major expansion of its workload and that of stakeholders. Despite the extra regulatory cost, OEB staff and stakeholders will inevitably struggle to effectively challenge the Company's capex proposal.

**Interrogatory:**

- a) Is it PEG's understanding that the Board approves Hydro One's capital forecast for each of the IRM term years?
- b) Presumably all investments are not equally productive (for example a larger more expensive car may serve the exact function as a smaller less expensive vehicle). The Applicant has presented a certain Transmission System Plan which includes specific projects. In the short term how might the Board best able to determine the extent (if any) of sub-optimal capital substitutions being made after the fact of the rate proceeding? Specifically is it the author's view that the Board should do a retrospective review of capital plans and judge prudence by the degree of adherence to the previously reviewed transmission rate capital plan?

**Response to VECC-3:** The following response was provided by PEG.

- a) PEG's understanding is that the OEB generally approves a capital spending envelope for the term of a utility's Custom IR plan and does not approve individual projects. For example, in the recent Hydro One distribution Custom IR decision, the OEB approved a \$3,273 million capex budget over the term of the Custom IR plan and did not itemize the specific reductions to the company's capex proposal.<sup>1</sup>
- b) PEG believes that the Board should monitor the Company's tendency to spend less than proposed. Spending priorities can change over the course of a multiyear rate plan. However, to

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<sup>1</sup> Ontario Energy Board (2019), Decision and Order in EB-2017-0049, p. 76-77.

the extent that the Company underspends, the impact on maintaining the quality of service is pertinent. The plan includes some provisions to monitor quality.