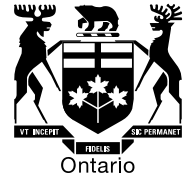


**Ontario Energy  
Board**  
P.O. Box 2319  
27th Floor  
2300 Yonge Street  
Toronto ON M4P 1E4  
Telephone: 416-481-1967  
Facsimile: 416-440-7656  
Toll free: 1-888-632-6273

**Commission de l'énergie  
de l'Ontario**  
C.P. 2319  
27e étage  
2300, rue Yonge  
Toronto ON M4P 1E4  
Téléphone: 416-481-1967  
Télécopieur: 416-440-7656  
Numéro sans frais: 1-888-632-6273



**BY EMAIL**

January 27, 2020

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

Dear Ms. Long:

**Re: Oakville Hydro Electricity Distribution Inc. (Oakville Hydro)  
EB-2019-0059 Application for 2020 Rates**

In accordance with Procedural Order No. 3, please find attached OEB staff's submission on the Incremental Capital Module requests in the above proceeding.

Oakville Hydro and all intervenors have been copied on this filing.

Oakville Hydro is reminded that its Reply Submission is due on February 10, 2020.

Yours truly,

*Original Signed By*

Marc Abramovitz  
Rates Advisor, Incentive Rate Setting & Regulatory Accounting

Encl.

**2020 ELECTRICITY DISTRIBUTION RATES**  
**Oakville Hydro Electricity Distribution Inc.**

**EB-2019-0059**

**OEB STAFF SUBMISSION**  
**On Incremental Capital Module**

**January 27, 2020**

## Introduction

Oakville Hydro Electricity Distribution Inc. (Oakville Hydro) filed an application with the Ontario Energy Board (OEB) on August 12, 2019 under section 78 of the *Ontario Energy Board Act, 1998* seeking approval for changes to the rates that Oakville Hydro charges for electricity distribution, effective January 1, 2020.

In Procedural Order (PO) No. 2, dated September 27, 2019, the OEB determined that it will process the standard incentive rate-setting mechanism (IRM) elements of the application separate from the request for Incremental Capital Module (ICM) funding. PO No. 2 also made provisions for parties to make written submissions on the preliminary question of whether it is appropriate for Oakville Hydro to apply for ICM funding as part of its 2020 IRM application. The OEB determined in a subsequent Decision and Order issued on November 14, 2019 that it would hear Oakville Hydro's requests for ICM funding.

In PO No. 3, dated December 17, 2019, the OEB made provisions for written submissions on Oakville Hydro's ICM requests.

The ICM is available to distributors on Price Cap IR and for projects that satisfy the ICM criteria of materiality, need and prudence. The purpose of this document is to provide OEB staff's submission on Oakville Hydro's requests for ICM funding.

## Summary

OEB staff submits that Project 3 does not meet the materiality threshold and should be denied. OEB staff submits that Projects 1, 2 and 4 meet the ICM criteria of materiality, need and prudence and should be approved. However, given that Projects 1, 2 and 4 went into service in 2019, OEB staff submits that the ICM revenue requirement should be calculated based on Oakville Hydro's maximum eligible incremental capital for 2019 of \$5,049,952.

## Background on ICM Requests

Oakville Hydro has requested to recover \$5,325,085 in incremental capital for four system access projects with a total incremental annual revenue requirement of \$432,953. The four projects are:<sup>1</sup>

- Project 1: Road Widening – Speers Rd. (\$2,000,000)
- Project 2: Road Widening – Trafalgar Rd. (\$2,200,000)
- Project 3: Road Widening – William Halton Parkway (\$1,200,000)
- Project 4: Feeder Replacement and Relocation – Bronte Transformer Station (TS) (\$1,700,000)

Projects 1, 2, and 3 are related to road widening projects undertaken by Oakville Hydro to fulfil its legal obligations under the *Public Service Works on Highways Act* (PSWHA).<sup>2</sup> The projects involve the relocation of Oakville Hydro's distribution assets at the request of the Town of Oakville (Project 1) and Halton Region (Projects 2 and 3).

Project 4 is a relocation and replacement of Oakville Hydro's feeder assets at the Bronte TS as Hydro One Networks Inc. (Hydro One) replaced and relocated obsolete station assets at Bronte TS that served Oakville Hydro's distribution system. Due to the relocation, Oakville Hydro undertook Project 4 in order to install new underground feeders, reconfigure Oakville Hydro's overhead circuits and install new feeder meters.

## Projects Already In-Service in 2019

Oakville Hydro indicated that three of its proposed ICM projects (Projects 1, 2 and 4) have already been put in-service in 2019. Oakville Hydro explained that it did not apply for ICM funding for these projects in its 2019 IRM application because it was uncertain of the in-service dates for the road widening projects (Projects 1 and 2) until late in 2019.<sup>3</sup> The uncertainty was driven by the fact that the in-service dates of these projects had been repeatedly deferred in the past by the road authorities.<sup>4</sup>

In reference to Project 4, Oakville Hydro indicated that it was aware that the project would be in-service in 2019. However, due to the uncertainty of the completion date of

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<sup>1</sup> The total cost of the four proposed ICM projects is \$7,100,000, which exceeds Oakville Hydro's maximum eligible incremental capital (discussed in a section below). Oakville Hydro has therefore requested its maximum eligible incremental capital of \$5,325,085, as noted above.

<sup>2</sup> As stated in Oakville Hydro's Reply Submission filed on October 24, 2019, Page 1.

<sup>3</sup> Reply Submission on the Preliminary Question, October 24, 2019, pp. 5-7

<sup>4</sup> Ibid, pp. 5-6

Projects 1 and 2, Oakville Hydro stated that it was not in a position to ascertain whether incremental capital funding would be required. Based on this uncertainty, if only Project 4 had been put in-service in 2019, Oakville Hydro estimated its maximum incremental eligible capital in 2019 to be \$676k, with an associated incremental revenue requirement of \$62k.<sup>5</sup> Oakville Hydro noted that this amount would not be material and that it would not have likely made a request to fund this amount through the ICM.<sup>6</sup>

Oakville Hydro acknowledged that the typical approach to applying for an ICM is for incremental funding to start in the year that an asset is planned to go into service, as indicated in the OEB's decision in Rideau St. Lawrence Distribution Inc.'s (Rideau St. Lawrence) 2018 IRM application (Rideau case).<sup>7</sup> However, Oakville Hydro noted that in that same decision the OEB provided ICM funding for assets that had gone in-service in a prior year to the rate application.<sup>8</sup>

In response to interrogatories, Oakville Hydro stated that it would be reasonable to follow the approach the OEB accepted in its decision for the Rideau case, which was to reduce the opening net book value of the ICM assets to account for the time elapsed from when the assets were put in-service.<sup>9</sup> In this case, Oakville Hydro proposed reducing the opening net book value of its 2019 projects (Projects 1, 2 and 4) by six months of depreciation.<sup>10</sup>

OEB staff acknowledges that the OEB approved ICM funding in the Rideau case for an asset that has gone in-service in a prior rate year. However, OEB staff notes that specific and unique circumstances led to the OEB's decision in the Rideau case. Due to a delay in filing its 2016 Cost of Service (CoS) application, Rideau St. Lawrence's Decision and Rate Order established rates as of July 1, 2017 (as opposed to May 1, 2016). As well, the OEB stated in its Decision and Rate Order that Rideau St. Lawrence should not apply for any further rate adjustments for the 2017 rate year and that its next IRM application should be for May 1, 2018 rates.<sup>11</sup> OEB staff notes that Rideau St. Lawrence's ICM request in 2018 for assets that went into service in 2017 was linked to the OEB's direction not to file a 2017 IRM application. Therefore, the earliest possible instance that Rideau St. Lawrence could apply for ICM funding was in 2018.

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<sup>5</sup> Reply Submission on the Preliminary Question, October 24, 2019, p. 6

<sup>6</sup> Ibid

<sup>7</sup> EB-2017-0265, Decision and Rate Order, March 22, 2018, p. 4

<sup>8</sup> Ibid, p. 5

<sup>9</sup> EB-2017-0265, Settlement Proposal, February 22, 2018, p. 12

<sup>10</sup> IRR Staff Question-2, part a)

<sup>11</sup> EB-2015-0100, Decision and Rate Order, June 15, 2017, p. 5

OEB staff submits that the practice of applying for ICM funding in the rate year that assets go in-service should continue to be the default expectation absent special circumstances. However, in Oakville Hydro's circumstance, OEB staff submits that it would be reasonable to provide Oakville Hydro with ICM funding given its explanation that it could not determine the actual in-service date of its ICM projects in a timely manner.

OEB staff notes that this proceeding was prolonged due to the matter of the ICM preliminary question. Given the circumstances, OEB staff supports a January 1, 2020 effective date for any potential ICM rate riders. However, for ICM projects already in-service in 2019, OEB staff submits that the appropriate treatment would be for Oakville Hydro to calculate the net book value of any approved assets as of January 1, 2020, taking into account any accumulated depreciation. Using these amounts, OEB staff submits that Oakville Hydro should calculate the incremental revenue requirement associated with the 2019 projects starting January 1, 2020, foregoing any 2019 revenue (for the projects that had gone in-service in 2019).

Oakville Hydro has not applied the half-year rule as it anticipates requesting a deferral of rebasing to beyond the 2021 rate year. While the OEB has not opined on the matter of potential future rebasing deferral requests from Oakville Hydro, OEB staff does not object with this treatment for purposes of the 2020 ICM proceeding. If the OEB approves a rebasing deferral request for Oakville Hydro's 2021 rates, then OEB staff submits that a full year's treatment of depreciation, return on capital and CCA is appropriate. In the event the OEB denies Oakville Hydro's request to defer rebasing for 2021 rates, and Oakville Hydro submits a rebasing application for 2021, then OEB staff notes that the OEB will have an opportunity to address the full year treatment, if it chooses to do so, through the variance account that tracks ICM costs and revenues, at the time of rebasing.

## **Materiality**

The *Report of the OEB: New Policy Options for Funding of Capital Investments: The Advanced Capital Module* (ACM Report) states that distributors must meet an OEB-defined materiality threshold and a project-specific materiality threshold.<sup>12</sup>

The ACM Report explains the "materiality" criterion as follows:

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<sup>12</sup> EB-2014-0219, Report of the OEB: New Policy Options for Funding of Capital Investments: The Advanced Capital Module, September 18, 2014, pp. 16-17

A capital budget will be deemed to be material, and as such reflect eligible projects, if it exceeds the OEB-defined materiality threshold. Any incremental capital amounts approved for recovery must fit within the total eligible incremental capital amount (as defined in this ACM Report) and must clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.

Minor expenditures in comparison to the overall capital budget should be considered ineligible for ACM or ICM treatment. A certain degree of project expenditure over and above the OEB-defined threshold calculation is expected to be absorbed within the total capital budget.<sup>13</sup>

In response to interrogatories, Oakville Hydro provided a revised ICM model with a price cap index of 1.7%. This was based on the OEB's 2020 inflation factor of 2% less a productivity factor of 0.00% and a stretch factor of 0.30%. Oakville Hydro stated it had calculated its materiality threshold for 2020 to be \$17,301,915. Oakville Hydro also calculated its maximum eligible incremental capital to be \$5,325,085 by subtracting its materiality threshold from its total forecasted 2020 capital expenditures of \$22,627,000. Since Oakville Hydro's total ICM project costs of \$7,100,000 exceed the maximum eligible incremental capital, Oakville Hydro has requested ICM funding equal to its maximum eligible incremental capital of \$5,325,085.

OEB staff notes that the ICM's materiality threshold calculation is an estimate of the amount of capital a distributor can be expected to fund through base rates in each rate year. In OEB staff's view, due to the unique nature of Oakville Hydro's ICM request, it is necessary to test Oakville Hydro's 2019 ICM projects (Projects 1, 2 and 4) against its materiality threshold in 2019, separate from Project 3 which will go into service in 2020. Project 3 should be tested against the 2020 materiality threshold. OEB staff submits that this would ensure that Oakville Hydro is not recovering more ICM funding than is typically allowed in 2020 by shifting all ICM projects to 2020, and would ensure that Oakville Hydro is not underspending in 2019. OEB staff notes that this methodology would be consistent and have the same results if Oakville Hydro had made a separate ICM request in its 2019 IRM application for the three projects that went in-service in 2019.

For 2020, OEB staff is in agreement with Oakville Hydro that the materiality threshold

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<sup>13</sup> ACM Report, p. 17

calculation of \$17,301,915 reflects the OEB's 2020 inflation factor. Oakville Hydro provided its 2020 forecast capital budget, inclusive of all ICM projects, to be \$22,627,000.<sup>14</sup> OEB staff calculates Oakville Hydro's total 2020 capital expenditures, less the three projects put in-service in 2019, to be \$16,727,000 (\$22,627,000 less \$5,900,000). This amount includes all of Oakville Hydro's 2020 capital expenditures and Project 3. The resulting maximum eligible incremental capital available is \$0 since the total 2020 capital budget is less than the materiality threshold calculation. Therefore, OEB staff submits that Project 3 should be denied.

For 2019, OEB staff proposes using the 2019 materiality threshold amount of \$14,924,048, which was found in the original ICM model filed as part of Oakville Hydro's initial 2020 IRM application filing. The original ICM model reflected the OEB's 2019 inflation factor, which OEB staff believes is consistent and appropriate for the purpose of calculating Oakville Hydro's 2019 materiality threshold. Oakville Hydro has indicated that its 2019 capital expenditures inclusive of all four ICM projects is \$21,174,000.<sup>15</sup> Therefore, by removing Project 3 (\$1,200,000), OEB staff calculates Oakville Hydro's 2019 total capital expenditures to be \$19,974,000. Based on these amounts, OEB staff calculates Oakville Hydro's 2019 maximum eligible incremental capital to be \$5,049,952. The total of the 2019 projects, Projects 1, 2 and 4, is \$5,900,000. Since this exceeds the maximum eligible incremental capital, OEB staff submits that Oakville Hydro should be eligible to recover a maximum of \$5,049,952 of ICM capital related to the 2019 rate year.

In its argument in chief, Oakville Hydro noted that the ACM Report introduced a project-specific materiality threshold, which requires that individual projects be material in relation to the overall capital budget.<sup>16</sup> In assessing whether the proposed ICM projects were material, Oakville Hydro relied on the OEB's Decision in Alectra Utilities Corporation's (Alectra) 2018 IRM Application for guidance and noted that Alectra's combined capital budget was \$267,700,000 and the lowest individual project that was approved for the recovery of incremental capital funding was the York MS project with a total cost of \$2,300,000 or 1% of its total capital budget.<sup>17</sup> Oakville Hydro submitted that each of the ICM projects far exceeds 1% of its 2019 capital budget of \$21,174,000 and

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<sup>14</sup> IRR AMPCO-11

<sup>15</sup> IRM application, pp. 11-12; To clarify, Oakville Hydro provided its 2019 capital budget inclusive of all ICM projects in its original filings. Through interrogatories, Oakville Hydro provided its 2020 capital budget inclusive of all ICM projects and indicated that Project 3 is now expected to go in-service in 2020. OEB staff calculations here removes the cost of Project 3 from the 2019 capital budget (since it is no longer in-service in 2019).

<sup>16</sup> ACM Report, page, 17.

<sup>17</sup> EB-2017-0024, Decision and Order, April 5, 2018



therefore, these projects meet the project-specific materiality threshold. Oakville Hydro also noted that the total of these mandatory system access projects is equal to approximately one half of its typical capital spending.<sup>18</sup>

OEB staff calculates the ICM project with the least amount of incremental capital funding, Project 3 at \$1,200,000, to be approximately 5% of Oakville Hydro's total capital expenditure for 2020. On this basis, OEB staff submits that Oakville Hydro's ICM projects make up a significant portion of its capital budgets and therefore meet the project-specific materiality threshold.

While OEB staff agrees with Oakville Hydro that the proposed ICM projects meet the project-specific materiality threshold, OEB staff notes that the OEB's ICM policies make no mention of a particular percentage for the project-specific materiality threshold. OEB staff submits that the project-specific materiality threshold has generally been evaluated on a case-by-case basis.

If the OEB approves Oakville Hydro's ICM funding request for Projects 1 and 2, OEB staff submits that the monies received should reduce Oakville Hydro's incremental capital needs for future projects of a similar nature. OEB staff notes that the ICM allows a distributor to recover the revenue requirement of an associated project. This is akin to the way a distributor would recover the revenue requirement through base rates for a project included in the distributor's previous cost of service test year. The mechanism of the ICM is such that once ICM rate riders are established, it is not adjusted and continues until the distributor next rebases. As assets are put in-service, the distributor recovers the depreciation expense of the assets as the assets depreciate, and the net book value of the value decreases correspondingly. If the revenue requirement of the assets were recalculated based on the depreciated asset with a lower net book value, the revenue requirement would decrease. That being said, policy and practice of the ICM is not to adjust the rate riders, even though assets have depreciated, just as base rates are not adjusted between rebasing applications. Except for the IRM rate adjustment mechanism (inflation less expected productivity), it is assumed that additions and removals, and changes in demand (primarily growth) can be managed by the utility and will largely "balance."

Not adjusting the rate riders means the distributor is essentially recovering a calculated revenue requirement that is in excess of what is required to compensate the utility for the originally invested capital. This additional revenue is available to the distributor to use and reinvest into its distribution system. To this effect, OEB staff submits that a

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<sup>18</sup> Interrogatory responses – ICM Element, EB-2019-0059, CCC 6, page 22.

portion of the ICM recovery of Projects 1 and 2 could be used to fund Project 3 and potential projects in future years. As such, in addition to Project 3 not exceeding the materiality threshold formula above, OEB staff submits that the additional capital available to Oakville Hydro through potential ICM rate riders for Projects 1 and 2 is similar to funding available to Oakville Hydro for annual type programs, and this further reduces Oakville Hydro's capital needs in relation to the 2020 road widening project, Project 3.

## **Need**

The ACM Report explains the "need" criterion as follows:

The distributor must pass the Means Test (as defined in the ACM Report).

Amounts must be based on discrete projects, and should be directly related to the claimed driver. The amounts must be clearly outside of the base upon which the rates were derived.<sup>19</sup>

Under the Means Test, if a distributor's regulated Return on Equity (ROE) exceeds 300 basis points above the deemed ROE embedded in the distributor's rates, then the funding for any incremental capital project will not be allowed. Oakville Hydro stated that its most recently available ROE is 10.65% for the 2018 rate year.<sup>20</sup> Oakville Hydro indicated that its 2018 ROE is not in excess of 300 basis points from its deemed ROE of 9.36%.<sup>21</sup> OEB staff submits that Oakville Hydro passes the Means Test.

Oakville Hydro's three road widening projects have a distinct scope and are being completed at the request of road authorities. Project 4 is a specific project to replace and relocate assets at Bronte TS in response to Hydro One replacement and relocation of station assets at Bronte TS. OEB staff submits that Oakville Hydro's proposed ICM projects are discrete and directly related to the claimed driver.

As indicated by Oakville Hydro, its distribution rates approved in its previous 2014 CoS application included \$403,000 for road widening, net of capital contributions.<sup>22</sup> Oakville Hydro's actual in-service capital additions related to road widening projects between 2014 and 2018 was \$2,008,678 or \$401,726 per year.<sup>23</sup> OEB staff submits that Oakville

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<sup>19</sup> ACM Report, p. 17

<sup>20</sup> IRM Application, p. 12

<sup>21</sup> Ibid

<sup>22</sup> IRR Staff Question-5, part b)

<sup>23</sup> Ibid

Hydro's base rates are able to support some amount of road widening projects and expects Oakville Hydro to be able to fund approximately \$403,000 per year through its base rates. OEB staff notes that, while the OEB has previously approved ICM funding related to road widening for utilities that already have a budget for road widening projects, the utility had to demonstrate that the ICM project represented a material, and incremental capital need.<sup>24</sup> In Oakville Hydro's case, OEB staff is unaware of any other road widening projects being put in-service in either 2019 or 2020 other than the three proposed ICM projects. That being said, OEB staff notes that Oakville Hydro's maximum eligible incremental capital for 2019 (as calculated by OEB staff above) is approximately \$900,000 less than the total cost of Oakville Hydro's 2019 projects. This \$900,000 is not eligible for ICM treatment and OEB staff believes it is appropriate to view the \$403,000 as being part of the \$900,000, which must be funded through base rates. Therefore, OEB staff submits no adjustment is necessary for the 2019 projects.

## **Prudence**

The ACM Report explains the "prudence" criterion as follows:

The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.<sup>25</sup>

Oakville Hydro is required under the PSWHA to complete the road widening Projects 1, 2 and 3. Oakville Hydro stated that it worked closely with the road authorities to optimize the roadway design, minimize the relocation requirements and minimize costs.<sup>26</sup> OEB staff submits that the amounts incurred for these three road widening projects are prudent because they allow Oakville Hydro to fulfil its obligations under the PSWHA. OEB staff notes that the OEB has in the past approved similar ICM requests related to road authority projects.<sup>27</sup> OEB staff also notes that Oakville Hydro has not replaced any overhead assets with underground assets, which avoids any incremental costs associated with burying assets underground.<sup>28</sup>

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<sup>24</sup> See EB-2017-0024, the OEB approved Alectra Utilities Corporation's request for ICM funding in relation to road authority projects. The OEB noted that a utility of the size of Alectra Utilities Corporation can be expected to undertake a certain amount of road authority projects per year, but found that the approved ICM project represented a material and incremental need.

<sup>25</sup> ACM Report, p. 17

<sup>26</sup> Argument in Chief, p. 7

<sup>27</sup> e.g. EB-2017-0024, EB-2018-0016

<sup>28</sup> IRR Staff Question-6

For Project 4, OEB staff notes that this is necessary to connect Oakville Hydro's distribution system to the supply at Bronte TS. OEB staff also expects this project to incur incremental costs because Oakville Hydro is replacing overhead infrastructure with underground infrastructure. In response to interrogatories, Oakville Hydro noted that it is required to implement underground infrastructure in order to conform to Hydro One's station design. To minimize costs, OEB staff notes that Oakville Hydro worked with Hydro One to optimize the design of Project 4 and to limit the impact on existing infrastructure so as to avoid incurring additional costs.<sup>29</sup> OEB staff submits Oakville Hydro's justification for implementing underground assets is reasonable, and that any potential incremental costs associated with an underground design is the result of Hydro One station design, which are not in Oakville Hydro's control. OEB staff submits that the costs associated with Project 4 are prudently incurred.

### **Embedded Distributor**

Oakville Hydro proposed not allocating any portion of the ICM costs to its embedded distributor. Oakville Hydro indicated that none of the assets contemplated in its ICM requests are upstream of the embedded distributor and none of the ICM projects would benefit the embedded distributor.<sup>30</sup> Furthermore, Oakville Hydro noted that in its last cost of service, it was allowed to use direct allocation on the costs associated with its embedded distributor, Milton Hydro Distribution Inc.<sup>31</sup> OEB staff submits that Oakville Hydro's proposal is appropriate because costs attributable to the embedded distributor have been directly allocated and therefore no costs related to the embedded distributor are being socialized with the rest of Oakville Hydro's customers.

OEB staff supports Oakville Hydro's proposal to not apply ICM riders to the embedded distributor class.

All of which is respectfully submitted.

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<sup>29</sup> Argument in Chief, p. 7

<sup>30</sup> IRR Staff Question-7, part d)

<sup>31</sup> IRR Staff Question-7, part c); EB-2013-0159, Settlement Proposal, April 17, 2014, p. 40