Ontario Energy Board | Commission de l'énergie de l'Ontario

BY EMAIL

March 4, 2021

Ms. Christine E. Long
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Long:

Re: Ontario Energy Board (OEB) Staff Submission
Halton Hills Hydro Inc.
Cost of Service Application
OEB File Number: EB-2020-0026

Please find attached OEB staff's submission in the above referenced proceeding, pursuant to Procedural Order No. 6.

Yours truly,

Original Signed By Shuo Zhang Digitally signed by Shuo Zhang Date: 2021.03.04 16:35:23 -05'00'

Shuo Zhang
Major Rate Applications & Consolidations

Encl.

cc: All parties in EB-2020-0026

ONTARIO ENERGY BOARD

OEB Staff Submission

Halton Hills Hydro Inc.

Cost of Service Application

EB-2020-0026

March 4, 2021

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Introduction

Halton Hills Hydro Inc. (HHHI) filed a cost of service application (Application) with the Ontario Energy Board (OEB) on August 28, 2020 under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that HHHI charges for electricity distribution, beginning May 1, 2021.

The OEB issued an approved issues list for this proceeding on December 2, 2020. A settlement conference was held on December 14-16, 2020, and continued through December 18 and 21, 2020. HHHI filed a settlement proposal setting out an agreement among all the parties to the proceeding on February 18, 2021. The parties to the settlement proposal are HHHI and the following four approved intervenors[1] in the proceeding: Distributed Resource Coalition, Energy Probe Research Foundation, School Energy Coalition, and Vulnerable Energy Consumers Coalition (the Parties).

The settlement proposal represents a partial settlement, with comprehensive settlement on all but one issue. No settlement was reached on an issue related to the net book value associated with a previously approved Incremental Capital Module (ICM) project.

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

In Procedural Order No. 6, the OEB established a single deadline for OEB staff's submission on both the settlement proposal and the unsettled issue.

If the OEB accepts the settlement proposal and HHHI's proposal on the unsettled issue, the total bill impact for a typical residential customer consuming 750 kWh per month would be an increase of $6.00, or 4.95% for 2021. The increase does not factor in applicable taxes or the Ontario Electricity Rebate.

This submission is based on the status of the record as of the filing of HHHI's partial 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 HHHI's application and the settlement proposal.

[1] Hydro One Networks Inc. (Hydro One) was also approved as an intervenor 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 HHHI 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.

Below, OEB staff provides specific submissions on the issues established by the OEB and the unsettled issue:

- 1.0 Planning
    - 1.1 Capital
    - 1.2 OM&A
- 2.0 Revenue Requirement
- 3.0 Load Forecast, Cost Allocation and Rate Design
- 4.0 Accounting
- 5.0 Other
    - 5.1 Effective Date
    - 5.2 Review of Long-term Debt Financing Options
    - 5.3 ICM True-up
- The Unsettled Issue with respect to the appropriate net book value associated with an ICM in 2021 opening rate base

[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

OEB Staff Submission

Issue 1.1 Capital

HHHI proposed a total net capital expenditure of $5.5 million for the 2021 test year, which was accepted in the settlement proposal.

OEB staff notes that the proposed 2021 capital expenditures are $2.2 million (29%) lower than the 2016 OEB-approved amount. Compared to the 2016 actual capital expenditures, the proposed 2021 budget represents a decrease of $2.6 million (32%). Compared to the 2019 actual capital expenditures, the proposed 2021 budget represents a decrease of $1.6 million (22%).

A comparison of HHHI's historical and forecast capital expenditures indicates that the lower capital budget for the test year is mainly driven by lower investments planned for the System Renewal and System Service categories.

HHHI explained that reduced capital expenditures in forecast System Renewal projects are a result of increased investments in this category over the historical period to replace assets such as wood poles. Compared to HHHI's last distribution system plan (DSP), improved asset conditions in this DSP support a lower capital budget for the forecast period than the historical capital spending. Lower capital expenditures in System Service is mainly driven by reduced planned investment in feeder improvement.

OEB staff notes that outage interruptions caused by defective equipment (in both number of interruptions and outage hours) were generally trending down over the historical period of 2015-2019.[4] OEB staff also notes that HHHI stated in the settlement proposal that the planned capital expenditures over the DSP period provide sufficient resources to it to maintain system reliability and service quality objectives. OEB staff supports the agreed-upon capital plan.

Issue 1.2 OM&A

HHHI proposed a 2021 OM&A budget of $7.56 million, excluding expenditures related to the Low-Income Emergency Assistance Program and property taxes.

The Parties agreed to a revised 2021 OM&A of $6.98 million, which represents a $580k (8%) reduction to the proposed level. The Parties arrived at the revised OM&A using an envelope approach.

[4] Exhibit 2, Rate Base and DSP, page 161.

OEB staff notes that the revised 2021 OM&A reflects an increase of $985k (16%) from the 2016 OEB-approved OM&A (a compound annual growth rate of 3%).

OEB staff supports the agreed-upon 2021 OM&A budget. To evaluate the reasonableness of the agreed-upon OM&A for the test year, OEB staff has calculated an estimated 2021 OM&A budget using an envelope approach, considered the trade-offs between capital and OM&A expenditures, and reviewed HHHI's productivity initiatives. OEB staff discusses its views on each of these considerations in the following sections.

<u>2021 OM&A Budget Using an Envelope Approach</u>

The OEB has employed an envelope approach for determining OM&A in a number of rebasing proceedings as opposed to a line-by-line review of each OM&A program.

By adopting this envelope approach for HHHI and using the 2016 OEB-approved OM&A budget as the baseline, OEB staff arrived at an estimated 2021 OM&A budget of $6.64 million. OEB staff applied escalators including the OEB's inflation factors adjusted for HHHI's assigned stretch factor, the elasticity factor as recommended by the Pacific Economics Group Research LLC (PEG) and customer growth factors.

OEB staff understands that the envelope approach does not capture OM&A increases that are driven by new requirements/responsibilities that were not included in HHHI's 2016 OEB-approved budget. OEB staff considers the following items as new cost drivers to HHHI over the 2021-2025 rate period:

- OM&A cost for the new municipal transformer station (MTS)
- Climate change budget

OEB staff agrees with HHHI that the MTS is a new asset as opposed to a replacement of an existing one; as such, there is an incremental OM&A cost associated with this new MTS that was not part of the 2016 OEB-approved envelope.

The OM&A budget also includes a proposed climate change budget of $279.7k, which represents 2% of distribution revenues. This budget will largely be used to support the low carbon initiatives of the Town of Halton Hills from 2020 to 2025.

As articulated in the settlement proposal, the Parties note that an agreed-to envelope OM&A amount should not be viewed as an acceptance that specific proposed expenses, including the climate change budget, are reasonable or appropriate. As noted elsewhere in this submission, OEB staff does not oppose the agreed-upon total

OM&A budget. However, when initiatives of this kind are brought before the OEB in future, OEB staff expects that the applicant will provide greater support for the assertion that these expenditures provide value to its electricity distribution system and customers, and are therefore appropriately recovered in distribution rates.

With respect to OM&A drivers that were not included in the 2016 OEB-approved budget, OEB staff views that an additional OM&A cost in the range of $220k to $290k associated with the new MTS and the climate change budget, compared to HHHI's proposed amount of $470k, is reasonable to cover these new requirements. This incremental OM&A cost would result in a budget in the range of $6.86 million to $6.93 million for the 2021 test year, which is close to the Parties' agreed-upon amount of $6.98 million. However, OEB staff also considered the trade-offs between capital and OM&A and HHHI's productivity initiatives, as discussed below.

Trade-offs between Capital and OM&A

As articulated in the Rate Handbook, the OEB expects utilities to optimize the trade-offs between capital and OM&A expenditures when developing its system plan, and to prioritize and pace investments in a way that results in predictable and reasonable rates.[5]

HHHI's planned capital expenditures for the 2021 test year are $2.0 million (27%) lower than its average annual spending over the 2016-2019 period. HHHI stated that it will strategically focus on maintenance work as opposed to historical levels of capital expenditures.

OEB staff acknowledges HHHI's overall strategy regarding the balance between capital and OM&A expenditures and considered this strategy in supporting the agreed-upon 2021 OM&A budget.

Productivity Initiatives

The OEB articulated its expectations for continuous improvement and productivity in the RRF Report as well as the Rate Handbook.

HHHI has demonstrated its commitment to ongoing productivity improvements by managing its total costs and remaining in Group 1 for seven consecutive years based on the annual PEG report.

[5] Handbook for Utility Rate Applications, October 13, 2016, pp. 12-13.

HHHI also has an established innovation process that requires each department to meet regularly to discuss and develop innovative ideas. Through this initiative, HHHI intends to provide improvements in all aspects of its business, including operating efficiency, time and cost savings.

HHHI estimated that at the end of 2019, this innovation process has resulted in OM&A savings of approximately $114k. HHHI stated that the bulk of identified savings are avoided costs and therefore this reduced the need for a further increase in budget/head count.[6]

OEB staff acknowledges HHHI's productivity initiatives are avoiding additional costs and encourages HHHI to continually pursue efficiency improvements and seek cost savings in both current spending and avoided additional costs in accordance with the OEB's expectations as articulated in the RRF Report as well as the Rate Handbook.

By calculating the 2021 OM&A budget using an envelope approach, reviewing the trade-offs between capital and OM&A, and taking HHHI's productivity initiatives into consideration, OEB staff concludes that the agreed-upon 2021 OM&A budget of $6.98 million is reasonable.

OEB staff agrees with the Parties that HHHI should present its OM&A costs by program rather than its current approach of tracking OM&A by the Uniform System of Accounts, in its next rebasing application.

Issue 2.0 Revenue Requirement

If the OEB accepts the settlement proposal and HHHI's proposal on the unsettled issue, the resulting base revenue requirement is $14.9 million for the 2021 test year. This reflects the acceptance of the proposed 2021 capital expenditures and the reduction of $580k in 2021 OM&A.

<u>2021 Opening Rate Base</u>

HHHI agreed to the following two adjustments related to its 2021 opening rate base:

- Removal of Account 1606 – Organization Costs, with a net book value of $192k
- Reduction of $453k associated with the 2020 capital expenditures

OEB staff notes that Account 1606 – Organization Costs was not included in HHHI's rate base in its 2016 Cost of Service application. The reduction of $435k in 2020 capital

[6] 1-Staff-5, November 25, 2020; SEC-CQR-4, February 8, 2021.

expenditures reflects the most up to date forecast of net capital expenditures for the 2020 bridge year. OEB staff supports the agreed-upon adjustments to HHHI's 2021 opening rate base.

Working Capital

To calculate cost of power and working capital, HHHI agreed to use a global adjustment (GA) cost of $83.62/MWh for customers who pay the Regulated Price Plan (RPP) price, and $93.05/MWh for non-RPP eligible customers.

The OEB set electricity commodity prices under the RPP on October 13, 2020 for the period of November 1, 2020 to October 31, 2021.[7] This RPP report set a GA charge of $109.47/MWh.

On November 5, 2020, the Ontario government announced a change to GA charges, where a portion of the costs of non-hydro renewable generation contracts will be funded by the Province, rather than by ratepayers. This change applies to both RPP and non-RPP customers. The OEB issued a letter dated December 15, 2020 to reflect this change and set new RPP prices with a GA charge of $83.62/MWh.[8] For non-RPP customers, GA charges are set by the IESO on a monthly basis.

OEB staff understands that non-RPP customers will see an increase in GA costs throughout 2021 due to a deferral amount from 2020. The IESO is responsible for the calculations of the monthly amount to recover the deferred GA costs. In the absence of an accurate GA estimate for non-RPP customers, the Parties agreed to a GA charge of $93.05/MWh for the calculation of cost of power. OEB staff does not oppose to HHHI's approach of calculating cost of power and working capital.

The agreed-upon revenue requirement also reflects updates to the cost of capital and other revenue. Table A in the settlement proposal summarizes changes in the revenue requirement from HHHI's initially filed application and the settlement proposal. OEB staff accepts the agreed-upon revenue requirement for the 2021 test year.

[7] Regulated Price Plan Price Report, November 1, 2020 to October 31, 2021. October 13, 2020.
[8] OEB Letter Re: New Regulated Price Plan Prices Effective January 1, 2021, dated December 15, 2020.

Issue 3.0 Load Forecast, Cost Allocation and Rate Design

Load Forecast

The Parties accepted HHHI's load forecast subject to two changes:

- A manual adjustment to account for the impacts of COVID-19 was removed. This adjustment had initially projected that COVID-19 would result in increases to Residential load while General Service load was decreased[9]
- The CDM adjustment to the Load Forecast (detailed below)

In the context of the settlement proposal, OEB staff does not have any concerns with the proposed load forecast of 479 GWh, 608,479 kW, and 28,040 customers and connections as shown in Tables 3.1A and 3.1B of the settlement proposal. OEB staff submits that the agreed-upon load and customer connection forecasts are reasonable.

CDM Adjustment to Load Forecast

As part of its pre-filed evidence, HHHI proposed to include a CDM adjustment to the 2021 load forecast. The load forecast included a reduction equal to a full year of savings from a customer that participated in the IESO's Process Systems Upgrade Initiative – Combined Heat & Power (CHP) program.

During the interrogatory process, HHHI clarified that the CHP project would not be complete until mid-2021.[10] In the context of the settlement proposal, HHHI agreed to reduce these forecast savings by one-half based on the project's revised in-service date. HHHI further indicated that it will not true-up forecast savings from this specific project to actual savings in the Lost Revenue Adjustment Mechanism Variance Account (LRAMVA) in a future rate application.

OEB staff does not have concerns with the revised CDM adjustment to the load forecast. Further, OEB staff does not oppose the agreed-upon approach of forgoing a true-up of forecast and actual savings through the LRAMVA.

Cost Allocation

Revenue-to-cost ratios for the Street Lighting and Sentinel Lighting rate classes are above the OEB's target ranges, and General Service (GS) 1,000 – 4,999 kW and Unmetered Scattered Load (USL) are below the target ranges in the original

[9] Exhibit 3, Section 3.2.9, pp 25-27.
[10] 3-Staff-40 a), November 25, 2020.

Application. The Parties proposed that Sentinel Lights and Street Lighting be reduced to 120%, the upper end of the policy range, by increasing the classes with the lowest revenue to cost ratios, GS 50 – 999 kW, GS 1,000 – 4,999 kW and USL to 81.42%. This also brings those classes that were below the target range above the lower boundary of the policy range. The agreed-upon revenue-to-cost ratios by rate classes are provided in Table 3.2B of the settlement proposal.

In the context of the settlement proposal, OEB staff does not have any concerns with the cost allocation agreed to by the Parties.

Rate Design

The Parties accepted HHHI's proposal for rate design. The fixed charge for the GS 50 – 999 kW rate class is above the Minimum System with Peak Load Carrying Capability adjustment (commonly referred to as the ceiling) and is proposed to be maintained at its current level. The proportion of revenue collected from the fixed and variable charges is proposed to be maintained for all other non-Residential rate classes. This results in fixed charges within the guidance from the cost allocation model.

OEB staff does not have any concerns with the rate design proposal.

Bill Impact

Based on the settlement proposal, one rate class, the Unmetered Scattered Load (USL) class, will experience a total bill impact of approximately 13.5%. All other rate classes have bill impacts of less than 10%. Mitigation is not being proposed.

The Parties note that the total bill impact of 13.5% modestly exceeds the 10% threshold, and that the additional 3.5% above the threshold represents an immaterial additional amount on an actual dollar basis. The total proposed revenue from the USL rate class is approximately $50k.

In the context of the settlement proposal, OEB staff does not oppose the proposal to not mitigate the USL bill impact.

Standby Charge

The Parties agreed that HHHI would withdraw its request for a standby/capacity reserve charge.

OEB staff does not have any concerns with the removal of the request for a standby charge.

Gross Load Billing

The Parties agreed that HHHI would apply gross load billing for retail transmission service rates (RTSRs) for customers who have load displacement generation in the GS 50 – 999 kW and GS 1,000 – 4,999 kW rate classes. The Parties agreed that HHHI will apply gross load billing for RTSRs consistent with how the IESO bills HHHI for uniform transmission rates (UTRs) and how Hydro One bills HHHI for sub-transmission host-RTSRs; i.e. the gross load billing method will apply to a generator unit rating of 2 MW or higher for renewable generation and 1 MW or higher for non-renewable generation.

OEB staff notes that gross load billing has been approved recently in Waterloo North Hydro's 2021 cost of service application (as part of the OEB-approved settlement proposal),[11] and Energy+'s 2019 cost of service application (following submissions by parties and OEB staff on that and other unsettled issues).[12] In both of these cases, it was also determined that gross load billing for RTSRs would apply under the same circumstances under which the local distribution company pays UTRs or, where it is an embedded distributor, the host distributor's RTSRs.

Issue 4.0 Accounting

Disposition of Deferral and Variance Accounts

In its pre-filed evidence, HHHI proposed to dispose of its Group 1 (credit balance of $2,281,669) and Group 2 (debit balance of $275,677) DVA balances as at December 31, 2019 (with some Group 2 DVAs including forecasted balances to December 31, 2020), as well as forecasted interest to April 30, 2021. One of the Group 2 balances, account 1508 Other Regulatory Assets - Sub-Account - Depreciation Adjustment was presented separately.

OEB staff noted in the prefilled evidence HHHI was seeking final disposition of the balance in account 1508 Other Regulatory Assets - Sub-Account - Depreciation Adjustment based on kWh as per the OEB's DVA Continuity Schedule and not based on the class-allocated revenue requirement as instructed by the OEB in HHHI's 2021 rate proceeding.[13]

However, as part of the settlement proposal, HHHI proposed to dispose the balance of account 1508 Other Regulatory Assets - Sub-Account - Depreciation Adjustment in the amount of a debit balance of $1,100,879, based on the class-allocated revenue

[11] EB-2020-0059.
[12] EB-2018-0028.
[13] EB-2017-0045, Decision and Order, pp. 19-21, April 26, 2018.

requirement as instructed by the OEB.

The remaining Group 1 and Group 2 DVA balances have not changed from what was originally proposed other than a minor change in the LRAMVA balance.

OEB staff submits that the balances of Group 1 and Group 2 DVAs, including the 1508 Other Regulatory Assets – Sub-Account-Depreciation Adjustment, sought for disposition are reasonable.

Sub-Account 1592 PILs and Tax Variance – Capital Cost Allowance (CCA) Changes

HHHI is currently under audit by the Ministry of Finance for the tax years 2015 and 2016 with respect to certain tax deduction(s) related to the expenses of pole replacement and deductions of related burdens. HHHI stated that this may be an industry-wide issue related to potential changes in how the Ministry of Finance treats these expenses. Should the Ministry of Finance issue reassessment(s) relating to tax deduction(s) of pole replacement and/or the deduction of burden related expenses, the Parties agreed that HHHI will be permitted to record amounts related to the PILs Tax consequence of that audit, as it might impact the period 2021 through 2025, into a new Sub-Account 1508 for possible future disposition. A PILs tax consequence would include any re-assessment interest and any other re-assessment penalties as related to the 2021 to 2025 rate period.

OEB staff submits that variances of this nature are more consistent with amounts that are typically recorded in a utility-specific 1508 sub-account. Account 1592 PILs and Tax Variances is intended for changes in the legislative tax rules.

In OEB staff's opinion, the issues brought forward by HHHI are not changes in the tax rules. Rather, these are differences that may or may not arise from how the relevant tax authorities ultimately assess HHHI's submissions of prior period PILs deductions. There is no legislative change in tax policy that is impacting HHHI's calculated tax provisions. Therefore, OEB staff submits that, given the Parties' agreement that it is appropriate to record these impacts in a variance account, these amounts should be recorded in a utility-specific variance account.

OEB staff also agrees with the Parties that this account should be effective on a prospective basis. The outcome of the 2015-2016 audit may result in changes to the way HHHI has expensed items for the purposes of the 2021 test year and beyond. Therefore, to the extent that the audit results in the expectation that these items will also not be deductible between the 2021 and 2025 tax years, the impact on PILs in those respective years shall be recorded in the account.

OEB staff notes that if the outcome of the audit translates into disallowed expenses in 2015/2016 that could impact the actual PILs payable amount, such difference would not be eligible for recording in the 1508 account. OEB staff's review of the settlement proposal indicates that it has been written in accordance with these expectations. In addition, the settlement proposal includes an accounting order including the mechanics to the entries required and reflects the substance of what was agreed by the parties.

Issue 5.1 Effective Date

OEB staff notes that the Parties accepted the proposed effective date of May 1, 2021.

HHHI filed the Application on August 28, 2020, which met the established deadline (i.e. August 31, 2020) for May 1 filers. HHHI requested a five-day extension to file interrogatory responses. HHHI also submitted three requests for extensions to the deadline for the filing of settlement proposal, which resulted in a total extension of five and a half weeks. The OEB approved these extension requests.

The OEB issued Procedural Order No. 6 on February 22, 2021. In the interest of efficiency, the OEB established a single deadline of March 4, 2021 for OEB staff's submission on both the settlement proposal and the unsettled issue, and for the other parties' submissions on the unsettled issue. Given the limited scope of the unsettled issue and a single round of submissions, OEB staff expects that the unsettled issue can be heard in a timeline that allows the OEB reasonable amount of time to issue a decision for May 1 rates.

OEB staff submits that in the event that a decision and final rate order cannot be issued in time for May 1, 2021 implementation, HHHI should be directed to file its calculations of any forgone revenue riders as part of the draft rate order process.

Issue 5.2 Review of Long-term Debt Financing Options

HHHI agreed as part of the accepted settlement proposal in its 2016 Cost of Service application that "it will conduct a review of long-term debt financing options available to HHHI, and will file the results of such review in its next cost-of-service application."[14]

To review its long-term debt financing options, HHHI consulted third party experts and considered various options, including interest rate swaps. OEB staff notes that HHHI's review of financing options included consultation with two third parties: TD Securities

[14] EB-2015-0074, Settlement Proposal, February 29, 2016, page 11.

Inc. and KPMG LLP. Documents related to the review were provided to parties as part of HHHI's responses to pre-settlement clarification questions and filed with the OEB as part of the settlement proposal.[15]

In this Application, HHHI presented its long-term debt instruments as follows: [16]

i. Promissory Note of $16.1 million [due to the Corporation of the Town of Halton Hills]
ii. Interest Rate Swap #1 of $23.0 million [due to a commercial third-party bank]
iii. Interest Rate Swap #2 of $31.1 million [due to a commercial third-party bank]

As noted above, HHHI's promissory note is with the Town of Halton Hills. As such, this promissory note is categorized as affiliated debt. HHHI agreed to repay the principal amount of $16.1 million over six years commencing in 2020. The principal amount of this promissory note is forecast to be $10.2 million as of April 1, 2021. The prescribed interest rate for this promissory note will change from the current rate of 4.12% to 2.85% as of April 1, 2021.[17]

For the purpose of calculating the long-term debt rate for the 2021 test year, HHHI agreed to use 2.85% for this promissory note. OEB staff notes that this interest rate of 2.85% is the OEB's deemed long-term debt rate for 2021 rate applications.[18] As such, OEB staff supports the use of 2.85% for this promissory note as of April 1, 2021.

To finance its new MTS, on January 15, 2019, HHHI forward booked a 30-year interest rate swap agreement at a fixed all-in rate of 4.095%. This swap note was effective September 6, 2019 with an initial notional amount of $23.0 million.

When asked how HHHI ensured that this swap note agreement was optimal at the time of its negotiation, HHHI stated that it undertook a risk management approach of matching the interest rate exposure to the corresponding service life of the asset (i.e. the new MTS), and pursued interest rate stability and consistency for its customers. HHHI noted that it suffered from interest rate volatility during 2018. At the time of seeking financing options for the new MTS, economic indicators reflected an upward

[15] Clarifying Questions SEC-CQR-13, February 18, 2021.
[16] Exhibit 5, Cost of Capital, August 27, 2020, page 14.
[17] 5-Staff CQR-89, February 18, 2021.
[18] OEB Letter Re: 2021 Cost of Capital Parameters, November 9, 2020.

pressure on future interest rates. As a result, HHHI decided to hedge interest rate risk by establishing a fixed rate at the time of negotiation for 30 years.[19]

On April 30, 2020, HHHI entered into another 30-year interest rate swap agreement at a fixed all-in rate of 2.954%. This swap note will be effective May 25, 2021 with a notional amount of $31.1 million.

Regarding these two swap notes, OEB staff accepts the agreed-upon all-in rates of 4.095% and 2.954% for Swap Note #1 and #2 respectively, considering that the effective rates are close to the OEB's deemed long-term debt rate at the time of issuance (i.e., signing) of each swap agreement.

OEB staff also supports the agreed-upon weighted average long-term debt rate of 3.36% for the purpose of calculating interest expense for the 2021 test year.

Issue 5.3 ICM True-up

The OEB approved ICM funding of $23.5 million for a new MTS to serve future growth in HHHI's 2019 rate application. The OEB accepted HHHI's proposal to deem the new MTS as a distribution asset.[20]

In the original Application, HHHI reported an actual cost of $24.5 million for this new MTS. HHHI also requested approval to true up the revenue requirement shortfall of $112,597 resulting from the additional capital expenditures through rate riders.

HHHI agreed to withdraw its request for the true-up of this variance. OEB staff has no concerns with this outcome.

The Unsettled Issue

HHHI describes the unsettled issue in the settlement proposal as follows:

> *Is HHHI's approach to applying the half-year rule (in the year the TS came into service) to the TS ICM costs included in the 2021 Test Year opening rate base correct or appropriate?*

The dispute relates to the appropriate amount of accumulated depreciation costs associated with the MTS being reflected in 2021 opening rate base. HHHI has included half-year depreciation costs for the 2019 rate year in opening rate base. In OEB staff's

[19] 5-VECC-36, November 25, 2020.
[20] EB-2018-0328

view, full-year depreciation costs for 2019 should be reflected in opening rate base to be consistent with the determination of ICM funding for the 2019 rate year.

The OEB approved ICM funding of $23.5 million for a new MTS to serve load growth in HHHI's 2019 rate application. HHHI started recovering the OEB-approved capital costs through rate riders effective May 1, 2019.[21] HHHI's rates are effective based on a May 1 to April 30 rate year, and so HHHI would have recovered a full year of depreciation expense pertaining to the MTS in the ICM rate riders in the 2019 rate year.

When deriving rate riders in the ICM proceeding, HHHI applied a full year of calculated depreciation costs in the OEB's ICM model. OEB staff agrees with HHHI that for the purpose of determining ICM rate riders, the half-year rule does not apply to the 2019 rate year. The OEB states in its ACM/ICM policy that "half-year rule should not apply so as not to build a deficiency for the subsequent years of the IR plan term."[22] The OEB also identifies an exception to this rule. For ICM projects entering into service in the final year of a Price Cap IR plan term, the OEB states that the half-year rule would apply to these projects. In HHHI's case, the new MTS came into service in 2019, which is not the final year of the 2016-2020 rate term. Therefore, OEB staff submits that HHHI's full-year depreciation approach in deriving ICM rate riders is consistent with the OEB's ACM/ICM policy.

In this 2021 rate application, HHHI recorded half-year depreciation costs associated with the MTS project in the asset continuity schedule for the 2019 year, the year in which the MTS entered service. In OEB staff's view, this is inconsistent with the full-year depreciation costs paid by ratepayers through ICM rate riders. HHHI's approach results in a half-year lower balance of accumulated depreciation and a higher net book value associated with the MTS project than it otherwise would have been for the 2021 test year. The higher net book value of the MTS in the 2021 rate base would also mean that the return on capital and associated taxes would be higher than they would be otherwise. OEB staff submits that full-year depreciation costs, paid by ratepayers through ICM riders for the 2019 rate year, should be reflected in the 2021 accumulated depreciation and opening rate base figures.

OEB staff notes that the full-year depreciation approach is also consistent with the OEB's accounting guidance for an approved ACM/ICM project. By illustrating a

[21] EB-2018-0328, Halton Hills Hydro Inc. ICM Application, Decision and Rate Order, April 4, 2019, page 8.

[22] EB-2014-0219, Report of the Board, New Policy Options for the Funding of Capital Investments: The Advanced Capital Module, September 18, 2014, page 23.

theoretical example, the accounting guidance shows the journal entries to record revenues and expenditures related to an approved ACM project for the IRM year and the cost of service year. For the IRM year when the ACM project entering into service, full-year depreciation costs are recorded in Account 1508 sub-account Depreciation Expense. In the distributor's cost of service application, the disposition of Account 1508 triggers the accounting recognition of the net book value of the approved ACM expenditures as assets in rate base. The accounting guidance shows that full-year accumulated depreciation expenses recorded in Account 1508 should be transferred to appropriate asset account.[23]

In discussing the applicant's position on the unsettled issue in the settlement proposal, Parties referred to section 3.3.2.4 of the *Filing Requirements for Electricity Distribution Rate Applications* (Filing Requirements) as the basis of applying the half-year rule for 2019. OEB staff notes however that section 3.3.2.4 of the Filing Requirements is consistent with the ICM/ACM policy where it states that the half-year rule should not apply in respect of deriving ICM rate riders.

In OEB staff's view, the ICM/ACM policy suspends the half-year rule to prevent a funding deficiency for necessary and approved incremental capital funding over several years of the IRM term until the next rebasing, not to overcompensate utilities over the life of an underlying asset, which is the unintended consequence of HHHI's proposed approach to calculating the NBV of the MTS assets to the 2021 opening rate base. Without a correction to HHHI's approach, the distributor will ultimately collect from ratepayers an additional half-year of depreciation that only notionally existed to avoid a funding deficiency through the ICM rate riders during the an IRM years of 2019 and 2020 (i.e., until HHHI's current application to rebase rates for the 2021 rate year). Therefore, OEB staff submits that it is appropriate to align the accumulated depreciation amount used to calculate the 2021 rate base with the depreciation expense already collected from ratepayers through the ICM rate riders in 2019 and 2020.

~All of which is respectfully submitted~

[23] OEB Accounting Procedures Handbook Guidance, March 2015, Sections 13 and 14.