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May 20, 2015

John Pickernell
Manager (Acting)
Applications Administration
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Mr. Pickernell:

Re: Chapeau Public Utilities Corporation – Review of Regulated Return on Equity in 2014 - EB-2015-0060

Background

On February 23, 2015, Chapeau Public Utilities Corporation (CPUC) filed a letter with the Ontario Energy Board (OEB) requesting the OEB to grant a one-year deferral of its Cost of Service (CoS) application for the 2016 rate year. The Audit and Performance Assessment department (Audit) of the OEB conducted a review of CPUC's regulated return on equity (ROE) that was earned in 2014. This letter outlines the results of the ROE review for CPUC.

Audit issued an engagement letter on April 15, 2015 regarding a review of CPUC's regulated ROE in 2014. The objective of this review was to determine the CPUC's regulated ROE earned in 2014, identify the key drivers for the ROE earned in 2014 as compared to its deemed ROE which was approved in CPUC's 2012 OEB Decision and Order EB-2011-0322, and report the review results to the CPUC's rate proceeding EB-2015-0060 for the 2016 rate year.

Conclusion

In 2013, CPUC earned an ROE of 19.84%, which was 10.72% over its OEB approved ROE of 9.12% from its 2012 Decision and Order EB-2011-0322. Audit calculated and reviewed the 2014 CPUC's ROE and determined that CPUC earned an ROE of 16.88%, which is an over-earning of 7.76%. This figure was confirmed by CPUC.

Key Drivers for Over-earning in 2014

Per Audit's review of CPUC's 2014 ROE and explanations provided by CPUC, the key driver for CPUC's over-earning in 2014 of 776 basis points was an increase in CPUC's distribution revenue. CPUC's distribution revenue in 2014 was \$855,023, which was \$56,104 (7%) higher than the 2012 OEB approved amount of \$798,919. Of this increase, \$35,106 was related to the residential customer's class which accounted for the majority (63%) of the revenue increase. The 2014 distribution revenue was also \$100,147(13%) higher than the 2013 distribution revenue and the 2013 distribution revenue was \$153,359 (25%) higher than the 2012 distribution revenue. CPUC explained the reason for increased revenue in 2014 and 2013 was due to an increase in volume for customers' electricity consumption. CPUC's electricity consumption figure was forecasted to be 27,574,744 kWh in its 2012 CoS application. Actual volume of electricity consumption was 26,031,597 kWh in 2012, 27,174,709 kWh in 2013 and further increased to 30,171,641 kWh in 2014. The annual increase in customer kWh consumptions in 2013 and 2014 were 1,143,112kWh (4%) and 2,996,932

kWh (11%), respectively. Of these increases, 1,008,799 kWh in 2013 and 1,974,812 kWh in 2014 were related to the residential customer's class which accounted for the majority (88% in 2013 and 66% in 2014) of the consumption increases. CPUC indicated that the increase in volume for electricity consumption by customers was due to cold weather as experienced in CPUC's service territory in 2013 and 2014. Audit noted that the number of total customers has been decreasing in 2013 and 2014 by 28 (-2%) and 13 (-1%), respectively¹.

In addition, CPUC stated that there were a number of additional drivers for CPUC's over-earning in 2013 and 2014. First, forgone revenue of \$68,633 in 2013 and \$47,571 in 2014 were recognized as revenues due to the timing of the rate approval. Secondly, smart meter disposition rate rider of \$34,286 in 2013 and \$38,060 in 2014 were also recognized as revenues. Lastly, regulatory debits of (\$24,413) in 2013 and (\$20,042) in 2014 related to IFRS depreciation were recognized offsetting the increase in revenues. Including all these amounts, the total distribution revenues further increased to \$847,249 in 2013 and \$928,309 in 2014. CPUC stated that its 2014 ROE would be 7.37% excluding the above items.

Additional information for the OEB's consideration

Audit also compared the actual number of customers (1,631) and electricity consumption (26,031,597 kWh) in 2012 with CPUC's 2012 CoS application forecasted number of customers (1,678) and electricity consumption (27,574,744 kWh). Audit noted that CPUC's forecast was higher than actual values by 47 (3%) for number of customers and by 1,543,147 kWh (6%) for electricity consumption in the 2012 CoS application, leading to increased revenue requirement for 2012.

It also appears that the CPUC's costs changed in 2014 as compared to its last rebasing application. Audit compared actual operating expenses in 2013 and 2014 with the 2012 OEB approved operating expenses and noted that the actual expenses were \$645,594 in 2013 and \$751,724 in 2014 compared to the OEB approved amount of \$654,490 in 2012 (lower by -\$8,896 (-1%) in 2013 and higher by \$97,234 (15%) in 2014).

CPUC has been under-investing in transmission and distribution system assets below the OEB approved annual capital expenditures of \$51,790 for 2013 and 2014 by \$4,445 (-9%) and \$32,867 (-63%), respectively (36% on average). It appears that CPUC did not implement its 2012 CoS approved capital expenditure plan. CPUC stated in its deferral request letter dated on February 23, 2015 that CPUC is in the process of developing its Distribution System Plan and long-term Asset Management Plan. In this regards, CPUC noted that consideration is being given to a significant investment in a 25 kV conversion and re-conductor project.

Audit notes that nothing has come to its attention during this review to lead it to believe that the ROE performance and main drivers provided by CPUC based on the results of this review are materially misstated. The findings discussed in this letter represent the views of Audit and are not binding on the OEB. I wish to thank CPUC's staff for the assistance and support provided to us during this review.

Yours truly,



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Cc: Earle Freeborn, Chairman, CPUC
Marita Morin, Secretary-Treasurer, CPUC

¹ In 2013, decrease in customer rate class of Residential by 23 and General Service less than 50kW by 5.
In 2014, decrease in customer rate class of Residential by 8, General Service less than 50kW by 3, General Service greater than 50kW by 1 and Unmetered Scattered Load Connections by 1.