

**Ontario Energy
Board**

**Commission de l'énergie
de l'Ontario**



EB-2014-0073

**IN THE MATTER OF AN APPLICATION BY
FESTIVAL HYDRO INC.**

FOR APPROVAL OF ELECTRICITY DISTRIBUTION RATES FOR 2015

**DECISION
April 30, 2015**

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EB-2014-0073

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Festival Hydro
Inc. for an order approving just and reasonable rates and
other charges for electricity distribution to be effective
January 1, 2015.

BEFORE: Christine Long
Presiding Member

Ellen Fry
Member

DECISION AND ORDER
April 30, 2015

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INTRODUCTION AND SUMMARY

Festival Hydro Inc. (Festival) filed an application with the Ontario Energy Board (the OEB) on May 30, 2014 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 Festival charges for electricity distribution, to be effective January 1, 2015.

Festival comprises seven geographically separate service territories (the City of Stratford, and the Towns of St. Marys, Seaforth, Dashwood, Hensall, Zurich, and Brussels). Festival serves about 20,500 residential and commercial customers and has historically had growth of 1% a year. The same rate of growth is expected to continue.

In order to determine the amount Festival can charge its customers for electricity service, the OEB determines how much revenue is reasonable for the company to recover from its customers. This amount is known as the revenue requirement. The OEB considers among other factors, the company's expected operating and maintenance costs and the investments the company expects to make which are necessary to provide reliable, and cost-effective service. An electricity distributor such as Festival uses its revenue requirement, coupled with forecasts of the number of customers it will have, those customers' associated energy needs and other relevant factors to arrive at a set of proposed electricity rates. It is up to the OEB to approve the specific rates a utility can charge its customers.

Festival has asked the OEB to approve distribution rates and charges to recover a base revenue requirement of \$10.6 million for 2015, which excludes any other revenues Festival might receive. The requested revenue requirement represents a 2.85% increase over the revenue requirement approved in Festival's last rebasing application, which was approved in 2010. The overall decline Festival has proposed in its rates for the 2015 rate year is due to the expiry of certain temporary charges related to the roll-out of smart meters, as well as refunds of certain amounts that have been kept in deferral and variance accounts. However, as part of Festival's application, after 2015 ratepayers would experience an increase in rates charged to them.

Procedure

In reaching its findings, the OEB was aided by the participation of four intervenors; Energy Probe Research Foundation (Energy Probe), the Vulnerable Energy Consumers Coalition (VECC), the School Energy Coalition (SEC) and the Association of Major Power Consumers in Ontario (AMPCO).

A settlement conference took place on September 29 and 30, 2014. Festival, SEC, VECC, AMPCO and Energy Probe and OEB staff participated in the settlement conference. The Parties reached a partial settlement and filed a settlement proposal with the OEB. The OEB approved and adopted the settlement proposal at the oral hearing, which commenced on November 13, 2014. In the settlement proposal, parties agreed to decrease Festival's proposed 2015 revenue requirement from \$11.1 million to \$10.6 million, a 5.3% reduction. A copy of the settlement proposal is attached as Appendix A.

The OEB heard the unsettled issues at the oral hearing.

This decision addresses in detail the unsettled issues. After implementing the findings of this decision, Festival will provide the OEB with a final calculation of its rates and charges. At that point, the OEB will determine final rates and the impact these rates will have on Festival's customers.

The Unsettled Issues

The unsettled issues are grouped into the following broad areas:

- 1) Rate Base
 - a) The appropriate amount of capital expenditure
 - b) The appropriate amount of working capital allowance to be included in rate base.
 - c) The inclusion of costs for a bypass agreement as an intangible asset
- 2) Operations, maintenance and administration (OM&A)
- 3) Incremental capital module (ICM) true-up
 - a) Adjustments to reflect actual capital costs relative to those forecast
 - b) Adjustment to depreciation expenses to address the difference from forecasts in Festival's rebasing application and the in-service date of the new asset.
 - c) Recovery of additional funding for operations, maintenance and administration (OM&A) costs incurred in 2013 and 2014.
- 4) Fixed/variable charges ratio for the general service customer class using less than 50kW

1.0 Rate Base

a. Capital Expenditures

Festival has requested approval for a capital budget of \$2,621,500 for 2015, with planned capital expenditures essentially constant from 2015 to 2019. Energy Probe, VECC and AMPCO submitted that the requested capital budget should be reduced. SEC and OEB staff made no submission on the planned capital budget.

Several parties submitted that the amount budgeted for wooden pole replacement, which is 25% of the proposed capital budget, is excessive. SEC and AMPCO submitted that Festival's program to replace poles over 40 years old is not justified, because it is significantly shorter than the Hydro One Networks Inc. (Hydro One) timeframe for pole replacement of 62 years. Festival submitted that its pole replacement program is required for safety and reliability and that the considerations for its urban service and the rural service of Hydro One are different. Based on the evidence provided at the oral hearing and on Festival's submission, the OEB is satisfied that Festival's proposed capital program to replace its wooden poles is reasonable.

Several parties argued that the cost of \$70,000 to purchase an electric vehicle and charging station should be disallowed. This expenditure involved an incremental cost of \$35,000 over the cost to purchase a conventional vehicle. This incremental amount is below Festival's materiality threshold and therefore is not a matter in issue before the Board in this proceeding.

AMPCO and VECC submitted that Festival's capital budget should be reduced because Festival has underspent historically and because its actual capital spending at the end of September 2014 was significantly lower than its 2014 capital budget. Festival submitted that its proposed capital budget is lower than in previous years; that its percentage underspending decreased from 2010 to 2013; and that its capital budget for 2015 as a percentage of depreciation is low in comparison to the 2013 capital budgets for most other utilities. Concerning 2014, a Festival witness testified that a large portion of its capital spending occurs late in the calendar year.

The OEB agrees with Festival that its overall capital budget compares favorably with that of other utilities, and that Festival is not likely to underspend significantly over the next five years. The OEB also notes that Festival's proposed capital budget would

essentially be flat over the next five years. Accordingly, the OEB considers that Festival's proposed capital budget is appropriate.

b. Working Capital Allowance

Festival has proposed using the OEB's default 13% working capital allowance.

The intervenors have submitted that the working capital allowance should be lower, because the default working capital allowance is based on a faulty methodology and because the fact that Festival bills monthly needs to be taken into account. Intervenors took the position that since Festival has not performed its own lead-lag study, lead-lag studies of other utilities should be used as guidance.

OEB staff has submitted that there is no evidence to lead the OEB to reduce the working capital allowance. In its view, methodological issues and monthly billing are factors to be included in the OEB policy review of the working capital allowance.

Festival has submitted that monthly billing is only one factor that impacts its working capital allowance requirement and that lead-lag studies of other utilities would not necessarily address circumstances comparable to those of Festival.

The OEB recently presented a full discussion of the principles currently applicable to the determination of working capital allowance, in the Hydro One Brampton case.¹ As indicated in that case, the policy indicated in the OEB Filing Guidelines is that an applicant may either propose a 13% working capital allowance or propose a different working capital allowance based on a lead-lag study. The only exception occurs when an applicant has previously been directed to file a lead-lag study, which is not the case for Festival. The OEB's existing policy will remain in effect until its policy review concerning the working capital allowance is complete.

The OEB is not of the view that it should depart from its normal policy in this case. The OEB agrees that the fact that Festival bills monthly is relevant, but it is only one of the factors that needs to be considered. As indicated in the Hydro One Brampton case, the OEB has previously explained that it is reluctant to apply a working capital allowance to one utility because it has been considered appropriate for another. The evidence in this case is not sufficient to establish that any other utilities with lead-lag studies have

¹ EB-2014-0083

operational characteristics sufficiently similar to Festival to indicate that Festival should have the same, or a similar, working capital allowance. The Board is not persuaded by the evidence heard in this proceeding that an alternative working capital allowance percentage is appropriate.

Accordingly, the OEB approves a 13% working capital allowance as proposed by Festival.

c. The Inclusion of Costs for a Bypass Agreement as an Intangible Asset

In its 2013 Incentive Regulation Mechanism (IRM) application², Festival obtained OEB approval for cost recovery for a new transformer station, through an incremental capital module (ICM).

Festival built the new transformer station to serve a forecast load that was expected to exceed the service capacity of the existing Hydro One transformer station in the near term. However, by the time the new transformer station went into service in December 2013, the closure of the facilities of two industrial customers decreased the forecast load significantly. Festival Hydro was able to transfer 20MW of existing transmission load from the Hydro One transformer station to Festival's new transformer station. This enabled Festival to avoid transmission charges to its customers of \$475,000 per year.

In order to transfer this transmission load, the Transmission System Code³ required Festival to sign a bypass agreement with Hydro One. The bypass agreement requires Festival to make a one-time payment, expected to be \$1.2 million, to Hydro One. As of the date of the hearing the amount of the payment had been neither calculated nor invoiced by Hydro One.

According to Festival, it was not aware at the time the OEB approved the ICM for the transformer station that the situation might call for a bypass agreement and therefore it did not make the OEB aware of this possibility.

OEB staff and all intervenors except SEC submitted that payment under the bypass agreement was reasonable, given the avoided transmission charges of approximately

² EB-2013-0214

³ Section 6.7.7

\$475,000 per year. SEC submitted that it was not prudent, because the payment amount under the bypass agreement would not decrease if Festival used more Hydro One transmission capacity in the future. Festival gave evidence that it does not intend to use more Hydro One transmission capacity. The OEB agrees that payment under the bypass agreement is reasonable.

Festival proposes to classify the payment as an intangible asset, which would be included in its rate base and amortized over the 45 year expected life of the new transmission station. Festival would earn a return based on the inclusion of the intangible asset in rate base. Festival submitted that treatment as an intangible asset was supported by an unqualified audit report. Festival also gave evidence that its accounting treatment was consistent with a similar situation for another utility and, based on what Hydro One told Festival, was consistent with the accounting treatment followed by Hydro One in respect of the same asset.

The intervenors and OEB staff submitted that Festival has not justified capitalizing the payment as an intangible asset and therefore it should be considered an expense. The intervenors submitted that Festival's auditors did not give an opinion supporting treatment as an intangible asset; that there was no link between the cost of the bypass agreement and the capital cost of the transformer station; and that the alleged accounting treatment by other utilities that was referred to by Festival should not be relied on.

The payment under the bypass agreement was not an integral part of the cost of building the transformer station. Building the transformer station did not require a bypass agreement, and indeed if the need for the bypass agreement had been known at the time of the ICM application, it might have led to a reassessment of the need for the transformer station.

The Transmission System Code, which establishes the requirement for bypass agreements, refers to payments under bypass agreements as "compensation"⁴. The Code does not define "compensation" as either an expense or a capital payment. The parties did not identify any other potential sources of accounting guidance in OEB decisions or policies.

Festival's auditor testified that it was not his function to give an opinion on single, stand-alone transactions. Accordingly, he did not give an opinion on the appropriate

⁴ Section 6.7.7

accounting treatment for the bypass agreement. Concerning Festival's submission that auditors in the past approved treatment by another utility as an intangible asset, there was no direct evidence on the content of the auditor's opinion or to what extent the circumstances were similar to those of Festival. There is also no direct confirmation of the accounting treatment by Hydro One, which in any event would be based on Hydro One's own accounting policies and not determinative of Festival's appropriate accounting treatment.

Accordingly, the OEB agrees with the intervenors and OEB staff that payment under the bypass agreement should be treated as an expense rather than an intangible asset.

Several intervenors and Board staff submitted that the payment under the bypass agreement should be recorded in a deferral account for recovery from Festival's customers. SEC submitted that this should not occur. In SEC's view, to allow recording of the payment for recovery at this point would constitute retroactive ratemaking because in its view the expense was incurred when the bypass agreement was signed, not when the payment becomes due.

The OEB finds, given the specific fact situation in this case, that the payment under the bypass agreement is to be removed from the intangible assets and expensed in 2015. The amount is to be recovered through a rate rider outside of the revenue requirement over three years, so that the annual amount of disposition is similar to the annual amount of savings in transmission charges. Accordingly, Festival will need to declassify this asset for regulatory accounting purposes following this decision. This declassification will trigger an expense in 2015. As the expense is incurred upon declassification of the asset for regulatory accounting purposes, no retroactivity issue arises.

2.0 Operations, Maintenance and Administration

Operations, Maintenance and Administration (OM&A) costs capture day to day maintenance of Festival's system and include employee compensation, corporate costs, customer service and other operations costs.

OM&A expenses for 2015 total \$5,188,507 million and constitute a significant component (approx.49%) of the forecast revenue requirement. The requested OM&A budget represents an increase of approximately 29% over Festival's last OEB-approved OM&A budget and a 5.8% increase over 2013 actuals.

Festival broke down its OM&A budget into uncontrollable and controllable expenses.

It stated that 57% of its OM&A expenses are uncontrollable expenses. These expenses include

- an increase in pension contributions
- incremental operating costs for the new transformer station, put in service in 2013
- additional charges related to smart meters
- mandatory changes to accounting practices that require Festival to charge certain expenses directly rather than including these costs as part of the capital cost of the assets.

The remaining 43% of OM&A expenses are controllable. These expenses are mainly driven by increases in compensation. Festival noted that while it has maintained its headcount at the same level since 2010, compensation increases are due to wage progression and an inflationary increase.

Arriving at an appropriate OM&A budget is critical in ensuring that Festival has sufficient funds to operate a safe and reliable system while at the same time considering the rate impact on customers. A distributor's rates are designed to recover OM&A expenses in the same year that they are made. In order to ensure that the rates it sets are reasonable, the OEB employs a number of tools, including identifying the information that distributors have to include in their applications, methods of testing the evidence through questions from intervenors and OEB staff, and quantitative comparison to similar distributors. In its evaluation of OM&A budgets, the OEB has often used what has come to be known as an 'envelope' approach to determine the appropriateness of an applicant's proposal. Rather than examine all components of OM&A costs line by line, an envelope approach assesses the reasonableness of the overall request, by reference to factors that include any increase from past periods, inflation and expectations regarding productivity and efficiency improvement. The overall amount must be supported by sufficient rationale for planned spending and proposed activities and support the outcomes-based approach under the OEB's Renewed Regulatory Framework.

All intervenors opposed Festival's OM&A proposal. They considered it to be unreasonably high and proposed reductions to the OM&A budget ranging from \$104,000 to \$279,000. Intervenors suggested a number of specific reductions. Most intervenors also argued that Festival's request does not reflect the outcomes-based

approach under the OEB's Renewed Regulatory Framework in the areas of operational effectiveness and financial performance.

Intervenors noted that under the OEB's new total cost benchmarking approach, Festival's operational efficiency ranking has declined significantly. Festival was in the most efficient group (group 1) for the years 2010 to 2013. In 2014, Festival's ranking changed and it is now positioned in the second least efficient group (group 4). Therefore intervenors concluded that Festival's OM&A budget reflects a lack of productivity and associated savings.

OEB staff took no issue with Festival's OM&A request and submitted that its cost per customer is among the lowest in the province, at \$250.

During the proceeding, Energy Probe provided a calculation of what it viewed as appropriate OM&A. It used an envelope approach that allowed for an inflation adjustment as applied under the OEB's incentive regulation process, changes due to billable work and new accounting rules under the international financial reporting standards (IFRS). Festival submitted that this envelope approach to assessing OM&A does not properly recognize the reasons for the changes to its OM&A budget, considering both controllable and uncontrollable expenses. Using Energy Probe's methodology of normalizing spending patterns over the 2010 to 2015 period, Festival made additional adjustments to account for incremental OM&A cost related to the new transformer station, smart meters and increased pension premiums. As a result, Festival calculated an annual average increase below 3%.

The OEB finds that Festival's OM&A budget is reasonable and has been supported by the evidence provided in this case. Accordingly, the OEB approves Festival's OM&A request for 2015 of \$5,188,507⁵. In making this finding, the OEB has considered Festival's past performance as well as a comparison with other distributors. The OEB has also considered the specific reductions requested by the intervenors and notes that with the exception of compensation these proposed reductions were not material.

The OEB does not agree with the intervenors that Festival's proposed OM&A budget reflects shortcomings in achieving the outcomes-based approach required by the OEB's Renewed Regulatory Framework.

⁵ \$32,225 (PILs and LEAP funding) of this amount was agreed on by the parties in the Partial Settlement Agreement.

The OEB is satisfied that the reason for the decline in Festival's efficiency ranking in 2014 is a result of the modified approach in calculating efficiency ratings adopted in that year. Prior to 2014, the OEB measured a distributor's efficiency based on two benchmarking evaluations of that distributor's OM&A costs. Festival ranked between 10 and 13 out of 77 distributors in these assessments. In 2014 the OEB changed to a total cost benchmarking evaluation. This methodology added a capital cost component to the calculation. The OEB accepts Festival's submission that the change in its efficiency ranking reflects the inclusion of this capital component in the benchmarking evaluation.

Festival noted that it has spent considerable capital to upgrade its electricity system since 2002, in particular in respect of the amalgamated distribution utilities that were added to its service area. Festival also submitted that the reduced capital budget put forward in Festival's Distribution System Plan will move Festival from the fourth cohort to the third cohort over a two and a half year period.

Based on its previous efficiency rating, taking into consideration OEB staff submissions concerning cost per customer, the OEB is satisfied that Festival has been among the province's more efficient performers.

In determining a reasonable overall OM&A level for Festival, the OEB has also considered the positions of the intervenors on incremental regulatory cost and compensation.

Incremental regulatory costs

While OM&A charges below a utility's materiality threshold are generally not subject to consideration in a cost of service proceeding, the OEB finds it necessary to comment on the amount of incremental regulatory costs included in Festival's proposed OM&A. Festival included an amount of \$103,000 in regulatory costs to be amortized over 5 years in its application. This amount includes a one-time cost of \$42,300 associated with this proceeding. Since parties reached a partial settlement in this proceeding, the parties requested and were granted approval to have the unsettled issues heard as part of an oral hearing. Consequently, Festival Hydro updated its OM&A budget to include regulatory costs of \$17,000 per year to account for the costs of an oral hearing.

VECC argued that such an inclusion was an attempt to introduce new evidence and associated additional costs. VECC argued that the additional cost is untested and should be denied as a matter of fairness.

The OEB notes that this update in the proposed OM&A budget was made prior to the oral hearing and that each party had the opportunity to cross-examine Festival on it. It should be clear to all parties that regulatory costs will very likely increase if a matter proceeds to an oral hearing. The OEB finds it appropriate for Festival to recover these costs and will allow incremental regulatory costs of \$17,000 annually for 5 years.

Compensation

Festival's total compensation for 2015 is projected at \$4.5 million which, compared to OEB 2010 approved compensation of \$3.6M represents an increase of 26%. Of this amount, the total compensation allocated to OM&A is \$3.9 million, while \$0.6 million is capitalized. Intervenors noted that the compensation allocated to OM&A increased from 77.5% in 2010 to 86.8% in 2015. Over the same period, the levels of capitalized OM&A correspondingly decreased significantly. Energy Probe and other intervenors submitted that compensation allocated to OM&A represents an annual compounded increase of 4.75% per year. Energy Probe further stated that this calculation ignores the fact that Festival's number of full-time employees fell from 47 to 45 over that period. The intervenors submitted that the proposed increase exceeds the OEB's adjustment under the incentive regulation mechanism and suggested that a reduction in the increase of the OM&A portion to an average of 4.0% per year would result in a reduction of \$137,000 in total OM&A.

The Board accepts Festival's evidence in respect of its compensation costs. Festival noted that its recently completed labour negotiations resulted in a 2.02% average wage increase. Festival gave evidence that its compensation levels are competitive in comparison to its neighboring utilities. Festival has maintained a relatively constant headcount since 2010, despite an increase in the activities it is undertaking. Based on the evidence provided in the proceeding, the Board has determined that the compensation costs as proposed by Festival are reasonable.

3.0 Incremental Capital Module

Adjustments – Forecast to Actual

In the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, July 14, 2008, the OEB established a mechanism for distributors under incentive regulation to address incremental capital needs, as they arise, through an incremental capital module (ICM). While the module itself may provide for a broad

scope for incremental capital needs, specific ICM requests are tested against the criteria of materiality, need and prudence at the time of an individual application. In accordance with the policy, the OEB conducts a final prudence review as part of the distributor's next rebasing. At that time, the OEB makes a determination as to the amount to be incorporated in rate base and the treatment of differences between forecast and the actual spending during the incentive regulation (IR) term.

As indicated earlier, the OEB's decision on Festival's application for 2013 rates granted incremental capital funding to support the construction and installation of a new transformer station. The new facility went into service in December 2013. In this application, Festival requests recovery of an additional \$634,496 as a result of reconciling its forecasted costs, which were approved as part of Festival's ICM application, with the actual costs it incurred. This true-up includes the following:

- Adjustment to reflect the actual capital cost of the transformer station relative to its initial forecast
- Adjustments stemming from the deferral of Festival's rebasing application:
 - Underrecovery of depreciation expenses
 - Correction for actual in-service date of the asset
 - Correction in the applied capital cost allowance for 2014
- Recovery of additional funding for OM&A costs incurred during the 2013 and 2014 rate years

The amounts are described in Table1 below.

Table1: ICM True-up Calculation (as of December 31, 2014)

Category	Amount (\$)
<u>1. Initial ICM Revenue Requirement</u>	
Initially approved revenue requirement based on expected capital costs.	1,120,687
<u>2. Revised ICM revenue requirement, reflecting adjustments for:</u>	
a) actual capital costs vs. forecast costs	
b) full depreciation over a 13 month period (as a result of deferral of rebasing)	
c) adjustment to the capital cost allowance	1,481,229
<u>3. ICM Revenues</u>	
Collections via the ICM Rate Rider from May 1, 2013 to December 31, 2014, based on the initially approved revenue requirement	1,091,548
<u>4. Variance (3 minus 2)</u>	389,681
<u>5. Additional costs sought for recovery</u>	
Incremental OM&A in 2013 and 2014	244,815
<u>6. Total Remaining Recovery Applied For (4 plus 5)</u>	634,496

Adjustment to Capital Costs

As part of Festival Hydro's 2013 rate application, the OEB approved an incremental capital module to recover the capital cost of the new transmission station at a total cost of \$15,863,113. In its application for 2015 rates, Festival reported actual capital expenditures of \$15,311,782 – a reduction of \$551,330. As a result of the actual capital costs being lower than forecast, the corresponding revenue requirement is now lower by an amount of \$1,120,687. Intervenors and OEB staff supported Festival's request as appropriate.

The OEB finds the capital costs of \$15,311,782 to be appropriate.

Depreciation over a 13 month period

Festival applied for the ICM as part of its application for rates for 2013, which was expected to be Festival's final year of its IRM period. Festival applied the half-year rule to the eligible capital costs for the purpose of calculating the incremental revenue requirement. Under the half-year rule, only half the value of an asset, including depreciation, is recovered in rates in the year it is put into service, reflecting the fact that new assets are not always placed in service at the beginning of the year.

Festival's use of the half-year rule for its new facility was consistent with the OEB's policy regarding the ICM, which indicates that a distributor should apply the half year rule if rebasing is expected in the year following an ICM application. The remaining capital investment would be recognized in the distributor's rate base in the subsequent cost of service application.

Following its 2013 incentive rate application, Festival Hydro requested and was granted the deferral of its rebasing application to January 1, 2015, an eight month delay.

In this application, Festival sought to recover the depreciation that would have been included in its rates had the eventual deferral of rebasing been known at the time of its initial ICM application. Festival now seeks to update its ICM calculation to reflect an actual in service date of December 2013 and the expected effective date of new rates on January 1, 2015. This approach reflects 1 month of depreciation in the 2013 rate year, and a full year's depreciation in 2014, 13 months in total.

The OEB notes that as indicated above, the half-year rule was correctly applied in Festival's original ICM application given the information available at the time, and that the current revenue deficiency is the result of the deferral of Festival's request to defer its rebasing application from May 2014 to January 2015. However, in this instance the OEB accepts Festival's proposal of 13 months of depreciation, because it reflects the actual in service date of the transformer station. The OEB considers that this methodology is suitable for this specific case, but it should not be considered a precedent.

Adjustment to the capital cost allowance

Festival also updated its evidence to make a corresponding adjustment to the amount of applicable capital cost allowance, which reflects the tax depreciation for the purpose of

calculating taxable income. This adjustment impacted the calculation of payments in lieu of taxes and resulted in a lower ICM revenue requirement.

The OEB accepts Festival's update and finds the adjustment to the capital cost allowance appropriate. In sum, the OEB accepts a total true-up of the revenue requirement related to capital expenditures in the amount of \$389,681 for the period of December 1, 2013 to December 31, 2014. The OEB expects Festival to update its true-up calculation to reflect the actual amount collected through the ICM rate rider to date and adjust its incremental rate rider calculation accordingly.

Recovery of additional funding for OM&A costs incurred in 2013 and 2014 related to the new transformer station

In addition to a true-up of capital related costs, Festival requested the recovery of \$244,815 in incremental OM&A for operational costs related to the new transformer station incurred during in 2013 and 2014. These costs are composed as follows:

Table 2: Incremental Capital Module - OM&A costs (2013 and 2014)

O & M Expenses	2013	2014
Training Costs	39,826	\$ 3,000
TS Monitoring Costs	3,750	15,000
TS Communication Costs	16,614	24,500
Property taxes	9,926	21,500
Insurance & property protection	7,395	18,000
SCADA maintenance		5,000
Internal labour & trucking costs	18,003	13,000
Station maintenance	9,301	40,000
Total	\$ 104,815	\$ 140,000

These OM&A costs were incurred after the in-service date of the transformer station and incorporate \$40,000 in training costs that were approved in the ICM application as capitalized costs. Following Festival's transition to International Financial Reporting Standards (IFRS), OM&A costs that were formerly capitalized can no longer be capitalized; hence Festival has included these costs in its OM&A request.

Festival based the inclusion of the non-training costs on the same principles as it applied to the smart meter recovery process. Festival further submitted that in its accounting treatment of these costs it sought advice from OEB staff, who in an email confirmed that Festival's approach was appropriate.

OEB staff and intervenors submitted that incremental OM&A costs in general are outside the scope of an ICM. Intervenor and OEB staff also noted that Festival did not request deferral account treatment before these costs were incurred. Therefore, the OEB did not have an opportunity at the appropriate time to consider cost recovery of incremental OM&A costs associated with the new transformer station. Accordingly, the OEB finds that these costs are out of period and cannot be recovered from rate payers.

The OEB allows the \$40,000 in training costs which were previously approved as part of the overall capital cost of the transformer station. The OEB agrees with Energy Probe's submission that it would not be appropriate to penalize Festival for not allowing the recovery of formerly capitalized training costs as a result of the change to accounting standards under which this expenditure is no longer recognized as capital.

In regard to all the other above OM&A expenses, the OEB notes that the ICM was designed to address concerns regarding the treatment of incremental capital needs. The OEB notes, that unlike the smart meter process, the ICM process approved by the OEB does not contemplate approval of incremental OM&A expenses associated with the new asset. If Festival had considered that these incremental expenses should be approved nonetheless, it could have sought an exception to the general policy in the ICM process as part of its 2013 rates application in the timeframe when the costs were incurred. To approve these 2013 and 2014 expenses at this point would amount to retroactive ratemaking.

Finally, while the OEB recognizes that Festival obtained OEB staff guidance regarding the accounting treatment of such expenses, the OEB notes that Festival's request for advice lacked specific details and context and accordingly yielded advice that was only of a very general nature. The OEB also notes that regardless of any advice that OEB staff might provide, only an OEB order can approve the accounting treatment of the expenses.

4.0 Fixed/Variable Split For The GS>50kW Customer Class

In the settlement proposal the parties reached a partial settlement with respect to rate design. However, the parties were unable to agree on the appropriate division between fixed and variable charges, also known as the fixed/variable split, for the GS>50 kW customer class. Festival proposed rates based on the existing fixed/variable split. This would have resulted in a fixed charge that would move further away from the ceiling

amount established by the OEB. The ceiling is based on the calculated cost for a basic system to provide electricity to an individual customer in any given class, irrespective of the amount of electricity consumed. In response to interrogatories, Festival took the position that the maximum fixed charge should be the greater of a) the existing rate or b) the ceiling amount. As a result, Festival Hydro proposed maintaining the status quo, which means retaining the current fixed charge for the GS>50 kW customer class at \$227.57, to maintain rate stability and predictability.

During the oral hearing Festival noted that the OEB's policy initiative on rate design for electricity distributors signaled the OEB's intention to pursue a fixed rate design solution for certain classes to achieve class revenue that would be independent of the forecasted electricity demand of that class. Festival submitted that the OEB's direction, at a high level, has been that fixed charges would tend to stay the same or increase.

SEC disagreed with Festival's proposal and proposed a fixed rate of \$64.55 for that rate class, consistent with the OEB's ceiling amount. While SEC accepted that a lower fixed rate might cause large variation in year-over-year rates, SEC submitted that a lower fixed rate would balance the impact with fairness to all GS>50 customers, including those on the lower end of the GS>50 demand spectrum, who SEC argues continue to pay higher rates than they should. SEC also argued that the OEB has not adopted a policy in which the cost of the distribution system attributed to the residential class would be recovered through only a fixed monthly rate, irrespective of the electricity consumed by residential customers to date. SEC also submitted that the fixed charges for the GS>50 rate class should not be impacted by a consideration of other rate classes.

OEB staff supported Festival's proposal as consistent with the OEB's 2015 Filing Requirements and aligned with the direction of the OEB initiative regarding rate design based on fixed charges only.

All other intervenors submitted that the fixed charge should remain at \$227.57 for the duration of the incentive rate period as a lowering the charge to the ceiling would unnecessarily impact rate stability and predictability for some customers in the GS>50 kW customer class.

The OEB approves Festival's proposal of \$227.57/month for the GS>50 kW customer class. Section 2.11.1 of the 2014 Filing Requirements for Electricity Distributors states that "if a distributor's current fixed charge is higher than the calculated ceiling, there is no requirement to lower the fixed charge to the ceiling, nor are distributors expected to raise the fixed charge further above the ceiling". The OEB finds that Festival's proposal to maintain the status quo is consistent with the OEB's guidance, promotes rate stability

and is consistent with the OEB's practices. The OEB is not persuaded that a change from the OEB's Filing Requirements is warranted in this case.

The OEB notes that its most recent policy document on fixed rates indicated that distributors should implement fixed rates only for residential customers at this time⁶; rates for general service customers are to be the subject of a subsequent review.

IMPLEMENTATION AND ORDER

Festival requested that its rates become effective January 1, 2015. The OEB's general practice with respect to the effective date of rates is that the final rate becomes effective at the conclusion of the proceeding. Consequently, the OEB finds that the rates resulting from the OEB's determination in this proceeding will be effective May 1, 2015. The OEB notes that while Festival's original application in this proceeding was filed on April 28, 2014, this application was incomplete. The OEB notes that a revised, complete application was not filed until May 30, 2014.

The OEB directs Festival to provide a revised ICM true-up calculation to account for ICM funding collected from January 1, 2015 to April 30, 2015. Given the OEB's determination in respect of the rates implementation date, the OEB will allow the ICM true-up calculation to incorporate the full depreciation expenses incurred during since January 1, 2015, raising the number of months of depreciation from 13 to 17. The OEB expects that this revision will be included in the calculation. The OEB also directs that the rate riders for the disposition of Group 1 and Group 2 account balances, Account 1575 and 1576, and stranded meter rate riders reflect a June 1, 2015 implementation date. Festival shall also include a calculation to recover any foregone revenue to reflect an effective date of May 1, 2015. Festival shall submit as part of its draft rate order detailed calculations in Microsoft Excel format.

The results of the settlement proposal together with the OEB's findings outlined in this decision are to be reflected in Festival's draft rate order. The OEB expects Festival to file detailed supporting material, including all relevant calculations showing the impact of the implementation of the settlement agreement and this decision on its proposed revenue requirement, the allocation of the approved revenue requirement to the classes, and the determination of the final rates, including bill impacts.

⁶ Board Policy: *A New Distribution Rate Design for Residential Electricity Customers*, April 2, 2015, EB-2012-0410, p 2

The draft rate order supporting documentation shall include, but not be limited to, filing a completed version of the revenue requirement work form spreadsheet which can be found on the OEB's website. Festival shall also show detailed calculations of any revisions to the rate riders or rate adders reflecting the settlement agreement and the findings in this decision.

THE BOARD ORDERS THAT:

1. Festival Hydro shall file with the OEB, and shall also forward to Energy Probe, SEC, VECC and AMPCO a draft rate order attaching a proposed Tariff of Rates and Charges reflecting the OEB's findings in this Decision and Order, within **7 days** of the date of this Decision and Order. The draft rate order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.
2. Energy Probe, SEC, VECC and AMPCO and OEB staff shall file any comments on the draft rate order with the OEB, and forward to Festival Hydro, within **6 days** of the date of filing of the draft Rate Order.
3. Festival Hydro shall file with the OEB and forward to Energy Probe, SEC, VECC and AMPCO responses to any comments on its draft Rate Order within **3 days** of the date of receipt of the submission.

Cost Awards

1. Energy Probe, SEC, VECC and AMPCO shall file with the OEB and forward to Festival Hydro Inc. their respective cost claims within **7 days** from the date of issuance of this Decision and Order.
2. Festival Hydro Inc. shall file with the OEB and forward to Energy Probe, SEC, VECC and AMPCO any objections to the claimed costs within **17 days** from the date of issuance of this Decision and Order.
3. Energy Probe, SEC, VECC and AMPCO shall file with the OEB and forward to Festival Hydro Inc. any responses to any objections for cost claims within **24 days** of the date of issuance of this Decision and Order.

4. Festival Hydro Inc. shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

All filings to the OEB must quote the file number, **EB-2014-0073**, be made through the OEB's web portal at <https://www.pes.ontarioenergyboard.ca/eservice/>, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at <http://www.ontarioenergyboard.ca/OEB/Industry>. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

DATED at Toronto, April 30, 2015

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary

APPENDIX A

**TO DECISION AND ORDER
EB-2014-0073**

**Festival Hydro Inc.
Settlement Proposal**

DATED: April 30, 2015