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BY EMAIL

September 29, 2020

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

Dear Ms. Long:

**Re: Hydro Ottawa Limited (Hydro Ottawa)
Application for Rates
Ontario Energy Board (OEB) File Number: EB-2019-0261
OEB Staff Submission on Settlement Proposal**

In accordance with Procedural Order No.7, please find attached OEB staff's submission on the settlement proposal in the above noted proceeding.

Yours truly,

Original Signed By

Shuo Zhang

Project Advisor – Electricity Distribution: Major Rate Applications & Consolidations

Attach.

**2021-2025 CUSTOM INCENTIVE RATE-SETTING
APPLICATION**

HYDRO OTTAWA LIMITED

EB-2019-0261

**OEB STAFF SUBMISSION ON SETTLEMENT
PROPOSAL**

SEPTEMBER 29, 2020

Introduction

Hydro Ottawa Limited (Hydro Ottawa) filed a complete custom incentive rate-setting (Custom IR) application with the Ontario Energy Board (OEB) on February 11, 2020 under section 78 of the *Ontario Energy Board Act, 1998* (OEB Act), S.O. 1998, c.15, (Schedule B), seeking approval for changes to the rates that Hydro Ottawa charges for electricity distribution, beginning January 1, 2021, and for each following year through to December 31, 2025 (the Application).

The OEB issued an approved issues list for this proceeding on June 22, 2020. A settlement conference was held from August 10, 2020 to August 17, 2020. Hydro Ottawa filed a settlement proposal setting out an agreement among all the parties to the proceeding on September 18, 2020. The parties to the settlement proposal are Hydro Ottawa and the following approved intervenors¹ in the proceeding: Building Owners and Managers Association (BOMA), Consumers Council of Canada (CCC), Distributed Resource Coalition (DRC), Environmental Defence (ED), Energy Probe Research Foundation (EPRF), Pollution Probe (PP), School Energy Coalition (SEC), and Vulnerable Energy Consumers Coalition (VECC) (the Parties).

The settlement proposal represents a comprehensive settlement with one unsettled issue. Parties have reached a complete settlement on issues related to the Custom IR framework, revenue requirement, load forecast, cost allocation, accounting and effective date. No settlement was reached on an issue related to rate design.

If the OEB accepts the settlement proposal and Hydro Ottawa's proposal on the unsettled issue, the total bill impact for a residential customer would be an increase of \$0.61, or 0.53% for 2021. The distribution portion of the total bill impacts would be a \$0.72 per month increase (2.51%) for residential customers.

This submission is based on the status of the record as of the filing of Hydro Ottawa's settlement proposal and reflects observations which arise from OEB staff's review of the evidence and the settlement proposal. It is intended to assist the OEB in deciding upon Hydro Ottawa's application and the settlement proposal.

¹ Richard Parry and Nash Smith are also approved as intervenors in the proceeding. They did not participate in the settlement conference.

Settlement Proposal

OEB staff has reviewed the settlement proposal in the context of the objectives of the *Renewed Regulatory Framework for Electricity Distributors* (RRF)², the *Handbook for Utility Rate Applications*³ (Rate Handbook), other applicable OEB policies, relevant OEB decisions, and the OEB's statutory objectives. OEB staff submits that the settlement proposal reflects a reasonable evaluation of the distributor's planned outcomes in this proceeding, appropriate consideration of the relevant issues, and ensures that there are sufficient resources to allow Hydro Ottawa to achieve its identified outcomes in the five years of the plan from 2021 to 2025.

OEB staff further submits that the explanations and rationale provided by the Parties support the settlement proposal and that the outcomes arising from the OEB's approval of the settlement proposal would reflect the public interest and would result in just and reasonable rates for customers.

With respect to the unsettled issue, OEB staff agrees with the Parties that this issue would be most efficiently disposed by way of a written hearing.

OEB staff supports the Parties' agreement on the settled issues as documented in the settlement proposal. OEB staff provides its submissions on the following issues:

- 1.2 Effective Date
- 1.3 Bill Impacts
- 2.1 & 2.2 Custom IR Framework
- 2.3 & 2.4 Custom Performance Scorecard and Annual Reporting
- 3.1 2021-2025 Rate Base
- 3.2, 3.3 & 3.4 2021-2025 Capital Expenditures
- 4.2 Load Forecast and Conservation and Demand Management Savings
- 5.1 Operating, Maintenance & Administration
- 6.1 Cost of Capital
- 7.1 & 7.2 Cost Allocation
- 7.3 Rate Design

² Report of the Board on the Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, October 18, 2012.

³ Handbook for Utility Rate Applications, October 13, 2016

- 7.4 Transformer Ownership Credit
- 7.5 Standard Supply Service Administrative Charge
- 8.2 Disposition of Balances in Existing Deferral and Variance Accounts
- 8.3 Establishment of New Accounts, Closing of Existing Accounts, and Modifications of Existing Accounts

Discussion and OEB Staff Submission

Issue 1.2 Effective Date

OEB staff agrees with the Parties that the proposed effective date of January 1, 2021 is appropriate. OEB staff concurs that if the OEB's rate order is not issued in time for Hydro Ottawa to implement rates for January 1, 2021, Hydro Ottawa should be allowed to collect the foregone revenues from its customers.

Issue 1.3 Bill Impacts

OEB staff notes that, if the OEB accepts Hydro Ottawa's proposal on the unsettled issue, bill impacts arising from the settlement proposal for customers in all rate classes fall below a 10% increase on a total bill basis. As such, no rate mitigation is required. OEB staff expects that bill impacts will be updated using the OEB's 2021 inflation and cost of capital parameters when they are issued by the OEB in the Fall of 2020.

Issues 2.1 & 2.2 Custom IR Framework

OEB staff notes that this is Hydro Ottawa's second consecutive five-year Custom IR plan, following the first one for 2016-2020.⁴ The first Custom IR plan was also the result of a settlement proposal that was subsequently accepted by the OEB with certain amendments that were accepted by the parties.

Hydro Ottawa's Custom IR plans are also distinguished from those of other utilities with approved Custom IR plans in that, in the case of Hydro Ottawa, the plans have been the result of negotiated settlements. OEB staff notes that settlement proposals are the result of negotiations that are conducted in confidence. They may involve trade-offs. As noted in the *Practice Direction on Settlement Conferences*, OEB staff's role is to:

⁴ EB-2015-0004

... attend the settlement conference to ensure that all relevant information is brought forward and considered in negotiations. OEB staff will endeavor to help the parties reach a settlement by presenting options for the consideration of the parties and offering advice on the strengths and weaknesses of the parties' proposals and the sufficiency of any rationale supporting the proposals.

...

Where it is not a party to the proposal, Board staff will file a submission with the Board commenting on two aspects of the settlement proposal: whether the settlement proposal represents an acceptable outcome from a public interest perspective, and whether the accompanying explanation and rationale is adequate to support the settlement proposal.⁵

With this in mind and in consideration of the settlement proposal in its entirety, OEB staff does not oppose the 5-year Custom IR methodology. OEB staff does make some submissions (below), on the various components and parameters of the Custom IR plan, and on how these align with OEB policy. However, OEB staff also submits that it is appropriate to remind the Parties that the results of a settlement proposal are not necessarily precedential, and cannot necessarily be relied upon in a subsequent application by this or any other applicant or party.

As noted, this is Hydro Ottawa's second consecutive Custom IR framework. The OEB established the Custom IR rate setting option in the RRF Report. The Rate Handbook affirmed and augmented the OEB's requirements and expectations for an application requesting approval of a multi-year (typically five year) Custom IR plan.

The OEB's policies do not mean that Custom IR is an automatic option. This has been recently confirmed in the OEB's decision and order with respect to Toronto Hydro-Electric System Limited's second Custom IR plan.⁶ While approving that plan, the OEB cautioned the utility that the need for a subsequent Custom IR plan would be carefully scrutinized and that other options should be considered:

⁵ *Practice Direction on Settlement Conferences*, Revised October 28, 2016, pp. 6-7

⁶ EB-2018-0165

Toronto Hydro indicated that intervenors are asking the OEB panel to either make changes to generic policy through a particular utility's rate application or to fetter the discretion of a future panel. Toronto Hydro also submitted that its proposed ratemaking formula is structurally the same as the one approved in its 2015-2019 Custom IR proceeding. The OEB notes that the Custom IR approach taken has required extensive evidence and time to consider the details provided. Toronto Hydro is encouraged to consider an alternative approach in the future that might be more efficient in establishing the revenue requirement for the base year and following years as well as meeting OEB RRF objectives, and improving the balance of risk between customers and the utility. Toronto Hydro should not assume that future panels will continue to accept Toronto Hydro's current proposed Custom IR framework.⁷

OEB staff submits that the same caution and guidance should also be applicable to Hydro Ottawa. In the context of the agreed-upon settlement proposal, OEB staff accepts the evidence on record in this proceeding in support of Hydro Ottawa's forecasted capital plan for 2021-2025. However, while accepting it for the current plan, OEB staff also notes evidence of more modest customer and demand growth, as forecasted by Hydro Ottawa over the 2021-2025 period relative to historical growth up to 2019.⁸ OEB staff submits that any proposal for continued significant capital expenditures in any subsequent multi-year plan proposal would warrant greater scrutiny. Hydro Ottawa should be expected to fully consider all options and to support its Distribution System Plan (DSP) proposal in its next rebasing application, currently planned for 2026 rates.

OEB staff notes that the majority of electricity distributors in Ontario do operate under the standard Price Cap IR option with or without availing themselves of incremental capital funding options, and submits that the onus is on the applicant to justify its proposed option, particularly in the case of a Custom IR plan.

⁷ EB-2018-0165, Decision and Order, December 19, 2019, p. 24

⁸ Hydro Ottawa documented a compound average growth rate (CAGR) in number of customers based on actuals and forecasts of 1.34% for 2021-2020 (Exhibit 1/Tab 1/Schedule 10 UPDATED/p. 21/Tables 7 and 8. However, the updated load forecast had a CAGR of 0.9% (discussed further in Issue 4.2 Load Forecast and Conservation and Demand Management Savings). Per the settlement proposal, the CAGR for number of customers is 0.95%, due to the agreed upon increase in the residential customer annual growth rate from 0.9%. to 1.0% (settlement proposal, page 15/Table 5 and page 23)

OM&A Custom Price Escalation Factor

The general methodology, proposed in Hydro Ottawa’s application and accepted in the settlement proposal subject to certain changes discussed below, is that Operation, Maintenance and Administration (OM&A) expenses would be escalated each year by a Custom Price Escalation Factor (CPEF):

$$OM\&A_t = OM\&A_{t-1} \times (1 + CPEF_t)$$

where

$$CPEF_t = I_t - X + G$$

Where I is inflation, X is a measure of base productivity and an explicit stretch factor, and G is a measure of growth (in customers) adjusted by an economies of scale factor (actually an estimate of the customer elasticity of OM&A expenses).⁹ A similar formula was approved in Hydro Ottawa’s first Custom IR plan. However, in this application Hydro Ottawa proposed updated labour and non-labour (materials) weights for the inflation factor (Input Price Index or IPI), as shown in Table 1 below.

⁹ An elasticity is the percentage change of one variable being explained (the dependent variable) relative to a 1 percentage change in the value of the explanatory variable.

Table 1: Component weights for components of Various Input Price Indices measuring Inflation for Rate Adjustment Formulae

| | Labour | Non-Labour | Notes |
|---|---|---|--|
| | Average Weekly Earnings, including Overtime, Ontario, all businesses except uncategorized | Implicit Price Index for National Gross Domestic Product – Final Domestic Demand (Canada) | |
| OEB distribution IPI for Price Cap IR ¹⁰ | 30% | 70% | Non-labour represents materials and capital assets and equipment |
| Hydro Ottawa 2016-2020 Custom IR (EB-2015-0004) ¹¹ | 60% | 40% | Non-labour represents only expensed materials |
| Hydro Ottawa 2021-2024 Custom IR (EB-2019-0057) as proposed ¹² | 55.5% | 44.5% | |

In addition, Hydro Ottawa proposed in its original application, that rather than updating inflation annually as part of each year’s application for distribution rates adjusted per the Custom IR formula, it would use an inflation forecast it had calculated for 2022-2025; Hydro Ottawa forecasted this to be 2.26% per year on average.¹³ This is also different than how formula-based annual rate adjustments are made for other utilities under price cap and Custom IR applications where the inflation factor is derived from current data available at the time of the decision or rate order.

In the settlement proposal, the following changes have been made to Hydro Ottawa’s proposal for the CPEF:

- 1) For inflation (*I*), the OEB’s standard IPI, with weights of 70% non-labour and 30% labour, will be used as the measure. The IPI will be updated annually with each

¹⁰ *Report of the Board - Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario’s Electricity Distributors*, (EB-2010-0379), (November 21, 2013, pp. 5-11

¹¹ EB-2015-0004, Decision and Rate Order, December 22, 2015, Settlement Proposal, p. 20

¹² Exhibit 1/Tab 1/Schedule 10 UPDATED, p. 14

¹³ *Ibid.*, pp. 13-17

year's application, as is standard for other Price Cap IR, Annual Index IR and Custom IR plans.

- 2) The X-factor will be set at 0.45%, which is Hydro Ottawa's current stretch factor per the annual cohort analysis conducted by Pacific Economics Group Research LLC (PEG) for the OEB, and thus is at least as challenging as if the utility were under Price Cap IR. The X-factor is derived as the sum of the OEB's current base productivity factor of 0% and an agreed upon stretch factor of 0.45%, and will be fixed for the plan term from 2022 to 2025.
- 3) G will be fixed at 0.34%, calculated as Hydro Ottawa's proposed "economies of scale" factor of 0.35 and an agreed upon estimated average annual growth in customers of 0.97% from 2021 to 2025. The G-factor will be fixed for the plan term.

OEB staff makes the following comments on the CPEF parameters.

On inflation, Hydro Ottawa is moving back to the standard electricity distribution IPI as updated and issued annually. This will make the calculation easier and ensure consistency with all other electricity distributors with rate adjustments under Annual Index, Price Cap and Custom IR rate adjustment plans. OEB staff also notes that this measure of inflation is also used for the annual adjustment of certain Specific Service Charges ($I - X$) and the working capital allowance of rate base (I only); these are discussed later in this submission.

The agreed upon base X and stretch factor are, in part, based upon existing OEB parameters, and are also informed by the econometric studies of Clearspring Energy Advisors and PEG.

The growth factor is not normally used in price cap-type rate adjustment mechanisms in other jurisdictions, and has only been used in Ontario for Hydro Ottawa's 2016-2020 Custom IR plan and that proposed for 2021-2025 in this application. It is commonly seen in revenue cap-type adjustments (although not with an adjustment for economies of scale, which are normally assumed to be factored into and hence recovered through the X-factor), as the effect of customer growth on costs and revenues is separate from the X + stretch factor. The OEB has not adopted an explicit growth factor in some recently approved revenue cap plans as historical and forecasted demand growth has

been close to 0%.¹⁴ In Hydro Ottawa's proposal, growth is added as the CPEF adjusts the OM&A expenses (i.e., the OM&A revenue requirement) in aggregate; this is in contrast with standard price cap adjustments which act on prices, which are actually the revenue requirement expressed on a unitized basis (i.e., per unit of demand). In Hydro Ottawa's Custom IR plan design, the adjusted OM&A revenue requirement is added to the updated capital-related revenue requirement, and the sum is then allocated between classes and fixed/variable proportions and divided by the billing determinants (customers/connections, kWh and kW) to derive distribution rates.

Taken together, the CPEF and its component parameters comprise, in OEB staff's submission, a suitable custom index that, for OM&A expenses, is at least as rigorous as would be the standard Price Cap IR index.

Capital Stretch Factor

In the Application as originally filed, the forecasted capital expenditures (as well as in-service capital additions) were not subject to any incentive index adjustment.

The Parties have agreed to an approach whereby the capital-related revenue requirement forecasted for each year based on the forecasted rate base for each year, adjusted for in-service additions and for retirements/removals, is further adjusted by a Capital Stretch Factor. The Capital Stretch Factor has a value of 0.60%, composed of the same 0.45% stretch factor in the CPEF plus an incremental stretch of 0.15%. Further, the Capital Stretch Factor is increased in an additive fashion, in order to preserve the expected productivity from earlier years while adding on the expected productivity for the current rate year.

There is no Capital Stretch Factor for 2021 as 2021 rates are rebased on a cost of service approach. The agreed upon Capital Stretch Factor is 0.6% for 2022, 1.2% for 2023, 1.8% for 2024 and 2.4% for 2025.

In OEB staff's submission, it is not readily apparent that this is an incentive formula, like the CPEF used to adjust OM&A expenses, or more common Price Cap IR formulae; this is because the standard parameters of inflation less productivity, and other factors are

¹⁴ EB-2018-0218 (Hydro One Sault Ste. Marie LP 2019-2023 revenue cap plan), EB-2019-0082 (Hydro One Networks Inc. Transmission 2019-2023 Custom IR plan)

not shown directly affecting the capital-related revenue requirement. However, OEB staff are satisfied that it is a suitable incentive formula in the context of the settlement proposal, as explained below.

Hydro Ottawa's evidence is that it has not factored inflation into program-based capital expenditures. It is not clear whether inflation is factored into capital expenditures for specific projects (which tend to be bigger and unique capital spends). However, OEB staff also notes that the IPI inflation index, discussed above, will adjust the working capital and hence the working capital allowance which is also part of the rate base from which the capital-related revenue requirement is updated for each year in the plan from 2022 to 2025. Also, since the capital-related revenue requirement is based on the average rate base in the rate year, and includes growth-related capital as well as replacement/sustainment capital, growth is implicitly factored into the determination of the capital-related revenue requirement. The Capital Stretch Factor adjustment is analogous to the $I - X + G$ formula applied to OM&A expenses, but the I and G factors are implicitly already factored, in some form, into the capital budget, and hence into in-service additions and rate base for each year.

OEB staff notes that the Capital Stretch Factor is applied to the capital-related revenue requirement, which is calculated each year from the updated rate base, composed of the average net book value of estimated in-service assets, taking into account net capital additions and removals, plus the inflation-adjusted working capital allowance. As is stated in the settlement proposal:

With the aim of ensuring that Hydro Ottawa has appropriate incentives to achieve productivity savings and continuous improvement in its 2021-2025 capital programs, the Parties agree to the application of a stretch factor to the utility's capital-related revenue requirement.¹⁵

However, OEB staff notes that, as the Capital Stretch Factor applies to the capital-related revenue requirement and not directly to capex or capital additions, achievement of capital-related productivity gains are not guaranteed. In the absence of realized productivity gains, the Capital Stretch Factor amounts to a temporary reduction to the revenue requirement and associated rates, analogous to a temporary rate freeze or reduction such as the OEB has approved in many applications for utility

¹⁵ Settlement Proposal, p. 15

consolidations.¹⁶ OEB staff submits that Hydro Ottawa should be required to file evidence at its next application to rebase rates (expected for 2026 rates) documenting its efforts and achievements with respect to productivity improvements on its capital programs and projects undertaken during the 2021-2025 term.

With this addition, OEB staff submits that the Capital Stretch Factor, considered along with the CPEF adjustment to OM&A expenses, and also taken in the context of the total settlement proposal, is a suitable Custom IR approach and compliant with the RRF and OEB expectations and policies for incentive rate-setting mechanisms.

Earnings Sharing Mechanism

An Earnings Sharing Mechanism (ESM) is required by OEB policy to be a component of a Custom IR plan.

In its original Application, Hydro Ottawa proposed an asymmetrical ESM with a deadband of 150 basis points (bps) above the approved Return on Equity (ROE) for each year of the plan, on a regulated basis. Overearnings above the ROE + 150 bps would be shared 50:50 between ratepayers and shareholders, with any amount to be credited to customers to be disposed of at the end of the plan.

In the settlement proposal, the Parties have agreed to an asymmetrical ESM with no deadband, and earnings above the allowed ROE being shared 50:50 between ratepayers and shareholders. Any amounts to be credited to ratepayers would be disposed of for the whole plan term at the end of the 2021-2025 Custom IR plan term. The ESM would operate differently than the current one in the 2016-2020 Custom IR plan in that under-earnings in subsequent years would go to offset, in whole or in part, over-earnings. In essence, it is only net over-earnings at the end of the plan term which would be distributed 50:50 between shareholders and ratepayers, and this would occur after the end of the 2021-2025 plan term.

OEB staff does not oppose the agreed-upon ESM in the context of the proposed settlement as a whole, and OEB staff submits that the proposal does act like an ESM in the context of established OEB policy. However, OEB staff views this design for an ESM to be less than optimal and makes the following submissions.

¹⁶ Commonly referred to as Mergers, Acquisitions, Amalgamations and Divestitures

Having no deadband means that any net over-earnings are shared equally between shareholders and ratepayers; shareholders thus perceive that there is less benefit in the firm pursuing significant productivity improvements that could result in over-earnings, while the shareholders get no safety net for years of under-earnings (due to, for example, weather and economic impacts). Accumulating over- and under-earnings over the plan smooths out the impact of under- and over-earnings due to exogenous (and endogenous) factors. The overall impact may be to motivate “mediocrity” in financial and productivity improvement performance. In OEB staff’s view, there are preferable ESM designs that would incentivize improved productivity performance and equitably share realized benefits between shareholders and ratepayers.

As it is commonly recognized, accepted settlement proposals do not necessarily constitute precedents for OEB policy. While accepting the agreed-upon ESM in the context of this settlement proposal, OEB staff submits that there are better ESM designs that could be preferred in multi-year rate-setting plans.

Z-factor

Hydro Ottawa proposed to follow the OEB’s existing policy with respect to Z-factor claims during the plan term, and this has been agreed to in the settlement proposal. OEB staff submits that this is compliant with OEB policy and practice.

Off-ramps

Hydro Ottawa proposed to follow the OEB’s existing policy with respect to off-ramps during the plan term, and this has been agreed to in the settlement proposal. OEB staff submits that this is compliant with OEB policy and practice.

Performance Outcomes Accountability Mechanism

Hydro Ottawa had an Efficiency Adjustment Mechanism (EAM) in its first Custom IR plan for 2016-2020. The EAM accounted for the incremental revenues recovered through rates for years in the plan when Hydro Ottawa’s efficiency, per the annual PEG analysis of cost benchmarking for all Ontario electricity distributors, was lower (i.e., higher stretch factor) than the 0.3% median stretch factor used for the annual rate adjustment for all years in the plan.

No EAM is proposed for the Custom IR plan for 2021-2025.

Instead, the parties have agreed upon a Performance Outcomes Accountability Mechanism (POAM) in its place. The POAM differs from the EAM in that it focuses on Hydro Ottawa's ability to deliver certain measurable outcomes that are intended through achievement of the five-year DSP. The POAM is an asymmetric plan, in that the utility could suffer a penalty of up to \$1 million in each year depending on actual measured performance upon the five agreed-upon metrics. The premise is that the utility is being provided with the incremental capital that it believes is necessary to achieve the outcomes in the DSP and that customers should be refunded some amount of that which they are paying for through rates if the utility does not deliver the intended outcomes. Details on the POAM deferral account are discussed under Issue 8.3 of this submission.

This is a new and unique proposal. However, as it is based on quantifiable metrics on performance in achieving certain measurable outcomes tied to the utility's DSP, OEB staff submits that the POAM proposal is consistent with the spirit of the OEB's RRF policy. Further, OEB staff views that certain performance metrics in the agreed-upon POAM proposal to be generally consistent with the OEB's current initiative for Activity and Program-Based Benchmarking with respect to unit cost,¹⁷ and that the POAM results may be informative for that consultative initiative.

Issues 2.3 & 2.4 Custom Performance Scorecard and Annual Reporting

In addition to the POAM discussed under the Custom IR Framework section, Hydro Ottawa proposed to track 26 measures in its Custom Performance Scorecard to assess its performance in achieving the four performance outcomes of the RRF: customer focus, operational effectiveness, public policy responsiveness, and financial performance. Hydro Ottawa will monitor and report on its Custom Performance Scorecard¹⁸ annually over the 2021-2025 rate term.

As part of the annual reporting, Hydro Ottawa will also provide updates on the progress of capital spending in key categories. These updates will track actual capital

¹⁷ EB-2018-0278

¹⁸ Settlement Proposal, Attachment 2.

expenditures by program type¹⁹ versus budgeted capital expenditures, including variance analysis.

OEB staff supports the proposed Custom Performance Scorecard and annual reporting. OEB staff acknowledges that the proposal aligns with the OEB's expectations articulated in the RRF Report, which encouraged distributors to achieve performance outcomes by establishing specific measures and targets and annual reporting.²⁰

Issue 3.1 2021-2025 Rate Base

2021 Opening Rate Base

The actual capital additions over 2016-2020 exceeded the OEB-approved amount by \$67.3 million. The Parties arrived at a disallowance of \$12.4 million by reviewing the budget overrun by investment categories.

For System Access, the Parties acknowledged that drivers for this investment category were largely outside of Hydro Ottawa's control and accepted the over-spending of \$41.7 million. For System Renewal/System Service and General Plant, the Parties agreed that capital plan execution for these categories are, to some extent, within Hydro Ottawa's control and agreed to a disallowance of \$12.4 million. The disallowance consists of \$4.9 million in System Renewal/System Service and \$7.5 million in General Plant. The \$7.5 million disallowance in General Plant includes \$5.4 million associated with the renovation cost spent on the retained Bank Street facility.

As a result, the revised capital additions entering into 2021 opening rate base are:

- \$103 million in System Access
- \$310 million in System Renewal/System Service
- \$59 million in General Plant

OEB staff supports the revised capital additions over 2016-2020 going into the 2021 opening rate base.

¹⁹ Settlement Proposal, Attachment 1.

²⁰ Report of the Board on the Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, October 18, 2012, page 55.

With respect to Hydro Ottawa's New Administration and Operations Facilities, subsequent to the \$92.3 million requested in the 2016-2020 Custom IR application, the actual cost reported in this Application was \$99.5 million. The actual cost is \$33.5 million higher than the OEB approved amount of \$66 million in the form of a Y-factor variance account. In the 2016-2020 Custom IR proceeding, the OEB found that Hydro Ottawa had demonstrated the need for the new buildings and expected Hydro Ottawa to provide the evidence to support its spending above \$66 million as part of its next rebasing application. The OEB also accepted the agreement that the value of the old facilities (three in total: Albion Road, Merivale Road and Bank Street) replaced by new ones would be removed from rate base.²¹

In this Application, Hydro Ottawa removed the Albion Road and Merivale Road properties from the rate base and decided to retain the Bank Street facility for training centre and fleet management purposes instead of building new facilities for these functions. OEB staff notes that the retention of the Bank Street facility deviated from the settlement agreement in the 2016-2020 proceeding, and OEB staff supports the Parties' agreed upon disallowance of \$5.4 million associated with the renovation cost spent on the Bank Street facility.

Regarding the prudence of the actual cost of the new facilities, OEB staff acknowledges that Hydro Ottawa has taken actions to exercise prudent management in the planning and execution of the new facilities project, including a competitive procurement process and cost benchmarking review against similar projects approved by the OEB.²² OEB staff agrees with the Parties that Hydro Ottawa has not fully demonstrated the prudent usage of the land and supports the agreed upon disallowance of \$2.9 million associated with the land.

OEB staff supports the revised cost of \$96.6 million for the New Administration and Operations Facilities going into the 2021 opening rate base.

Working Capital Allowance

The Parties agreed to a working capital allowance (WCA) of \$85.5 million for 2021. For 2022-2025, the Parties agreed to adjust the WCA each year using the OEB's annual

²¹ EB-2015-0004, Decision on Settlement and Procedural Order No. 11, November 23, 2015, pp. 2-5.

²² Exhibit 2/Tab 1/Schedule 1/Attachment A.

inflation factor (i.e. IPI). OEB staff submits that the agreed-upon annual update to WCA would be mechanistic in nature, which generally aligns with the OEB's expectation with Custom IR applications as set out in the Rate Handbook.

OEB staff supports the agreed-upon WCA proposal for 2021-2025.

2021-2025 Rate Base

With the acceptance of the revised 2016-2020 capital additions, revised cost of New Administration and Operations Facilities, agreed-upon WCA, and the revised 2021-2025 capital plan (discussed below), OEB staff supports the revised 2021-2025 rate base as shown in Table 11 in the settlement proposal.

Issues 3.2, 3.3 & 3.4 2021-2025 Capital Expenditures

2021-2025 Capital Plan

Hydro Ottawa developed its capital expenditure plan for the 2021-2025 period based on its system investment needs as detailed in the DSP. The proposed net capital expenditures over the 2021-2025 period is a total of \$507.5 million (an average of \$101.5 million per year).

The Parties agreed to a reduction of \$10 million (1.9%) in capital expenditures over the 2021-2025 rate term. The revised capital expenditures over the 2021-2025 period is \$497.6 million, which represents a decrease of \$121 million (19.3%) from the actual/forecast spending for the 2016-2020 period. Compared to the OEB-approved capital expenditures for the 2016-2020 period, the revised capital expenditures represent a decrease of \$30 million (5.6%).

The Parties agreed to the \$10 million reduction on an envelope basis. Hydro Ottawa implemented the reduction across the System Renewal, System Service, and General Plant categories and translated the reduction to a \$10 million reduction in capital additions. Hydro Ottawa provided a breakdown of reductions in capital additions by year and by investment categories with a reduction of \$5 million in System Renewal/System Service and \$5 million in General Plant.²³

²³ Settlement Proposal, Table 12.

OEB staff notes that capital expenditures proposed in the original Application were forecasted on a cost of service basis with no explicit financial incentives for continuous improvement. This concern was addressed by applying a Capital Stretch Factor to the 2022-2025 capital-related revenue requirement and establishing the POAM deferral account. In addition to the reductions to capital expenditures agreed to by the Parties, in OEB staff's view, the Capital Stretch Factor provides incentives for Hydro Ottawa to pursue and achieve productivity savings and continuous improvement in its capital plan. The application of the Capital Stretch Factor results in a reduction of \$8.6 million to Hydro Ottawa's revenue requirement over 2022-2025. The POAM serves as a mechanism to link the outcomes of Hydro Ottawa's execution of its DSP to the recovery of its revenue requirement.

OEB staff supports the revised capital expenditures/capital additions in the context of the enhanced custom IR framework and views the agreed-upon proposal to be consistent with a key objective of the RRF, which is for utilities to cost-effectively achieve tangible outcomes that are valued by customers, and to plan and operate their systems on an efficient basis.

Capitalization of Cloud Computing Costs

Hydro Ottawa has an Enterprise Resource Planning (ERP) system which performs various business functions such as finance, procurement, and supply chain. Hydro Ottawa launched a human resource model called Workday covering the full spectrum of Human Capital Management in 2018 on a cloud-based platform and integrated the cloud-based module with its existing ERP system.

Hydro Ottawa capitalized the implementation costs related to Workday and reflected them in the opening 2021 rate base. Hydro Ottawa stated in the technical conference that the main rationale for capitalizing the integration and implementation costs of a cloud-based program was that Workday was a key component of the ERP system, which still remains on Hydro Ottawa's premises.²⁴

Hydro Ottawa also confirmed in the technical conference that, regarding the capitalization of the cloud-based human resource program, there is alignment between

²⁴ Technical conference transcript, July 16, page 81

their proposed regulatory accounting treatment and financial reporting under International Financial Reporting Standards (IFRS),²⁵ and further stated that Hydro Ottawa received an unqualified audit opinion for the year in which that project was capitalized.²⁶

OEB staff submits that, in the absence of regulatory accounting policy specific to the treatment of the cloud-based costs, OEB staff supports regulatory accounting treatment that aligns with Hydro Ottawa's financial reporting standards under IFRS. As a result, OEB staff does not oppose the capitalization of the cloud-based implementation costs in opening rate base. However, OEB staff submits that such treatment does not represent an explicitly stated view of the OEB and should not be interpreted as OEB policy on this matter.

For the 2021-2025 rate term, Hydro Ottawa proposed to capitalize some integration-related, non-recurring cloud computing costs associated with its ERP system.

OEB staff supports the capitalization of the implementation costs of Hydro Ottawa's ERP system upgrades. OEB staff concurs with the Parties and reiterates that its support should not be construed as a generally accepted regulatory treatment specific to such costs, an OEB-approved regulatory treatment of cloud-based computing, or any particular interpretation or guidance from Hydro Ottawa's auditors.

Distribution Losses

Hydro Ottawa filed a Distribution Loss Update report as part of its 2012 distribution rate application.²⁷ The report provided an update on a plan that was adopted by Hydro Ottawa in 2006 to reduce line losses by 5%. Hydro Ottawa noted that although it has not updated its plan of reducing line losses since the submission of the Distribution Loss Update report, the actual losses on an average basis were close to the 5% loss reduction target over the 2016-2019 period. Hydro Ottawa also noted that the average losses in the original study were 3.17% over the 2001-2005 period, and as such, a 5% reduction against these historical losses equates to a target of 3.02%.²⁸

²⁵ *Ibid.*, page 84

²⁶ *Ibid.*, page 82

²⁷ EB-2011-0054.

²⁸ Technical Conference Undertaking JT 3.15.

To achieve the target of 3.02% and to continue reducing distribution losses through cost effective measures, the Parties reached agreement on an action plan. OEB staff supports these actions:

- Between 2021-2025, Hydro Ottawa shall endeavour to maintain its five-year average total system losses below the target of 3.02%
- Over the course of 2020-2021, Hydro Ottawa shall prepare a plan to reduce distribution losses through cost-effective measures and file the plan with the OEB. In 2022-2025, Hydro Ottawa shall implement as many of the cost-effective measures set out in its plan as possible and incorporate all other cost-effective measures into its next rebasing application and DSP
- Hydro Ottawa shall, as proposed in the Application, complete a pilot Grid Edge Volt/VAr Control solution project by the end of 2020, and increase the deployment of these (or equivalent) units with an estimated investment of up to \$1 million over 2021-2025 within the overall agreed-upon capital budget, if the pilot is successful

MiGen Program

The MiGen program consists of projects that enable and empower customers to participate in a smart transactive energy future. Phase 1 of the MiGen project includes the installation of solar panels and the gathering of customer behaviour data. Hydro Ottawa undertook Phase 1 of the MiGen project at no cost to ratepayers over the 2016-2020 rate term.

For the 2021-2025 rate term, Hydro Ottawa plans to proceed to Phase 2 of the project with a rate funded budget forecasted at \$2.2 million. Phase 2 of the project will focus on behind-the-meter technologies and seek solutions to support the deployment of technologies and tools to customer premises in order to enhance the collaboration between customers and the utility.²⁹

The Parties are generally supportive of Phase 1 of the MiGen project and support Phase 2 of the project with a limited budget of \$2.2 million over the 2021-2025 period.

²⁹ Exhibit 2, Tab 4, Schedule 3, Attachment E, Section 2.3.3.

OEB staff sees merit in activities that support testing of innovative approaches that can inform options for rational integration of distributed energy resources (DERs) in Ontario. OEB staff recognizes that this project offers an opportunity to learn about the real-world costs and benefits of integrating DERs using a transactive approach. OEB staff also recognizes that while the project expenditures are forecast to exceed the materiality threshold in 2022, it only accounts for about 0.4% of the proposed capital expenditures over 2021-2025. However, OEB staff also notes that, based on the project description included in the application and responses to OEB staff's and DRC's interrogatories,³⁰ it is not clear specifically what kinds of activities Hydro Ottawa will be engaging in as part of this project. Therefore, OEB staff is unable to determine whether, or the extent to which, these activities constitute distribution activities under s. 71 of the OEB Act. OEB staff notes that any costs associated with non-distribution activities Hydro Ottawa engages in, in relation to the MiGen project, would have to be accounted for separately in accordance with s. 72 of the OEB Act and would not be rate funded.

OEB staff supports the Parties' proposal that Hydro Ottawa report all parameters and metrics (including the project's impact on reliability, customer costs/savings, generation, electric vehicle penetration, line losses, and potential costs and savings from any proposed future expansion of the pilot after 2025) in its next rebasing application.

OEB staff also notes that the role of distributors with respect to DER integration is one of the issues being explored in the OEB's Utility Remuneration and Responding to DERs consultations.³¹ OEB staff notes that there may be additional value in Hydro Ottawa, which has participated in the consultations to date, sharing information gleaned from its MiGen initiative in these consultations, as appropriate, at an earlier date than its next rebasing, as part of future steps on these policy development initiatives.

Issue 4.2 Load Forecast and Conservation and Demand Management Savings

In its Application, Hydro Ottawa had forecasted 316,346 residential customers for 2021 increasing to 327,975 for 2025.³² This reflects a cumulative growth of 3.68% over four years, or a geometric mean growth rate of 0.9% per year. Instead, the Parties agreed that the annual residential customer growth rate would be 1% for 2022 to 2025, resulting in 239,191 customers in 2025. The parties also agreed that the load forecast

³⁰ OEB-186 and DRC-9.

³¹ EB-2018-0287 & EB-2018-0288

³² Technical Conference Undertaking JT 3.8.

would not include adjustments related to conservation and demand management (CDM) other than those related to the wind down of the Conservation First Framework (CFF).

The proposed total energy delivered is:

| | Energy (GWh) | Change from prior year |
|-----------------|--------------|------------------------|
| 2019 (Actual) | 7,269 | |
| 2020 (Forecast) | 7,155 | -114 |
| 2021 (Forecast) | 7,120 | -35 |
| 2022 (Forecast) | 7,164 | 44 |
| 2023 (Forecast) | 7,215 | 51 |
| 2024 (Forecast) | 7,286 | 71 |
| 2025 (Forecast) | 7,320 | 35 |

The proposed total customer connections are:

| | Connections | Change from prior year |
|-----------------|-------------|------------------------|
| 2019 (Actual) | 309,165 | |
| 2020 (Forecast) | 313,134 | 3,969 |
| 2021 (Forecast) | 316,346 | 3,212 |
| 2022 (Forecast) | 319,510 | 3,164 |
| 2023 (Forecast) | 322,705 | 3,195 |
| 2024 (Forecast) | 325,932 | 3,227 |
| 2025 (Forecast) | 329,191 | 3,259 |

Hydro Ottawa’s customer connection forecast in its Application was performed using a regression methodology.³³ The use of regression methodologies for forecasting customer connections has been accepted in large utility applications including Hydro One Networks Inc.’s Custom IR³⁴, and Hydro Ottawa’s previous Custom IR application.³⁵ Regression is also the most frequent methodology used for energy forecasting, and one of the two methodologies addressed by the OEB’s *Filing*

³³ Exhibit 3, Tab 1, Schedule 1, Attachment C, page 17.

³⁴ EB-2017-0049.

³⁵ EB-2015-0004.

Requirements for Electricity Distribution Rate Applications for this purpose.³⁶ As noted above, using the regression methodology, Hydro Ottawa arrived at a compound annual growth rate of 0.9% for 2022-2025. Hydro Ottawa's regression methodology relied on a relationship of population growth to customer growth.³⁷ Population growth is forecasted to slow from 1.5% per year based on the 2013-2019 period used by the regression to 1.3% per year over the 2020 to 2025 forecast period.³⁸

Alternatively, historical average growth rates are the most frequently used methodology for forecasting customer connections by Ontario utilities. This method has been accepted in rate applications for Algoma Power Inc.,³⁹ ENWIN Utilities Ltd.,⁴⁰ Greater Sudbury Hydro Inc.,⁴¹ Hydro 2000 Inc.⁴² and Kitchener Wilmot Hydro Inc.⁴³ Hydro Ottawa had 293,884 residential customers in 2015, and 309,165 residential customers in 2019.⁴⁴ This reflects a total growth rate of 5.20% over the four years, or a geometric mean growth rate of 1.28%. Therefore, this methodology would project growth of 1.28% for 2022-2025.

The proposed residential customer connection growth rate of 1% for 2022 to 2025 is therefore bounded by two methodologies which are regularly accepted by the OEB, the more frequently used historical average growth rate, and the regression methodology which accounts for slowing population growth, and therefore OEB staff supports its use in the context of the settlement proposal.

Conservation and Demand Management (CDM) Adjustment

Hydro Ottawa's CDM adjustment, as originally proposed for 2021-2025, included wind-down program savings related to the former Conservation First Framework (CFF), LDC-led CDM program savings, and the continuation of Independent Electricity System Operator (IESO)-led CDM program savings administered at the provincial level. As a result of the settlement, Hydro Ottawa's CDM adjustment to the load forecast was

³⁶ *Chapter 2 Filing Requirements for Electricity Distribution Rate Applications – 2020 Edition for 2021 Rate Applications*, May 14, 2020, page 23.

³⁷ Exhibit 3, Tab 1, Schedule 1, Attachment C, page 16.

³⁸ *Ibid.*, page 7.

³⁹ EB-2019-0019.

⁴⁰ EB-2019-0032.

⁴¹ EB-2019-0037.

⁴² EB-2019-0041.

⁴³ EB-2019-0049.

⁴⁴ Exhibit 3, Tab 1, Schedule 1, Attachment C, page 17.

revised to include only forecast savings from CFF wind-down program activity. Any future CDM savings driven by the (IESO) or other government initiatives are proposed to be recorded as part of the lost revenue adjustment mechanism variance account (LRAMVA).

OEB staff submits that the inclusion of CFF wind-down savings in the revised CDM adjustment is consistent with OEB policy⁴⁵ as the CDM adjustment remains premised on CFF-related program savings.

OEB staff is of the view that the revised CDM adjustment (Tables 7-8 of Attachment 3) for 2021-2025 appropriately includes half-year impacts from CDM savings on the load forecast. The revised LRAMVA threshold (Tables 9-10) captures the annualized impact of forecast savings for prospective LRAMVA calculations, consistent with the requirements of the 2012 CDM Guidelines.⁴⁶

In the context of the settlement proposal, OEB staff does not have any concerns with the proposed load forecast.

Issue 5.1 Operating, Maintenance & Administration

2021 OM&A

Hydro Ottawa proposed a 2021 OM&A budget of \$93.9 million, inclusive of property taxes. For the 2022-2025 test years, as discussed in the Custom IR Framework section, OM&A will be updated on an annual basis using the CPEF.

The Parties agreed to a revised 2021 OM&A of \$90.6 million, which represents a \$3.3 million (3.5%) reduction to the proposed level. The Parties arrived at the revised OM&A using an envelope approach.

OEB staff notes that the revised 2021 OM&A reflects an increase of \$7.9 million from the 2016 actual OM&A (a compound annual growth rate of 1.9%). Compared to the most recent year of actual OM&A of \$83.1 million in 2019, the revised OM&A is an

⁴⁵ *Chapter 2 Filing Requirements for Electricity Distribution Rate Applications – 2020 Edition for 2021 Rate Applications*, May 14, 2020, section 2.3.1.3.

⁴⁶ *Guidelines for Electricity Distributor Conservation and Demand Management*, EB-2012-0003, April 26, 2012

increase of \$7.5 million (a compound annual growth rate of 4.4%). OEB staff compared the proposed growth rate in OM&A with the OEB's annual inflation factor for the 2016-2020 rate term. OEB staff found that inflation factors set by the OEB for 2016-2020 rate years is equivalent to a compound annual growth rate of 1.7%, which is close to the compound annual growth rate of 1.9% resulting from the settlement proposal.

The OEB articulated its expectations for continuous improvement and productivity in the RRF Report as well as the Rate Handbook. OEB staff acknowledges Hydro Ottawa's activities to improve productivity and efficiency and to enhance services for its customers. As part of the Application, Hydro Ottawa identified initiatives it undertook over the course of 2016-2020 rate term and planned new initiatives for the 2021-2025 rate term. Hydro Ottawa also provided quantified savings associated with these initiatives. Productivity savings included in OM&A that persist into the 2021 test year is forecasted at \$6.04 million.⁴⁷

OEB staff supports the revised 2021 OM&A of \$90.6 million. OEB staff submits that the revised OM&A represents a reasonable increase from the last rebasing year of 2016, reflects existing and new productivity initiatives, and provides sufficient resources for Hydro Ottawa to fulfill its mission of providing safe and reliable electricity distribution services in accordance with its statutory requirements and the expectations of its customers.

Rates Funded CDM Staffing Costs

The revised OM&A budget was agreed to by Parties on an envelope basis, without specific approval of the \$0.2 million for CDM positions included within the proposed 2021 OM&A budget.

OEB staff has concerns with the inclusion of CDM staffing costs in the OM&A budget. The OEB's current policy is that costs attributable to the delivery of CDM programs (i.e. staff labour dedicated to such programs) must not be included in the revenue requirement to be recovered through distribution rates.⁴⁸

Hydro Ottawa proposed to retain four full-time positions for CDM staff, previously

⁴⁷ Technical Conference Undertaking JT 1.1.

⁴⁸ *Chapter 2 Filing Requirements for Electricity Distribution Rate Applications – 2020 Edition for 2021 Rate Applications*, May 14, 2020, section 2.4.6.

funded through the global adjustment mechanism, with a budget of \$0.2 million included in the 2021 OM&A. From 2022 to 2025, Hydro Ottawa plans to manage the additional annual cost of \$0.3 million to support CDM staffing costs within the escalated OM&A budget.

Hydro Ottawa stated that funding is required to retain existing CDM staff after obligations for the CFF wind-down and delivery of IESO-funded local programs under the Interim Framework are complete.⁴⁹ The sustained availability of CDM resources from 2022 to 2025 would assist with Hydro Ottawa's regional, system and asset planning processes, including the identification of non-wires alternatives to help manage demand growth on the 115 kV system.⁵⁰

Under the former electricity conservation framework, CDM programming was centrally administered by the IESO (and by the former the Ontario Power Authority) with assistance from electricity distributors between 2011 and 2019. The cost of CDM staff was previously recovered through the global adjustment mechanism. Consistent with this practice, the OEB denied Alectra Utilities Corporation's request for a deferral account to recover CDM severance costs in rates due to the termination of the CFF. The OEB ruled that costs arising from CDM activity were not rate regulated and subsequently were not approved for the 2011-2020 term.⁵¹ The OEB's policy has remained unchanged in light of the revocation of the CFF.

As part of the new CDM framework (2021-2024) which is currently under development, electricity conservation programs may continue to be centrally delivered by the IESO.⁵² While OEB staff recognizes the benefit of having continued research support and expertise from in-house CDM resources, Hydro Ottawa has not identified any specific CDM projects or programs to support the costs for ratepayer funded CDM staff over the test year period.

Although OEB staff has concerns with the inclusion of CDM staffing costs in the OM&A budget for the reasons outlined above, OEB staff does not oppose the agreed-to OM&A budget in light of the OM&A envelope reduction that was agreed to by Parties and the immateriality of CDM staffing costs as part of the OM&A budget.

⁴⁹ OEB-134 Updated, p. 13

⁵⁰ Undertaking TC-JT 1.27, p. 5

⁵¹ EB-2019-0018, Partial Decision and Interim Rate Order, December 12, 2019, pp. 31-34

⁵² <https://ero.ontario.ca/notice/019-2132#supporting-materials>

Issue 6.1 Cost of Capital

As documented in the settlement proposal, OEB staff submits that the proposal for the cost of capital agreed to by the Parties is compliant with OEB policy. OEB staff provides some additional description for each of the components of the cost of capital (capital structure, return on equity, deemed short-term debt and long-term debt) below.

Deemed Capital Structure

Hydro Ottawa proposed to adopt the OEB's deemed capital structure for electricity distributors for the purposes of setting rebased rates for 2021. This deemed capital structure is 40% equity and 60% debt (4% deemed short-term debt and 56% long-term debt). This capital structure would remain unchanged throughout the plan term from 2021 to 2025. This proposal was accepted by the Parties in the settlement proposal. OEB staff submits that this proposal is compliant with OEB policy as documented in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (Cost of Capital Report)*.⁵³

Return on Equity

In its original Application, Hydro Ottawa proposed to use a forecasted ROE for each year of the plan term (i.e., a unique forecasted ROE that varied for each calendar rate year of the plan). Hydro Ottawa used the same ROE formula as is documented in the Cost of Capital Report.⁵⁴ However, Hydro Ottawa used different data than the OEB uses for the annual update; these differences were necessary because of the extended time period over which Hydro Ottawa was forecasting the cost of capital parameters.⁵⁵

In the settlement proposal, the Parties have agreed that Hydro Ottawa will use the 2021 ROE as issued by the OEB, expected sometime in the Fall of 2020. This, and other updated cost of capital parameters will be used in the draft rate order process to update

⁵³ *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (EB-2009-0084), issued December 11, 2009

⁵⁴ *Ibid.*, Appendix B

⁵⁵ Hydro Ottawa was forecasting cost of capital parameters 2 to 6 years ahead, while the the OEB forecasts the cost of capital parameters one year ahead for the next calendar rate year.

and finalize distribution rates for 2021. The ROE will remain unchanged for 2022 and 2023.

The Parties have agreed that Hydro Ottawa would update the ROE in 2023, as part of the 2024 rate adjustment. The ROE would be updated to that which the OEB issues in late 2023 as the ROE for rebasing applications in 2024, and this ROE would be unchanged for the last (2025) year of the plan.

OEB staff notes that OEB policy in the Rate Handbook contemplates no updates to the cost of capital parameters, after rebasing during the plan term.⁵⁶ However, OEB staff notes that Hydro Ottawa's first Custom IR plan for 2016-2020, established by way of a settlement proposal accepted by the OEB, also provided for a midterm update of the ROE to the OEB-issued ROE for 2019 rates, which was then held constant for 2020, the last year of the current Custom IR plan.

OEB staff submits that the proposed update would be relatively mechanistic for the updating of the revenue requirement and associated distribution rates. OEB staff also notes that there may be a practical basis for the update; while noting that government and central bank initiatives have cushioned the impact of the current COVID-19 pandemic, there have been socioeconomic impacts, and the recovery is more gradual and lengthier than first expected. Assuming recovery over the years, allowing for an update of the ROE in 2023 for 2024 rates may result in rates aligned with socioeconomic conditions in the latter part of the plan.

Taken in the context of the settlement proposal as a whole, OEB staff submits that the proposal is reasonable.

Deemed Short-term Debt

In its original Application, Hydro Ottawa proposed to fix the deemed short-term debt rate at the 2020 value of 2.75%, as issued by the OEB on October 31, 2019. Hydro Ottawa proposed no update for any year of the plan term, including for the 2021 rebasing year.

In the settlement proposal, the Parties have agreed that the deemed short-term debt rate for 2021, as issued by the OEB during the Fall of 2020, will be used for rate-setting

⁵⁶ Rate Handbook, page 26.

purposes for setting 2021 rebased distribution rates. The deemed short-term debt rate will not be updated for the remaining years (2022-2025) of the plan term.

The proposal for the deemed short-term debt agreed to by the Parties is, in OEB staff's submission, compliant with OEB's policy in the Cost of Capital Report.

Long-term Debt

As proposed in the original Application, Hydro Ottawa's treatment of long-term debt was, in large part, consistent with OEB policy, in that the weighted average cost of long-term debt was to be calculated based on the actual rate of existing debt and on rates forecasted for anticipated new debt. Hydro Ottawa proposed to use formulae derived from the deemed long-term debt rate formula documented in Appendix C of the Cost of Capital Report, but with its own data. However, Hydro Ottawa originally proposed that the weighted average cost of long-term debt be updated annually, along with the ROE.

Most of Hydro Ottawa's long-term debt is existing debt. There are two forecasted debt issuances expected:

- 1) \$80.0 million expected to be incurred July 1, 2021
- 2) \$60.0 million expected to be incurred mid-2023

The new debt would be provided through Hydro Ottawa's parent corporation.⁵⁷ Hydro Ottawa estimates that the new debt will be a mix of 10-year and 30-year instruments.

As agreed to in the settlement proposal, Hydro Ottawa will calculate the weighted average cost of long-term debt for 2021. The debt rate for the \$80.0 million of new debt will be calculated using Hydro Ottawa's proposed formulae for 10-year and 30-year debt rates, but with using *Consensus Forecasts* data available at the time of the draft rate order; this will be the same data as the OEB will use for updating the cost of capital parameters annually for the 2021 calendar rate year. Existing debt will use the actual rate of each instrument. The weighted average cost of long-term debt will be weighted based on the principal for each instrument and the number of days in 2021 that the debt is active.

⁵⁷ Exhibit 5/Tab 1/Schedule 1 UPDATED/p. 6/Table 1, May 6, 2020

The weighted average cost of long-term debt will not be updated during the remainder of the plan term.

OEB staff submits that the proposal for long-term debt treatment agreed to by the Parties in the settlement proposal is compliant with the OEB's policies in the Rate Handbook and the Cost of Capital Report.

Issues 7.1 & 7.2 Cost Allocation

The Parties agreed that Hydro Ottawa's proposed cost allocation and resulting revenue-to-cost ratios are appropriate.

The proportion of assets operating at primary and secondary voltages were explored by OEB staff and intervenors through the proceeding. Hydro Ottawa stated that the proportion of poles, towers, and fixtures remains unchanged from the 2016-2020 rate application, and had been estimated by experienced staff at the time.⁵⁸

Similarly, when asked about demand allocators, Hydro Ottawa stated that "the utility does not have sufficiently detailed demand data to derive secondary demand separately from primary demand."⁵⁹ In response to questioning at the technical conference, Hydro Ottawa noted that it was doing a study on the secondary and primary voltage.⁶⁰

Hydro Ottawa committed to completing the following studies, prior to its next rebasing application:

- i) Determine the appropriate split between primary, secondary, and services assets for cost allocation purposes
- ii) Determine the appropriate customer count and non-coincident peak (NCP) split between primary and secondary for the Residential and GS < 50 customer classes.

In the context of the settlement proposal, OEB staff does not have any concerns with the cost allocation or Hydro Ottawa's commitment to complete the studies identified above.

⁵⁸ Interrogatory Response to Staff-154.

⁵⁹ Interrogatory Response to Staff-157.

⁶⁰ Technical Conference Transcript, July 17, page 164

Issue 7.3 Rate Design

The Parties were unable to reach a settlement on the fixed / variable split for the general service 50 to 1,499 kW, general service 1,500 to 4,999 kW and Large Use rate classes. In these rate classes, the fixed charge is in excess of the ceiling as established by the cost allocation model. The Parties propose that this remaining matter be dealt with by way of a written hearing, OEB staff supports this approach.

In the original Application, Hydro Ottawa proposed to adjust Specific Service Charges using the proposed CPEF for the years 2022 to 2025. The Parties agreed that the Specific Service Charges are to be escalated using the “I-X” components of the CPEF and will not include the “G” factor.

OEB staff notes that the enhanced CPEF as applied to OM&A expenses includes a “G” factor which reflects the impact of customer connection growth on total OM&A expenses.⁶¹ Specific Service Charges are applied on a per-incident basis. To the extent that additional customers generate work and therefore additional costs through additional incidents, the additional incidents will also generate additional revenue. Given this, OEB staff agrees that a growth factor is not required in adjusting specific service charges.

OEB staff notes that certain service charges (i.e. Retail Service Charges) are subject to annual inflationary adjustments to be determined by the OEB through a generic order.⁶² Hydro Ottawa proposed to adopt the generic Retail Service Charges and the annual inflation adjustment per the OEB’s decision.

With respect to Specific Service Charges, OEB staff notes that these charges would typically remain unchanged in non-rebasing years for distributors under Price Cap IR and Annual Index IR rate-setting options. However, OEB staff is aware of the OEB’s approval of the annual adjustments to Specific Service Charges proposed by Hydro One Networks Inc. (Hydro One) in its most recent rebasing application.⁶³

⁶¹ Exhibit 1, Tab 1, Schedule 8, Custom Price Escalation Factor, Updated, May 5, 2020, page 22.

⁶² Decision and Order on Energy Retail Service Charges EB-2015-0304, Issued on February 14, 2019.

⁶³ EB-2017-0049.

OEB staff also notes that the “I - X” adjustment does not apply to the Access Power Poles – Wireline charge given that the Parties agreed to the adoption of the OEB’s generic charge. As such, the Access Power Poles – Wireline charge will be adjusted by the OEB’s inflation factor over the 2021-2025 period.

OEB staff submits that the annual inflation adjustment to Specific Service Charges is consistent with the OEB’s approval of Hydro One’s proposal. It is also consistent with the OEB’s annual adjustment to Retail Service Charges and the Access Power Poles – Wireline charge. OEB staff takes no issue with the agreed-upon annual adjustment to Specific Service Charges.

In the context of the settlement proposal, including the proposed modifications and subject to the unsettled rate design issue, OEB staff does not have any concerns with the agreed-upon rate design.

Issue 7.4 Transformer Ownership Credit

The Parties accepted Hydro Ottawa’s proposal to eliminate the transformer ownership credit (TOC) effective November 1, 2025.

OEB staff notes that Version 5 of Hydro Ottawa’s Conditions of Service, effective April 1, 2015 included an intent to eliminate the TOC effective November 1, 2025. Hydro Ottawa communicated the update to the Conditions of Service in April and May, 2015.⁶⁴

Hydro Ottawa stated that, since it amalgamated on November 1, 2000, it has required all customers to pay for their transformer installation at the time of construction, regardless of whether the transformer was utility-owned or customer-owned. It indicated that the end of the TOC corresponds to the expected 25-year life of transformers installed prior to amalgamation.⁶⁵ Since all customers are effectively paying for the transformers serving them, Hydro Ottawa reasoned that customers should not receive differential treatment based on actual ownership.

OEB staff submits that the proposal to end the TOC is reasonable considering that the costs are borne by customers. Further, the communication to customers dating back

⁶⁴ Response to OEB-162, June 5, 2020.

⁶⁵ Interrogatory Response to Staff-162.

more than five years indicated a sunset date of November 1, 2025. Therefore, once the sunset date for the TOC is reached, customers will have received communication on this change for more than 10 years.

In the context of the settlement proposal, OEB staff does not have any concerns with the elimination of the TOC.

Issue 7.5 Standard Supply Service Administrative Charge

In its Application, Hydro Ottawa proposed to increase the Standard Supply Service (SSS) Administrative Charge to \$0.62 from the standard charge of \$0.25 per customer per month. The proposal was based on establishing consistency between it and the Retail Services Distributor – Consolidated Billing Charge⁶⁶ (CBC) of \$0.62 per customer. The CBC is applied to the customers of electricity retailers to cover the costs of billing services. It is similar to the SSS Administrative Charge, which is applied to customers served directly by Hydro Ottawa and also recovers costs of billing services.

The Parties agreed that Hydro Ottawa will continue to use the OEB’s prescribed SSS Administrative Charge of \$0.25 per customer per month.

OEB staff does not have any concerns with the proposal to continue using the prescribed SSS Administrative Charge.

The Parties note that the SSS Charge has not been adjusted for inflation since it was introduced in 2002. As a result, they indicate that “timely review of the rate design methodology associated with the SSS Charge is warranted as part of the OEB’s ongoing review of miscellaneous rates and charges.” OEB staff notes that the review of customer service rules⁶⁷ includes miscellaneous rates and charges and is anticipated to include review of the SSS Administrative Charge. However, it is not possible to determine whether it would result in an update to the rate, or when this work will be completed.

⁶⁶ Interrogatory Response to Staff-167.

⁶⁷ EB-2017-0183.

Issues 8.2 Disposition of Balances in Existing Deferral and Variance Accounts

Hydro Ottawa is seeking disposition of its audited December 31, 2019 Group 1 deferral and variance account (DVA) balances, its audited December 31, 2019 Group 2 DVA balances, plus forecast 2020 balances for certain Group 2 DVAs, including accounts related to Y-factor, New Facilities, and Payment in lieu of Taxes (PILs) and Tax variances - Capital Cost Allowance (CCA) changes.

Hydro Ottawa has confirmed that it has categorized DVAs based on the OEB's report on the Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR Report) and that DVAs are being used as prescribed in the OEB's Accounting Procedures Handbook.⁶⁸ Interest on the principal portion of the DVA balances was calculated using the OEB's prescribed quarterly interest rates.⁶⁹ Hydro Ottawa also reconciled the DVA balances requested for disposition to the December 31, 2019 RRR 2.1.7 filings with explanations on the adjustments that were made during this proceeding.⁷⁰

Group 1 DVA Balances

OEB staff submits that it has no concerns with the disposition of the December 31, 2019 Group 1 DVA net credit balance of \$2,044,173 (principal and interest) as presented in the settlement proposal.

Hydro Ottawa requested disposition of the Group 1 rate riders over two years. OEB staff notes that the default disposition period to clear the Group 1 account balances through rate riders should be one year. However, a distributor may propose a different disposition period to mitigate rate impacts or address any other applicable considerations, where appropriate.⁷¹ Hydro Ottawa stated that the two-year rate riders help facilitate a more levelized rate impact. OEB staff submits that it has no concern with the two-year disposition period.

⁶⁸ Exhibit 9/Tab 1/Schedule 1, page 1

⁶⁹ Exhibit 9/Tab 1/Schedule 1, page 3

⁷⁰ Exhibit 9/Tab 1/Schedule 1, pages 5-7 & DVA continuity schedule

⁷¹ EDDVAR report, page 24

Group 2 DVA Balances

Hydro Ottawa confirmed that it has complied with all utility-specific accounting orders and generic regulated accounting orders⁷² and requested disposition of its Group 2 DVA balances over a two-year period in order to facilitate a more levelized rate impact.

OEB staff notes that the default disposition period used to clear the Group 2 Account balances through a rate rider should be one year. However, a distributor may propose a different disposition period to mitigate rate impacts or address any other applicable considerations, where appropriate.⁷³ OEB staff submits that it has no concern with the two-year disposition period.

Account 1592 PILs and Tax Variance

On June 21, 2019, Bill C-97, the *Budget Implementation Act, 2019*, No.1, was given Royal Assent. One of the changes introduced by Bill C-97 is the Accelerated Investment Incentive (All) program, which provides a first-year increase in CCA deductions on eligible capital assets acquired after November 20, 2018.⁷⁴

As a result of the All program, an eligible capital asset⁷⁵ that would have been subject to the half-year rule will, in essence, qualify for an enhanced CCA equal to three times the normal first-year deduction until 2023 and two times the normal first-year deduction during the phase out period of 2024 to 2027. However, the All does not change the total amount that a utility can deduct over the life of the eligible capital asset.

On July 25, 2019, the OEB issued accounting direction regarding Bill C-97 and other changes in regulatory or legislated tax rules for CCA (Bill C-97 letter), in which it indicated that it expects utilities to reflect the aforementioned CCA rule changes in their cost-based applications for 2020 rates and beyond.⁷⁶

⁷² Exhibit 1/Tab 3/Schedule 6

⁷³ EDDVAR report, page 24

⁷⁴ Explanation of All program by Canada Revenue Agency. Accessible online: <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>

⁷⁵ The eligible property must be acquired after November 20, 2018 and must be available for use before 2028 in order to qualify for the incentive.

⁷⁶ OEB Accounting Direction Regarding Bill C-97 and Other Changes in Regulatory or Legislated Tax Rules for Capital Cost Allowance dated July 25, 2019

Hydro Ottawa recorded the impact of the All in Account 1592 sub-account PILs and Tax Variances – CCA Changes. The All impacted the following areas of Hydro Ottawa's application:

- Eligible capital additions from the approved settlement proposal during the 2016 to 2020 rate term⁷⁷,
- New Facilities, and
- Connection Cost Recovery Agreement (CCRA) payments

In the Bill C-97 letter, the OEB stated that "Electricity distributors and transmitters are to record the impact of any differences that result from a legislative or regulatory change to the tax rates or rules assumed in the OEB Tax Model that is used to determine the tax amount that underpins rates. The impact of any differences that are not reflected in rates (due to such factors as timing of known changes) is to be recorded in Account 1592 – PILs and tax variances." OEB staff submits that since the PILs amounts underpinning rates in the 2016 to 2020 rate term were derived using a different set of tax rules, recording the impact of the All on the eligible capital additions during that term is in accordance with the OEB's accounting direction.

In the settlement proposal, the Parties agreed to a disallowance from the 2021 opening rate base of \$2.9 million associated with the land as part of the actual costs of Hydro Ottawa's New Facilities. The disallowance is related to a parcel of land, the costs of which do not fall under the scope of accelerated CCA treatment. Therefore, the disallowance has no impact on Account 1592 sub-account PILs and Tax Variances – CCA Changes.

Hydro Ottawa proposes to clear the 2018-2020 balance in this sub-account in full, with the exception of the amounts related to the 2020 CCRA payments. The 2020 accelerated CCA impact of the CCRA payments were based on forecasted CCRA additions that would become available for use in 2020 and when these 2020 forecasted CCRA additions were/would be paid for. Since the balance is based on an estimate, Hydro Ottawa proposes to clear the impact of accelerated CCA related to CCRA on

⁷⁷ Interrogatory response OEB-183

audited balances per the typical Group 2 disposal process.⁷⁸ OEB staff submits that it has no issue with this proposal.

While All impacts pertaining to New Facilities are known at this time, the All impacts related to the approved capital additions in 2020 may be subject to some minor variability, depending on the percentage of the 2020 capital additions that ultimately qualify for accelerated CCA treatment.

In the original evidence, it was estimated that 100% of approved capital additions in 2020 would qualify for accelerated CCA. In the updated Application, Hydro Ottawa revised the percentage to approximately 94%⁷⁹ to reflect the remeasurement of 2020 additions.⁸⁰ Hydro Ottawa acknowledged that the estimated percentage that ultimately qualifies in 2020 based on actuals could be slightly different.⁸¹

OEB staff supports clearance of the December 31, 2020 balances being requested for disposition, with the caveat that the variance between forecast and actual impacts are trued-up, if material, in Hydro Ottawa's subsequent application.

OEB staff notes that the OEB's stated policy is to dispose of audited DVA balances.⁸² However, the OEB has previously approved the disposition of unaudited forecast balances⁸³, under certain circumstances. OEB staff is of the view that a reasonably accurate forecast has been established in this case.

Sub-account 1508 Y-Factor Variance Account

The Y-factor account was established to recover the revenue requirement impact of the capital cost of the New Facilities, up to \$66 million when the New Facilities went into service. The Y-factor account was also intended to capture the existing facilities' revenue requirement when they were taken out of service. The New Facilities were put in service in May 2019. The existing facilities, with the exception of Bank Street, were

⁷⁸ Exhibit 9/Tab 1/Schedule 4, Updated May 5, 2020, page 6

⁷⁹ HOL_UPDATE_AcceleratedCCAfor2020_914C, updated evidence on May 5, 2020

⁸⁰ Exhibit 9/Tab 1/Schedule 4/page 2 of 7, updated evidence on May 5, 2020

⁸¹ Interrogatory Response OEB-183, page 6 of 8

⁸² OEB Chapter 2 Filing Requirements for Cost of Service, May 14, 2020, page 65.

⁸³ EB-2018-0165, Toronto Hydro-Electric System Limited Decision and Order dated December 19, 2019, page 178

removed from service in 2019.⁸⁴ The revenue requirement impact of doing so was credited to the Y-factor account.

Hydro Ottawa received approval for interim disposition of the Y-factor in its 2020 Decision and Rate Order.⁸⁵ Hydro Ottawa also confirmed that the Y-factor revenue requirement calculation does not reflect the impact of Bill C-97 which includes the accelerated CCA rules.⁸⁶

In the settlement proposal, Hydro Ottawa requested a final disposition of the remaining balance of \$320,332 in the Y-factor account, after taking into account the interim disposition approved in the 2020 Decision and Rate Order.

OEB staff notes that the additional disposition amount is comprised of the following:

- Changes in the depreciation and CCA of the New Facilities up to \$66 million for 2019 and 2020 due to the availability of more accurate information
- Changes in depreciation and CCA from the removal of the existing facilities, with the exception of Bank Street, for 2019 and 2020 due to the availability of more accurate information
- The correction of an error related to the PILs gross-up reflected in the revenue requirement from the interim disposition in the 2020 application

OEB staff submits that it has no concern with the final disposition of the Y-factor account presented in the settlement proposal.

Sub-account 1508 New Facilities Deferral Account

The New Facilities account was established to record the revenue requirement impacts of the cost of the New Facilities and related land that are above \$66 million. Any amounts recorded in this account are subject to a prudence review.⁸⁷

In the settlement proposal, the Parties agreed to a disallowance from the 2021 opening rate base of \$2.9 million associated with the land cost as part of the actual costs of

⁸⁴ Exhibit 9/Tab 1/Schedule 3, page 4

⁸⁵ EB-2019-0046

⁸⁶ EB-2019-0046

⁸⁷ Exhibit 9/Tab 1/Schedule 3, page 8

Hydro Ottawa's New Facilities. A corresponding disallowance has been agreed to in relation to the balance of the New Facilities Deferral Account.

OEB staff submits that it has no concern with the updated New Facilities account balance submitted in the settlement proposal, which reflected the disallowance of \$2.9 million on the cost of the land and the disposition through the Y-factor for the cost of the New Facilities up to \$66 million.

Sub-account 1508 Gains/Losses from Sale of Existing Facilities

This account was established to capture the after-tax gains/losses from the sale of land and buildings associated with the Existing Facilities. Two of the three Existing Facilities were removed from service in 2019. The Bank Street facility is being kept and remains part of Hydro Ottawa's rate base for the 2021 to 2025 rate term, which was agreed to as part of this settlement proposal.

The total gains from the sale of the two Existing Facilities and associated land was \$2.2 million and Hydro Ottawa proposed to return the full amount to customers. OEB staff submits that it agrees with the return to customers of 100% of the gain on the sale of the two Existing Facilities and associated land.

Sub-account 1508 Actuarial Gains/Losses for Pension & Other Post-Employment Benefits (OPEB)

Sub-Account 1508 - OPEB is used to record cumulative actuarial gains or losses in Hydro Ottawa's post-retirement benefits. This account was originally approved in Hydro Ottawa's 2012 rate application.⁸⁸

In Hydro Ottawa's 2016 application, OEB approved the disposition of a debit balance of \$4.4 million in this sub-account.⁸⁹ The \$4.4 million represents the cumulative actuarial losses from the period of 2010 to 2014.⁹⁰ In the settlement proposal, Hydro Ottawa proposed to dispose of a credit balance of \$4.4 million⁹¹ and described the credit

⁸⁸ EB-2011-0054

⁸⁹ Schedule A of Decision and Order EB-2015-0004 dated December 22, 2015, Revised 2016 DVA workform in the approved consolidated settlement proposal

⁹⁰ Interrogatory response OEB-178

⁹¹ Exhibit 9/Tab 3/Schedule 1 /page 7, Updated May 5, 2020

balance as the return of the funds to customers, as it was inadvertently included as a charge to customers as part of the Group 2 disposition associated with the OEB's Decision and Order on Hydro Ottawa's 2016 rebasing application.⁹²

Essentially, Hydro Ottawa is requesting to reverse the previously approved disposition amount of \$4.4 million in the Sub-account 1508 OPEB actuarial gains/losses in the current Application.

On September 14, 2017, the OEB issued *Regulatory Treatment of Pension and Other Post-Employment Benefits Costs*⁹³ (OPEB Report). In the OPEB Report, the OEB addresses its expectation with respect to utilities that have been tracking balances in this account.

The OPEB Report states that a "Utility may propose disposition of the account in the future cost-based proceedings if the gains and losses that are tracked in this account do not substantially offset over time."⁹⁴ The Report also stated that "the OEB has not made a determination on a generic approach to the regulatory treatment of actuarial gains and losses under IFRS. The OEB will consider the potential need for further analysis and guidance on this matter in due course."

Hydro Ottawa explained that the rationale for giving back to customers the same amount that was approved for collection in the previous application was that the customers should not pay for the amount when the actuarial gains or losses continues to fluctuate over time.⁹⁵ Hydro Ottawa also stated that it proposes to use this account as a tracking account for OPEB actuarial gains or losses and as a result, is suggesting to return the amount that was previously disposed.⁹⁶

OEB staff notes that if the OEB approves the proposed disposition of the credit balance of \$4.4 million, which reverses the previous disposition of the debit balance of \$4.4 million, the account balance will be restored to show the accumulated actuarial losses from 2010 to 2019 in an amount of \$5.68 million.

⁹² Exhibit 9/Tab 3/Schedule 1/page 2, Updated May 5, 2020

⁹³ EB-2015-0040

⁹⁴ *Ibid.*

⁹⁵ Technical Conference Transcript, July 15, page 38

⁹⁶ Technical Conference Transcript July 15, page 39

OEB staff submits that although it is not conventional that the OEB reverses the impacts of a previously-approved disposition, OEB staff supports this proposal due to the fluctuations and volatile nature of the actuarial gains or losses for OPEBs and the possibility that the actuarial gains or losses may substantially offset from year to year as a result of actuarial valuations. OEB staff further submits that the reversal would also benefit the customers as it would result in a refund of \$4.4 million to Hydro Ottawa's customers. Therefore, OEB staff finds it appropriate to reverse the prior disposition and use this account as a tracking account on a forward-looking basis until such time as the OEB issues further guidance on this matter.

Issue 8.3 Establishment of New Accounts, Closing of Existing Accounts, and Modifications of Existing Accounts

OEB staff submits that it has no concern with the continuation and closing of the DVA accounts as proposed by Hydro Ottawa. OEB staff also submits that it has no concern with the Accounting Orders included in the settlement proposal to properly account for the modifications of the CCRA Payments Differential Variance Account, Capital Additions Revenue Requirement Differential Variance Accounts, ESM and POAM Deferral Account.

ESM

In the settlement proposal, the Parties agreed to an asymmetrical ESM with no deadband. The ESM will function as a cumulative account, in that under-earnings would offset, in whole or in part, over-earnings. In essence, it is only the net over-earnings at the end of the plan term that would be distributed on a 50:50 basis between shareholders and ratepayers. Therefore, the Accounting Order specifies that previous years' ESM entries may be reversed.

As discussed in the Custom IR Framework section, OEB staff views this ESM design as less than optimal but supports the agreed-upon ESM for the purpose of the settlement proposal.

POAM Deferral Account

In the settlement proposal, the Parties have agreed upon a POAM deferral account. The POAM is an asymmetric account, in that the utility could suffer a penalty of up to \$1

million in each year depending on actual measured performance upon the five agreed-upon metrics. Each metric is weighted equally. In a given year of the Custom IR term, the failure to achieve the designated target for a specific performance metric will result in the utility being required to credit the deferral account up to \$200k. The maximum amount Hydro Ottawa would have to credit to the account on an annual basis would be \$1.0 million. If all targets are met in a given year, Hydro Ottawa would not credit any amount to the account.

For the reasons noted earlier, OEB staff is supportive of the POAM mechanism and the associated variance account.

Account 1509 - Impacts Arising from the COVID-19 Emergency

On March 25, 2020, the OEB issued an Accounting Order for the establishment of deferral accounts to record impacts arising from the COVID-19 emergency. The OEB established Account 1509 - Impacts Arising from the COVID-19 Emergency, together with three sub-accounts, for electricity distributors to use to track incremental costs and lost revenues related to the COVID-19 pandemic.⁹⁷ The three sub-accounts are:

- Billing and System Changes for Electricity Distributors as a Result of the Emergency Order Regarding Time-of-Use Pricing
- Lost Revenues Arising from the COVID-19 Emergency for Electricity Distributors and Natural Gas Distributor
- Other Incremental Costs for Electricity Distributors and Natural Gas Distributors

On August 6, 2020, the OEB issued an Accounting Order for the establishment of a fourth Sub-account called Foregone Revenues from Postponing Rate Implementation.⁹⁸ Any utility that has already recorded forgone revenue amounts due to postponing rate implementation in the Lost Revenues sub-account must transfer these amounts to the Foregone Revenues from Postponing Rate Implementation sub-account.⁹⁹

⁹⁷ Accounting Order for the Establishment of Deferral Accounts to Record Impacts Arising from the COVID-19 Emergency, March 25, 2020

⁹⁸ Accounting Order for the Establishment of a Sub-account to Record Impacts Arising from the COVID-19 Emergency for Foregone Revenues from Postponing Rate Implementation, August 6, 2020

⁹⁹ *Ibid.*

On August 14, 2020, the OEB issued an Accounting Order for the establishment of a fifth Sub-account called Impacts Arising from the COVID-19 Emergency, Sub-account Bad Debt. The Bad Debt Sub-account will record amounts related to bad debt resulting from the COVID-19 emergency. The effective date for the sub-account is March 24, 2020. Any bad debt amounts previously recorded in the Other Costs Sub-account from March 24, 2020 shall be transferred to the Bad Debt Sub-account.¹⁰⁰

Through the settlement process, the Parties have agreed that, as of January 1, 2021, Hydro Ottawa will not record any amounts in the first three sub-accounts established under Account 1509 or any additional sub-accounts that may be created on a generic basis, with one exception.¹⁰¹ Parties agree that Hydro Ottawa will, however, be permitted to continue recording amounts in the Bad Debt Sub-Account for as long as the OEB permits this sub-account to remain in place. For this purpose, Hydro Ottawa will follow whatever methodology and clearance guidelines that ultimately emerge from the OEB consultation¹⁰² that is underway as of the filing of this settlement proposal.

With respect to the sub-account associated with Forgone Revenues from Postponing Rate Implementation, Hydro Ottawa confirms that it is not applicable, as the utility's prior rate implementation was for January 1, 2020 in advance of the COVID-19 emergency.

OEB staff submits that, although the OEB has established the five sub-accounts on a generic basis, it has no concerns with Hydro Ottawa only using the Bad Debt Sub-Account as of January 1, 2021 based on the settlement by the Parties and Hydro Ottawa's own estimation that its forecasts for the 2021-2025 period do not need to be materially revised as a result of the COVID-19 emergency.

Capital Variance Account

For the 2016-2020 rate period, Hydro Ottawa established three asymmetrical sub-accounts to track the revenue requirement impact resulting from underspending in the three investment categories: System Renewal/System Service, System Access and General Plant.

¹⁰⁰ Accounting Order for the Establishment of a Sub-account to Record Impacts Arising from the COVID-19 Emergency from Bad Debt, August 14, 2020

¹⁰¹ Refer to details in section Account 1509 - Impacts Arising from the COVID-19 Emergency of the Settlement Proposal

¹⁰² EB-2020-0133, Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency

In the current Application, Hydro Ottawa originally proposed to split System Access capital additions into a symmetrical separate sub-account while maintaining the asymmetrical sub-accounts for System Renewal/System Service and General Plant.

The Parties accepted Hydro Ottawa's proposal with a modification to the System Access sub-account. While acknowledging that some investments in System Access are customer-driven and Hydro Ottawa does not have control over their costs, intervenors questioned the reasonableness of capturing 100% of the investments in System Access in a symmetrical account. The Parties agreed to a symmetrical System Access sub-account with a limited scope. This symmetrical System Access account will only track the revenue requirement associated with either plant relocation requested by third parties or residential expansion. The rest of the investments in System Access will continue to be tracked in an asymmetrical sub-account.

For the purpose of the settlement of this proceeding, OEB staff agrees with the Parties that investments in plant relocation and residential expansion programs are driven by third parties and should be tracked in the symmetrical System Access sub-account, while Hydro Ottawa should be responsible for the budget overrun for the rest of the programs in System Access and track those costs in an asymmetrical sub-account.

All of which is respectfully submitted