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Ontario

ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

Sioux Lookout Hydro Inc.

2018 Cost of Service Electricity Distribution Rate Application

EB-2017-0073

June 27, 2018

Background

Sioux Lookout Hydro Inc. (SLHI) filed a cost of service application with the Ontario Energy Board (OEB) on August 27, 2017 (Updated January 8, 2018) 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 SLHI charges for electricity distribution, to be effective May 1, 2018.

SLHI's 2018 rebasing application is being considered under the OEB's proportionate review approach. The proportionate review process is intended to allow for a streamlined hearing of applications where it is appropriate.

OEB staff filed its Report to the Registrar (the Report) on February 14, 2018, which set out OEB staff's recommendations as to the issues that it believed should proceed to a hearing. The OEB issued its Decision on the Scope of Review (the Decision on Scope) on March 29, 2018. In the Decision on Scope, the OEB determined that five issues would proceed to an abridged hearing process in which an opportunity for written submissions would be provided. The OEB attached an approved issues list to the Decision on Scope.[1]

OEB Staff Submission

OEB staff's submissions on the five issues established in the Decision on Scope are set out below.

<u>Capital</u>

1) Is the proposed 2018 test year capital budget for the planned pole replacement program appropriate?

As discussed in the Report, OEB staff noted that, for 2018, SLHI proposed $130,000 in pole replacements.[2] During the historic period (2013-2017)[3], the average annual

[1] EB-2017-0073, Decision on the Scope of the Hearing, March 29, 2018, Schedule A.
[2] This includes primary and secondary planned pole replacements and unplanned pole replacements.
[3] OEB staff notes that the 2017 capital expenditure budget used in this analysis is based on a forecast. However, SLHI explained, in response to a question from OEB staff, that it is tracking very close to 2017 forecast on an actual basis.

expenditure for pole replacements was about $79,000. OEB staff believes that an incremental amount above the historic period average for the test year is appropriate but $51,000 seems excessive. The average annual expenditure for pole replacements (all types) for the forecast period (excluding the test year) (2019-2022) is $115,000. OEB staff recognizes that the 2018 test year budget includes $20,000 for planned secondary pole replacements (and that amount essentially comprises the difference between the 2018 test year amount and the average for the remainder of the forecast period).[4] However, OEB staff is of the view that the proposed increased budget for pole replacements in the test year, relative to the historic period and the forecast period, is not appropriate.

OEB staff submits that an appropriate test year budget for pole replacements is $110,000. This amount would still be a $31,000 increase (39%) relative to the historic period average (and a $20,000 – 15% - decrease relative to SLHI's proposed budget). This amount is equal to the removal of the approximate $20,000 planned secondary pole replacement budget in the test year, which is not proposed for any other years of the forecast period (2019-2022). OEB staff is of the view that an envelope budget of $110,000 in the test year for all pole replacements could reasonably allow for the planned secondary pole replacements.

OEB staff believes this increased level of capital budget for pole replacements in the test year, relative to the historical period, is reasonable based on the Asset Condition Assessment, which identified that there is a need for incremental pole replacements as a large number of poles are at, or close to, their end of useful lives.[5] However, OEB staff believes that the proposed increase is too large and that $110,000 is more appropriate.

2) **a) Should the 2018 test year capital budget reflect the application of a smoothing mechanism to address the annual variances in SLHI's forecast period capital budgets caused by the vehicle replacement program? b) If so, how should the test year capital budget be revised?**

[4] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 22.
[5] EB-2017-0073, Revised Application, January 8, 2018, Exhibit 2, Appendix 2A, p. 80 and Appendix A to Appendix 2A, p. 40.

In the Report, OEB staff stated that SLHI's proposed annual capital budgets during the forecast period (2018-2022) are not well paced on an aggregate basis. SLHI's capital budget is set out in the table below.[6]

		Forecast Years				
Investment Category	Project	2018	2019	2020	2021	2022
System Access	New Connections	60,000	61,080	62,179	63,299	64,438
	General Upgrades	40,000	40,720	41,453	42,199	42,959
Total:		100,000	101,800	103,632	105,498	107,397
System Renewal	Planned Primary Pole Replacements	91,620	93,270	94,949	96,658	98,398
	Planned Secondary Pole Replacements	20,360				
	Unplanned Pole Replacements	18,324	18,654	18,990	19,331	19,679
	Polemount Transformer Replacements	24,025	24,457	24,897	25,346	25,802
	Planned U/G Cable Replacement		62,560			
	Meter Reverifications - New Meters		21,515			
Total:		154,329	220,456	138,836	141,335	143,879
System Service						
General Plant	Vehicle Replacement	355,000	60,000	300,000	35,000	
	Office Computer hardware	2,000	2,000	2,000	2,000	2,000
	Office Equipment	2,000	2,000	8,000	2,000	2,000
	General Small Tools	5,000	5,000	5,000	5,000	5,000
	Warehouse - foundation repair		10,000			
Total:		364,000	79,000	315,000	44,000	9,000
Total:		618,329	401,256	557,468	290,833	260,276

OEB staff noted that it is the vehicle replacement program that is the cause of the "lumpiness" of the investments during the forecast period. Given that each vehicle replacement investment ($355,000 in 2018 and $300,000 in 2020) cost more than the entire remainder of SLHI's annual average capital budget ($294,632) it is not surprising that there is an inherent "lumpiness" in the capital budget over the years. This is a common small utility issue whereby distinct projects or purchases (like the purchase of a new vehicle) that are placed into service during a single year cause unavoidable instability in the pacing of capital expenditures.

OEB staff is of the view that the instability of the pacing of capital expenditures over the forecast period is a natural function of SLHI's small size and its need to make expensive vehicle replacements.

However, this situation creates issues from a ratemaking perspective. The proposed test year capital expenditures (which form part of the rate base calculation) are higher than the capital expenditures in the remaining years of the forecast period (and relatedly the average annual level of capital expenditures). This means that the revenue

[6] EB-2017-0073, Revised Application, January 8, 2018, Exhibit 2, Appendix 2A, p. 13.

requirement, upon which rates are set, going into SLHI's next IRM period will be based on a rate base amount which includes capital expenditures that will not persist at the same high level throughout the forecast period. In this case, the "lumpiness" is caused by large one-time purchases that have no way to naturally be smoothed over a period of time (for example, by spreading the forecast in-service dates of a long-term multi-asset program over multiple years).[7]

In these specific circumstances, OEB staff submits that it is appropriate to apply a smoothing mechanism for ratemaking purposes to better reflect the average capital expenditures expected to be incurred over the entire forecast period in the test year rate base amount. OEB staff submits that the OEB should approve a 2018 test year capital budget that reflects the average capital expenditure over the entire forecast period (2018-2022) net of the $20,000 pole replacement reduction argued for by OEB staff above. This would result in a 2018 test year capital budget of $422,000.

OM&A

3) Is the proposed 2018 test year budget for bank and merchant fees appropriate?

In the Report, OEB staff noted that the bank and merchant fees have increased from $50,000 in 2013 (actual) to $84,000 in 2018 (proposed). SLHI's materiality threshold is $50,000. This proposal reflects an increase of $34,000 (67%) in 5 years.[8] OEB staff also notes that $34,000, which is the increase between 2013 actual and 2018 proposed, reflects approximately 25% of the revenue deficiency. SLHI explained that the reason for the increase is that its debit machine supplier added additional service charges in 2016 for system maintenance fees (which averaged an additional $1,000 a month in costs). SLHI noted that it has not attempted to renegotiate these fees but it intended to look into this issue in the near-term.[9]

OEB staff submits that a 67% increase in bank and merchant fees over a 5-year period is not reasonable. OEB staff submits that the containment of cost increases associated with third-party vendors is the responsibility of the utility and SLHI has not taken sufficient steps to contain bank and merchant fee increases. Therefore, OEB staff

[7] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 23.
[8] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 30.
[9] EB-2017-0073, SLHI Responses to OEB Staff Questions, November 14, 2017, p. 23.

submits that the bank and merchant fees should be reduced by $19,000 to $65,000 (a decrease of 23% relative to the proposed amount). OEB staff submits that a $65,000 budget for bank and merchant fees (which reflects a 30% increase relative to 2013 actual) is reasonable as it is expected that there would be cost pressure on bank and merchant fees over time due to both inflationary factors and incremental electronic transactions occurring.

Rate Design

4) Is the proposed wording change to the pole attachment related specific service charge appropriate?

In the Report, OEB staff stated that the change to the pole attachment related specific service charge should not occur at this time.[10] SLHI proposed to change the wording for the charge entitled “Specific charge for access to the power poles - $ / pole / year (with the exception of wireless attachments)” to “Specific charge for all attachments to the power poles (including street lighting attachments) $ / pole / year (with the exception of wireless attachments)”.[11] OEB staff notes that an alternative proposed wording change is shown in two other places of the application. The alternative wording states, “Specific charge for all attachments to the power poles - $ / pole / year (with the exception of wireless attachments).”[12] OEB staff’s submission below applies to either version of the proposed wording change.

At the time that the Report was filed, OEB staff noted that there was a policy consultation ongoing regarding a framework for determining wireline pole attachment charges.[13] OEB staff stated that until such time that the OEB concludes that consultation and issues a report, no changes to pole attachment charges (including the wording) should be made.[14]

The OEB issued its *Report of the Board on Wireline Pole Attachment Charges* on March 22, 2018. OEB staff submits that the *Report of the Board on Wireline Pole Attachment Charges* does not address the status of streetlight connections and does not speak

[10] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 40.
[11] EB-2017-0073, Revised Application, January 8, 2018, Exhibit 8, p. 11.
[12] EB-2017-0073, Revised Application, January 8, 2018, Exhibit 8, Appendix 8C (Specific Service Charges Tariff) and Exhibit 3, p. 34.
[13] EB-2015-0304.
[14] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 40.

directly to the issue of the appropriate wording for pole attachment specific service charges.

The Decision on Scope stated that it is not clear whether the proposed wording change is intended to reflect current practice (i.e., that streetlight attachments are currently subject to the charge) or whether it is intended as a substantive change by including streetlight attachments where they were previously not. The Decision on Scope also stated that it is not possible based on the current record to understand the purpose of the proposal. For this reason, the question of whether the wording change is appropriate and aligned with current OEB policy was made the subject of submissions to assist the OEB to make a determination on this issue.[15]

OEB staff submits that the applicant has not provided sufficient information to demonstrate that the wording change is simply “housekeeping” (i.e. changing the wording to match SLHI’s existing practice) as discussed in the application[16] or is reflective of a substantive change to the applicability of the specific service charge to include street lighting attachments. Therefore, in either scenario, OEB staff submits that no change to the existing language for the pole attachment related specific service charge should be approved for the reasons set out below.

If SLHI is currently applying the noted specific service charge for street lighting attachments, OEB staff submits that they should continue to do so and the existing language is broad enough to support the application of that charge.

If SLHI is seeking a substantive change to their practice as reflected in the updated language (i.e. the expanded scope of the applicability of the charge to include street lighting attachments), OEB staff submits that this change is not appropriate. First, there does not seem to be any supporting documentation that this change was adequately communicated to the affected customers. Also, there does not seem be any evidence highlighting how the related incremental revenues associated with the expansion of the applicability of the charge has been reflected in the specific-service charge-related revenue offset to the revenue requirement. As such, OEB staff submits that, in this scenario, the OEB should order that no change to the practice be made and the proposed wording change is not necessary as there will be no change to the existing practice.

[15] EB-2017-0073, Decision on the Scope of the Hearing, March 29, 2018, p. 15.
[16] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 40.

The *Report of the Board on Wireline Pole Attachment Charges* does require two changes to the dollar value of the specific service charge related to pole attachments (the first change effective September 1, 2018 and the second change effective January 1, 2019).[17] OEB staff expects that the applicant will implement the necessary changes as set out in the *Report of the Board on Wireline Pole Attachment Charges*, and that as part of this current proceeding, the OEB find that the applicability of the new charge be unchanged from the current applicability of the charge.

Accounting

5) **Should the proposed balances in the commodity variance accounts (1588 and 1589) be disposed of at this time? If not, what should be the next steps?**

In the Report, OEB staff stated that it has concerns with respect to adjustments made to balances in the power accounts (Accounts 1588 and 1589) in advance of SLHI filing its current application.

OEB staff understands the purpose and nature of the adjustments made. SLHI proposed the disposition of credit amounts of $252,777 and $78,755 in the two accounts respectively. These amounts are underpinned by a $314,140 credit adjustment to account 1588 with an offsetting debit of $314,140 to account 1589. SLHI made this adjustment in order to address deficiencies in their settlement process with Hydro One Networks Inc. (Hydro One). These deficiencies were discovered in preparation for this application and arose following SLHI's review of the results of the OEB's global adjustment workform, which is a new requirement set out in the OEB's filing requirements commencing for 2018 rates. However, the application does not support or explain why the resulting quantum for account 1588 is so large for a utility the size of SLHI once it has apparently addressed prior deficiencies in its settlement processes. For context, SLHI's proposed 2018 base revenue requirement is $2,079,719.

OEB staff notes that the amount in question may very well be reasonable. However, absent a detailed review of the change to SLHI's settlement processes, it is not possible

[17] EB-2015-0304, Report of the Board on Wireline Pole Attachment Charges, March 22, 2018, p. 4.

to determine whether SLHI has addressed the gaps in its settlement process adequately.[18]

OEB staff submits that the detailed review envisioned by OEB staff is the type of review that is generally not practical to conduct as part of an application. As such, OEB staff submits that the OEB should approve the proposed disposition of Accounts 1588 and 1589 on an interim basis pending a review by OEB staff of the December 31, 2017 balances in accounts 1588 and 1589. OEB staff is of the view that a detailed review outside the application process is required to determine whether the account balances are accurate and the adjustments made were appropriate. In addition, the OEB should order SLHI to undertake a review and update its business processes relating to RPP settlement with Hydro One and have such business processes confirmed for accuracy by OEB staff.

Other Issues

Smart Metering Entity Charge

OEB staff notes that the Smart Metering Entity Charge is a component of the “Distribution Charge” on a customer’s bill, established by the OEB through a separate order. The Smart Metering Entity Charge was set at $0.57 by the OEB on March 1, 2018, effective January 1, 2018 to December 31, 2022.[19] OEB staff submits that the OEB should order SLHI to reflect this change in its tariff of rates and charges as part of the draft rate order process.

Forgone Revenue

In its application, SLHI proposed an effective date of May 1, 2018. The OEB declared SLHI’s rates interim effective May 1, 2018 until such time that final 2018 rates are established as the OEB was not in position to issue a final decision prior to the proposed effective date.[20]

OEB staff submits that the OEB should approve May 1, 2018 as the effective date and provide SLHI with the forgone revenue for the period between May 1, 2018 and the

[18] EB-2017-0073, OEB Staff Report to the Registrar, February 14, 2018, p. 42.
[19] EB-2017-0290, Decision and Order, March 1, 2018.
[20] EB-2017-0073, Interim Rate Order, April 27, 2018.

eventual implementation date. OEB staff submits that SLHI agreed to participate in the first proportional review pilot and, as such, should be afforded its effective date request given that the original application was filed on time.

All of which is respectfully submitted.