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March 22, 2021
Our File: EB20200249

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

Dear Ms. Long:

Re: EB-2020-0249 – PUC Distribution ICM – SEC Final Argument

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order #7 in this matter, this is SEC's Final Argument in this proceeding.

SEC notes that, because of the unusual nature of the Applicant's proposal, SEC has taken a somewhat different approach to organizing and structuring these submissions.

SEC further notes that there have been a number of communications and discussions between intervenors in this proceeding to grapple with the issues presented. While in the end SEC's positions may be different from those of some other intervenors, the dialogue has been very helpful to us in preparing these submissions.

Summary of SEC Position

Despite numerous issues with this ICM project, and despite its inherently high risk, SEC ultimately concludes that the OEB should approve the project, with conditions more particularly set out and explained below.

Analysis

1. The Applicant proposes to essentially transform its distribution system over the next couple of years, modernizing it by adding VVM, improving reliability, and increasing system automation. It appears that this has never been done before on this system-wide scale, either in Ontario or elsewhere in North America, and as a result NRCan is prepared to cover

approximately 25% of the cost. This significantly improves the project economics, but has minimal impact on the project's risks[1].

2. This proposal presents the OEB with a difficult set of competing factors to balance, and there are no apparent precedents available for the OEB to follow in this respect. Among those factors are:

   2.1. ***Innovation.*** The OEB seeks to facilitate innovation by utilities, and this is an innovative project. While the Applicant stresses in its Argument in Chief that the technologies it plans to implement are not new, and are well understood[2], the Applicant is walking a fine line. The reason NRCan is willing to put up so much money is that this is innovative. Further, being innovative can also be a benefit that in some cases may support a higher probability of approval by the regulator.

   2.2. ***Risk.*** Innovation carries risk, and in many respects the concept of innovation is inimical to the concept of prudence. Many people would argue that if a project does not carry a high level of risk, it cannot by definition be innovative. While the Applicant would like to portray this project as both low risk and innovative, that is not a realistic description of what is being proposed[3].

   2.3. ***Project Size***. An already risky project is made even more risky where its size relative to the size of the utility is substantial. In this case, a project of more than $33 million will increase the Applicant's net fixed assets by 35.5% before accounting for the NRCan funds, and about 25.9% after deducting that contribution[4]. The result will be an increase in revenue requirement that, when fully played out, will be more than 13%.[5] Relative to the size of the utility, this appears to be the second largest single capital project for any existing utility in the last decade, behind only the Darlington Refurbishment Project.

   2.4. ***Planning Context – No DSP or COS Information.*** This project is intended to result in significant changes to the Applicant's distribution system, and so would normally be considered by the OEB in the context of a Distribution System Plan and a rebasing application that take this project and its impacts into account. It is very unusual for the OEB to consider a project like this without that important context. The Applicant has not yet assessed the operational and other impacts of the project[6], although it forecasts that OM&A will increase. It currently does not believe that the project will have any impact

[1] The cost-benefit analysis is improved, but whether the customers are spending $33 million or $25 million, it is still a very significant amount of money for them.
[2] AIC p. 10 et seq.
[3] Asked why other utilities have considered this kind of project and rejected it, the Applicant didn't know: SEC-8.
[4] Derived from Exhibit AA16.
[5] There is considerable confusion in the evidence about this. The prefiled evidence has an impact of $875,610 in Ex. AA16, Sheet 10. The Applicant claims the full year increase in revenue requirement is eventually $2,069,976 [SEC-11], but that includes the impact of accelerated CCA to reduce the tax impact in the early years. That is used up and the tax impacts are then much greater in later years, with the result that the impact should be closer to $2.6 - $2.7 million on average over time.
[6] SEC-3.

on the upcoming Distribution System Plan[7], despite the fact that the project is equivalent to almost four years of normal capital spending. Thus, there is a significant lack of relevant information[8]. The reason for this lack of context, however, is legitimate. If the utility waits until rebasing to do this, they may lose their government money (see below).

2.5. ***High Rates.*** This is not a particularly low cost utility, so this project piles additional costs on top of relatively high rates. The Applicant has provided a comparison for a GS>50 customer at 100kW such as a school in SEC-1, but the comparison excludes a number of lower cost LDCs. The comparison also does not include the impact of the ICM project on rates once all costs kick in, which will put the Applicant 4th highest even on the list they have provided (before accounting for benefits). Of course, if they are able to deliver the benefits forecast, then they reduce customer bills, and improve the position of their ratepayers relative to other LDCs.

2.6. ***NRCan Funding.*** Unlike other major utility initiatives, this one benefits from a large funding offer from the federal government. This has two impacts. First, it improves the project economics, meaning that the Applicant can claim "no bill increases" with credibility, assuming they are able to deliver the volume savings they are forecasting. Second, it creates a time limit on the project, requiring the utility to move forward quickly or lose almost $9 million of financial support[9].

2.7. ***Local Support.*** The fact that the government and the people of Sault Ste. Marie support this project is a double-edged sword for the Applicant:

2.7.1. ***Customer Engagement.*** On the one hand, the local customer engagement is highly suspect. The consistent pitch to the public has been "We are going to modernize our entire system at no net cost to customers. In fact, your bills will go down. Should we do it?"[10] Not surprisingly, the customers said yes. If the Applicant had said "We are going to increase your rates by $10 a month, but we hope that on average you'll get $12 a month of other bill savings to more than offset that", there is some likelihood the answers may have been different[11].

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[7] SEC-4.

[8] For example, one of the important issues that would be addressed if this Application were being considered with the full context would be whether the $4.6 million of internal costs, many of them costs flowing from an affiliate, are actually incremental. See SEC-19 and JTC1-6. The Applicant in fact proposes that this issue be considered at the time of the next rebasing, which is not a replacement for the full context now, when the Board is considering approval of the project, but is at least a step in the right direction.

[9] It is not clear that the NRCan funding deadline is absolute, as it has already been extended. On the other hand, any government money is at risk if it is not collected when offered, and the Applicant appears to be sensitive to that fact.

[10] See Appendix JTC1-1.

[11] Even in this Application, the utility has been reluctant to show the raw increase in rates from the project. A good example is SEC-1, in which the increases for a typical school are buried first by the half-year rule, then by accelerated CCA, and then by persistently showing the volume reductions as if they were guaranteed. In fact, the total increase for that school could easily be $1,000 a year, or about 11% on the distribution line.

2.7.2. ***City Support.*** On the other hand, there is little doubt that the City, the ultimate shareholder, has been actively involved in reviewing the project from its inception, and throughout[12]. There is equally no doubt, based on the evidence before the Board, that the City supports the project, and has had ample opportunity to look under the hood and understand the costs and benefits. While there is little evidence in support of this assumption, SEC believes it likely that the City is also very cognizant of the economic and other benefits to the residents of a transformative and innovative project like this[13].

2.8. ***North vs. South***. The OEB is in a somewhat unique position when dealing with proposals by northern communities to improve their systems and benefit their communities. The Board has a statutory mandate to protect all ratepayers, no matter where they are in the province. On the other hand, the Board should, SEC believes, be reluctant to say no to bold initiatives by local communities (particularly those in the north that face challenges different from those in southern Ontario) seeking to improve their own situation.

2.9. ***Responsive Utility Management***. Another relatively unusual aspect of this project is that utility management had this project before the Board two years ago, got feedback from OEB Staff and intervenors, and listened. Instead of just bulling forward and taking their chances on a Board decision at that time, the utility paused the application and took a hard look at the project in light of the feedback. As a result, they made major structural changes, including reducing the project costs, tightening up the main project contract[14], extending the NRCan deadline to get more runway for completion, and doing scenario analysis to test the potential project benefits. This was the right thing to do. The OEB should, in our submission, be more inclined to support utility proposals that have shown high levels of responsiveness, as here.

2.10. ***Benefits Variable and Hard to Measure.*** The Applicant admits candidly[15] that it will be difficult to monitor and measure many of the expected benefits of the project. Further, the terms of the main design-build contract explicitly trade off the reliability benefits if necessary to cover cost overruns[16]. Given that the project can only deliver on its "no bill increases" promise if the benefits materialize, this would normally be a serious problem for the Board.

2.11. ***GHG Reductions.*** The Applicant is proposing that it will deliver GHG reductions over the first ten years with a value of $1.4 - $6.0 million, depending on how it is

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[12] JTC1-4.

[13] One of the continuing benefits of local ownership of LDCs is that they can be an economic engine in their communities, and the local government, as shareholder, can use their influence to promote those benefits. While the Board's mandate does not include local economic improvement, the shareholder's mandate does. This is not a regulatory consideration, but it is a practical one.

[14] Including adding things like liquidated damages tied to forecast volume savings.

[15] SEC-9.

[16] SEC-6.

calculated[17]. Given that this is a ten year estimate for a project with a much longer realistic life, these benefits should be an important consideration.

2.12. ***Dangerous Precedent.*** As with any application before it, the OEB has to be concerned with how its decision will be used as a precedent (or a signal) by other utilities that the OEB regulates. If the OEB approves a high risk project like this for Sault Ste. Marie, is there much doubt that other LDCs will be coming before the Board, asking for approval to take similarly high risks? Is this the direction in which the OEB wants to head?

3. ***SEC Conclusion***. This is a project that the OEB could easily refuse, and be justified in so doing. Approval could be denied because of a) the high risk, b) the rate impacts, c) the softness of the expected benefits, d) the procedural context (ICM rather than rebasing), e) the unsatisfactory customer engagement, f) the risk of "opening the floodgates", or any number of other reasons.

4. However, SEC ultimately concludes that this local community is stepping up and offering to be leaders in transforming their local distribution system. If successful, they will be a model for other LDCs to follow to reduce customer bills, both in Ontario and elsewhere. It may also in some small way put Sault Ste. Marie on the map, even attract additional business activity by companies that see the city as more bold and innovative than perhaps they thought in the past.

5. Therefore, SEC submits that the OEB should approve the project as filed, and allow it to proceed.

6. ***Conditions.*** This is clearly a high risk project. While SEC is conscious that the City has decided – eyes open – to take the risk, it is true that risking shareholder money is different than risking ratepayer money. One of the key roles of the OEB is to minimize risks taken with ratepayer money.

7. To that end, SEC therefore proposes that the OEB attach conditions to the approval of this project that limit the risks being taken by the customers of the Applicant:

7.1. COS and DSP. The Applicant should be directed to file a report, identifying and quantifying all capital and operating impacts of this project to their Distribution System Plan and revenue requirement, at the time of their next rebasing. The report should also include details of the project's implementation, including all tradeoffs in project scope made to manage cost overruns. It should allow the OEB to compare the costs and benefits as implemented with the costs and benefits as forecast in this Application.

7.2. Moderate Future Capital Spending. SEC believes that the OEB should also signal to the Applicant that this large amount of spending should result in capital spending

[17] JTC1-8.

reductions in their DSP going forward, in order to reflect both the upgrades in this project of many parts of their system, and the cumulative rate impacts.

7.3. ***No Delay.*** Many LDCs delay rebasing for a variety of reasons. This project should be reviewed as built by the OEB earlier rather than later. The Board should therefore direct the Applicant to file for rebasing no later than 2023 rates.

7.4. ***Reporting of Benefits.*** The Applicant should be required to make public, within 18 months of completion of the project, and at least in every rebasing application after that, a report showing the actual benefits of the project, broken down by customer class, with specific consideration of variation in cost responsibility and benefits by groups within each customer class (such as low volume customers). This report, coupled with the project implementation report described above, should provide benefits to the sector as a whole in better understanding this kind of initiative.

7.5. ***Shareholder Risk.*** As proposed, the City as ultimate shareholder has approved the project, but is taking no financial risk. SEC believes that the OEB should make clear in its decision that, if the benefits proposed for this project do not materialize sufficiently to provide the ratepayers with a net benefit, the shareholder should consider itself at risk to bear some or all of that net cost[18]. If part of the reason the OEB should approve this project is that it is a local initiative, then the local owners should share with the local ratepayers the downside risks of the project. In addition, a signal that high risk projects like this have the potential to include shareholder risk may ameliorate the danger of too many other utilities seeking to take similar risks at ratepayer expense.

All of which is respectfully submitted.

Yours very truly,
Shepherd Rubenstein Professional Corporation

Jay Shepherd

cc: Wayne McNally, SEC (by email)
Interested Parties (by email)

[18] It would be preferable if there were actually a formula to implement this in the future, so that it is more certain. However, we have been unable to suggest a realistic formula that the Board could stipulate based on the evidence in this proceeding.