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Ontario Energy Board
2300 Yonge Street
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January 31, 2020
Our File: EB20190023

Attn: Christine Long, Registrar & Board Secretary

Dear Ms. Long:

Re: EB-2019-0023 – Burlington Hydro Inc. ICM – SEC Submissions

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order No. 1, these are SEC's submissions on the application brought by Burlington Hydro Inc. ("BHI") for approval of an Incremental Capital Module ("ICM") for two projects, i) a new Customer Information System ("CIS"), and ii) a new Geographic Information System ("GIS"). As discussed below, the Board should deny the application. The issue is not that these two systems are not needed, or the expenditures are necessarily imprudent, but that the evidence is that BHI does not need the incremental revenue to fund these projects.

Need and Prudence

BHI has proposed an ICM for two projects, a new CIS and GIS, which will cost a total of $2,682,275.[1]

CIS System. The evidence does demonstrate a new CIS system is needed. BHI's current CIS system is outdatedand does not meet the needs of its customers. There are significant concerns regarding the vendors ability to be able to provide required maintenance services for much longer.[2]

With respect to the prudence of the cost of the replacement CIS system, SEC is unable to determine if the updated project cost of $2,092,862 is prudent. SEC does recognize that the joint utility competitive RFP process is a very commendable way to select a new CIS system at a reasonable cost, to the benefit of ratepayers.[3] What concerns SEC is that even after the vendor had been selected, the project cost increased by 44.5% from the $1,445,000 forecast when the application was filed.

In response to Interrogatory SEC-4(a), BHI provided a short bullet point list of four reasons for this significant increase. This information provided is insufficient for SEC to understand, let alone for BHI to justify to the Board, the significant increase. There is no breakdown of the cost increase by driver,

[1] Interrogatory Response OEB Staff-14(b), Table 8
[2] Interrogatory Response OEB-Staff-16; Interrogatory Response SEC-2; Application, Exhibit 1, p.52
[3] Interrogatory Response OEB-Staff-15(d)

or an explanation of why these changes were required. For one cost increase, for example,, "[a]dditional funding for backfill of Burlington Hydro staff;" it is not even clear if this is an appropriate capital cost, as opposed to an operating expense.[4]

While SEC is unable to say the amount is necessarily imprudent, it is not able to say that it is prudent either. The burden of proof is on BHI to justify the costs of its proposed project[5].

GIS. The evidence demonstrates that a new GIS is needed. The current system is near or at obsolescence. It is unable to do certain tasks that are required of a modern utility, and certain software that is required to run the system is no longer supported.[6] With respect to the prudence of the expenditure, the evidence is that an appropriate competitive RFP process was undertaken and the most cost effective solution was chosen.[7]

ICM Funding Not Material

SEC accepts that the project meets the two existing materiality tests under the Board's ICM policy – the materiality threshold formula, and the project-specific materiality test. But what is unique about this proceeding is that once corrected to account for changes in the tax rules, the 2020 revenue to be collected by way of the ICM rate rider is below BHI's materiality threshold as defined by the Board's *Filing Guidelines.* On this basis, the Board should deny the ICM.

A confluences of factors, specifically Capital Cost Allowance ("CCA") rates related to IT projects, newly enacted accelerated CCA rules, and the application of the half-year rule, have resulted in two projects with a combined cost of $2.6M having a 2020 ICM revenue requirement of only $60,490.

A cost that falls below the normal materiality threshold is spending that the Board should, and in other situations does, expect a utility to be able to manage without incremental funding during IRM.

CCA Impact. The proposed CIS and GIS systems are two largely information technology ("IT") projects. IT projects, as opposed to more traditional capital that a utility may spend, include significant PILs benefits in the first one or two years of the capital going in-service. This is because the CCA rates for IT projects are very high, which has the impact on creating a tax shield, leading to a significant amount that the utility can deduct against its taxable income in those first few years. BHI has included in its PILs calculation for the ICM, the ability to claim 55% of the total capital cost for the project in the first year (the ICM year).[8] The impact is that since the CCA deductions will exceed the taxable income caused by its annual depreciation and return on capital expenses, it ends up having a taxable loss which it can apply against other PILs payable (which are collected from customers through base rates), and reduce the required incremental revenue needed to fund the expenditures.[9]

C-97 Accelerated CCA. In 2019, the Federal Government implemented Bill C-97, the Accelerated Investment Incentive program, which provides, for eligible capital assets acquired after November 20,

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[4] Interrogatory Response SEC-4(a)
[5] *Ontario Energy Board Act, 1998*, section 78(8)
[6] Interrogatory Response SEC-2; Application, Exhibit 1, Appendix J
[7] Interrogatory Response SEC-18(d)
[8] Burlington_Hydro_IRR_2020_ACM_ICM_Module_20200116, Sheet 9b, cells I64 and I65
[9] This can be shown in Schedule 10, Rows 58 to 72 of Burlington_Hydro_IRR_20 ACM_ICM_Module_20200116

2018, an increase in their first year CCA deduction of 1.5 times their usual rate.[10] BHI has not included the impact of this allowed accelerated depreciation, but instead plans to record the amount in DVA 1592 - PILS and Tax Variances, as set out in the Board's letter to all regulated utilities dated July 25, 2019.[11]

SEC submits that BHI should include the impact of the changes to the CCA rules caused by Bill C-97 in the calculation of the ICM. The Board's letter was to provide direction in situations where regulated utilities were in the midst of an incentive rate plan (IRM or Custom IR). The Board noted that it wanted to provide greater transparency related to the impact of the CCA changes and because the Board was not sure if the normal tax savings rules (50/50 sharing) that occurs during incentive plans would apply to these changes.[12]

In the same letter, the Board directed utilities in cost-based applications to include the impact of the changes in those applications:

> The OEB expects Utilities, including those whose applications are currently before the OEB, to reflect any impacts arising from CCA rule changes in their cost-based applications for 2020 rates and beyond.[13]

While BHI is still within its IRM plan, an ICM is a cost-based application. Under the ICM rules, if the proposed projects meet the need, prudence, and materiality requirements, the revenue requirement to be collected from the rate rider is calculated on a cost of service basis. There is no reason the impact of the C-97 tax changes should not be included in the calculation of the revenue requirement to be collected from any ICM rate rider.

The issue is not simply a matter of timing in which BHI can simply refund customers the difference in PILs later. The new CCA rules impact whether BHI is eligible for the ICM in the first place. The DVA sub-account does not record the entire revenue requirement related to the ICM, just the PILs impact.

Moreover, whereas there may be a need for smoothing of the effect of the accelerated CCA for ICM where the rate rider will be in place for multiple years, to more accurately reflect the PILs cost until the utility rebases, the issue simply does not arise in the present case, where BHI plans to file a cost of service application for 2021 rates.

Half-Year Rule. Consistent with the Board's ICM policy, BHI has applied the half year rule to the calculation of the ICM rate rider, as it plans to file a cost of service application for 2021 rates.[14] This reduces the amount that will be collected in 2020 from the ICM rate rider in half.

Revised ICM Amount. Based on SEC's calculation, if the new CCA rules are used in the calculation of the ICM revenue requirement, it would reduce the requested incremental revenue requirement from

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[10] See https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/sole-proprietorships-partnerships/report-business-income-expenses/claiming-capital-cost-allowance/accelerated-investment-incentive.html

[11] Interrogatory Response Staff-13; Letter from Board Secretary, Re: Accounting Direction Regarding Bill C-97 and Other Changes in Regulatory or Legislated Tax Rules for Capital Cost Allowance (July 25, 2019)

[12] *Ibid.*

[13] *Ibid.*, p.2

[14] Application, Exhibit 1, p.54;

$193,463 [15] to $60,490 [16] (See Appendix A). This is well below BHI's materiality threshold of $144,178.[17]

The Board has noted that ICM is not available for projects that do not have a significant influence on the operations of the distributor.[18] A project that is below the materiality threshold is one that cannot seriously be considered to have such an influence.

If the Board expects a utility on IRM to be able to absorb within its overall budget the impact of a Z-Factor event, which is entirely outside of management's control, of less than its materiality threshold[19], then it should expect the same for a project that it does have control over, such as the proposed ICM projects.

<u>BHI Did Not Disclose ICM in Deferral Request</u>

SEC is concerned that BHI did not inform the Board when it sought a second deferral of the requirement to file a cost of service application, that it would seek another ICM.[20] If it had, the Board may have very well denied the request and required BHI to come forward with a cost of service application, which would include a full DSP.

BHI was clearly aware that it would file an ICM for these projects. It had been planning for a new CIS since at least 2016.[21] While the Board did not ask for this information from BHI, as it noted in a recent decision regarding Oakville Hydro, a distributor who intends to rely on an ICM to defer rebasing should disclose that information:

> If a distributor intends to rely upon an ICM to manage an additional year before its cost of service application, that should be disclosed in its letter requesting the deferral. Not providing this information is an error of omission that can affect the OEB's assessment of whether the deferral request should be granted.[22]

Without this information, the Board likely expected BHI to file an application that would include a simple Price Cap adjustment of below inflation for 2020. This is especially true after it had granted BHI a deferral the previous year, and later approved an ICM for capital contribution.[23]

SEC's most significant concern is that, as BHI has not rebased since 2014, embedded within its rates is the then default value for working capital of 13%.[24] The current default value for working capital is

[15] Interrogatory Response OEB Staff-14(b), Table 8
[16] See Appendix A; Burlington_Hydro_IRR_2020_ACM_ICM_Module_20200116_SECVersion, see Sheet 10, Row 93;
[17] Interrogatory Response Staff-19(c)
[18] *Report of the Board New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, September 18, 2014, p.13; *Decision and Order* (EB-2018-0328 – Halton Hills Hydro Inc.), April 4, 2019, p.4
[19] *Filing Requirements For Electricity Distribution Rate Applications - 2018 Edition for 2019 Rate Applications - Chapter 3 Incentive Rate-Setting Applications*, p.20, referencing *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, p.36
[20] Interrogatory Response SEC-1
[21] Interrogatory Response SEC-4(e), Attachment, CIS Replacement Project Charter
[22] *Decision and Order on Preliminary Question of ICM Funding* (EB-2019-0059 - Oakville Hydro), November 14 2019, p.6
[23] An ICM for amounts it turned out it did not need. See Application, Exhibit 1, p.56
[24] EB-2013-0115, Proposed Settlement Agreement, dated May 6 2014, p.13

7.5%.[25]

If it were set at 7.5% today, and without making any adjustments for increases in any cost categories from the approved amount in 2014, the revenue requirement would be at least $751,984 less, and the rate base would be at least $11 million less.[26] This is almost four times the requested ICM annual revenue requirement, and more than four times the forecast rate base for the two projects.

Summary

SEC submits the Board should deny the approval of the proposed ICM, as BHI does not require the incremental revenue to fund the proposed CIS and GIS projects.

Yours very truly,
Shepherd Rubenstein P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicants and intervenors (by email)

[25] Filing Requirements For Electricity Distribution Rate Applications - 2018 Edition for 2019 Rate Applications, Chapter 2, p.16

[26] Revenue requirement calculation was made by adjusting working capital allowance from 13% to 7.5% in the RRFW included with BHI's 2014 Settlement Proposal (EB-2013-0115, Proposed Settlement Agreement, dated May 6 2014, Attachment J). The rate base calculation was made by substituting 7.5% for 13% on sheet 8 of the current ICM spreadsheet (Burlington_Hydro_IRR_2020_ACM_ICM_Module_20200116, Sheet 8).

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Capital Module
Applicable to ACM and ICM

Ontario Energy Board

Burlington Hydro Inc.

Incremental Capital Adjustment | **Rate Year:** **2020**

Current Revenue Requirement

Current Revenue Requirement - Total		$ 29,406,581	A

Eligible Incremental Capital for ACM/ICM Recovery

	Total Claim	Eligible for ACM/ICM (Half Year* Prorated Amount) *(from Sheet 10b)*	
Amount of Capital Projects Claimed	$ 2,682,275	$ 1,341,138	B
Depreciation Expense	$ 536,455	$ 268,228	C
CCA	$ 2,212,877	$ 1,106,438	V

**The half year rule is applied as the distributor is scheduled to rebase in the next rate year.*

ACM/ICM Incremental Revenue Requirement Based on Eligible Amount in Rate Year

Return on Rate Base

Incremental Capital			$ 1,341,138	B
Depreciation Expense (prorated to Eligible Incremental Capital)			$ 268,228	C
Incremental Capital to be included in Rate Base (average NBV in year)			$ 1,207,024	D = B - C/2
	% of capital structure			
Deemed Short-Term Debt	4.0%	E	$ 48,281	G = D * E
Deemed Long-Term Debt	56.0%	F	$ 675,933	H = D * F
	Rate (%)			
Short-Term Interest	2.11%	I	$ 1,019	K = G * I
Long-Term Interest	4.73%	J	$ 31,972	L = H * J
Return on Rate Base - Interest			$ 32,990	M = K + L
	% of capital structure			
Deemed Equity %	40.00%	N	$ 482,810	P = D * N
	Rate (%)			
Return on Rate Base -Equity	9.36%	O	$ 45,191	Q = P * O
Return on Rate Base - Total			$ 78,181	R = M + Q

Amortization Expense

Amortization Expense - Incremental	C	$ 268,228	S

Grossed up Taxes/PILs

Regulatory Taxable Income		O	$ 45,191	T
Add Back Amortization Expense (Prorated to Eligible Incremental Capital)		S	$ 268,228	U
Deduct CCA (Prorated to Eligible Incremental Capital)			$ 1,106,438	V
Incremental Taxable Income			-$ 793,020	W = T + U - V
Current Tax Rate	26.5%	X		
Taxes/PILs Before Gross Up			-$ 210,150	Y = W * X
Grossed-Up Taxes/PILs			-$ 285,919	Z = Y / (1 - X)

Incremental Revenue Requirement

Return on Rate Base - Total	Q	$ 78,181	AA
Amortization Expense - Total	S	$ 268,228	AB
Grossed-Up Taxes/PILs	Z	-$ 285,919	AC
Incremental Revenue Requirement		$ 60,490	AD = AA + AB + AC