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November 18, 2020

Christine Long
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th floor
Toronto, ON M4P 1E4

Dear Ms. Long

Re: Hydro One Networks Inc. ("HONI")
2018-2022 Distribution Rate Application – 2021 Annual Rate Update
Board File #: EB-2020-0030

Pursuant to Procedural Order No. 1 dated October 9, 2020, please consider this letter as the submissions of Canadian Manufacturers & Exporters ("CME") with respect to HONI's application for an Order or Orders approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2021.

CME represents 400 Ontario-based member companies that operate energy intensive businesses. This includes businesses which operate throughout HONI distribution's service territory. Their continued competitiveness in their respective industries is tied directly to energy costs and, as a result, have a direct interest in the outcome of this proceeding.

CME does not oppose the majority of HONI's application, however, it is concerned about the following aspects of HONI's application:

1) The request for final disposition of HONI's 2018 and 2019 ESM amount; and

2) HONI's application of the stretch factor to its capital spending amounts.

1. <u>2018 and 2019 ESM Amounts Should be Disposed of on an Interim Basis</u>

HONI proposes to dispose of 2018 and 2019 ESM amounts on a final basis.[1] However, in CME's view, the Board's decision in EB-2019-0043 indicated that the ESM should be disposed of on an interim basis. The Board stated:

[1] EB-2020-0030, Exhibit I, Tab 1, Schedule 17, p. 3.

"The ESM deferral account is to be reviewed as part of the 2021 rate application and will also be reviewed for disposition in Hydro One's next rebasing application"[2]

CME understands this comment to mean that the deferral account will be reviewed as part of the 2021 rate application, but that the account, including the entries for 2018 and 2019 would be reviewed for disposition in HONI's next rebasing application. As a result, CME submits that the disposition of this account should be interim, and finalized as part of the next rebasing application in accordance with the Board's direction.

2. Adjustment to the Application of HONI's Supplementary Stretch Factor Applied to Its Capital Spending

CME has had the benefit of reviewing School Energy Coalition's ("SEC") submissions on this issue. CME concurs with SEC and submits that the Board should adjust HONI's calculation of the capital factor stretch to be consistent with the principles that underpin incentive ratemaking, and with how it is calculated by other utilities.

The Problem

In EB-2017-0049, the Board approved HONI's proposal for a custom IR methodology which used a revenue cap index and capital factor rather than a price cap index to set rates throughout the plan term. The revenue cap index increased rates through a formulaic adjustment using the traditional I-X inputs, as well as a capital factor which increased rates to account for HONI's capital spending forecasts.[3]

The capital factor is a relatively new addition to incentive ratemaking in Ontario, which was popularized by Toronto Hydro in EB-2014-0116. The purpose of the capital factor is to ensure that the utility recovers all of its approved capital-related costs that are not already collected as part of the overall increases in the ratemaking formula. HONI confirmed that its request for a capital factor was similar to that requested by Toronto Hydro in EB-2014-0116.[4]

The Board approved HONI's revenue cap index proposal as well as the capital factor as part of its decision in EB-2017-0049. However, the Board imposed an overall stretch factor of 0.45% to HONI's overall revenue requirement, and an additional 0.15% stretch factor for the capital factor, for a total capital factor stretch of 0.6%. The purpose of the additional stretch factor, according to the Board was to:

> "[I]ncent further productivity improvements throughout the term, and to provide customers the benefit from these additional improvements upfront."[5]

Most utilities, when they have computed the application of the stretch factor, have applied the stretch factor on a cumulative basis. In other words, the initial year's stretch factor is used to

[2] EB-2020-0030, Exhibit I, Tab 1, Schedule 17, p. 1.
[3] EB-2020-0030, HONI Distribution, 2021 Rate Application, p. 9.
[4] EB-2017-0049, Exhibit A, Tab 3, Schedule 2, page 2.
[5] EB-2017-0049, Decision and Order, March 7, 2019, p. 32.

calculate an amount for recovery from ratepayers. That initial amount is then adjusted through the incentive ratemaking formula (including the stretch factor) to arrive at the subsequent year's value. By using the initial year amount as the basis for the subsequent calculations, stretch factor amounts are locked-in throughout each succeeding year of the plan term, and offer lasting and meaningful incentives for utilities to become more efficient.

HONI's calculation of the stretch factor, while consistent with its original proposal in EB-2017-0049, is inconsistent with the way other utilities in Ontario have calculated stretch factors, the Board's intention in applying a stretch amount to the capital factor, and the principles underlying incentive ratemaking.

HONI's capital factor was forecast on a cost of service basis, in other words – absolute values for its forecast capital spending were provided for each year of the plan term. In calculating the impact of the stretch factor, HONI applied the 0.6% reduction to each year's cost of service amount independently to each year without regard to the impact of the 0.6% reduction in prior years. As a result, HONI has applied a 0.6% flat reduction to each year, rather than a cumulative 0.6% reduction.

This change in calculation methodology undermines the purpose of the stretch factor. As articulated by the Board, the stretch factor is "intended to reflect the incremental productivity gains that distributors are expected to achieve under IR".[6] The stretch factor furthers the Board's goal of continuous improvement:

> "The Board remains committed to continuous improvement within the electricity sector, The Board's policies for setting distributor rates as outlined below are supported by fundamental principles of good asset management; coordinated, long term planning; and a common set of performance, including productivity expectations."[7]

Calculating the stretch factor independently for each year of the plan term effectively means that the stretch factor no longer reflects the incremental productivity gains that the Board expects of utilities, and no longer represents "continuous improvement". For instance, if HONI were able to find 0.6% worth of efficiencies immediately upon commencement of the plan term, it could sit back for the remaining years of the plan term and cease striving for meaningful productivity improvements. This does not reflect incremental productivity gains, or continuous improvement.

Accordingly, CME submits that the Board should make adjustments to align HONI's capital factor stretch with the principles underpinning incentive rate-making, and the methodology used by other utilities when calculating the stretch factor over multiple years.

[6] Report of the Board, Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach, October 18, 2012, p. 17.
[7] Report of the Board, Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach, October 18, 2012, p. 3.

The Solution

The Board has the power to change HONI's prospective rates going forward as part of this application. The Board has found that while it cannot breach the rule of retroactivity outlined by the Ontario Court of Appeal in *Union Gas Limited v. Ontario Energy Board*, 2015 ONCA 453, it does have "broad powers to set just and reasonable rates" on a prospective basis.[8]

The division between retroactive ratemaking and prospective ratemaking is whether or not the parties have knowledge of whether the rate is subject to future change.[9] In this instance, HONI and other parties are aware that rates for 2021 and onwards are subject. HONI's application itself asks for an approval of the 2021 distribution rates by way of an update to the revenue requirement already approved by the OEB, the load forecast by rate class, and disposition of deferral and variance accounts.[10]

As a result, it is within the Board's authority to order a prospective change in the calculation of the capital stretch factor to align it with incentive ratemaking principles. CME has had the opportunity to review SEC's proposal, including an adjustment to the 2021 capital factor, and the 2020 revenue requirement, which would be used as the basis for the 2021 revenue cap index formula adjustment. CME believes that this approach is appropriate under the circumstances, as it successfully emulates the impact of a properly calculated stretch factor.

Yours very truly

Borden Ladner Gervais LLP

Scott Pollock

enclosure

c. Eryn MacKinnon (HONI)
EB-2020-0030 Intervenors
Alex Greco (CME)

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[8] EB-2017-0045, Decision and Order, April 26, 2018, p. 20.

[9] EB-2017-0045, Decision and Order, April 26, 2018, p. 20, quoting from *Atco Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2014 ABCA 28.

[10] EB-2020-0030, HONI Distribution 2021 Rate Application, p. 4.