Ontario Energy Board | Commission de l'énergie de l'Ontario

**BY EMAIL**

November 15, 2019

Christine E. Long
Registrar and Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Long:

Re: **Alectra Utilities Corporation (Alectra Utilities)**
**Application for 2020 Electricity Distribution Rates**
**Ontario Energy Board (OEB) Staff Submission on the M-Factor**
**Board File Number: EB-2019-0018**

In accordance with the Procedural Order No. 1, please find attached OEB staff's submission on the M-factor in the above noted proceeding. Alectra Utilities and all intervenors have been copied on this filing.

Yours truly,

*Original Signed By*

Katherine Wang
Advisor
Incentive Rate-setting and Accounting

# ONTARIO ENERGY BOARD

## OEB STAFF SUBMISSION

## On the M-Factor

## Alectra Utilities Corporation

## 2020 Electricity Distribution Rates

**EB-2019-0018**

**November 15, 2019**

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# 1. Introduction

Alectra Utilities Corporation (Alectra Utilities) filed its Price Cap Incentive Rate-setting application with the Ontario Energy Board (OEB) on May 28, 2019 under section 78 of the *Ontario Energy Board Act*, *1998* (OEB Act) seeking approval for changes to its distribution rates, to be effective January 1, 2020.

In Procedural Order (PO) No. 1, dated July 9, 2019, the OEB determined that Alectra Utilities' application would be processed in three streams, namely the Incentive Rate-setting Mechanism (IRM), a proposal for additional capital funding (M-factor) and the capitalization policy. This submission deals with the M-factor proposal.

Alectra Utilities was formed in 2017 from the amalgamation of four predecessor utilities, namely Enersource Hydro Mississauga (Enersource), Horizon Utilities Corporation (Horizon), PowerStream Inc. (PowerStream) and Hydro One Brampton Networks Inc. (Hydro One Brampton).[1] The newly formed Alectra Utilities went on to amalgamate with Guelph Hydro Electric Systems Inc. (Guelph Hydro) in 2019.[2] The OEB's Decision and Order for the amalgamation application with Guelph Hydro[3] granted approval for the four existing rate zones (i.e. Enersource, Horizon, PowerStream and Hydro One Brampton) to defer rebasing until 2027, and for the Guelph Hydro rate zone to defer rebasing until 2028.

Alectra Utilities filed rate applications for both the 2018 and 2019 rate years, consisting of Custom IR updates for the Horizon rate zone and Price Cap IR adjustments for the remaining rate zones.[4] In the applications, the OEB approved Incremental Capital Module (ICM) funding of $28.79 million and $26.27 million in 2018 and 2019 respectively.

As part of the OEB's Decision and Order for Alectra Utilities' 2018 rate application, the OEB required Alectra Utilities to file a consolidated Distribution System Plan (DSP) with any ICM application requesting rate changes for 2020 rates and beyond.[5] In accordance

[1] The OEB granted approval for the amalgamation of the four predecessor utilities in the Decision and Order for EB-2016-0025.
[2] The OEB granted approval for Alectra Utilities to amalgamate Guelph in the Decision and Order for EB-2018-0014.
[3] EB-2018-0014
[4] EB-2017-0024 / Alectra Utilities 2018 rate application; EB-2018-0016 / Alectra Utilities 2019 rate application
[5] EB-2017-0024 / Decision and Order / April 6, 2018 / p. 29

with that Decision and Order, in the current 2020 rate application Alectra Utilities has filed a five-year consolidated DSP. For reasons that will be discussed in the sections below, Alectra Utilities stated that the ICM mechanism is unable to fund the capital needs contained in its DSP, and proposes an alternate mechanism called the M-factor. As part of its M-factor proposal, Alectra Utilities is seeking OEB approval for five years of M-factor rate riders, along with two new deferral and variance accounts: the Capital Investment Variance Account (CIVA) and the Externally Driven Capital Variance Account (EDCVA). Alectra Utilities calculated the M-factor rate riders based on a total incremental capital need of $265 million over five years with an associated cumulative revenue requirement of $21.8 million.

In accordance with PO No. 1, Alectra Utilities filed its Argument-in-Chief (AiC) regarding the M-factor proposal on November 1, 2019. In the AiC, Alectra Utilities revised its materiality threshold calculation, which increased its unfunded capital from $274.3 million to $370.4 million. Alectra Utilities did not request a change in its M-factor funding to accommodate the change; however, it made a new request for OEB approval to record in its CIVA any capital expenditure amounts that are unfunded through both base rates and the M-factor, for possible future disposition. Alectra Utilities also made additional corrections to its request for the M-factor and the associated CIVA.

Alectra Utilities received interrogatories from eight separate intervenor groups and OEB staff. Alectra Utilities responded to a number of undertakings throughout the technical conference and oral hearing. The amount of evidence filed on the record by Alectra Utilities is not insignificant. OEB staff recognizes the amount of information Alectra Utilities has been asked to provide in response to their unique application and commends Alectra Utilities for filing interrogatories responses on time and providing undertaking responses on a timely basis.

## 2. Summary of Submission

OEB staff's submission is organized into four areas and can be summarized as follows:

- Just and Reasonable rates: the M-factor in the context of OEB policies and rate-setting practices

  The discussion below provides OEB staff's analysis of the M-factor in the context of the OEB's Mergers, Acquisitions, Amalgamations and Divestitures (MAADs) policies, ICM policy, and the OEB's general rate-setting framework. OEB staff's

view is that the proposal for the M-factor and the associated deferral and variance accounts, is not warranted in light of prevailing OEB policies, does not provide for just and reasonable rates, and therefore should be denied.

Although OEB staff is of the view that the M-factor should be denied, should the OEB approve the M-factor, OEB staff submits that there should be revisions to Alectra Utilities' proposal, including to the calculated materiality threshold, the project specific threshold, and the manner in which the discrete criterion is applied. Specifically, OEB staff submits the OEB should make the following changes to Alectra Utilities' proposal:

- Use an inflation factor of 2% for the materiality threshold calculations for all years in this application; this is discussed in section 3.3.
- Reduce the total M-factor funding from $265 to $168 million. This is discussed in section 4.
- Consider making provision for offsets in regards to operations, maintenance and administration (OM&A) savings achieved through the M-factor separately. This is discussed in section 4.5.

- Analysis of Alectra Utilities' capital plan as laid out in the DSP

  Alectra Utilities' DSP forecasts a total capital spend of $1,456.5 million over the 2020-2024 period. In the event the OEB approves incremental capital funding by way of an M-factor, OEB staff is of the view that a reduction in the total capital requirement of $165 million to $1,291 million, resulting in an 11% reduction is appropriate. However, as discussed below, OEB staff submits that Alectra Utilities' capital needs can be addressed by way of certain discrete projects funded through ICMs. OEB staff discusses these projects in section 6.

- New deferral and variance accounts

  The CIVA is an integral part of the M-factor proposal; therefore OEB staff submits that the CIVA should be denied along with M-factor proposal. OEB staff has no concerns with approval of the CIVA in the event the M-factor proposal is approved. With regard to Alectra Utilities' new request in its AiC to record additional "unfunded" projects in the CIVA, OEB staff submits that the evidence is untested and parties have not had a chance to test if Alectra Utilities' request is reasonable. As such, OEB staff submits that, even if the OEB decides to approve

Alectra Utilities' M-factor and CIVA, the request to record additional amounts in this new sub-account of the CIVA should be denied.

OEB staff submits that the EDCVA should also be denied as the OEB has already established the ICM mechanism for incremental capital needs. However, should the OEB approve the M-factor, OEB staff submits that the EDCVA would be appropriate given the manner in which the CIVA will operate.

- Appropriate methods of incremental capital relief for Alectra Utilities

  OEB staff recognizes that Alectra Utilities can reasonably be expected to have incremental capital needs during the remainder of its deferred rebasing period. In accordance with OEB policy, OEB staff submits that the ICM mechanism remains available to Alectra Utilities during the remainder of its deferred rebasing period and would provide adequate incremental capital funding relief. OEB staff provides further discussion on sources of incremental capital funding in section 6.

# 3. OEB Policies and Regulatory Framework

## 3.1 Just and Reasonable Rates

Section 78(3) of the OEB Act provides that the OEB may make orders approving or fixing just and reasonable rates for the distribution of electricity. OEB staff agrees with Alectra Utilities that in carrying out this function the OEB has broad discretion in how to establish just and reasonable rates. In this section, OEB staff discusses what it considers just and reasonable rates for both Alectra Utilities and its customers.

OEB staff agrees with Alectra Utilities that the OEB has discretion to deviate from the OEB's established capital funding policy in establishing rates, but the question is: should the OEB do so? Alectra Utilities' customers are being asked to fund $265 million (and perhaps as much as $370.4 million) for what Alectra Utilities considers DSP capital expenditures not funded by price cap-adjusted distribution rates (the "unfunded" capital)[6] – even though a significant amount of this funding is for projects that would not

[6] OEB staff does not agree with the characterization that this capital is "unfunded" through distribution rates since utilities have the ability and freedom to manage their existing funding envelopes as they see fit. For purposes of this submission however, OEB staff will use the term "unfunded" capital to refer to the total eligible incremental capital envelope that arises out of the difference between Alectra Utilities' annual capital budget forecast and the output of the OEB's materiality threshold formula.

qualify for ICM treatment. This point is important to consider in the context of the OEB MAADs policies[7] that permits shareholders to retain net synergy savings, which in this case is an estimated total of $420 million.[8]

In OEB's staff view, the OEB should not deviate from the established capital funding policy. Just and reasonable rates require consideration not only of a distributor's opportunity to earn a fair return, but must also ensure that customers are "paying no more than what is necessary for the service they receive."[9]

When Alectra Utilities' 2016 MAADs application was submitted to the OEB, Alectra Utilities' predecessor utilities knew or ought to have known that the ability to recover incremental capital during a deferred rebasing period is limited. Specifically, the ICM allows for the recovery of discrete and significant capital projects and the *Report of the OEB: New Policy Options for Funding of Capital Investments: The Advanced Capital Module* (ACM Report) is clear that the ICM is not to be used for expenditures that fit within typical annual capital programs.[10] The ACM Report further states that minor expenditures in comparison to the overall capital budget are not eligible for ICM funding.[11] With these limitations, Alectra Utilities was also aware of the threshold calculation and could therefore forecast an approximate amount of unfunded capital over a deferral period.

In addition, Alectra Utilities would also have been aware of the OEB's revisions to the ICM formula. Overall, in OEB staff's view, these revisions made the prospect of ICM funding more likely, and in some instances, increased the unfunded gap between annual budgets and the threshold calculation. For example, the OEB reduced the deadband, eliminated the non-discretionary criterion and affirmed that consolidated entities should not calculate one combined capital threshold for any ICM requests. The OEB allowed consolidating utilities to maintain separate ICM threshold calculations for the respective legacy service areas despite the fact that the ICM threshold calculation was intended to proxy a cash flow test. These three changes provide, in theory, more flexibility to consolidating utilities for consideration of incremental capital funding requests.

[7] MAADs policies refer to the MAADs report and the MAADs handbook, see footnotes 16 and 26
[8] IRR G-Staff-15
[9] *Ontario (Energy Board) v. Ontario Power Generation Inc*. / 2015 SCC 44 / para. 20
[10] EB-2014-0219 / Report of the OEB: New Policy Options for Funding of Capital Investments: The Advanced Capital Module / September 18, 2014 / p. 13
[11] *Ibid* / p. 17

Alectra Utilities requested, and was granted, a 10 year deferred rebasing period as part of the MAADs application.[12] With a longer deferred rebasing period comes increased risks, including the potential need for more spending on ongoing capital programs during the deferral period than originally expected. Those risks are to be balanced against the opportunity to earn increased shareholder returns through the retention of synergy savings until rebasing and with no earnings sharing with customers for up to five years. While OEB staff acknowledges that Alectra Utilities has kept its customers in mind when developing this proposal,[13] in OEB staff's view, it is both unjust and unreasonable to expect ratepayers to fund virtually all of the "unfunded" capital costs, while at the same time, permitting Alectra Utilities' shareholders to receive all of the net synergy savings[14] until its next rebasing; especially in light of the fact that it is not uncommon for utilities in Ontario to incur some amount of "unfunded" capital[15] over the course of an incentive rate-setting term, and in consideration of the enhancements made to the ICM noted earlier. As OEB staff discusses in later sections, Alectra Utilities' proposals represent a stark departure from OEB policy that is simply not warranted.

As a result, OEB staff submits that the M-Factor proposal should be rejected and Alectra Utilities given two options. First, Alectra Utilities could, with the OEB's approval, make a cost-based application so that it can propose updated capital requirements and, at the same time, the OEB can examine all of Alectra Utilities' costs to establish just and reasonable rates. This would in effect be an allowable early termination of the deferral period as is contemplated in the OEB's *Handbook for Electricity Distributor and Transmitter Consolidation* (MAADs Handbook).[16] OEB staff notes that Alectra Utilities will have fully recovered all transition and transaction costs of the merger and netted a gain of just under $30 million by the end of 2019.[17] OEB staff further submits that such an approach would allow Alectra Utilities the opportunity to earn a fair return but would also ensure that customers pay no more than what is necessary for the service they receive.

[12] EB-2016-0025, EB-2016-0360 / Decision and Order / December 8, 2016
[13] Exhibit 1 / Tab 3 / Schedule 1 / pp. 4-6
[14] This is subject to the earnings sharing mechanism under which Alectra Utilities must share any earnings that are 300 basis points above its regulated rate of return with its customers, commencing in year six of the deferred rebasing period. See EB-2016-0025, EB-2016-0360 / Decision and Order / December 8, 2016 / pp. 18-19
[15] By this, OEB staff means that a utility may, at some point, and temporarily, incur some capital expenditures to serve customers for unanticipated (or accelerated) capital projects beyond what is factored into distribution rates. However, the utility has ability to incur and manage the costs in the short-term without financial impairment, and the utility's ability to recover the costs, including the opportunity to earn its approved return on equity, on a longer horizon is not adversely or materially impacted.
[16] Handbook for Electricity Distributor and Transmitter Consolidation / January 19, 2016 / p. 13
[17] Oral hearing / Vol. 3 / p. 165; IRR G-Staff-15

Second, Alectra Utilities could request funding for projects that meet the ICM criteria of materiality, need and prudence.[18] OEB staff notes that there are a number of projects in the M-factor list that may qualify for ICM funding, and as such expects the actual amount of unfunded capital to be lower than $370.4 million.

OEB staff acknowledges that, without more experience with long deferral periods, it is difficult to assess for certain whether the current capital funding policy sufficiently balances the interests of both customers and shareholders. Alectra Utilities was one of the first consolidated utilities to choose the maximum allowable deferral period after it was extended to 10 years. In Alectra Utilities' case, however, the evidence provided, including evidence on reliability and utility financial health as will be discussed further below, is not persuasive that the OEB's existing policies are not sufficient to fund Alectra Utilities' capital requirements.

### 3.2 MAADs Policies

OEB staff submits that any deviation from the OEB's MAADs policies requires detailed review to ensure the resulting rates remain just and reasonable. OEB staff discusses below why the M-factor proposal is not in accordance with the OEB's MAADs policies, and why it would not result in just and reasonable rates.

*Is the M-factor appropriate in light of the OEB's MAADs policies?*

Alectra Utilities stated numerous times that the M-factor is not an ICM, and OEB staff agrees.[19] The M-factor is in essence a capital budget 'top-up' or a 'capital rebasing'. OEB staff submits that this is diametrically opposed to the intent of the deferred rebasing period in an incentive rate-setting regime, as is discussed below.

Initially, Alectra Utilities requested $265 million M-factor funding based on a $274.3 million difference between its calculated capital funded through base rates over five years and its forecasted capital budget as per the DSP.[20] This request was revised in Alectra Utilities' AiC. In addition to $265 million to be recovered through M-Factor rate riders, Alectra Utilities is now also asking to:

[18] ACM Report / pp. 12-13
[19] Oral Hearing / Vol. 1 / p. 20
[20] Exhibit 2 / Tab 1 / Schedule 3 / p. 13 / Table 4

- Increase the amount of unfunded capital to $370.4 million to reflect corrections made to the growth factor calculations.[21]
- Record, in a separate sub-account of the proposed CIVA, the revenue requirement associated with DSP projects other than the 203 M-factor projects for which the revenue requirement is not fully funded by base rates,[22] for potential disposition at the end of the five year DSP term.[23]This addresses the change in the amount of unfunded capital identified in the bullet above.
- Fix the inflation rate at the five-year historical average, and thereby the PCI (for both price cap-adjusted distribution rates and the ICM materiality threshold), for the five-year period 2020-2024.[24]

If approved, the current M-Factor proposal would ensure, subject to the $9.3 million cap for the M-factor CIVA sub-account and any subsequent prudence review for CIVA balances, full funding for the annual capital budget for all projects in the DSP.[25] It would also be a departure from the annual price cap adjustment to rates. Taken together, OEB staff submits that Alectra Utilities is essentially asking to convert to a Custom IR plan during its deferred rebasing period, but without having to rebase rates.

In the *Report of the Board Rate-Making Associated with Distributor Consolidation* (MAADs Report),[26] in addition to lengthening the allowed deferred rebasing period to ten years, the OEB clarified which incentive rate plan would apply to distributors who are party to a MAADs transaction during any deferred rebasing period after the distributor's original IR plan is complete. They are as follows:

[21] AiC / p. 5
[22] Alectra Utilities claims that the work identified for the M-factor are all 'projects'. As will be explained later in the submission, OEB staff does not believe that all 203 'projects' qualify as projects under the ICM criteria of discrete projects. For consistency with the application, this submission will use the term 'projects', but this should in no way be taken to imply that OEB staff accepts that all of the 203 projects listed would qualify as ICM projects.
[23] This is discussed in greater detail in section 5.1 below
[24] AiC / p. 23
[25] This amount is the difference between the $274.3 million (itself calculated as the difference between the full DSP capital budget for 2020 to 2024 of $1,456.5 million and the $1,182.2 million that Alectra Utilities estimated based on using the ICM model for each of its five rate zones and the 2019 inflation index of 1.5%) and the $265 million that Alectra Utilities estimated as the capital budget for the 203 M-factor projects. The calculation of the $274.3 million is shown in Exhibit 2 / Tab 1 / Schedule 3 / p. 13 / Table 4.
[26] EB-2014-0138 / Report of the Board: Rate-Making Associated with Distributor Consolidation / March 26, 2015

- A distributor on Price Cap IR or Annual IR, whose plan expires, would continue to have its rates based on the Price Cap adjustment mechanism or Annual IR index during the remainder of the deferral period.
- A distributor on Custom IR, whose plan expires, would move to having rates based on the Price Cap IR adjustment mechanism, during the remainder of the deferral period.[27]

The OEB determined that providing an extension of the allowed deferral period, up to 10 years after the closing of the transaction, would address distributors' key concern that it may take anywhere from six to ten years to reach the break-even point where cumulative savings exceed cumulative acquisition and integration costs.[28] Requiring a distributor to adopt an incentive rate setting framework that decouples costs from revenues encourages it to continue to find greater economic efficiencies that can be passed onto the ratepayers when the deferral period ends.

Alectra Utilities' revised proposal to additionally record unfunded capital revenue requirements for non-M-factor projects in the CIVA, to track the variance between the actual revenue requirement and rate rider revenues for M-factor projects, and to fix the inflation index at the five-year historical average for all years of the 2020-2024 period covered by the DSP, supports Alectra Utilities' intention to fully fund all capital projects in the DSP at a 2.15% capital inflation factor assumed by Alectra Utilities.[29]

OEB staff submits that approval of the M-factor, which essentially 'tops-up' Alectra Utilities' capital funding, removes any incentive to pursue capital efficiencies (e.g. completing more work with the same budget) during the deferred rebasing period, and is contrary to the intent of the underlying incentive rate-setting regime and the OEB's MAADs Handbook.[30] The MAADs Handbook requires that amalgamation proposals be assessed with respect to section 1 of the OEB Act and the consolidating distributor is to show continuous improvement and maintained or enhanced financial viability.[31] Alectra Utilities' proposed M-factor, with essentially full DSP capital recovery and no demonstrable OM&A savings, as will be discussed later, may not demonstrate this.

[27] MAADs Report / pp. 11-12
[28] MAADs Report / p. 5
[29] Undertaking JT1.7
[30] MAADs Handbook for Electricity Distributor and Transmitter Consolidation / January 19, 2016
[31] *Ibid* / pp. 6-9

Further, Alectra Utilities' proposal to fix the price cap index over five years fundamentally changes the Price Cap IR plan they are under as part of the deferred rebasing period. Without having rebased, OEB staff submits that Alectra Utilities will have essentially transitioned into a five-year Custom IR plan with full capital budget recovery. OEB staff submits that this is contrary to OEB policies under the *Handbook for Utility Rate Applications* (Rate Handbook),[32] MAADs policies and the OEB capital funding policy.

*ICM policy for post-MAADs distributors*

While Alectra Utilities has noted that its current application before the OEB is a proposal for the M-factor mechanism, and not ICMs, OEB staff submits that the ICM mechanism remains the appropriate method for addressing Alectra Utilities' incremental capital needs arising from its consolidated DSP. Therefore, in this section OEB staff provides its views on Alectra Utilities' interpretation of the MAADs and ICM policies.

Alectra Utilities has advanced more than one argument supporting its M-factor mechanism. One of those arguments is that the ICM (as implemented by the OEB in Alectra Utilities' previous two rate applications) is not sufficient to address Alectra Utilities' capital needs during its deferral period.[33] This argument is addressed below. Another argument is that the OEB's MAADs policies provide for a separate set of ICM criteria for post-consolidation situations, whereby consolidated distributors are permitted ICM recovery for "normal and expected capital investments."[34] OEB staff does not agree with this argument and will address this in more detail in this section.

It is OEB staff's understanding that there are no policies, guidance documents or decisions from the OEB which state that distributors can expect to receive ICM funding for "normal and expected capital investments" even if those investments do not satisfy the ICM criteria of need, prudence, and materiality.

In support of its position, Alectra Utilities has relied on a five-word excerpt from the MAADs Report read in isolation. In the MAADs Report, the OEB considered distributors' concerns that "few, if any, distributors would be able to operate over an [*sic*] deferred

[32] Handbook for Utility Rate Applications / October 13, 2016
[33] Exhibit 2 / Tab 1 / Schedule 1 / pp. 3-4; Oral Hearing / Vol. 3 / pp. 166-167
[34] Oral Hearing / Vol. 3 / p. 133-134

rebasing period without incorporating normal and expected capital expenditures into rate base."[35] [emphasis added] In response to this concern, the MAADs Report stated:

> The OEB believes that the clarification set out in the September 18th Report [the ACM Report] establishes that a distributor may now apply for an ICM that includes normal and expected capital investments. This clarification of policy should address the need of those distributors who may not consider entering into a MAADs transaction due to concerns over the ability to finance capital investments.[36]

Reviewing this sentence in context, the OEB was clearly not setting out a new MAADs ICM condition, but rather simply clarifying that a distributor can apply for capital funding as long as it meets the ICM requirements. This is in contrast to ICM policy that existed prior to the ACM Report, which had limited ICM funding to extraordinary and unanticipated capital investments.[37] This expansion of the ICM funding policy in the ACM Report was not intended just for consolidating distributors, but for all distributors.

As acknowledged by Alectra Utilities in their testimony at the oral hearing, it is not appropriate to look at parts of an OEB policy in isolation. Instead, those policies need to be considered as a whole and one also needs to read policy documents that follow.[38] OEB guidance that postdates the MAADs Report confirms OEB staff's view that there are not different ICM criteria for MAADs situations. The MAADs Handbook, released January 2016, has a section that discusses ICMs. That section of the MAADs Handbook explicitly states that details of the ICM mechanism are described in the ACM Report.[39] It does not state that the MAADs Report altered the ICM requirements. It does not state that distributors can be expected to receive ICM funding for "normal and expected capital investments" even if those investments do not satisfy the ICM criteria of need, prudence, and materiality. In fact, the words "normal and expected capital investments" do not appear anywhere in the MAADs Handbook.

Similarly, the *Report of the OEB: New Policy Options for Funding of Capital Investments: Supplemental Report* (Supplemental Report)[40] released after the MAADs

[35] MAADs Report / p. 8
[36] *Ibid* / p. 9
[37] *Ibid* / p. 8
[38] Oral Hearing / Vol. 1 / p. 66 / ll. 15-21
[39] MAADs Handbook / p. 17
[40] EB-2014-0219 / Report of the OEB: New Policy Options for Funding of Capital Investments: Supplemental Report / January 22, 2016

Handbook also does not state that the MAADs Report changed the ICM requirements. To the contrary, the Supplemental Report states that the filing requirements for ICM/ACM applications remain unchanged from the ACM Report.[41] The Supplemental Report also indicates that the policies for ICM and ACM remain "[u]nchanged from the ACM Report".[42]

Of all the OEB policy documents referenced in this submission, the most recent is the OEB's Rate Handbook, released in October 2016. The purpose of the Rate Handbook is to outline the key principles and expectations that the OEB will apply when reviewing rate applications. If the scope of the ICM policy had in fact been expanded for consolidating distributors, the Rate Handbook would have been the document that confirmed this.

The Rate Handbook states that the ICM allows for funding of *significant* capital investments for *discrete* projects during a rebasing period.[43] The description of the ICM does not state that the MAADs Report changed the ICM requirements. To the contrary, the section of the Rate Handbook discussing capital funding options states that the OEB's policies on the ICM and ACM are documented in two reports: the ACM Report and the Supplemental Report.[44]

OEB staff further observes that the "normal and expected capital" test advanced by Alectra Utilities in this application is inconsistent with the submissions made in its MAADs application and rate applications for 2018 and 2019.[45] Alectra Utilities did not assert, as it has done in this application, that a different ICM policy applies to post-MAADs distributors. Nor did Alectra Utilities' previous submissions reference the phrase "normal and expected capital investments" to describe what is eligible for ICM funding. Instead, in both its 2018 and 2019 rate applications, Alectra Utilities relied on parts of the ACM Report and the criteria for an ICM set out therein.[46]

[41] *Ibid* / p. 21
[42] *Ibid* / p. 22
[43] Rate Handbook / Appendix 2 / p. iv
[44] Rate Handbook / Appendix 3 / p. i
[45] EB-2016-0025 / Applicant's Reply Submission / October 18, 2016; EB-2017-0024 / Applicant's Argument-in-Chief / December 22, 2017 / pp. 12-13; EB-2017-0024 / Applicant's Reply Submission / January 30, 2018; EB-2018-0016 / Applicant's Reply Submission / January 9, 2019
[46] See, for example, Alectra Utilities' submissions made in its 2018 rate application EB-2017-0024 / Applicant's Argument-in-Chief / December 22, 2017 / pp. 12-13 and EB-2017-0024 / Applicant's Reply Submission / January 30, 2018 / p. 16.

Alectra Utilities stated that the ICM (as implemented by the OEB in Alectra Utilities' previous two rate applications) is not sufficient to address Alectra Utilities' capital needs during its deferral period.[47] OEB staff notes that it is difficult to properly test this claim as Alectra Utilities has refused to identify projects that meet the established ICM criteria.[48] Alectra Utilities has not provided evidence that its financial viability would be impaired if the M-factor was not approved and Alectra Utilities received only ICM funding. In fact, Alectra Utilities' return on equity (ROE) is forecast to be above the deemed rate of return each of the next five years.[49]

It is also important to remember that during a Price Cap IR term, when revenues are unlinked from costs, there can often be some capital costs incurred, temporarily and without financially impairing the utility, that are not reflected in base rates.[50] With regard to reliability, as will be further discussed in section 4, OEB staff does not agree with Alectra Utilities' conclusion that the ICM is insufficient to address all of its distribution system needs. The OEB continues to monitor Alectra Utilities' reliability metrics through annual Reporting and Record Keeping Requirements (RRR) filings. If Alectra Utilities remains of the opinion that the Price Cap IR with ICMs is unable to accommodate its capital needs with regard to reliability, it can request early termination of the deferral period as per the MAADs Handbook.[51]

### 3.3 ICM Policy

As previously discussed, OEB staff remains of the view that the ICM mechanism is the appropriate method for Alectra Utilities to request incremental capital funding. OEB staff discusses below the appropriate ICM policy that should be applied to Alectra Utilities' current application for incremental capital funding.

[47] Exhibit 2 / Tab 1 / Schedule 1 / pp. 3-4; Oral Hearing / Vol. 3 / pp. 166-167
[48] In response to the School Energy Coalition's motion to compel answers to questions including identifying projects that qualify for ICM funding based on the 2018 and 2019 rate decisions, Alectra Utilities took the position that (i) this information was not relevant as it was not requesting ICM funding; and (ii) all of its projects met the ICM criteria as properly applied. See Oral Hearing / Vol. 1 / pp. 19-23, 29-30
[49] Exhibit K 1.2 indicates that Alectra Utilities' forecasted ROE is 10.4% (2020); 9.4% (2021); 9.5%(2022); 9.3% (2023); and 9.0% (2024).
[50] See footnote 15.
[51] MAADs Handbook / p. 13

*The ICM "Discrete" Project Criterion*

As previously discussed, Alectra Utilities has repeatedly asserted that the MAADs Report permits utilities to apply for ICMs that include normal and expected capital investments by pointing to page 9 of the MAADs Report. OEB staff agrees that this is what the MAADs Report states; however, OEB staff notes that page 9 also refers to this clarification as being included in the ACM Report which removed the restriction of ICM availability being limited to non-discretionary projects and stated "[a]ny discrete project (discretionary or otherwise) … is eligible for ICM funding …."[52] OEB staff submits that, while the ACM Report uses the words 'discretionary or otherwise' and the MAADs Report uses 'normal and expected' capital investments, the criterion that projects proposed for incremental capital funding must be discrete projects and not part of typical annual capital programs continues to apply in both situations.

In response to an interrogatory, Alectra Utilities provided a list of 203 M-factor projects by rate zones.[53] Alectra Utilities stated that in its opinion all of the projects were discrete.

> MR. WANG: …I was just wondering if you believe that the discrete criteria applies to Alectra's ICM request? And if so, what is your interpretation of the discrete criteria?
> MS. BUTANY-DESOUZA: Each of the projects listed in the M-factor listing are discrete projects. Each one of them is executed on its own. I believe that is the meaning of discrete, and falls squarely within the underlined sentence of discrete and in the OEB policy of normal and expected capital investments.[54]

Alectra Utilities also provided its understanding of what a project is as follows:

> MS. ANDERSON: …In my experience, everyone has a slightly different definition of the word "project". Do we have one from you on the record?
> MR. WASIK: We think so. In our view, it generally follows that there is a defined scope, defined schedule, and a defined cost associated with an initiative. And in our view, it is one that drives a specific outcome, one

[52] MAADs Report / p, 9
[53] IRR G-Staff-4
[54] Technical Conference / Vol. 2 / p. 44 / l. 8

> desired outcome.[55]

Alectra Utilities then continued:

> DR. ELSAYED: …If you take an example like cable replacement, is that a project or a program?
> MR. WASIK: That would be a project. Each site that we select, Mr. Chairman, is a project because we evaluate each neighbourhood.[56]

In Alectra Utilities' 2018 decision, the OEB explained what a discrete project entailed:

> In addition, the OEB finds that a discrete project is not simply one that is distinguishable or defined at a new location - or all capital would be eligible. ICM projects do need to be different in kind from those that are carried out through typical base capital programs.[57]

OEB staff submits that 'normal and expected investments' does not preclude the requirement that ICM requests, whether during a MAADs deferred rebasing period or otherwise, be for discrete projects, and further submits that only some of the listed 203 projects can be described as discrete projects. Therefore, not all of the listed activities qualify as discrete projects and therefore should not be approved under ICM funding in the event the OEB denies the M-factor.

For example, Alectra Utilities provided a list of all cable replacement and cable rehabilitation projects and identified which projects are to be funded by base rates and which are to be funded by incremental capital funding.[58] The list includes the following two projects, one of which is funded in base rates, the other by incremental capital funding:

Table 1 – Examples of Cable Injection Projects

| | | |
|---|---|---|
| 151460 | M-Factor | Cable Injection Project - (V17) - Langstaff - Keele - Rutherford - Dufferin, Vaughan |
| 150025 | Base | Cable Injection Project - (V18) - Major Mackenzie and Keele, Vaughan |

[55] Oral Hearing / Vol. 3 / p. 189 / ll. 15-22
[56] Oral Hearing / Vol. 3 / p. 190 / ll. 8-13
[57] EB-2017-0024 / Decision and Order / April 6, 2018
[58] Undertaking J1.2 / Attachment 1

The only distinction between these two projects appears to be the different locations.

OEB staff also notes that even Alectra Utilities characterizes some of its projects as programs in their business cases.[59] For example:

- 150043 Rear Lot Renewal Project: "This project is part of the long-term rear lot supply remediation program."[60]
- 150138 Cable Replacement Project: "This project is part of the long-term cable rehabilitation program."[61]
- 150317 Voltage Conversion: "Historical projects that compare would be from other similar voltage conversion projects undertaken as part of the 4kV/8kV Renewal Program."[62]

In addition, the following projects are identified as part of Alectra Utilities' Stations Replacement Program:

- 150519 Upgrade to Station Facilities[63]
- 150609 Driveway Paving – Various Stations – Multi-year initiative – East[64]

Based on the OEB's decision in the 2018 application, in which a Connection Cost Recovery Agreement project in the Brampton rate zone was approved, some of the proposed projects do appear to meet the criteria of a discrete project, such as:[65]

Table 2 – Potential ICM Projects

| | | | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|
| 151125 | M-Factor | Connection Cost Recovery Agreement (CCRA) – Midhurst TS – 15th Anniversary True-up | 3.2 | - | - | - | - |
| 151124 | M-Factor | Goreway TS Expansion (CCRA) - 10 Yr True-Up Payment, Brampton | 5.6 | - | - | - | - |
| 151117 | M-Factor | Vansickle TS True-up Payment (CCRA), St.Catharines | - | 1.6 | - | - | - |

[59] Undertaking J3.3 / Attachment 1
[60] *Ibid* / p. 337
[61] *Ibid* / p. 372
[62] *Ibid* / p. 389
[63] *Ibid* / p. 493
[64] *Ibid* / p. 509
[65] Undertaking J2.4 / Attachment 1

If the OEB were to approve ICM funding, OEB staff submits the list of 203 projects would need to be vetted to remove those projects which do not meet the discrete criterion, or do not meet the project materiality threshold (discussed later).

*Input Price Index Used for ICM Materiality Threshold Calculations*

As originally filed, Alectra Utilities' application for the M-factor used the current (2019) Input Price Index (IPI) as the inflation factor for the ICM materiality threshold calculation for each rate zone. The IPI is the inflation factor for formulaic annual rate adjustments (e.g., price cap and revenue cap adjustments for annual inflation less expected productivity). It is included in the ICM materiality threshold calculation, along with growth in number of customers and electricity demand (kW and kWh), to account for the amount of depreciation expense recovered in rates and available for financing capital investments. This formulation, and the conceptual basis for it, was established when the ICM concept was first adopted in 2008,[66] and subsequently revised in 2014 and 2016.[67]

Alectra Utilities used 1.5% as the current value of the IPI for 2019, but stated in its original application filing that it would update the value with the IPI for 2020 once made available by the OEB:

> The PCI [Price Cap Index] of 1.2% is a placeholder to be updated with the OEB's approved PCI for 2020 when it is available. It is based on inflation [IPI] of 1.50% less a productivity factor of 0.00% and a stretch factor of 0.30% as identified in Table 3 below.[68]

During the technical conference, Alectra Utilities confirmed that it would update the IPI with the 2020 value once issued by the OEB.[69] OEB staff notes that this proposal with respect to the IPI is consistent with OEB policy.

However, Alectra Utilities subsequently proposed to use a five-year historical average IPI instead, for the purposes of calculating the ICM materiality threshold for each rate zone. It acknowledged that this was a change in its application proposal.[70] In

[66] EB-2007-0673 / Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors / September 17, 2008
[67] EB-2014-0218 (ACM Report and Supplemental Report)
[68] Exhibit 2 / Tab 1 / Schedule 3 / p. 12
[69] Technical Conference / Vol. 1 / pp. 138-139; Subsequent to the Oral Hearing, on October 31, 2019, the OEB issued the 2020 IPI with a value of 2.0% inflation.
[70] Oral Hearing / Vol. 3 / pp. 110-114

Undertaking J3.1, based on OEB staff's exhibit,[71] Alectra calculated a five-year average IPI for the period 2015-2019 of 1.66%. This is also documented in the "blue pages" update of Exhibit 2/Tab 1/Schedule 1, filed as an undertaking from the oral hearing.[72]

The wording on page 12 of this "blue page" updated exhibit retains the sentence that "[t]he PCI is a placeholder to be updated with the OEB's approved PCI for 2020 when it becomes available." OEB staff remains uncertain whether Alectra Utilities' proposal includes the idea of updating the average for the 2020 IPI – i.e., extending the range to 2016-2020.

OEB staff wishes to clarify the record with respect to Undertaking J3.1. Alectra Utilities stated:

> The threshold value based on an inflation factor of 1.74% as calculated by OEB Staff, is $1,100.1MM. OEB Staff's inflation factor is a compound average growth rate over the 2007 to 2019 period. Alectra Utilities submits that it is not appropriate to use data over a 12-year [sic] period[73] which included an economic recession and subsequent recovery. Further the calculation of the inflation factor has evolved over this period from a 1-Factor IPI to a 2-Factor IPI beginning in 2014. Alectra Utilities submits that the use of a five-year historical average (2015 to 2019) of 1.66% is consistent with the DSP fling requirements and results in a threshold value of $1,086.1MM. [74]

OEB staff wishes to clarify two matters in Alectra Utilities' rationale.

First, OEB staff did not propose at any point using the 13-year average IPI to formally calculate the ICM materiality threshold. OEB staff prepared two sensitivity analyses for the M-factor materiality threshold:

- The 13-year geometric average IPI based on the OEB-issued inflation factors for electricity distribution price cap adjustments under the 2nd, 3rd, and now 4th

[71] OEB staff's Compendium / Exhibit K3.1 / tab 2. OEB staff calculated an average annual IPI of 1.74% for the period 2007-2019.
[72] Undertaking J2.1 / Attachment 2
[73] The index was set at 100 in 2006, and the average was based on the OEB issued inflation factors for 13 consecutive years of electricity distribution price cap adjustments from 2007 to 2019.
[74] Undertaking J3.1 / p. 2

Generation IRM; this was used as the 2020 IPI was not known at the time of the technical conference or the oral hearing.

- An assumed IPI of 2.15%, corresponding to Alectra Utilities' capital price inflation that it used to calculate the capital budget for the portfolio of 886 projects documented in its 2020-2024 DSP, as documented in Undertaking JT1.7.

The discussion during the oral hearing made it clear that the two sensitivity calculations in OEB staff's compendium were assessing the sensitivity of the M-factor materiality threshold and the corresponding M-factor capital envelope.[75]

Second, the purpose of the ICM (or M-factor) materiality threshold calculation is to calculate how the historical PCI and growth have affected the level of depreciation expense being recovered in current rates (based on what was contemplated at the time of the utility's last rebasing). It has nothing to do with the 5-year period of the forward-looking DSP. Alectra Utilities' assertion that "a five-year historical average […] is consistent with the DSP filing requirements […]" has no conceptual basis.[76]

OEB staff submits that Alectra Utilities' amended proposal to use a five-year average IPI should not be adopted. This amendment is inconsistent with ICM policy and with the OEB's general incentive rate-setting framework.

OEB staff has considered Alectra Utilities' circumstances to try to assess what form of inflation, or other aspects of the ICM materiality threshold, would be reasonable. The last "rebasing" year for each of Alectra Utilities' predecessor utilities (now part of individual rate zones), per the ICM models filed in responses to interrogatories, are as follows: [77]

[75] Oral Hearing / Vol. 3 / pp. 109-120
[76] Undertaking J3.1 / p. 2
[77] IRR G-Staff-8, Attachments 2-6 are Excel models for the ICM calculations by predecessor utility. The models for Guelph, Horizon and PowerStream were updated during the Oral Hearing as Undertakings J2.1 and J3.2.

Table 3 – Alectra Utilities' Rate Zones Last Rebasing Years

| **Predecessor Utility** | **Last Rebasing Year** |
|---|---|
| Enersource Hydro Mississauga | 2013 |
| Guelph Hydro | 2016 |
| Horizon Utilities | 2019[78] |
| Hydro One Brampton Networks | 2015 |
| PowerStream Utilities | 2017 |

On this basis, it would be necessary to calculate an average annual IPI for the period since the last rebasing specific to each of the predecessor utilities (rate zones).

OEB staff submits that this approach adds additional complexity to the calculations. Further, OEB staff submits that even calculating rate zone-specific average annual IPIs would not accurately reflect Alectra Utilities' circumstances. Since rebasing, and the merger of Alectra Utilities, there has been approved ICM funding for specific capital projects. In particular, the following ICMs have been approved subsequent to the last rebasing of the predecessor utilities:

- In 2016, for Enersource, $40.5 million[79]
- In 2018, for Alectra Utilities:
    - Hydro One Brampton $6.8 million
    - PowerStream $11.24 million
    - Enersource $10.754 million[80]
- In 2019, for Alectra Utilities:
    - Enersource $7.5 million
    - PowerStream $18.77million[81]

OEB staff submits, as it did in Alectra Utilities' 2019 rate application,[82] that ACM/ICM funding proxies the incremental revenue requirement impact of a rebasing application through a cost of service approach. The advantage of the ACM/ICM methodology is that it allows the utility to remain on IRM for rate-setting, and to avoid what would otherwise be premature rebasing applications.

[78] Last year of Horizon Utilities' previous 5-year Custom IR plan.
[79] EB-2015-0065 / Decision and Rate Order / April 7, 2016 / p. 10
[80] EB-2017-0024 / Decision and Order / April 6, 2018 / pp. 31, 33, 45
[81] EB-2018-0016 / Decision and Order / January 31, 2019 / pp. 1, 10-14
[82] EB-2018-0016 / OEB Staff Submission / December 17, 2018

While the ACM/ICM revenue requirement and recovered revenues are subject to tracking in a deferral and variance account,[83] the main regulatory accounting issue is on the variance between what should be recovered versus what is recovered through the estimated ACM/ICM rate riders. The qualifying projects are approved at the time that the rate riders are established, and so the return of invested capital is not a matter of debate in OEB staff's view.

This return of capital on ICMs is thus available for reinvestment and, hence, is a source of funding for future capital projects.[84] OEB staff notes that the OEB, in its decision on Alectra Utilities' 2019 rate application, stated the following on Alectra Utilities' ICM request for completion of replacement of leaking transformers:

> The OEB finds it prudent for Alectra Utilities to complete its program to replace the backlog of leaking transformers identified in the last asset condition assessment. The OEB remains concerned about potential environmental impacts of leaking transformers and finds that ICM funding is warranted to complete the work in 2019. The OEB finds that Alectra Utilities appropriately prioritized its schedule for the program during the 2017-2019 period based on asset condition and potential environmental impacts.
>
> Many intervenors referenced the decision for 2018 rates in which the OEB indicated that it expected this project to evolve into a typical ongoing capital program in subsequent years. The OEB finds that Alectra Utilities addressed this expectation by advancing the completion of this program to 2019 such that the ongoing capital program will commence in 2020.[85]

In OEB staff's view, there are two points in the OEB's finding:

- First, the OEB noted that normal transformer replacement at the usual end-of-life is a normal capital program (and would re-commence in full in 2020 once all of the leaking transformers had been replaced by the end of 2019). This contrasts with Alectra Utilities' categorization of all capital activities as "projects" in its DSP.

[83] Further discussion is provided in section 5.1 for the proposed Capital Investment Variance Account
[84] One difference from the funding available from depreciation expense being recovered through base distribution rates is that ACM/ICM rate riders are not adjusted for the price cap formula. Thus, depreciation expense from ICMs would be subject to the impacts of growth (in customers, kWh and kW) but not for annual price cap adjustments.
[85] EB-2018-0016 / Decision and Order / January 31, 2019 / p.11

- Second, as the replacement transformers are fully installed by the end of 2019, depreciation expense recovered through the ICM rate riders approved in 2018 and 2019, and continuing until Alectra Utilities rebases, becomes available to re-invest in future capital projects and programs.

OEB staff also notes that the OEB's ACM/ICM policy was considered during the MAADs and rate application for the proposed merger of Enbridge Gas Distribution Inc. and Union Gas Limited.[86] The OEB determined that the existing ACM/ICM policy and methodology would apply for any incremental capital funding requested during the approved five-year price cap plan from 2018 to 2022); this is the same approach as the OEB has applied to Alectra Utilities' ICM requests in its 2018 and 2019 rate applications. Alectra Utilities used the ICM materiality threshold as a starting point for its M-factor proposal.

Alectra Utilities witnesses acknowledged that the ICM materiality threshold was tried and tested and should be used to determine the amount of capital being funded through price cap-adjusted rates:

> MR. MURRAY: But you would agree with me if you looked at the table number 2, factoring in inflation and growth, it suggests that based on historical in-service additions, there may be more capital available to fund your DSP than you claim.
> MR. BASILIO: Mr. Murray, this to me looks like a very indirect way of trying to determine what capital is supported in rates.
> I think the ICM calculation, threshold calculation is certainly far and away more detailed, has been tested against ratemaking principles.
> So you know, in terms of a detailed and complex approach to substantiating what is supported by base rates, I think that's largely why we use the ICM engine.
> This is a very indirect approach and it is very difficult to accept that, you know, simply applying factors to capital at a point in time is going to substantiate what is supported by base rates.
> So I think that is what we take exception to here, and that is why we relied on the ICM engine.[87]

[86] EB-2017-0306, EB-2017-0307 / Decision and Order / August 30, 2018 (Amended September 17, 2018) / pp. 32-34
[87] Oral Hearing / Vol. 3 / p. 131 / ll. 7-26

OEB staff concurs with Alectra Utilities on this. Moreover, as has been pointed out earlier, the exhibits in OEB staff's compendium were intended solely as sensitivity analyses; OEB staff did not propose alternative methodologies. To this end, OEB staff submits that the ACM/ICM materiality threshold as documented in the Supplemental Report should be used, without change for any ICMs or for any M-factor proposal, should the OEB decide to approve the latter. In other words, OEB staff submits that the ICM materiality threshold for each rate zone should be calculated based on the existing formula per the ICM policy and using the 2020 IPI of 2.0%, as communicated in the OEB's letter of October 31, 2019. OEB staff also submits that the calculation of the ICM materiality threshold should be done once and not updated throughout the term of the M-factor, if approved.

*The Project-Specific Materiality Threshold*

Alectra Utilities argues that the ICM remains unable to fund its capital needs. In particular, Alectra Utilities points to the OEB's application of an "additional test" – the project-specific materiality threshold as first identified in a Toronto Hydro Decision.[88] The test, in the OEB's decisions in Alectra Utilities' 2018 and 2019 rate applications, assessed whether each of Alectra Utilities' proposed projects are individually significant compared to Alectra Utilities' total capital budget.

OEB staff does not agree with Alectra Utilities that the OEB, in Alectra Utilities' 2018 and 2019 rate applications, applied an "additional test" in the form of the project-specific materiality threshold. The project-materiality threshold is specifically detailed in the ACM report as part of the criteria for determining eligibility for ICM funding.[89] OEB staff notes that, since the release of the ACM report, the OEB has consistently applied the project-specific materiality threshold in ICM decisions. In particular, OEB staff notes Enersource's 2016 rate application as well as the Union Gas Limited and Enbridge Gas Distribution Inc. MAADs application (Enbridge MAADs application).[90]

The OEB's decision in Enersource's 2016 rate application discussed the project-specific materiality threshold and noted that "[e]ach capital project approved for ICM funding must be material to the distributor."[91] The OEB went on to further define the threshold at

[88] AiC / p. 25; EB-2012-0064 / Partial Decision and Order / April 2, 2013 / pp. 18-19
[89] ACM Report / p. 17
[90] EB-2015-0065 / Decision and Rate Order / April 7, 2016; EB-2017-0306, EB-2017-0307 / Decision and Order / August 30, 2018
[91] EB-2015-0065 / Decision and Rate Order / April 7, 2016 / p. 4

"0.5% of distribution revenue requirement for distributors with a revenue requirement greater than $10 million and less than or equal to $200 million."[92] Considering that Enersource is one of Alectra Utilities' predecessor utilities, OEB staff submits that Alectra Utilities would have been aware that ICM projects must meet the project-specific materiality threshold.

The OEB's decision in the Enbridge MAADs application determined that "any individual project for which ICM funding is sought [by the amalgamated utility] must have an in-service capital addition of at least $10 million [which] will reduce the chance that any proposed ICM project will be found not to be significant to Amalco's operations."[93] Again, OEB staff submits that the OEB has consistently affirmed the application of the project-specific materiality threshold, in both MAADs and non-MAADs (e.g. the Enersource decision) ICM circumstances.

For this application, OEB staff suggests the OEB define a project-specific materiality threshold for Alectra Utilities at $2 million. OEB staff submits that explicitly defining the threshold would provide Alectra Utilities with greater clarity on ICM eligibility and greater rate certainty for any future ICM requests (should the OEB order Alectra Utilities to continue to use the ICM mechanism).

OEB staff calculates $2.67 million by taking 0.5% of Alectra Utilities' 2018 Distribution Revenue of $534.14 million.[94] OEB staff acknowledges that the policy document cited by the Enersource decision specifies a materiality threshold of $1 million for distributors with a distribution revenue requirement of more than $200 million, which would ostensibly apply to Alectra Utilities. However, in the Enbridge MAADs decision, the OEB found the need for a higher materiality threshold to ensure that any eligible ICM project would be significant to a distributor's operations. In addition, OEB staff notes that while no specific threshold was identified in previous ICM applications by Alectra Utilities, projects just under $2 million were disallowed. Therefore, OEB staff submits that a threshold of $2 million is appropriate.

[92] *Ibid*
[93] EB-2017-0306, EB-2017-0307 / Decision and Order / August 30, 2018 / p. 32
[94] OEB 2018 Yearbook of Electricity Distributors / August 19, 2019 / p. 31

## 4. DSP and Capital Plan

Alectra Utilities' total forecasted capital budget for 2020-2024 is $1,456 million and is summarized in the table below:[95]

Table 4 – Alectra Utilities 2020-2024 Forecasted Capital Expenditures

| | Planned Expenditures ($MM) | | | | |
|---|---|---|---|---|---|
| | **2020** | **2021** | **2022** | **2023** | **2024** |
| **System Access** | $66.5 | $66.9 | $63.2 | $67.1 | $70.2 |
| **System Renewal** | $139.0 | $142.0 | $154.0 | $156.1 | $177.2 |
| **System Service** | $38.0 | $36.9 | $36.0 | $42.4 | $37.2 |
| **General Plant** | $39.4 | $34.4 | $35.1 | $30.2 | $24.7 |
| **Total** | **$282.9** | **$280.2** | **$288.3** | **$295.8** | **$309.3** |

OEB staff's discussion below focuses on Alectra Utilities' proposed investments in underground cables, customer connections, reactive capital and fleet renewal as the DSP proposed large incremental spending increases in these areas as compared to historical levels. Additionally, OEB staff discusses its concerns regarding the level of OM&A savings identified through the DSP. In OEB staff's view, focusing on categories that represent the highest incremental spending in order to assess prudence is a reasonable proxy that can be representative of the prudence of the 203 M-factor projects envelope proposed for recovery.

While OEB staff recognizes that this is not a rebasing application, and that the OEB is not approving Alectra Utilities' capital budget for establishing base rates, OEB staff is providing its review of Alectra Utilities' proposed capital expenditures with the intention of providing OEB staff's recommendations on the appropriate level of incremental capital in the event the OEB was to approve the M-factor proposal. OEB staff submits that a total reduction of $165 million (which would have represented an 11% reduction to the total five year capital budget had this been a rebasing application), as shown in the table below, is appropriate subject to OEB staff's further thoughts below.

[95] Exhibit 4 / Tab 1 / Schedule 1 / p. 375

Table 5 – OEB Staff Suggested Capital Reductions

| | $MM |
|---|---|
| Cable Renewal | $127.7 |
| Customer Connections | $10.0 |
| Reactive Capital | $9.9 |
| Fleet Renewal | $17.4 |
| Total | $165.0 |

As noted above, OEB staff's $165 million in suggested reductions are in areas of large incremental capital spending, compared to historical levels. OEB staff submits that, if the OEB approves the M-factor, a reduction to the $265 million M-factor capital envelope proportional to the $165 million, could be justified. The reduction of the total 2020-2024 capital budget should correspond to the same decrease for the M-factor because the reduction reduces the amount of capital unfunded by base rates. On this basis, OEB staff calculates an M-factor capital envelope of $100 million ($265 million less $165 million).

However, OEB staff recognizes that since some of the projects reviewed below have been identified by Alectra Utilities as base rate projects, the reductions suggested could apply to both M-factor projects as well as base rate projects (had this been a rebasing application for example). Therefore, a different approach could be to take 11% of $265 million which gives an M-factor capital envelope of $236 million. Given these two different methodologies, OEB staff submits that a range between $100 million and $236 million for the M-factor capital envelope is appropriate. Therefore, OEB staff recommends that, in the event that the M-factor proposal is approved, the OEB set the M-factor capital envelope to be $168 million, which is the average of $100 million and $236 million.

### 4.1 Cable Renewal

Alectra Utilities' historical and forecast capital expenditures for underground cables and cable accessories is shown in the table below:[96]

[96] Exhibit 4 / Tab 1 / Schedule 1 / p. 10

Table 6 – Underground Cable and Cable Accessories Historical and Forecast Spending

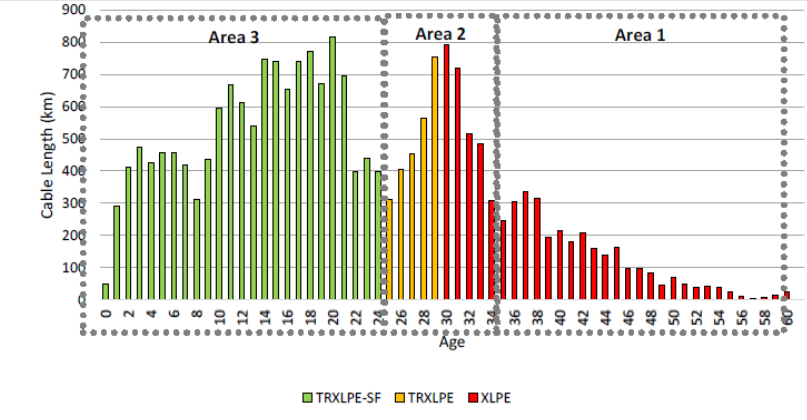
| | Historical Spending | | | | Bridge | Forecast Spending | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Year** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **CAPEX ($MM)** | $38.6 | $36.4 | $46.5 | $40.8 | $34.6 | $48.0 | $61.1 | $68.3 | $74.2 | $81.0 |

The forecast spending for 2020-2024 totals $332.6 million and is $135.7 million higher than the five-year historical spending (2015-2019) of $196.9 million. This represents an increase of 69% in cable renewal spending and is responsible for the bulk of Alectra Utilities' increased spending in the system renewal category.[97] OEB staff has concerns with Alectra Utilities' justification for the increased spending, particularly with its assessment of asset condition and reliability trends. OEB staff is of the view that Alectra Utilities has not appropriately paced its cable renewal and therefore submits that a $127.7 million (38%) reduction to Alectra Utilities forecasted cable budget is appropriate.

*Asset Condition*

Alectra Utilities' planned cable renewal investments are in large part to replace or rejuvenate cables in what Alectra Utilities calls Area 1 and Area 2 cables.[98] As shown in the figure below, Area 1 and Area 2 cables make up the population of Alectra Utilities' cable fleet with the highest age:[99]

Figure 1 – Underground XLPE Cable Population




[97] *Ibid* / p. 367
[98] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A10 / pp. 14-15, 22-23
[99] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A10 / p. 14

Aside from cable type (XLPE, PILC, EPR) and construction type (in-duct, direct buried), OEB staff notes that Alectra Utilities bases the asset conditions of its cable solely on age.[100] In other words, within the same cable and construction type, older cables are considered to be in worse condition because of their age. OEB staff submits that replacing cables based solely on age, and without consideration of the actual condition of the assets, is not prudent. The strategy of replacing cables based solely on the criterion of age could result in the replacement of cables that, despite being old, would otherwise be in serviceable condition. OEB staff further notes that Alectra Utilities is still in the process of implementing recommendations made by Kinectrics Inc. in its Asset Condition Assessment (ACA) Assurance Review.[101] Therefore, OEB staff believes that Alectra Utilities' ACA, while acknowledged by Kinectrics Inc. to be in line with "good utility practices," should be considered a work in progress and should not be the sole determining factor for justifying large amounts of incremental capital spending.[102]

In reviewing Alectra Utilities' business cases, OEB staff notes several projects that relate to OEB staff's concerns above. In particular, OEB staff notes a number of proposed projects to replace cables with no history of past failures.[103] While OEB staff agrees with Alectra Utilities that cables with histories of failure (and kept in service through repairs) are likely to continue to fail, OEB staff does not agree that cables, without having ever failed, should be replaced solely because of age.[104] Moreover, OEB staff submits this is in contradiction with Alectra Utilities' claims that all of the cables proposed to be addressed through this DSP are in areas where there has been failures or multiple failures.[105] In the absence of Alectra Utilities-specific degradation curves based on failure statistics, as recommended by Kinectrics Inc., OEB staff sees little justification to undertake these projects.[106] The fact that these cable assets have operated to now with no failures is testament to the fact that age is not fully reflective of asset condition, and does not suggest replacement is necessary in the near term.

As part of an undertaking response, Alectra Utilities provided the project scores for every project contemplated in its DSP.[107] By Alectra Utilities' description, the project scores are a method for Alectra Utilities to evaluate all of its projects in a uniform and

[100] IRR G-Staff-89 d)
[101] Exhibit 4 / Tab 1 / Schedule 1 / Appendix E / p. 9
[102] *Ibid* / p. 8
[103] Undertaking J2.4 / Project Numbers: 151332, 151338, 150138, 151337, 151335, 151334, 150139, 150141 (Note this is not meant to be an exhaustive list)
[104] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A10 / p. 4; Undertaking J2.4
[105] Technical Conference / Vol. 2 / p. 4
[106] Exhibit 4 / Tab 1 / Schedule 1 / Appendix E / p. 9
[107] Undertaking J2.4

consistent manner.[108] OEB staff notes that the list of projects provided by Alectra Utilities offers a wide range of project scores from the highest project score of 184,357 to the lowest score of 1.[109] Overall, OEB staff believes the large variance in project scores raises concerns about Alectra Utilities' capital investment planning process. Further, even when focused solely on projects of the same investment category, in this case cable renewals, OEB staff notes that the project scores can vary significantly. As an example, OEB staff notes that the highest scoring cable replacement project (Project Number 151301) has a project score of 61,747, while the lowest scoring cable replacement project (Project Number 150255) has a score of 99.[110] As Alectra Utilities noted in its application, its value framework is calibrated to a common scale with 1 value point approximately equal to $1,000.[111] OEB staff interprets this to mean that project 151301 is 624 times more beneficial than the lowest scoring project 150255.[112] The fact that projects differ in value by such large orders of magnitude does not support Alectra Utilities' claim that it has created a capital investment portfolio that yields the maximum value to its customers.[113] In other words, the scores assigned to each project should be a measure of how efficiently capital is being spent on each project. The scoring is ultimately a ratio of benefit to cost such that a project with a large amount of benefits relative to the cost should score high, while a project with a low amount of benefits relative to the cost should score low. The large variance in project scores suggests to OEB staff that Alectra Utilities has not found an adequate balance between costs and the amount of benefit arising from the costs and that there are additional projects that can be reasonably deferred.

*Reliability*

Alectra Utilities points to its reliability metrics as one of the main drivers for the need for increased cable renewal investments. Specifically, Alectra Utilities points to an 8% increase in SAIDI (excluding Major Event Days) from 2014-2018 and a 6% increase in SAIFI (excluding Major Event Days) for the same period.[114] This is summarized in the two figures below:[115]

[108] Exhibit 4 / Tab 1 / Schedule 1 / pp. 334-335, 342
[109] Undertaking J2.4 / Project Numbers 150404 and 151029
[110] *Ibid* / Project Numbers 151301 and 150255
[111] Exhibit 4 / Tab 1 / Schedule 1 / p. 342
[112] 61,747 divided by 99 to arrive at a factor of 624
[113] AiC / p. 15
[114] Exhibit 4 / Tab 1 / Schedule 1 / pp. 108, 110
[115] *Ibid*

Figure 2 – Alectra Utilities 2014-2018 SAIDI

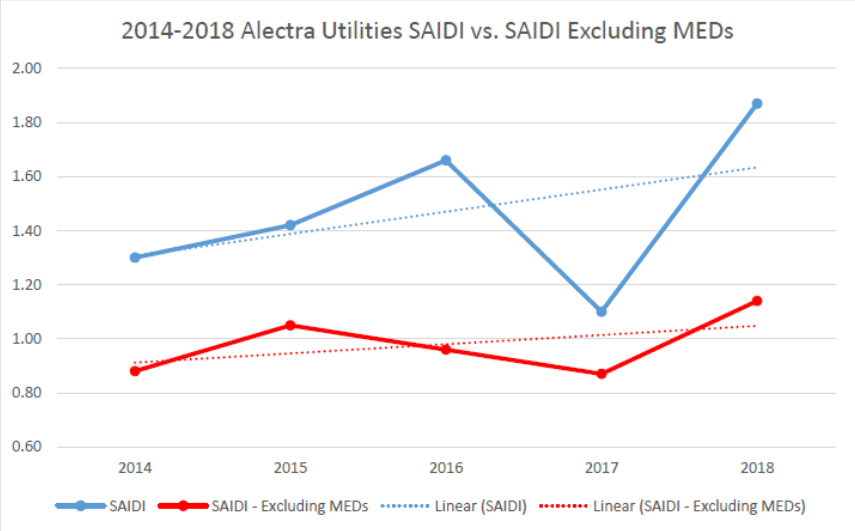
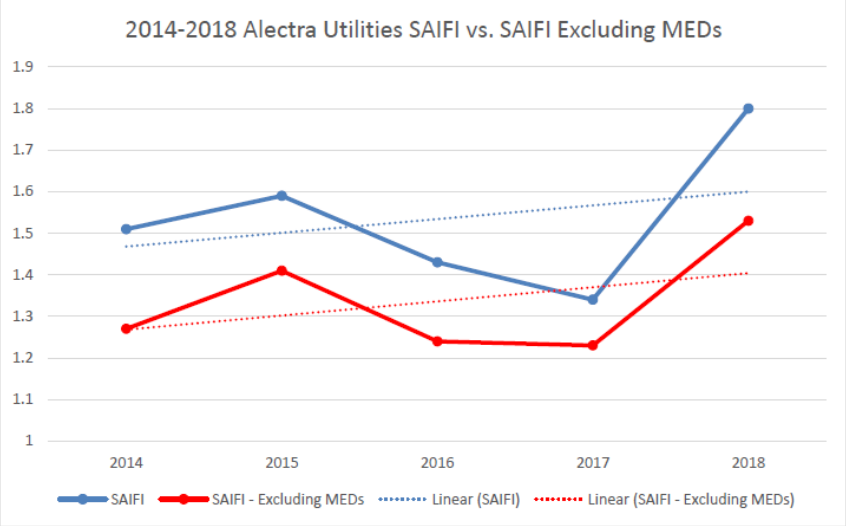



Figure 3 – Alectra Utilities 2014-2018 SAIFI




Regarding the SAIFI and SAIDI metrics, OEB staff disagrees with Alectra Utilities that a large increase in cable renewal spending is necessary for the following two reasons. First, OEB staff notes that reliability metrics are inherently subject to inter-year variances. As shown in the two graphs above, the SAIDI and SAIFI scores improve in 2016 and 2017, but then decline (in performance) again in 2018. Given the volatility of

the data, OEB staff submits that five-years of data is not sufficient to draw a conclusion that a large increase in capital spending is required.

Figure 4 – Alectra Utilities Number of Customer Interruptions by Cause Code

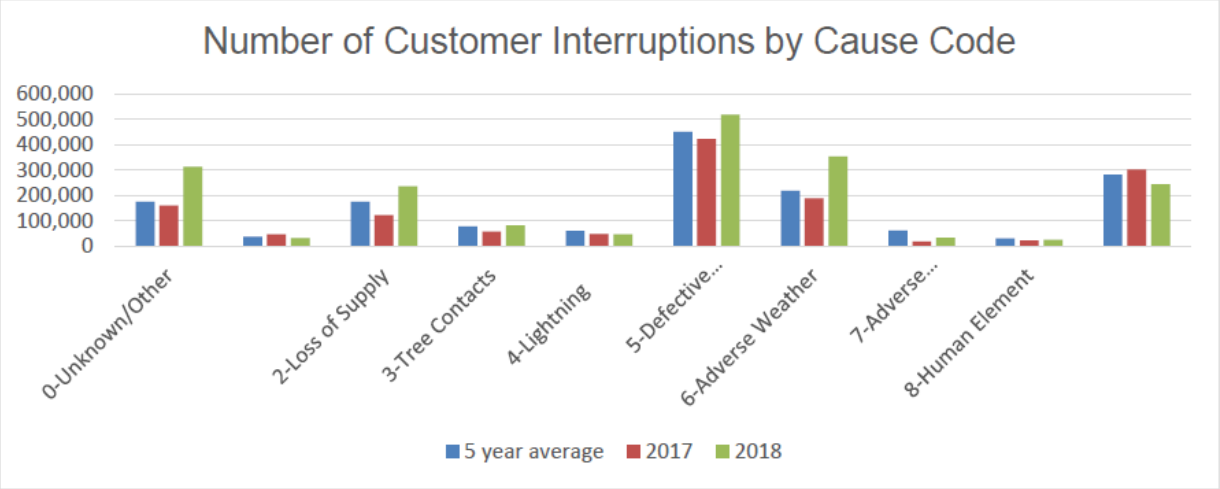
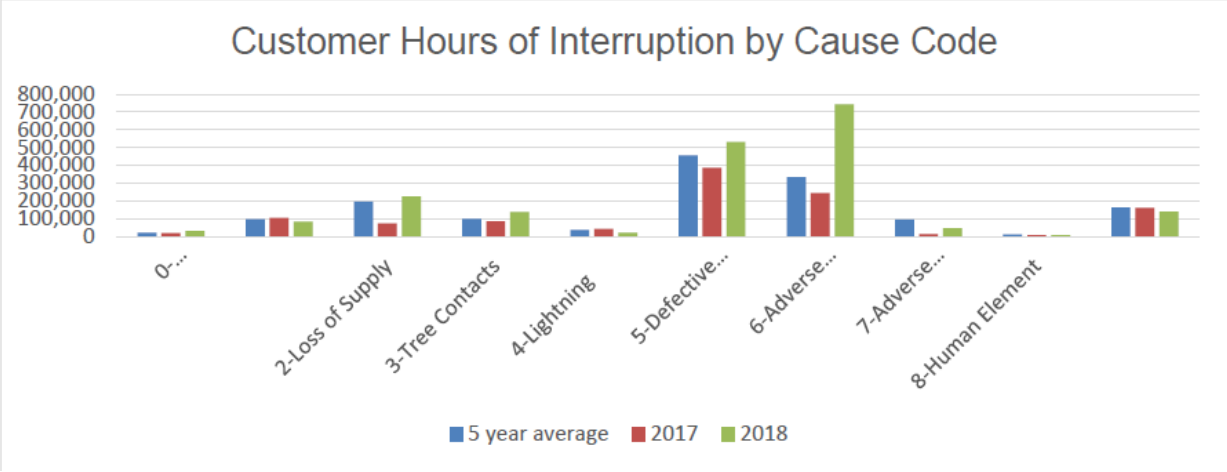


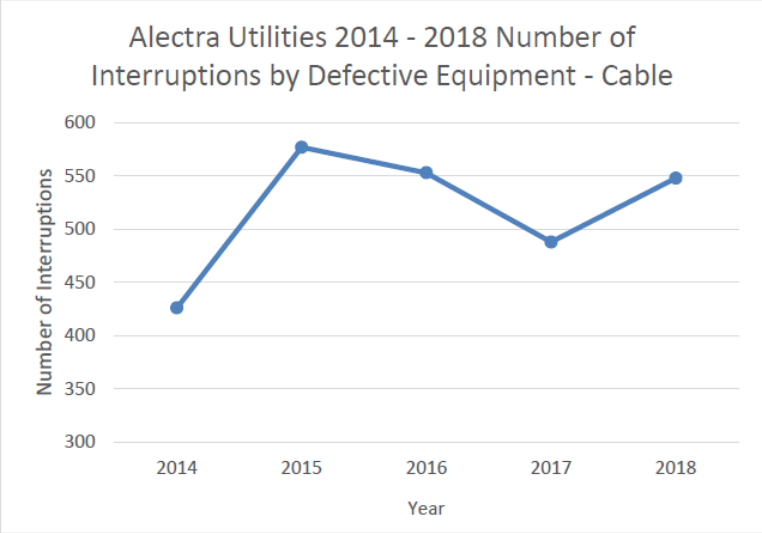

Figure 5 – Alectra Utilities Hours of Customer Interruptions by Cause Code




Second, as shown in the graphs above, adverse weather outages had a far greater impact on the increase in SAIDI and SAIFI between 2017 and 2018 than cable failures. It is not sufficient justification to simply point to an increase in SAIDI and SAIFI in 2018 for increased cable renewal spending.

When looking at the interruptions caused strictly by defective cable equipment, OEB staff notes that the number of interruptions in 2018 is actually lower than 2015, and similar to the number of interruptions in 2016.[116] Based on the figure below, the numbers do not appear to support the view that Alectra Utilities is experiencing an abnormal increase in interruptions due to defective cables:[117]

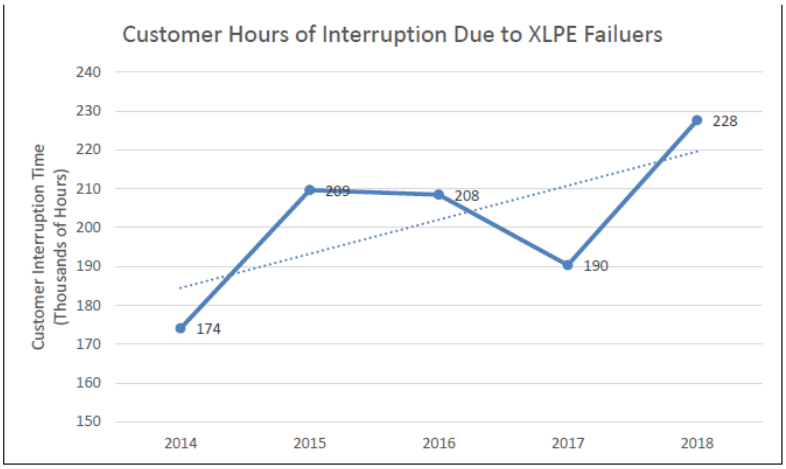
Figure 6 – Alectra Utilities Number of Interruptions by Defective Cables




Alectra Utilities disagreed with OEB staff and argued that the number of interruptions does not fully reflect the impact of defective cables because the duration of interruptions due to defective cables increased in 2018.[118] The following figure shows the duration of interruptions caused by defective cables:[119]

[116] IRR G-Staff-70
[117] *Ibid*
[118] Oral Hearing / Vol. 3 / p. 179
[119] Exhibit 4 / Tab 1 / Schedule 1 / p. 264

Figure 7 – Alectra Utilities Hours of Interruption Due to XLPE Cable Failures




OEB staff submits that, as previously discussed, a one year increase in reliability data is not sufficient to draw a conclusion on long-term reliability. Moreover, Alectra Utilities explained that the reason for the increase in duration of interruptions caused by defective cables in 2018 is because of double cable faults or multiple failure events.[120] OEB staff believes this is more reason for Alectra Utilities to reduce its cable renewal investments to focus on areas of cable with histories of past failures. By eliminating areas with cables prone to multiple failures, Alectra Utilities will address a large source of the interruptions.

While OEB staff agrees that replacing aging cables reduces the likelihood of cable failures, there must be an appropriate balance between reliability and capital spending. This should be especially important during the course of a deferred rebasing period, and with customers having indicated that electricity prices is a top concern.[121] Based on the concerns discussed above, OEB staff does not believe Alectra Utilities has sufficiently justified increases to its cable renewal budget and submits that Alectra Utilities should be expected to manage within historical levels of cable renewal.

OEB staff suggests that Alectra Utilities' 2020 cable renewal budget be $39.4 million, which is the average of the five historical years (2015-2019). The budget of the remaining four years of the DSP period (2021-2024) should be based on the 2020

[120] IRR AMPCO-35; Double cable faults occur when the primary supply and alternative supply in an underground cable loop both fail. Multiple failure events occur when the cable fails along with a transformer or elbow.
[121] Exhibit 4 / Tab 1 / Schedule 1 / Appendix C / Customer Engagement Planning Placemat

budget, adjusted for an annual inflation of 2%. This results in a total reduction of Alectra Utilities' cable renewal budget of $127.7 million. OEB staff's suggested reductions are summarized in the table below:

Table 7 – OEB Staff Suggested 2020-2024 Cable Renewal Budget

| | Historical | | | | | Forecast | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| $MM | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| Alectra Utilities DSP | 38.6 | 36.4 | 46.5 | 40.8 | 34.6 | 48 | 61.1 | 68.3 | 74.2 | 81 |
| OEB staff | | | | | | 39.38 | 40.17 | 40.97 | 41.79 | 42.63 |

### 4.2 Customer Connections

OEB staff submits that a reduction to the proposed customer connections investment category of $10 million (6%) for the 2020-2024 period is appropriate.

Alectra Utilities defines its customer connections investments as "[…] connections, modifications or realignments to the distribution system that provide Alectra Utilities' customers with access to electricity."[122] There are five types of customer connections investments: layouts, new services, new subdivisions, renewable generation and customer initiated distribution system projects. Alectra Utilities' capital spending for each category is summarized in the table below:[123]

Table 8 – Customer Connection Investment Breakdown

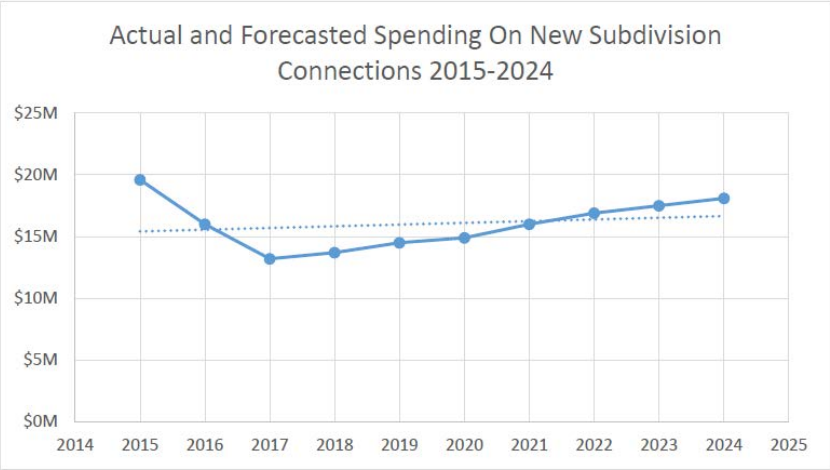
| | Historical Spending ($MM) | | | | Bridge | Forecast Spending ($MM) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| Layouts | $2.0 | $2.0 | $2.0 | $2.1 | $3.7 | $3.9 | $4.1 | $4.3 | $4.5 | $4.7 |
| ICI | $10.4 | $8.6 | $9.8 | $7.6 | $9.0 | $10.3 | $10.5 | $11.0 | $11.5 | $12.0 |
| Subdivisions | $19.6 | $16.0 | $13.2 | $13.7 | $14.5 | $14.9 | $16.0 | $16.9 | $17.5 | $18.1 |
| RGEN | $1.8 | $0.5 | $0.9 | -$0.6 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Customer Initiated | -$0.5 | $4.7 | $1.0 | $2.4 | $7.5 | $2.3 | $2.5 | $2.6 | $2.8 | $2.9 |
| TOTAL | $33.3 | $31.8 | $26.9 | $25.2 | $34.7 | $31.4 | $33.1 | $34.8 | $36.3 | $37.7 |

OEB staff's suggested capital reductions pertain to the "Subdivisions" category of spending. For subdivision connections, the historical spending shown above reflects a decrease in spending from 2015-2017 followed by an increase in spending from 2017-

[122] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A02 / p. 1
[123] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A02 / p. 26 / Table A02 - 14

2019. The year-over-year increase in spending is forecasted to continue over the 2020-2024 period. The overall trend of Alectra Utilities' historical and forecast spending is shown in the graph below:[124]

Figure 8 - Alectra Utilities' Actual and Forecasted Spending on New Subdivision Connections 2015-2024




The number of new connections under each category over the 2015-2024 period (2015-2018 actuals and 2019-2024 forecast) is reflected in the following table:[125]

Table 9 – Number of New Connections 2015-2024

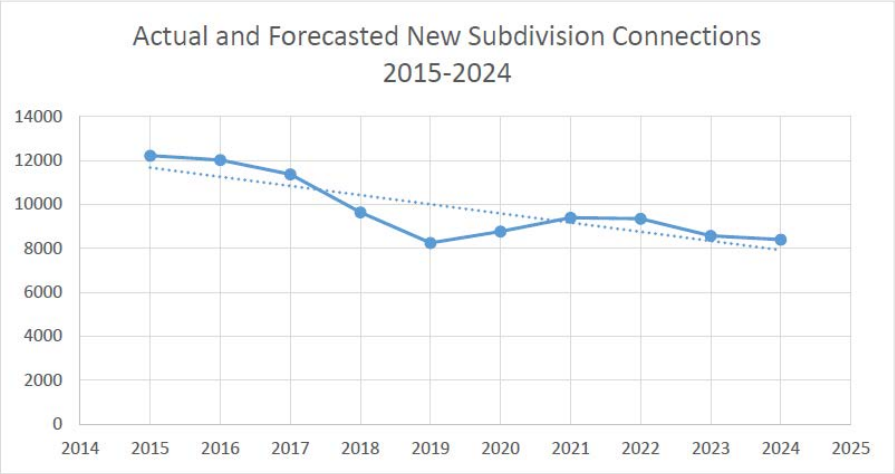
| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|
| Number of New Subdivisions (lots) | 12226 | 12023 | 11368 | 9640 | 8250 | 8775 | 9400 | 9350 | 8575 | 8400 |
| Number of ICIs | 466 | 524 | 490 | 431 | 471 | 511 | 538 | 552 | 567 | 582 |
| Number of Layouts | 7981 | 7523 | 8194 | 7133 | 7447 | 7493 | 7520 | 7631 | 7745 | 7861 |
| Number of RGEN connections | n/a | 827 | 929 | 882 | 130 | 224 | 272 | 199 | 142 | 108 |

As shown in the table, for the number of subdivision connections, there is a marked decrease over the forecast period compared to historical years (the average number of

[124] Exhibit K3.1 / p. 392
[125] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A02 / p. 21 / Table A02 - 9

subdivision connections over 2020-2024 is 8,900 compared to 10,700 for 2015-2019). Despite the trend of decreasing subdivision connections, Alectra Utilities has forecasted a consistent year-over-year increase to its subdivisions connections budget. By 2024, Alectra Utilities' annual subdivision connection budget will be $2.1 million more than its actual spend in 2016 ($18.1 million vs. $16 million).[126] This is despite forecasting the number of 2024 subdivision connections to decrease to 30% less than the actual number of connections in 2016 (8,400 compared to 12,023). Figure 9 below shows the trend of Alectra Utilities' historical and forecasted number of subdivision connections.[127]

Figure 9 – Alectra Utilities' Actual and Forecasted Subdivision Connections 2015-2024




Alectra Utilities explained that the forecasted increases to its budget are to accommodate increased redevelopment and urban intensification experienced in its service area.[128] In particular, Alectra Utilities noted that it is dealing with higher-density developments that require additional capital to deal with infrastructure constraints.[129]

However, OEB staff notes that an interrogatory response provided by Alectra Utilities, and the responses provided in the oral hearing, demonstrate that urban intensification is not a new phenomenon and has been occurring in Alectra Utilities' service area over the past ten years.[130] OEB staff submits that there is no indication that Alectra Utilities' situation with regards to urban intensification has changed, and moreover, that Alectra

[126] See Table 9 above
[127] K3.1 / OEB staff compendium / p. 391
[128] Oral Hearing / Vol. 3 / pp. 185-188
[129] *Ibid*
[130] *Ibid*; IRR EP-24

Utilities has historically been able to manage within what is contemplated in its current base rates. Additionally, OEB staff believes that the material decrease in the overall number of subdivision connections should help offset any increased costs.

Alectra Utilities argued that urban intensification will grow considerably over the DSP period and drive the need for additional capital.[131] OEB staff believes the evidence suggests a situation to the contrary. Alectra Utilities provided the following two tables in its application showing percentage increases over 5-year increments in population and employment:[132]

Table 10 – Population Increases (in %) by Cities/Regions

| City/Region | Population (% Increase from Previous Five Years)[72] | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | 2011 | 2016 | 2021 | 2026 | 2031 | 2036 | 2041 |
| Peel Region | 17% | 12% | 6% | 19% | 9% | 8% | 7% | 7% |
| City of Hamilton | 3% | 3% | 3% | 12% | 6% | 6% | 5% | 5% |
| York Region | 22% | 16% | 7% | 12% | 8% | 8% | 8% | 7% |
| City of Guelph | 8% | 6% | 8% | 9% | 9% | 8% | 7% | 6% |
| Simcoe County | 12% | 10% | 8% | 4% | 8% | 7% | 7% | 7% |
| City of St. Catharines | 1% | 0% | 1% | 3% | 4% | 6% | 6% | 5% |

Table 11 – Employment Increases (in %) by Cities/Regions

| City/Region | Employment (% Increase from Previous Five Years)[73] | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | 2011 | 2016 | 2021 | 2026 | 2031 | 2036 | 2041 |
| Peel Region | 14% | 12% | 9% | 8% | 5% | 5% | 5% | 5% |
| City of Hamilton | 7% | 7% | 8% | 9% | 5% | 6% | 7% | 8% |
| York Region | 20% | 17% | 13% | 12% | 7% | 7% | 7% | 7% |
| City of Guelph | 8% | 1% | 10% | 8% | 5% | 6% | 3% | 4% |
| Simcoe County | 17% | 8% | 9% | 6% | 4% | 3% | 7% | 7% |
| City of St. Catharines | 5% | -9% | 4% | 5% | 3% | 5% | 5% | 7% |

The purpose of new customer connections is to accommodate growth in Alectra Utilities' service area and enable new customers to have access to electricity. In both tables, OEB staff notes that the rate of increase is generally slowing between the period of 2016-2021 versus the period of 2021-2026. The change is particularly large for the population in three of Alectra Utilities' largest service territories (Peel Region, City of

[131] Oral Hearing / Vol. 3 / pp. 185-188
[132] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A02 / p. 25 / Table A02 – 11; Table A02 – 12

Hamilton and York Region).[133] The period 2021-2026 covers the latter years of Alectra Utilities' DSP period (2021-2024) and the tables above forecast slower growth over this period. OEB staff submits that the evidence suggests that the rate of urban intensification is decreasing, and that it is not reasonable to suggest an increasing capital need based on the information provided.

OEB staff submits that the increased levels of spending in new subdivision connections is not adequately justified. OEB staff suggests that Alectra Utilities' forecasted 2020 subdivision budget be calculated as the average of 2018 and 2019. This is because the average number of subdivision connections in 2018 and 2019 (average of 8,945) approximately equals the forecasted amount for 2020 (8,775 new connections). OEB staff submits that the remaining 2021-2024 forecast period budget should be the 2020 budget escalated by inflation of 2%. OEB staff's suggested reductions are summarized in the table below. The overall impact to the customer connections budget is a reduction of $10 million over the 2020-2024 period.

Table 12 – OEB Staff Suggested 2020-2024 Customer Connection Budget

| | Historical | | | | | Forecast | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **$MM** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **Alectra Utilities DSP** | 33.3 | 31.8 | 26.9 | 25.2 | 34.7 | 31.4 | 33.1 | 34.8 | 36.3 | 37.7 |
| **OEB staff** | | | | | | 30.60 | 31.48 | 32.57 | 33.76 | 34.86 |

### 4.3 Reactive Capital

OEB staff submits that a $9.9 million reduction (10%) to the reactive capital investment category for the 2020-2024 period is appropriate. OEB staff's recommendation is based on the assumption that Alectra Utilities is ordered to reduce its cable renewal budget in line with OEB staff's submission in section 4.1. In the event that the OEB approves incremental capital for Alectra Utilities' cable renewal budget, OEB staff submits that further reductions in reactive capital are appropriate as will be discussed later in this section.

[133] As shown in table 10, the expected population increase for Peel Region between 2021 and 2026 is 9% - a 10 percentage point decline from the previous 5 year period. For the City of Hamilton it is a 6 percentage point decrease from 12% to 6% and for York Region it is a 4 percentage point decrease from 12% to 8%.

Alectra Utilities' reactive capital budget is used to address assets that have failed or are at a high-risk of failing or causing safety issues. These investments are by their nature unplanned, and Alectra Utilities therefore forecasts its reactive capital budget based on historical spending. The following table summarizes Alectra Utilities' historical and forecasted reactive capital expenditures:[134]

Table 13 – Reactive Capital Historical and Forecast Investment Spending

| | Historical Expenditure | | | | Bridge | Forecast Expenditure | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| CAPEX ($MM) | $16.7 | $14.6 | $15.6 | $20.5 | $17.2 | $18.8 | $19.2 | $19.6 | $20.0 | $20.4 |

Alectra Utilities forecasted its 2020 reactive capital budget using the average spending of 2018 and 2019. The remaining years 2021-2024 reflect an annual 2% inflationary increase above the 2020 budget. OEB staff submits that it would be more appropriate to use a five-year (2015-2019) average in calculating the budget for 2020. The capital forecast should be based on historical averages, and accounting for only 2018 and 2019 does not reflect the longer-term trend and makes the calculation susceptible to inter-year variances. OEB staff notes that spending in 2018 was in fact 21% greater than the five-year average (2015-2019) of $16.9 million. Further, OEB staff submits that the decrease in reactive capital spending from 2018 to 2019 reinforces the idea that 2018 was an anomalous year.

OEB staff submits that using a five-year average can help reduce inter-year variances and provide a more accurate forecast of Alectra Utilities reactive capital needs. For 2020, OEB staff submits Alectra Utilities' 2020 reactive capital budget be set to the five-year average (2015-2019) of $16.9 million. For 2021-2024, OEB staff submits that the budget should reflect the 2020 budget of $16.9 million escalated by an inflation of 2%. OEB staff's suggested reductions is summarized in the table below. The overall impact to Alectra Utilities' reactive capital budget is a reduction of $9.9 million over the 2020-2024 period.

[134] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A06 / p. 10 / Table A06 – 4

Table 14 – OEB Staff Suggested 2020-2024 Reactive Capital Budget

| | Historical | | | | | Forecast | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **$MM** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **Alectra Utilities DSP** | 16.7 | 14.6 | 15.6 | 20.5 | 17.2 | 18.8 | 19.2 | 19.6 | 20 | 20.4 |
| **OEB staff** | | | | | | 16.92 | 17.26 | 17.60 | 17.96 | 18.31 |

*Incremental Cable Renewal Capital*

OEB staff's suggested reductions to the reactive capital budget above is based on the assumption that Alectra Utilities is not approved incremental cable renewal capital as proposed (per OEB staff's submission in section 4.1). However, in the event that the OEB approves incremental cable renewal capital for Alectra Utilities, OEB staff submits that additional reductions should be made to Alectra Utilities' reactive capital budget for the following reasons.

Alectra Utilities has indicated that reactive replacement of underground cables account for a significant portion of its reactive capital budget. An example from Alectra Utilities' 2020-2024 DSP is the York Hill/Hilda neighbourhood in Vaughan, which ultimately required Alectra Utilities to invest $3.8 million in capital to address cable failures.[135] As noted by Alectra Utilities, cable replacements on a reactive, emergency basis is generally more expensive than planned cable replacements.[136] Alectra Utilities estimated the cost of reactive replacement to be 3.21 times more expensive on average (when compared to a planned replacement).[137]

As previously noted in section 4.1 of this submission, Alectra Utilities' proposed cable renewal budget over the DSP period is a $135.7 million increase above the 5-year historical spend 2015-2019. Given the large incremental amount of cable renewal, OEB staff submits it is reasonable to expect Alectra Utilities' reactive capital needs to decrease. By increasing the pace of planned cable replacements, Alectra Utilities will be reducing the need to make expensive reactive investments like the York Hill/Hilda example. Further, because reactive cable replacements are significantly more expensive than planned replacements, OEB staff expects any avoided reactive cable investments to have a large impact on Alectra Utilities' overall reactive capital budget.

[135] Exhibit 4 / Tab 1 / Schedule 1 / p. 3; IRR G-Staff-25
[136] *Ibid*; Oral Hearing / Vol. 3 / p. 182
[137] IRR SEC-51

Alectra Utilities noted that, despite Alectra Utilities' proposed increases to cable renewal spending, reactive capital needs are not expected to decrease because an increasing number of cables are expected to reach their end-of-life.[138] OEB staff disagrees with the premise that Alectra Utilities' aging cable population will increase the need for reactive capital. As previously discussed in section 4.1, OEB staff does not view age as an adequate indicator of asset condition for cables. Moreover, OEB staff notes that, despite the increasing age of Alectra Utilities' cable population over the historical period of 2015-2019, there has not been a significant increase in actual reactive capital spending (between 2015-2019).

If 2015 is used as a baseline year, escalating the actual 2015 reactive capital spending for a 2% inflation year-over-year to 2019 would result in a five-year total budget of $86.9 million. This is more than Alectra Utilities' 2015-2019 actual reactive capital spending of $84.6 million and suggests that Alectra Utilities' reactive spending needs are not increasing beyond inflation.[139] Alectra Utilities' cable renewal budget has also remained relatively stable, with higher spending in 2017 that is offset by a decrease in spending in 2019. Based on this evidence, OEB staff submits that Alectra Utilities' historical reactive capital spending does not support its assertion that reactive capital will continue to increase despite increased spending in cable renewal. There has not been a correspondingly large increase in reactive capital over the 2015-2019 period, despite Alectra Utilities' assertions that its historical levels of cable renewal have been insufficient. OEB staff is of the view that historical levels of reactive capital spending have remained consistent given the historical level of Cable Renewal spending, and that any significant increase in Cable Renewal spending should reasonably reduce the amount of reactive capital required.

In the event that the OEB approves Alectra Utilities' request for incremental funding of cable renewal investments, OEB staff recommends that a percentage reduction in reactive capital be made. OEB staff suggests that half of the reactive capital budget be reduced by a percentage equal to the percentage increase in approved cable renewal spending compared to 2015-2019 historical period.[140] OEB staff suggests using half of

[138] Oral hearing / Vol. 3 / pp. 182-183
[139] See Table 13 above
[140] As an example, if Alectra Utilities is approved all of the requested extra cable renewal capital for its 2020-2024 budget (a 69% increase above 2015-2019 spending), OEB staff suggests reducing half of Alectra Utilities' Reactive Capital by 69%. In this case that would be a reduction of ($98 / 2) * 69% = $33.8 million. A reduction of $33.8 million would mean a total 2020-2024 Reactive Capital budget of $64.2 million.

the reactive capital budget to account for the fact that reactive cable replacement make up only a portion of Alectra Utilities' reactive capital budget.

### 4.4 Fleet Renewal

Alectra Utilities' fleet renewal budget over the 2020-2024 DSP period totals $48.8 million and is summarized in the table below:[141]

Table 15 – Alectra Utilities' Fleet Renewal Budget

| | Historical Spending | | | | Bridge | Forecast Spending | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| CAPEX ($MM) | $7.5 | $4.3 | $3.2 | $6.7 | $8.5 | $8.9 | $9.5 | $9.9 | $10.3 | $10.2 |

Alectra Utilities' forecasted fleet renewal expenditures is $18.6 million (61.6%) higher than its five-year historical spending of $30.2 million from 2015-2019. OEB staff submits that a total reduction of $17.4 million (36%) in Alectra Utilities' fleet renewal investment category is appropriate.

Alectra Utilities uses its fleet renewal budget to replace vehicles that it has determined to be deteriorated and in need of replacement. Alectra Utilities stated that a significant portion of its fleet is due for replacement, and that even with the increased pace of fleet renewals contemplated in this DSP, it will not be able to replace all of its end-of-life vehicles by the end of the DSP period.[142] As part of its vehicle renewal process, Alectra Utilities explained that it considers the usage of a vehicle when determining whether a vehicle should be replaced, and that Mercury Associates is currently in the process of conducting a vehicle utilization study on its behalf.[143]

Alectra Utilities explained that it can reduce its fleet, and will use the outcome of the vehicle utilization study to inform its vehicle replacement approach.[144] Further, Alectra Utilities noted that the plan laid out in its current DSP proposes to only replace vehicles that it identifies to be fully utilized and beyond end-of-life.[145] OEB staff finds Alectra

[141] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A19 / p. 15
[142] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A19 / pp. 9-10
[143] *Ibid* / pp. 5-6
[144] IRR G-Staff-58
[145] *Ibid*

Utilities' explanation to be at odds with the fact that the Mercury Associates study is yet to be completed. The vehicle utilization study should provide a holistic view of Alectra Utilities' fleet and the utilization levels of its vehicles. Pending the conclusions of the report, OEB staff does not understand Alectra Utilities' assertions that it can identify vehicles that are fully utilized, and that it is realistically reducing its fleet. OEB staff is of the view that it would be more prudent for Alectra Utilities to defer additional fleet renewal spending until it has had the chance to consider and implement the conclusions of the Mercury Associates report. This would reduce the risk of Alectra Utilities replacing vehicles that the Mercury Associates report deems underutilized and unnecessary.

Alectra Utilities noted that the lack of fleet renewal capital in historical years has made it necessary to keep vehicles in operation past end-of-life through repairs and maintenance.[146] Alectra Utilities stated during the oral hearing:[147]

> […] the first preference obviously, as any good prudent manager would do, is maintain the fleet and you do maintenance and repairs as much as possible, to the point where it doesn't make any business sense to continue to invest money into that vehicle, and then it becomes a candidate for replacement.

OEB staff recognizes Alectra Utilities' efforts to manage within its means and to extend the life of its assets to the greatest extent possible. OEB staff agrees that this is the most prudent approach to fleet management and expects Alectra Utilities to continue to manage its fleet renewal in this manner. However, the M-factor business cases provided for fleet renewal seem to suggest a departure from the strategy to maintain the fleet, and a shift to replacing vehicles solely based on age.[148] As an example, the business case for "Project Code 150811 – Fleet Central Couth Vehicle Replacement-Pick ups" provides the following project summary description:[149]

> […] Units 416-14, 421-14, 429-14 will be a projected 7-8 years in service when decommissioned. Parts availability is low due to the overall age of this unit and will continue to decline as time progresses. Repair costs will continue to increase, unit reliability, and lower availability of parts will contribute in the reduction of vehicle availability, decreasing productivity and challenging planning and scheduling[….]

[146] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A19 / p. 13
[147] Oral hearing / Vol. 1 / p. 153
[148] Alectra Utilities provided business cases for each M-factor project in undertaking J3.3
[149] Undertaking J3.3 / p. 286

OEB staff notes that nowhere in the business case is there any mention of a deficiency in the asset condition of these specific vehicles. While the business case does make mention of a process to assess the condition of vehicles, there is no mention any specific deficiencies for the vehicles that are being replaced as part of this business case. The sole criterion appears to be the increasing age of the vehicles, and similar business cases can be found for other fleet renewal projects.[150] OEB staff views the approach taken in the business cases for the current DSP to be at odds with the prudent approach of maintaining assets as long as economically feasible. OEB staff submits that Alectra Utilities should reevaluate its planned fleet replacements, and continue to operate vehicles that can be reasonably repaired and maintained.

The business cases provided by Alectra Utilities also seem to be at odds with Alectra Utilities' own investment pacing as shown in the table below:[151]

Table 16 – Alectra Utilities Vehicles 2020 – 2024 Replacement Age

| Fleet Types (2020-2024) | Replacement Criteria (Years) | Average Age at Replacement Period (Years) |
|---|---|---|
| Trailers Replacement | 15 | 19.5 |
| Fleet Equipment Replacement | 15 | 21.8 |
| Light Duty Vehicles Replacement | 10 | 10.6 |
| Medium Duty Vehicles Replacement | 12 | 12.3 |
| Heavy Duty Vehicle Replacement | 15 | 17 |

As shown in the second column of the table above, Alectra Utilities has set out a replacement criteria for the vehicles it expects to replace throughout the course of this DSP period. However, OEB staff notes that many of the vehicles being replaced do not meet the age criterion for replacement.[152] To illustrate, OEB staff takes as an example the business case for Project Code 150786, which refers to the replacement of an SUV in the Mississauga service territory.[153] The business case states that the "Units 512-12 will be a projected 8 years in service when decommissioned."[154] The lowest age for replacement of any vehicle class, as noted in the table above, is 10 years. If Alectra

[150] Project codes: 150786, 150796, 150797, 150810
[151] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A19 / p. 9
[152] While not an exhaustive list, examples include project codes: 150786, 150796, 150797, 150810, 150811, 150812
[153] Undertaking J3.3 / p. 266
[154] *Ibid*

Utilities classifies SUVs as a "light duty vehicle," then this particular SUV should not be replaced for an additional two years. By Alectra Utilities' own criteria, it appears that this SUV is being replaced too early. The evidence suggests that Alectra Utilities is budgeting for vehicle replacements at a greater pace than is prudently necessary. OEB staff submits that Alectra Utilities' forecasted fleet renewal budget should be reduced.

In light of the deficiencies identified above, OEB staff submits that it is appropriate to reduce Alectra Utilities' fleet renewal budget to historical levels, plus inflation. OEB staff calculates the average annual expenditure 2015-2019 to be $6 million and submits that this be Alectra Utilities' forecasted budget for 2020. For 2021-2024, OEB staff applies a 2% inflation onto the 2020 budget. OEB staff's suggested forecast fleet renewal expenditures is $31.4 million which represents a 36% reduction from Alectra Utilities' proposed budget. OEB staff's suggested reductions are summarized in the table below.

Table 17 – OEB Staff Suggested 2020-2024 Fleet Renewal Budget

| | Historical | | | | | Forecast | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| $MM | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| **Alectra Utilities DSP** | 7.5 | 4.3 | 3.2 | 6.7 | 8.5 | 8.9 | 9.5 | 9.9 | 10.3 | 10.2 |
| **OEB staff** | | | | | | 6.04 | 6.16 | 6.28 | 6.41 | 6.54 |

### 4.5 OM&A Synergies

Sections 4.1 to 4.4 outline OEB staff's recommendations for capital disallowances in the event that the OEB approves the M-factor mechanism for 2020-2024 rates. These recommendations may also assist the OEB in determining appropriate capital funding under the existing ICM policy should an M-factor mechanism be rejected.

In this section, OEB staff will address the potential for OM&A savings as a result of a substantially increased capital funding envelope through the M-factor mechanism, and the treatment of those incremental savings.

Alectra Utilities takes the position that the MAADs policies allow for it to retain all capital and OM&A synergies arising from its consolidation during the course of its deferred rebasing period.[155] OEB staff agrees. However, OEB staff submits that the OEB may

[155] IRR G-Staff-15

wish to consider offsets due to incremental OM&A savings resulting from capital expenditures proposed in the DSP funded through the M-factor given that such a funding mechanism was not contemplated by the MAADs policies.

OEB staff submits that Alectra Utilities' M-factor proposal is similar to a rebasing application in the sense that Alectra Utilities is seeking OEB approval for rates to fund essentially all of its capital needs. However, as opposed to a regular rebasing application, OEB staff is of the view that Alectra Utilities' M-factor proposal is asymmetrical and inequitable for ratepayers because there is no corresponding mechanism to address the trade-off between capital and OM&A, and any potential OM&A savings.

With respect to OM&A savings in the DSP, OEB staff submits that Alectra Utilities has not sufficiently justified the lack of forecasted savings in OM&A. Alectra Utilities notes in its application that, overall, the impact of its DSP capital investments on OM&A costs will be relatively minimal.[156] OEB staff disagrees and will discuss below potential areas of significant OM&A savings, namely related to Rear Lot Conversions, Underground Cable Renewal, and Other Projects with Synergies. OEB staff's discussion below is not an exhaustive list of potential areas of synergies and is intended to illustrate OEB staff's concerns with Alectra Utilities' lack of identified OM&A savings.

*Rear Lot Conversion*

Certain neighbourhoods in Alectra Utilities' service areas continue to be served through rear lot overhead infrastructure. As noted in the application, rear lot configurations pose a number of difficulties for Alectra Utilities including:[157]

- Line clearing hazards and related additional costs with large trees being near power lines
- Not being able to use labour saving tools and devices like bucket trucks
- Congestion and difficulty in using ladders due to Ministry of Labour restrictions
- Constraints due to legacy porcelain top tie insulators and undersized conductors

[156] Exhibit 4 / Tab 1 / Schedule 1 / p. 374
[157] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A07 / pp. 2-3

Alectra Utilities further notes that rear-lot service reliability metrics are significantly higher than its overall system reliability, with its rear-lot SAIFI being nine times greater than its average three year system-wide SAIFI.[158]

In business cases for rear lot projects, Alectra Utilities acknowledges that rear lot conversion projects introduce efficiencies. As an example, the business case for "Project Code 150044 – Rear lot renewal project Blake/Kempenfelt" notes "[this project] introduces efficiencies for the utility, as tree trimming activities can be eliminated."[159] Further, the business case states that the O&M cost for failures is $50,000 per failure, which is avoided by undertaking the conversion project.[160]

With a proposed total investment of $19.9 million in removing rear lot infrastructure over the DSP period, OEB staff notes that Alectra Utilities will have addressed a significant portion of its rear lot infrastructure.[161] OEB staff believes this should have a material impact on Alectra Utilities' OM&A spending as it eliminates the difficulties associated with performing maintenance on rear lot infrastructure, and reduces the frequency of outages to which Alectra Utilities crews must respond.

*Underground Cable Renewal*

Alectra Utilities' proposed cable renewal investments have a focus on addressing its direct-buried XLPE cables.[162] As noted by Alectra Utilities, direct-buried cables do not have "[…] any additional mechanical protection that would be offered by a ducted installation [and makes it more…] difficult to replace or repair when they fail."[163] Alectra Utilities' current practice is to install all new cables in-duct.[164]

OEB staff submits that the practice of replacing direct-buried with in-duct cables should reduce the OM&A costs for Alectra Utilities to maintain, replace or repair these cables in the future, and that the reduction to OM&A is not insignificant. As an example, OEB staff points to the direct-buried cable replacement in the York Hill/Hilda neighbourhood,

[158] *Ibid* / p. 12
[159] Undertaking J3.3 / p. 64
[160] *Ibid*
[161] *Ibid* / p. 15
[162] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A10 / p. 2
[163] Exhibit 4 / Tab 1 / Schedule 1 / p. 263
[164] Technical Conference / Vol. 2 / p. 154; Exhibit 4 / Tab 1 / Schedule 1 / Appendix A10 / p. 8

where Alectra Utilities spent $0.208 million in operating and maintenance costs related to the excavation and repair of the deteriorated cable.[165]

*Other Projects with Synergies*

In reviewing Alectra Utilities' business cases for the M-factor projects, OEB staff notes the following projects with potential material impacts on Alectra Utilities' OM&A spending. OEB staff's discussion below is not intended to be an exhaustive review of the entirety of Alectra Utilities' business cases but is meant to illustrate the potential impact of Alectra Utilities' capital projects on OM&A.

**Project code 102263 – Work Force Management / Mobile Dispatch:**[166] This project is to implement a new Work Force Management, Dispatch and Reporting Tool to support Alectra Utilities' needs related to Mobile Work Force and Work Flow Management.[167] By Alectra Utilities' own description, the new system will enable its staff to process higher volumes of data, and enable the utility to gain efficiencies. The stated expected benefits are:[168]

- reduced time on allocating resource and scheduling jobs
- productivity gains in the execution of field work
- reduced fuel costs due to route optimization, and improved scheduling and tracking of short-duration work

OEB staff submits that, for a utility the size of Alectra Utilities, the impact on OM&A from the benefits listed above can be significant

**Project code 150317 – Voltage Conversion – Deerhurst MS, Hamilton:**[169] This project is one of Alectra Utilities' many voltage conversion projects to upgrade feeder assets to higher distribution voltages. The "Justification for Recommended Alternative" section of the business case lists reduced O&M costs due to the elimination of substation assets as one of the incremental benefits of the project.[170] Although reduced O&M costs is listed only as an incremental benefit, OEB staff expects all of Alectra Utilities' voltage conversion projects to provide similar benefits and therefore, on

[165] IRR G-Staff-25
[166] Undertaking J3.3 / pp. 47-49
[167] *Ibid* / p. 48
[168] *Ibid* / p. 49
[169] Undertaking J3.3 / pp. 111-113
[170] *Ibid* / p. 112

aggregate, to have a significant impact on Alectra Utilities' OM&A costs. Given that Alectra Utilities' total proposed capital expenditures on voltage conversion over the 2020-2024 period is $49.4 million, OEB staff submits that it is reasonable to expect material OM&A savings through the implementation of voltage conversion projects.[171]

**Project code 150758 – Facilities Reno Staff Relocation from Jane St.:**[172] This project is to renovate Alectra Utilities owned facilities to accommodate its employees moving in from its Jane St. facility. Alectra Utilities expects to terminate the lease for the Jane St. office in 2022, and in the business case states that it expects to reduce operational expenditures through this project.[173] The business case notes that remaining status quo (i.e. continuing to lease the Jane St. facility) results in high costs for the lease of the Jane St. facility.[174] OEB staff submits that the OM&A costs of leasing the Jane St. facility would have reasonably been contemplated and included in Alectra Utilities' base rates at the time of its predecessor utilities' rebasing application. If the lease is terminated, OEB staff submits it would be reasonable to expect Alectra Utilities' OM&A budget to be reduced by this amount.

**Project codes 150749, 150773, 150785 – New WiMAX Communications System – Central South, Central North, West:**[175] These three projects all pertain to new WiMAX systems in three of Alectra Utilities' service territories. In each business case, under the "Justification for Recommended Alternative" section, Alectra Utilities notes significant OM&A reductions for proceeding with these projects.[176] The expected annual savings for the Central North, West and Central South territories are, respectively, $75,000, $80,000 and $570,000.[177] OEB staff submits that these are sources of significant and material OM&A savings that have not been sufficiently accounted for in Alectra Utilities' OM&A forecast. Alectra Utilities' DSP does mention its expectation that decreases in OM&A due to system renewal investments would be offset by the increased volume of new asset installations.[178] However, the DSP does not make any mention in that section on potential OM&A savings through the use of new technologies, and the impact of its

[171] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A05 / p.49
[172] Undertaking J3.3 / pp. 256-257
[173] *Ibid* / p. 256
[174] *Ibid*
[175] Undertaking J3.3 / pp. 253-255, 258-260, 263-265
[176] *Ibid* / pp. 254, 259, 264
[177] *Ibid*
[178] Exhibit 4 / Tab 1 / Schedule 1 / p.374

system service spending, which is the category of investments these three projects are under.[179]

*Treatment of OM&A Savings*

OEB staff notes that, under the terms of Alectra Utilities' consolidation, there does exist an Earning Sharing Mechanism (ESM) for Alectra Utilities to share any earnings 50/50 in excess of 300 basis points.[180] However, OEB staff submits that the ESM is in the context of consolidation synergies and does not necessarily provide an appropriate venue to deal with OM&A savings related to incremental capital spending. OEB staff submits that the M-factor proposal, and its potential ramifications for OM&A, was not contemplated at the time of Alectra Utilities' consolidation application. OEB staff notes that, in a rebasing application, a utility's revenue requirement would be set to allow the utility to recover its deemed ROE. Absent a rebasing application, there is no opportunity to set Alectra Utilities' OM&A budget to reflect its actual needs.[181]

In light of the above, OEB staff submits that, in the event that the M-Factor is approved, the OEB may wish to consider whether separate treatment of OM&A savings through some form of offset (such as a 50/50 sharing) is warranted. OEB staff acknowledges that this may be difficult to track, but suggests that if the OEB was to approve some form of offset, Alectra Utilities could file a proposal for how to track these savings in its next rate application.

### 4.5 Customer Engagement

Alectra Utilities retained Innovative Research Group to conduct its customer engagement for its 2020-2024 DSP. The customer engagement was completed through two phases in 2018 and 2019. Feedback from the first phase of engagement provided input on customers' needs and preferences and formed the basis for the second phase of customer engagement.[182] The second phase of engagement surveyed customers' preferences on specific areas of capital investment and informed Alectra Utilities' pacing

[179] The section being referred to is Exhibit 4 / Tab 1 / Schedule 1 / Section 5.4.2.4 System O&M Costs / p. 374
[180] EB-2016-0025, EB-2016-0360 / Decision and Order / December 8, 2016 / pp. 18-19
[181] As an example, the business case for project 150749 found on p. 254 of Undertaking J2.4 notes "1) Substantial OM&A Cost Reductions: Alectra will save ~$570,000/year[….]" OEB staff believes the potential OM&A savings are significant.
[182] Exhibit 4 / Tab 1 / Schedule 1 / Appendix C / Executive Summary – p. 2

of its investments.[183] Alectra Utilities stated that the overall impact of customer engagement on its 2020-2024 capital investment plan was a net reduction of $17.5 million.[184]

OEB staff submits that Alectra Utilities has conducted an extensive survey of its customers' needs and preferences. OEB staff is generally of the view that Alectra Utilities has conducted an appropriate level of customer engagement, but notes some concerns in the discussion below.

As shown in the Customer Engagement Planning Placemat and acknowledged by Alectra Utilities, price is a top concern for customers.[185] OEB staff believes this is further reinforced by the fact the majority of customers in all rate classes indicated their preference for the "recommended pace" or "base pace," as opposed to the "accelerated pace," for all investment categories.[186] Alectra Utilities stated that their proposed investments provide what their customers want.[187]

However, this does not appear to be the case to OEB staff. For underground cable renewal, an investment category with one of the largest increases in forecasted capital spending, customers did not select the pace that Alectra Utilities ultimately chose: the accelerated pace. In fact, no rate class indicated a strong preference for the accelerated pace, and all rate classes had a majority of customers indicate a preference for the "recommended pace."[188] Despite the clear mandate from customers, Alectra Utilities is proposing an accelerated underground cable renewal program in the current DSP.[189] Alectra Utilities asserted that an accelerated approach to underground cable renewal is necessary to address asset deterioration.[190] OEB staff notes that the slower paced

[183] Exhibit 2 / Tab 1 / Schedule 2 / p. 10
[184] *Ibid*
[185] Exhibit 4 / Tab 1 / Schedule 1 / Appendix C / Customer Engagement Planning Placemat; Exhibit 2 / Tab 1 / Schedule 2 / p. 9
[186] Exhibit 4 / Tab 1 / Schedule 1 / Appendix C; wherever Alectra Utilities provided options between an accelerated pace versus a slower paced option, the majority of customers opted for the slower option. Alectra Utilities did not provide an "accelerated pace" option for all investment categories, in which case the majority of customers generally selected the "recommended pace."
[187] Oral Hearing / Vol. 2 / p. 169
[188] Exhibit 4 / Tab 1 / Schedule 1 / Appendix C; the number of customers that chose the "recommended pace" is: 52% of residential customers, 49% of small business customers (next preferred option is "base pace" at 27%), 71 out of 137 GS < 50kW customers, and 8 out of 13 large users.
[189] Exhibit 4 / Tab 1 / Schedule 1 / Appendix A10 / pp. 16-17
[190] IRR G-Staff-23

option customers chose in the customer engagement was actually the option put forward and recommended by Alectra Utilities themselves.[191]

The majority of customers generally chose the option recommended by Alectra Utilities. However, OEB staff believes that Alectra Utilities overstated some of its assertions in its customer engagement material. Alectra Utilities states that it spends an average of approximately $19 million on reactive spending.[192] OEB staff disagrees with this statement and notes that, out of the five recent historical years (2015-2019), only in 2018 did reactive capital spending exceed $19 million. The average reactive capital spending 2015-2019 is actually $16.9 million. While OEB staff agrees that customers generally support funding Alectra Utilities' reactive capital needs, OEB staff believes that the customer engagement has provided customers with a false dichotomy. The choice is seemingly between either allocating approximately $19 million annually for reactive capital spending, which OEB staff submits is overstated and excessive, or allocating no money for reactive capital funding.

As previously noted, Alectra Utilities' AiC asserts the funding gap to be $370.4 million based on a revised materiality threshold calculation.[193] To accommodate the revised funding gap, the AiC requested OEB approval to record in the CIVA for future disposition any DSP projects unfunded through base rates or the M-factor.[194] If this request is denied, the AiC stated that Alectra Utilities would not have the funding required to execute its DSP.[195]

OEB staff submits that, in light of Alectra Utilities' revised calculations and request, the customer engagement information should be afforded slightly less weight in reflecting customer preferences. As stated in the application, one part of the customer engagement was an online workbook that allowed customers to select various investment options and see the rate impact of their decisions and provide "[…] an opportunity to reconsider their answers on individual investment choices after reviewing the total rate impact of their initial choices."[196] Given that Alectra Utilities has calculated an increase in the funding gap of 35%, from $275 million to $370.4 million, there is now a separate group of "unfunded" projects that need to be considered. Customers have

[191] The "recommended pace" in the customer engagement is the moderate pace (i.e. not the accelerated pace) described in the DSP.
[192] Exhibit 4 / Tab 1 / Schedule 1 / Appendix C / p. 36
[193] AiC / p. 5
[194] *Ibid* / p. 23
[195] *Ibid* / p. 32
[196] Exhibit 2 / Tab 1 / Schedule 2 / p. 10

not had the opportunity to evaluate investment options in the context of the larger $370.4 million funding gap (that may be virtually fully funded per the revisions to the CIVA) and therefore would not have had an opportunity to consider the potential rate impact of their choices.

OEB staff submits it is reasonable to expect customer's preferences to change if the incremental capital request, and associated rate impact, increases by up to 35%. Therefore, OEB staff submits that the customer engagement, in the context of the revised $370.4 million funding gap, is less indicative of customer preferences or approval for Alectra Utilities' capital plans than if Alectra Utilities has not proposed these changes.

OEB staff submits that the OEB should weigh the results of Alectra Utilities' customer engagement efforts as only one input in Alectra Utilities' decision-making process, along with all other evidence that have been filed in this proceeding. That said, if the OEB approves the M-factor mechanism, OEB staff submits that the expansion of the CIVA as proposed by Alectra Utilities in its AiC should be denied. As noted above, OEB staff gives reduced weight to the customer engagement information because customers have not had the chance to provide input on the revised CIVA proposal. This, along with an additional concern about the lack of opportunity to test the revision to the CIVA proposal, demonstrates a lack of justification for the proposed revisions to the CIVA. This is discussed further below.

# 5. Requests for New Deferral and Variance Accounts

## 5.1 Capital Investment Variance Account

In conjunction with its M-factor request, Alectra Utilities is also proposing a CIVA that,[197] as originally proposed, would capture the variance between the actual capital investments (i.e., capital additions)[198] in each year and each rate zone and the currently proposed 203 M-factor projects.[199] The CIVA would track any differences between the capital funding provided through its proposed M-factor and the actual revenue requirement for M-factor projects placed in service during the 2020-2024 period. As proposed originally in the application, the only variances that would be recorded in the

[197] This CIVA is distinct from the existing CIVA that Alectra Utilities has, and is being dealt with separately in the EB-2019-0018 application under accounting matters; Exhibit 2 /Tab 1/ Schedule 4 / pp. 1-3
[198] Technical Conference / Vol. 1 / pp. 119-120
[199] As amended in the AiC; 194 in the original application and to the end of the oral hearing.

CIVA would be variances attributable to work being accelerated, deferred or re-prioritized between rate zones, variances in actual versus forecast costs of execution and variances in the scope of individual M-factor Projects that may be necessary. No new projects would be added for recovery as part of the M-factor.[200]

The CIVA is proposed as a symmetrical account, in that capital cost over-runs and under-runs for the 203 M-factor projects would be accumulated over the five-year plan; the one caveat is that there would be a ceiling of $9.3 million for the CIVA, while there would be no floor. The CIVA would include zone-specific sub-accounts to enable tracking of investments for each rate zone.

While Alectra Utilities has corrected data for several of the rate zones and changed its materiality threshold calculations, it is not proposing to alter the list of M-factor projects, the M-factor budget or the $9.3M ceiling.[201]

Alectra Utilities agreed to also record the variance, by rate zone, between what is the revenue requirement for the M-factor capital projects based on actual costs and the revenues from the M-factor rate riders as collected from Alectra Utilities' ratepayers.[202] Exhibit JT1.5 provides further description of the CIVA.

Finally, in its AiC, Alectra Utilities proposed that it be allowed to track in a separate sub-account of the CIVA the revenue requirement associated with any capital expenditures for projects, other than the 203 M-factor projects, documented in the DSP and for which recovery was not afforded through price cap-adjusted distribution rates. The amounts recorded would be subject to a review for prudence, and Alectra Utilities would apply for disposition to recover the amounts at the end of the 2020-2024 plan term.[203]

If the OEB rejects Alectra Utilities' M-factor, as OEB staff submits it should in this submission, OEB staff submits that the CIVA is unnecessary. If the OEB provides Alectra Utilities with ICM treatment of some qualifying 2020 capital projects, OEB staff notes that ACM/ICM policy already specifies the accounting treatment for approved ACM/ICM projects through specified sub-accounts of Account 1508 – Other Regulatory

[200] *Ibid* / pp. 120-122
[201] Oral Hearing / Vol. 2 / pp. 3-5; AiC, pp. 31-32
[202] *Ibid* / pp. 134-137
[203] AiC / pp. 6, 21, 23, 32

Assets.[204] Alectra Utilities will also have to record the information with the necessary sub-accounts for each of the five rate zones.

OEB staff concurs with Alectra Utilities that the CIVA is integral to the M-factor proposal.[205] OEB staff submits that, should the OEB approve the M-factor, the accompanying CIVA should also be approved as it provides protection for customers should Alectra Utilities fail to spend its approved M-factor capital funding or alters the timing of putting assets in-service. The rate zone sub-accounts will also ensure that ratepayers in each zone only pay for capital that is invested for them. Capping the CIVA at $9.3 million limits the total amount ratepayers could be responsible for.

As noted earlier however, OEB staff does not support the expansion of the CIVA to cover further projects that are not contemplated in the current M-factor proposal. OEB staff submits that parties have not had the opportunity to test the reasonableness of this proposal.

If the OEB does approve the M-factor, in some form, OEB staff submits that Alectra Utilities should be directed, as part of any draft rate order, to provide a draft accounting order detailing the accounting for the CIVA. OEB staff also submits that the proposed accounting order and the CIVA sub-accounts should be informed by and consistent with the accounting treatment as documented in the OEB's ACM/ICM policy.

### 5.2 Externally Driven Capital Variance Account

Alectra Utilities has requested approval of a new symmetrical EDCVA to capture differences between the revenue requirement associated with externally driven capital expenditures (related to regional transit projects and capital works required by road authorities) as forecasted in the DSP, and the actual revenue requirement for in-service additions associated with such projects in the same period. This includes changes in scope and timing of anticipated road authority and transit projects and for additional road authority and transit projects not currently contemplated. Alectra Utilities stated that these are non-discretionary projects that are driven by third parties who have control over the timing, scope and costs of their projects, which dictates the need, timing, scope and costs of distribution system relocation and reconstruction work. Alectra Utilities is obligated to remove, relocate or reconstruct parts of its distribution infrastructure to allow for the installation of rapid transit and road infrastructure.

[204] ACM Report / Section 7.5: Accounting Treatment
[205] Oral Hearing / Vol. 1 / pp. 159-160

While Alectra Utilities has included a forecast of capital costs for projects related to regional transit projects and work required to road authorities based on historical actuals in its capital budget, it noted that the expenditures can be highly volatile.[206] The requested deferral account would capture any unanticipated expenditures on these type of projects.

In Alectra Utilities' 2018 rate application there was a request for a similar deferral account for two of the rate zones; one for each of the PowerStream rate zone and Enersource rate zone, to record the financial impacts resulting from the Metrolinx Crossing Remediation Project.[207] The OEB denied approval of the new deferral accounts, stating that:

> [t]he OEB has adopted the ICM for incremental funding for capital projects. When more details of these projects are available, including budgets and in-service date, Alectra Utilities can apply for an ICM if it meets the OEB's criteria. To adopt deferral accounts to address the funding of capital would make the ICM materiality threshold calculation meaningless because there would be two different funding mechanisms for incremental capital.[208]

OEB staff submits that, in keeping with its submission that the OEB should deny Alectra Utilities' request for an M-factor and that ICM funding is the appropriate mechanism for funding incremental capital during the deferral period, the request for the EDCVA should also be denied. The reasons stated by the OEB in the 2018 application decision quoted above also apply in this situation.

If, however, the OEB decides to approve the M-factor, OEB staff submits that the EDCVA should be approved as well. If the M-factor is approved, Alectra Utilities has indicated that it will not seek any ICM funding during the remainder of its DSP term (2020-2024).[209] Consistent with the OEB's decision in the 2018 application, OEB staff submits the EDCVA would be appropriate if the M-factor is approved as there would no longer be the availability of ICMs for unforeseen incremental capital needs.

[206] Exhibit 2 / Tab 1 / Schedule 4 / p. 4
[207] EB-2017-0024
[208] EB-2017-0024 / Decision and Order / April 6, 2018 / p. 72
[209] IRR G-Staff-17

# 6. Funding of Incremental capital

## 6.1 ICM funding

In the event the OEB rejects the M-factor proposal and in the event the OEB wishes to approve incremental capital funding for Alectra Utilities for 2020, OEB staff submits that there are a number of projects, out of the requested $52.7 million 2020 M-factor funding, that could be approved as ICM projects as they meet the project specific materiality threshold and similar projects have been approved in the past, for example:

Project 151124 Goreway TS Expansion (CCRA) - 10 Yr True-Up Payment, Brampton $5.6 million

Project 151125 Midhurst TS (CCRA) – 15 Yr True-Up Payment, $3.2 million

The above two projects are similar in nature to the Brampton rate zone Pleasant TS True-up ICM project approved as part of Alectra Utilities' 2018 application.[210]

Project 150343 Bathurst Street Widening $3.4 million

The above project is the 2020 portion of the Bathurst Street road widening as per requirements of Public Services Works on Highway Act. Phase 1 of this project was approved as an ICM as part of the 2019 application.[211]

OEB staff provides the examples above to illustrate projects that would likely be eligible for ICM funding. While this is not necessarily an exhaustive list of all possible eligible ICM projects, Alectra Utilities has not provided a list of projects that it would potentially seek to fund through ICMs for 2020 rates. Moreover, the evidence is not sufficient for OEB staff to evaluate whether additional projects are likely eligible for ICM treatment. As a result, OEB staff is unable to support that ICM funding be provided for any other projects as part of 2020 rates.

OEB staff acknowledges that one potential benefit of the M-factor proposal is that it is more efficient than annual ICM proposals as funding for all five remaining years of the deferral period will be approved in this application (subject to a review of the CIVA and potentially the EDCVA). It is true however that the ICM has a companion funding

[210] EB-2017-0024 / Decision and Order / April 5, 2018 / p. 32
[211] EB-2018-0016 / Decision and Order / January 31, 2019 / p. 14

mechanism for cost based applications in the form of the ACM. If the OEB was inclined to provide more certainty to Alectra Utilities for its capital funding envelope for the remainder of the term, it could allow Alectra Utilities to file supplemental evidence as part of a phase 2 to the M-factor proceeding so that parties can make submissions, following an additional discovery process, as to what projects should be approved for ACM-like treatment for 2021-2024. These submissions would be in the context of parties knowing any changes to the parameters of the threshold calculation should the OEB adopt any changes as part of the current process.

Alternatively, Alectra Utilities would have to file annual ICM applications for the remainder of the term.

## 7. Foregone Revenue

Alectra Utilities requested the OEB approve foregone revenue rate riders in the event that the OEB is unable to issue a decision on Alectra Utilities' M-factor proposal before January 1, 2020.[212] This would allow Alectra Utilities to recover foregone revenue from any potential incremental funding rate riders from January 1, 2020 to the implementation date of any such rate riders as approved by the OEB.

OEB staff submits that it is not possible to provide definitive views on whether foregone revenue rate riders would be appropriate without the context of the OEB's decision on the M-factor proposal. Therefore, in the event that the OEB is unable to issue a decision on Alectra Utilities' M-factor proposal before January 1, 2020, OEB staff submits that subsequent procedural steps (perhaps as part of any draft rate order stage of the current proceeding) would be necessary to provide parties an opportunity to address Alectra Utilities' request for foregone revenue. As noted at the beginning of this submission, in OEB staff's view, Alectra Utilities filed this application at a time that is more commensurate with a cost based application than an IRM application, and it made significant efforts to respond to interrogatories and undertakings in a timely fashion. Absent any other considerations that OEB staff may need to contemplate once the OEB's decision on the M-factor proposal is known, OEB staff is generally not opposed to a January 1, 2020 effective date.

[212] Exhibit 1 / Tab 3 / Schedule 1 / p. 6; AiC / p. 9

# 8. Conclusion

In conclusion, OEB staff submits that Alectra Utilities' proposed M-factor and related CIVA and EDCVA should not be approved. Alectra Utilities has failed to demonstrate that the M-factor is warranted in light of prevailing OEB policies nor that it would provide for just and reasonable rates. OEB staff submits that ICM funding should be sufficient to fund Alectra Utilities' incremental capital requirements. Should the OEB decide to approve the M-Factor, OEB staff submits that changes to what is included as part of the construct need to be made as discussed in this submission, including reducing the approved incremental envelope from $265 million to $168 million over the five year term.

- All of which is respectfully submitted -