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Our File No. 20190059

Ontario Energy Board
2300 Yonge Street
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Toronto, Ontario
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Attn: Christine Long, Registrar and Board Secretary

Dear Ms. Long;

Re: EB-2019-0059 – Oakville 2020 Rates – SEC Final Agument

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #3, this letter represents SEC's Submissions relating to the ICM funding requested in this proceeding.

Introduction and Summary

The Applicant is seeking, in this 2020 rate application, ICM treatment for three projects that actually went into service in 2019, and one project that is expected to go into service in 2020. In total, the net capital cost of the three projects is about $7.1 million.

SEC believes that the Application for ICM funding should be denied, for at least the following reasons:

1. As discussed in detail in the Preliminary Motion, it was not appropriate for the Applicant to seek a deferral of rebasing without telling the Board that it would be seeking incremental capital funding as well.

2. The Applicant appears to have had an ROE of 334 basis points above the Board's allowed ROE in 2018 before taking into account the reduction in working capital allowance, and more than 402 basis points above the Board's allowed ROE after taking the WCA change into account.

3. The underlying capital budgets for both 2019 and 2020 appear to include large unexplained increases in some categories of costs that increase the total capital spend and cause the ICM projects to exceed the threshold.

4. A claim for ICM funding for 2019 projects should not be entertained by the Board in 2020. Although it may not meet the technical test for retroactive ratemaking, it is inappropriate in a case like this to consider a rate increase for past costs.

In the alternative, if the Board does not agree that the Application should be denied in total, the calculation of the threshold is incorrect. Some of the projects are in 2019, to which the 2019 threshold should apply. One of the projects is in 2020, to which the 2020 threshold should apply. SEC calculates that the maximum allowed incremental capital is $4,176,172 in 2019 and zero in 2020.

Extension of Price Cap Period

The parties' concerns about the extension of the Price Cap period, and the non-disclosure of the impending ICM, have been canvassed fully in the arguments on the Preliminary Motion, and do not need to be repeated.

The Board's decision on the motion did not, as SEC understands it, determine that the combination of rebasing deferral and ICM was irrelevant to the ICM Application. As we interpret the decision, the Board accepted that this was a new situation, and it was possible that the Applicant didn't tell the Board because of the uncertainty of the timing of the ICM projects.

The interrogatory responses, and particularly the attachments to those responses, make clear that the Applicant was fully aware that the four projects were imminent long before it asked for a rebasing deferral, and in fact the projects ended up being completed in 2019, even though the Application is for 2020 rates.

SEC submits that the Board, having now seen additional evidence, should conclude that the Applicant knew or should have known that the projects were going to proceed before the end of 2020, and probably earlier, and therefore should have advised the Board that the Applicant was NOT, in fact, able to manage within its Price Cap revenues. Armed with the knowledge it has today, the Board would almost certainly have told the Applicant that a cost of service application and a DSP were required.

Interestingly, the result of that would have been that the Applicant would not have been able to recover its 2019 ICM revenue requirement for these projects. It did not make a 2019 ICM application, and in 2020 it would have been in cost of service, and therefore ineligible for ICM. This is, in our submission, a further reason to deny the Application.

The Applicant's Earnings

In response to CCC-3, the Applicant has provided details of its earnings from 2014 to 2018. Because this table (which was not provided in Excel format) had an unusual format, SEC has reconstructed it as follows (an Excel version is being filed with these submissions):

Oakville Hydro Regulated Rate of Return							
	BA 2014	***2014***	***2015***	***2016***	***2017***	***2018***	***Change %***
Distribution Revenues	$35,586,668	$38,423,903	$38,292,999	$40,372,924	$38,898,364	$40,900,145	14.93%
Other Revenues	$2,205,265	$45,735	$1,006,322	$2,542,944	$2,995,572	$2,699,768	22.42%
Total Revenues	$37,791,933	$38,469,638	$39,299,321	$42,915,868	$41,893,936	$43,599,913	15.37%
OM&A	$17,784,721	$17,498,629	$18,149,202	$17,980,234	$18,383,553	$18,787,858	5.64%
Amortization	$8,124,658	$8,260,513	$8,545,048	$8,984,647	$9,156,545	$9,123,190	12.29%
Financing	$4,984,042	$6,043,164	$6,031,002	$6,066,505	$5,912,617	$5,961,112	
Less Interest Adjustments		$810,002	$956,010	$855,862	$690,631	$535,751	
Net Interest Expense	$4,984,042	$5,233,162	$5,074,992	$5,210,643	$5,221,986	$5,425,361	8.85%
Effective Interest Rate	4.51%	4.78%	4.57%	4.57%	4.57%	4.62%	
Taxes		$237,124	$179,270	$2,027,995	$1,041,253	$872,051	
Less Tax Adjustments		$460,281	-$201,600	-$14,118	$41,839	$277,961	
Net Tax Expense	$0	-$223,157	$380,870	$2,042,113	$999,414	$594,090	
Total Expenses	$30,893,421	$30,769,147	$32,150,112	$34,217,637	$33,761,498	$33,930,499	9.83%
Regulated Net Income	$6,898,512	$7,700,491	$7,149,209	$8,698,231	$8,132,438	$9,669,414	40.17%
Regulatory ROE claimed Rate Base	9.36%	10.54%	9.65%	11.45%	10.67%	12.34%	
Board's Deemed Rate	9.36%	9.36%	9.30%	9.19%	8.78%	9.00%	
Difference	0.00%	1.18%	0.35%	2.26%	1.89%	3.34%	
Excess Earnings + Gross-up	**$0**	**$1,172,754**	**$351,311**	**$2,335,087**	**$1,959,185**	**$3,560,959**	
Regulatory ROE adjusted Rate Base	**9.91%**	**11.16%**	**10.21%**	**12.10%**	**11.27%**	**13.02%**	
Board's Deemed Rate	9.36%	9.36%	9.30%	9.19%	8.78%	9.00%	
Difference	0.55%	1.80%	0.91%	2.91%	2.49%	4.02%	
True Excess Earnings + Gross-up	**$519,699**	**$1,692,453**	**$867,679**	**$2,845,347**	**$2,446,681**	**$4,060,669**	
"Items not in Base Rates"		$436,217	$220,075	$561,099	$742,853	$1,323,181	
Claimed Net Income	$6,898,512	$7,264,274	$6,929,134	$8,137,132	$7,389,585	$8,346,233	
Claimed ROE	9.36%	9.94%	9.35%	10.71%	9.69%	10.65%	
Board's Deemed Rate	9.36%	9.36%	9.30%	9.19%	8.78%	9.00%	
Difference	0.00%	0.58%	0.05%	1.52%	0.91%	1.65%	
Claimed Excess Earnings + Gross-up	**$0**	**$425,757**	**$38,138**	**$1,155,190**	**$697,148**	**$1,294,124**	
Rate Base Calculations							
Rate Base	$184,255,129	$182,652,692	$185,241,817	$189,933,137	$190,559,133	$195,891,928	6.32%
Equity Component	$73,702,052	$73,061,077	$74,096,727	$75,973,255	$76,223,653	$78,356,771	
Debt Component	$110,553,077	$109,591,615	$111,145,090	$113,959,882	$114,335,480	$117,535,157	
Impact of 7.5% WCA	$10,202,429	$10,202,429	$10,202,429	$10,202,429	$10,202,429	$10,202,429	
Revised Rate Base	$174,052,700	$172,450,263	$175,039,388	$179,730,708	$180,356,704	$185,689,499	
Equity Component	$69,621,080	$68,980,105	$70,015,755	$71,892,283	$72,142,682	$74,275,800	
Debt Component	$104,431,620	$103,470,158	$105,023,633	$107,838,425	$108,214,022	$111,413,699	

Basically, SEC changed the table in three ways. First, the adjustments to taxes and to interest, which were buried with the mysterious “items not in base rates”, were made directly to the cost lines to which they relate, getting net taxes and net interest. This, incidentally, solved a problem that the implied interest rate, given the level of rate base, was far too high (well over 5%). Once the adjustments were netted against the interest expense, the average interest rate came down

to a range of 4.57% to 4.62%. This is still higher than one would expect (and would certainly prompt questions in a cost of service proceeding, given that the Board's deemed rate is currently 3.21%), but it is not completely out of range. We did not adjust for the still high net interest rate in our net income and ROE calculations, described below, even though the impact of the high interest rate is more than $1 million per year reduction in net income.

Second, SEC calculated the rate base two difference ways, i.e. with and without the change of the working capital allowance from 13% to 7.5%. To simplify things, we have assumed that the WCA difference in 2014 (readily calculable because it is in the ICM model on sheet #8) continues for all five years. In fact, of course, the WCA would increase as cost of power and OM&A increase each year, but the point is made without those additional complications.

Third, SEC calculated regulated ROE before the line "items not in base rates", and then again after those adjustments. Since that line reduces net income, but is not supported with any evidence that SEC has seen, the ROE before those adjustments is a key number.

In addition to these changes, we also added percentages and other analytics to assist the Board.

Once we made these corrections to the material provided by the Applicant, three things appeared to be true:

1. In 2018, the Applicant's regulatory ROE was 334 basis points higher than the Board's allowed ROE for 2018, and 298 basis points higher than the Board's allowed ROE embedded in 2014 rates. This is not consistent with the information provided by the Applicant to the Board when it sought a deferral of rebasing.

2. The impact of the reduced working capital allowance is that rates should be reduced by more than $500,000 per year just for the equity component, plus a further amount for the debt component. This is not consistent with the Applicant's evidence that the impact of the reduced WCA is about $160,000 per year (CCC-11). We have been unable to replicate the Applicant's WCA calculations using any possible assumptions.

3. If the revised rate base using the new WCA is applied, the ROE in 2018 is 402 basis points above the 2018 Board deemed rate, and 366 basis points higher than the Board's allowed ROE embedded in 2014 rates.

Depending on whether one assumes the new WCA rate, or the 13% embedded in rates, the Applicant's customers have paid either $9.4 million (based on 13% WCA) or $12.4 million (based on 7.5% WCA) more in rates than the Board's allowed ROE for each year. The Applicant consistently over-earns, despite coming back to this Board and asking for more money this year.

We have no information on 2019, but based on the pattern from 2014 to 2018 (i.e. the high level of revenue growth), it is not unreasonable to assume that the over-earnings are even higher still.

SEC submits that, based on the evidence before the Board, the Board must conclude that the Applicant passed the 300 bp threshold in 2018, and did not advise the Board of that fact.

On this basis, and wholly separate from the lack of disclosure of the impending ICM need, the Applicant should have come in for rebasing in 2019 or, at the very latest, for 2020. In the meantime, the Applicant knew or should have known that it was not eligible for ICM funding, because its ROE was too high for it to remain qualified.

On the basis of this information, SEC submits that the Board should deny this application for ICM funding.

Qualification of Individual Projects

SEC has looked at the individual capital projects proposed. While we do not believe that ICM funding is appropriate, for the reasons described elsewhere in these Submissions, we can provide the following comments on the ICM project criteria:

Need. See our comments above on the Applicant's real ROE. This test does not appear to be met.

Discrete Projects. SEC believes that these each qualify as discrete projects.

Normal Capital Programs. SEC agrees with others that municipal road widening projects in a town like Oakville are in the same category as normal capital programs. That is, Oakville does some of this every year. However, the size of these projects makes them significantly different from their normal annual obligations. Each one of these projects is larger than the total road widening budget for any of the previous five years. Therefore, we believe this criterion is met, and these projects should not be considered part of normal annual capital programs.

Prudence. Nothing in the evidence leads us to believe that the spending on any of the projects is not prudent. While there have been questions raised about some of the project design decisions, SEC believes they have been answered appropriately.

Project Materiality. SEC does not agree with the Applicant (CCC-6) that the Board has established a project materiality standard of 1% of capital budget. What is material for Alectra, the example used, and the Applicant can be very different. The Board has expressly determined that it will not set a formula for project materiality. That having been said, these projects are significant undertakings for this Applicant, and should be treated as such. Thus, SEC believes that these projects, which likely would not be material for some other distributors, are material for this one.

Calculation of Threshold and Eligible Capital

There are two issues associated with the calculation of the threshold, and the calculation of eligible capital.

First, the projects are in two different years, but the calculation of the threshold is only done for one year.

SEC has gone back to the ICM model, sheet #8, where the thresholds for 2019 and 2020 are calculated. The threshold for 2019 is $16,997,828, and the threshold for 2020 is $17,301,915.

The capital budget for 2019 is $21,174,000 (AMPCO-5), meaning that the excess over the threshold is $4,176,172. The capital budget for 2020 is $17,275,500 (base capital budget of $15,600,000 plus Bronte TS $1,675,500 – AMPCO-11), which is below the threshold, so the eligible capital is zero.

SEC has not attempted to recalculate the eligible capital assuming the WCA is 7.5% rather than 13%. There is no accepted way of doing that calculation, so it would appear to us to be an additional, unnecessary complication.

Second, the underlying capital budgets have no evidentiary basis, and are not supported by a current DSP. This would not be a problem in all cases, and the Board has allowed ICM funding before without a DSP. However, in this case the underlying budgets have unusual items.

In 2019, the budget shows (AMPCO-5) an increase of $5.3 million (246%) in the budget for services. The services budget has been fairly static for several years, so this stands out as an unexplained anomaly. There are also large increases in transformer replacements ($1.1 million, 300%), and software ($0.4 million, or 82%).

There are also large decreases in some categories.

However, once you back out the ICM projects, the 2019 budget, at $15,699,000, is $3,167,796 (25.3%) higher than the average of the preceding four years. We note that the average includes the $2 million 2018 distribution meters spend and the $4.2 million 2014 and 2015 Glenorchy backup transformer.

The “preliminary” base capital budget forecast for 2020 continues that higher level of spending, at $15,600,000 plus the Bronte project (AMPCO-11).

The Applicant notes (AIC, p. 7) that “Oakville Hydro is not seeking approval for its planned capital investment program”, as if that is enough. While that is true, it misses the point. Incremental capital projects are only “incremental” if the base capital program plus the ICM projects exceed the eligibility threshold. The utility can’t just make up any number for the base capital program, and tell the Board “you aren’t allowed to look at that”. If the base capital program is much higher than previous years, or has unusual components, or lacks any context like a DSP, of course the Board has to consider that.

We note that the Applicant did not provide a five year internal capital plan when requested, because they apparently do not have one, and although referring to a 20-year capital outlook, did not provide that either (AMPCO-7), or even their 2020 capital forecast (AMPCO-5), also requested. Thus, they do not appear to have the most basic of capital plans (every distributor has a five year capital plan), and they didn’t let the Board see the documents they do have.

SEC submits that there are too many questions about the underlying capital budgets for the Board to conclude that the ICM projects are actually incremental to the threshold. If there was a DSP, the Board could perhaps see the context of the base budget, and reach conclusions on whether it was a reasonable starting point. On the evidence before the Board, that is not possible. At best there would appear to be at least $3 million too much in the base budgets, which would decrease the eligible ICM capital dollar for dollar.

The onus is on the Applicant to demonstrate that the ICM projects are truly incremental to their threshold amount. In this case, it would appear to SEC that they have not met this onus, because they have left the Board with no foundation on which to conclude that the base capital budgets are reasonable.

Board of Directors

SEC is concerned that the Applicant does not appear to have included its Board of Directors in the loop for either the deferral of rebasing or this $7.1 million ICM application (CCC-1).

The Board will be aware that SEC does not believe that the Board should regulate the internal oversight procedures for regulated utilities. In addition, SEC believes that the delegation of responsibility for many aspects of utility operations to competent management is something that Boards of Directors should regularly consider and, where appropriate, implement.

Then there are examples that are more extreme. In this case, one has to ask how the Board of Directors is providing oversight to management at all if decisions of this magnitude – deferring rebasing, and seeking $7.1 million of incremental funding – are not considered appropriate for board-level discussion and at least input. This is especially concerning if, as the Applicant suggests, financing these projects has to date been a challenge to its cash flow (Application, p. 12).

Other Issues

In Staff-8, the Applicant notes that it did not reflect the new accelerated CCA rules in its calculation of the revenue requirement for these projects. In SEC's submission, that is incorrect.

The Board has mandated that the accelerated CCA rules should be reflected in a deferral account, like other tax changes. That makes perfect sense in most circumstances, because it is one of many changes for a utility on Price Cap IR, and it is contrary to normal practice to adjust formula rates during IRM for these items.

But that is not what is going on here. What is happening is that the Applicant is seeking extra money. In those circumstances, SEC submits that they should be required to calculate the extra money they need based on the current tax rules. ICM is calculated on a quasi-cost of service basis. If the Applicant were in cost of service, the new rules would apply. So too the new rules should apply to the ICM calculation.

In CCC-11, the Applicant provides a breakdown of their Monthly Billing Variance Account. SEC does not believe that the calculations in this table are correct, but understands that this total is not in issue in this proceeding.

SEC requests that the Board make clear that its decision – even if it considers WCA impacts – is not providing any comments on this variance account until after parties have a chance for discovery with respect to the calculations, and the opportunity to provide submissions on those calculations once provided.

In Staff-7, the Applicant seeks to explain why Milton Hydro, its embedded distributor, is not being including in the allocation of the costs of these projects. It is not clear to SEC that this is a sufficient explanation.

It is not normal cost allocation to cherry-pick which capital spending applies to which class, based on who benefits. Categories of spending are allocated as a group. Some components of a category will not apply to this customer, or that customer, or even whole groups of customers, but others will be specific to that customer. The cost allocation process assumes that there are puts and takes in each category, and they balance each other out.

In VECC-12, the Applicant proposes that the half-year rule not apply to its ICM projects, on the basis that it is seeking a further deferral of rebasing. SEC advises the Board that we, at least, will if given the opportunity ask the Board to deny permission for a further deferral, given the high level of over-earnings at this utility.

It is further submitted that, unless the Board determines in this proceeding that the rebasing deferral should be granted, the Board should follow its normal practice and apply the half-year rule to any ICM that it does grant in this Application.

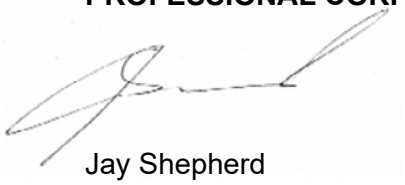
Conclusions

SEC therefore submits that, for multiple reasons as outlined above, the Board should deny this ICM application.

In the alternative, in the event that the application is allowed, the threshold and eligible capital amount should be recalculated, the half-year rule and accelerated CCA should apply, and the cost should be allocated to all customer classes included the embedded distributor class.

All of which is respectfully submitted.

Yours very truly,
SHEPHERD RUBENSTEIN
PROFESSIONAL CORPORATION



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties