

John A.D. Vellone
T (416) 367-6730
F (416) 367-6749
jvellone@blg.com

Borden Ladner Gervais LLP
Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada M5H 4E3
T 416.367.6000
F 416.367.6749
blg.com



July 18, 2018

Delivered by Email, RESS & Courier

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
Suite 2701
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Sioux Lookout Hydro Inc.
2018 Rate Application (EB-2017-0073)
Reply Submissions of Sioux Lookout Hydro Inc.**

Pursuant to Procedural Order No. 1, please find enclosed Reply Submissions of Sioux Lookout Hydro Inc.

Yours very truly,

BORDEN LADNER GERVAIS LLP

Per:

Original signed by John A. D. Vellone

John A. D. Vellone

cc: Parties to EB-2017-0073

TOR01: 7511348: v1

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 Sioux Lookout Hydro Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2018.

**REPLY SUBMISSIONS OF
SIOUX LOOKOUT HYDRO INC.**

July 18, 2018

BORDEN LADNER GERVAIS LLP

Barristers and Solicitors
22 Adelaide Street West,
Toronto, Ontario,
M5H 4E3

John A.D. Vellone

Tel: (416) 367-6730
Fax: (416) 367-6749
jvellone@blg.com

Counsel to the Applicant

**REPLY SUBMISSIONS OF
SIOUX LOOKOUT HYDRO INC.**

DELIVERED: JULY 18, 2018

A. INTRODUCTION

1. Sioux Lookout Hydro Inc. (“**SLHI**” or the “**Applicant**”) filed a cost of service application (the “**Application**”) with the Ontario Energy Board (the “**Board**”) 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. The Board assigned the Application file number EB-2017-0073.
2. On February 14, 2018, Board staff (“**Staff**”) filed its Report to the Registrar, which set out Staff’s recommendations as to the issues that it believed should proceed to a hearing. In its Decision on Scope of Review issued on March 29, 2018, the Registrar determined five issues that would proceed to an abridged hearing process and to which written submissions would be provided.
3. SLHI is pleased to present this written reply to the Staff submissions received on June 27, 2018. These reply submissions are organized to address each of the five approved issues.

B. CAPITAL

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

4. Staff take issue with SLHI’s proposed \$130,000 budget for planned primary pole replacements, planned secondary pole replacements and unplanned pole replacements in the test year. Staff argue that \$110,000 is a more appropriate budget for the test year. Staff arrive at this conclusion after comparing the pole replacement budget over the historical period and the forecast period.
5. SLHI does not agree with OEB Staff for three reasons.

(i) The evidence demonstrates that Staff’s proposed reduction in SLHI’s pole replacement program will increase an already large backlog of poles in “Very Poor” condition which still

need to be replaced. SLHI management confirms that this will decrease reliability and is not, in SLHI's view, in the public interest.

6. First, there is compelling evidence that SLHI's historical pole replacement program was not sufficient and that additional pole replacement activity starting in the test year and continuing into the future is required to ensure SLHI's customers can continue to benefit from the reliable distribution services that they have come to expect.
7. SLHI has 2,427 primary wood poles and 277 secondary poles, all of which are wood.¹ The *Kinetrics Asset Depreciation Study for the Ontario Energy Board* dated July 8, 2010 indicates that fully dressed wood poles have a minimum useful life of 35 years, a maximum useful life of 75 years and an average total useful life of 45 years.
8. SLHI management uses this information to inform an analytic assessment of its system renewal efforts. If SLHI were to replace an equal number of poles each year to ensure that the entire system is renewed within 45 years, this would be achieved by completing 53.93 (2427 / 45) primary and 6.16 (277 / 45) secondary pole replacements per year. If SLHI were to replace an equal number of poles each year to ensure that the entire system is renewed within 75 years, this would be done by completing 32.36 (2427 / 75) primary and 3.69 (277 / 45) secondary pole replacements per year. The mid-point between these two estimates (and ignoring poles with only a 35 year useful life) would involve completing 43.145 primary and 4.925 secondary pole replacements per year. This is helpful to keep in mind as one assesses what SLHI management has proposed to do in the test year.
9. The evidence demonstrates that SLHI's secondary pole infrastructure was in much worse condition than was originally thought. Specifically, Table 14 of the SLHI Asset Condition Assessment prepared by Costello Utility Consultants shows that 26% of secondary poles (72 out of 277) are in "Very Poor" condition, 10.5% (29 out of 277) are in "Poor" condition, and another 25.3% (70 out of 277) are in "Fair" condition.²

¹ Exhibit 2, Appendix 2A – SLHI Distribution System Plan for 2018-2022, Appendix A - Costello Utility Consultants Asset Management Plan at page 4, Table 2.

² Exhibit 2, Appendix 2A – SLHI Distribution System Plan for 2018-2022, Appendix A - Costello Utility Consultants Asset Management Plan at page 12, Table 14.

10. Since “Very Poor” condition poles are already past their useful life, and “Poor” condition poles will reach the end of their useful life within 5 years, this evidence demonstrates that absent any intervention by SLHI - a total of 101 (36.5%) of secondary poles will reach the end of their useful life over the term of SLHI’s five year distribution system plan.
11. This evidence led SLHI management to propose a program in 2018 focused exclusively on secondary pole replacements called “*Planned Secondary Pole Replacements*” with a budget of \$20,360 to replace an expected 5 secondary poles in the test year. This program is, by definition, not going to be comparable to the historical period spending since prior period budgets did not distinguish between primary and secondary pole replacements. This program is new, and is driven by clear evidence of need for this focused spending on secondary pole replacements.
12. SLHI is proposing to complete these replacements in a planned manner, which is significantly less expensive than doing the same replacements on an unplanned basis (with overtime and diverting crews from other priorities). With a large population of secondary poles in “Very Poor” and “Poor” condition, SLHI ratepayers are at high risk of service outages and high cost reactive replacements in the absence of a SLHI’s planned replacement program.
13. With no reductions in its planned secondary pole replacement expenditures SLHI will replace approximately 25 secondary poles over the next five years. Over that same period, the evidence shows that 101 poles will have reach the end of their useful life. Meaning that at the end of the five years, a total of 76 out of 277 secondary poles (27.4%) will still be in “Very Poor” condition at the end of the five year period.
14. With its proposed secondary pole replacement program, SLHI management has proposed the bare minimum effort required to maintain the distribution system at its current state of health. In-fact, secondary pole health will get slightly worse (72 poles in “Very Poor” condition will increase to 76 poles over the five year planning horizon).
15. The evidence also demonstrates that SLHI’s primary pole infrastructure is still in bad condition even after years of implementing a targeted replacement strategy. Specifically,

Table 14 of the SLHI Asset Condition Assessment prepared by Costello Utility Consultants shows that 10.2% of primary poles (248 out of 2,427) are in “Very Poor” condition, 16.3% (395 out of 2,427) are in “Poor” condition, and another 15.8% (384 out of 2,427) are in “Fair” condition.

16. Since “Very Poor” condition poles are already past their useful life, and “Poor” condition poles will reach the end of their useful life within 5 years, this evidence demonstrates that absent any intervention by SLHI - a total of 643 primary poles will reach the end of their useful life over the term of SLHI’s five year distribution system plan.
17. In light of this evidence, SLHI management did not believe it was prudent to reduce expenditures on its primary pole replacement program. Rather, SLHI proposed a proactive primary pole replacement program of approximately 20 poles per year with a test year budget of \$91,620.³ SLHI also proposed an allocation for unplanned pole replacements of \$18,654, which accounts for the unplanned replacement of another approximately 3-4 poles per year. The proposed total expenditure for primary pole replacements is \$110,274 in the test year.
18. Notably, SLHI’s proposed primary pole replacement program, at an estimated 24 poles per year, is still far less than the required normalized pole renewal rate even when assuming a 75 year useful life.
19. With no reductions in its planned primary pole replacement expenditures SLHI will replace approximately 120 primary poles over the next five years (at an estimated rate of 24 poles per year). Over that same period, the evidence shows that 643 poles will have reach the end of their useful life. Meaning that at the end of the five years, a total of 523 out of 2,427 primary poles (21.55%) will still be in “Very Poor” condition at the end of the five year period.
20. This evidence demonstrates that, absent budgetary constraints, SLHI should be spending even more on its pole replacement program. As it stands, the proposed primary pole

³ A complete program justification can be found at Exhibit 2, SLHI Distribution System Plan, Appendix A, Costello Utility Consultants Asset Management Plan at Section 11.2 (page 34).

renewal program (with no reductions) means that the system will progress from 10.2% of primary poles in “Very Poor” condition to 21.55% of primary poles in “Very Poor” condition over a five year period.

21. SLHI management is very concerned that, in light of this evidence, Staff’s proposed reduction in pole replacement expenditures will mean that over the next five years the SLHI pole conditions will continue to get materially worse, overall, not better. This in turn will drive lower reliability performance for SLHI customers, which is not in the public interest.
22. In this context, SLHI’s planned pole replacement program represents a prudent and measured approach in direct response to the very poor state of its primary and secondary pole infrastructure. SLHI management already accounted for ratepayer impacts of increased pole replacement work in its proposed program. SLHI management’s focus is aimed at keeping the system at close to the same level of reliability as it is today by ensuring the population of poles in the “Very Poor” category is carefully managed with a thoughtful and targeted system renewal program without material ratepayer impacts.
23. SLHI submits that any further reductions in its proposed pole replacement program budget will allow the population of “Very Poor” condition poles to grow at a rate that is unsustainable, which in turn will lead over time to reductions in reliability performance and a backlog of system renewal that future generations will need to deal with. This in SLHI’s submissions, is not in the public interest.

(ii) OEB staff’s historical comparison is overly simplistic and flawed.

24. Second, Staff’s analysis is overly simplistic. Historical comparisons within a single line item of complex and interdependent capital budget with many moving parts needs to be done with considerable care and attention to detail. Applying this level of care and attention to detail demonstrates serious flaws in Staff’s comparison methodology.
25. There are numerous constraints that affect SLHI’s capital plan in any given year. As just one example, SLHI must manage workflow so that it optimizes the utilization of its highly skilled workforce. These workers cannot be in two places at once. In addition, SLHI cannot

simply lay-off these workers if they are not needed in one year, and then expect them to be available the following year. Because of its remote northern location, SLHI does not have ready access to skilled contractors (which southern utilities do have access to), which makes workforce optimization a strategic imperative for SLHI.

26. For this reason, the historical averaging of pole replacement expenditures proposed by Staff must be adjusted to account these circumstances. For example, in 2015 SLHI intentionally scaled back its pole replacement program so as to ensure sufficient resources would be available to address a sudden and dramatic increase in System Service work and to address the Winoga Submarine Cable project.⁴ In 2015, System Service work increased to \$95,645. By comparison, in 2014 System Service work was \$0 and in 2013 it was only \$10,254. SLHI had no ability to refuse to do this new work, and because its workers cannot be in two places at once, management had to temporarily scale back its pole replacement program for a single year.
27. SLHI submits that Staff's historical averaging of the pole replacement program fails to exclude the 2015 calendar year, even though the evidence demonstrates that it is not representative of SLHI's average pole replacement spending. SLHI management is confident that the conditions that occurred in 2015 were a discrete, one-time event, and are not going to recur in the test year. For this reason, Staff's comparison methodology is flawed and understates the historical comparator.

(iii) OEB staff's analysis fails to account for other trade-offs that SLHI management made (such as deferring needed renewal of underground cables) to allow for the much needed planned pole replacement work to occur in the test year.

28. Third, OEB Staff's analysis is limited to a single line item in a complex multi item capital plan. As a result, OEB Staff fail to recognize the deliberate trade-offs that have already been made by SLHI management.

⁴ Exhibit 2, SLHI Distribution System Plan at Page 70, Table 30.

29. For example, SLHI intentionally deferred much needed increases in system renewal expenditures on “Planned U/G Cable Replacement” of \$62,560 to the 2019 year to allow for the needed pole replacement work to occur in the test year. This smoothing was done by SLHI’s management so as to reduce ratepayer impacts and so as to ensure that high priority items – for pole replacements – happen as planned in the test year.
30. In conclusion, SLHI submits that the 2018 test year capital budget for planned pole replacements is appropriate. The AMP clearly sets out a need for an increase in the amount spent on pole replacements going forward. This is based on Asset Condition Assessment results, as discussed above, together with a measured and paced approach to achieve a sustainable pole replacement level.
- B.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?***
31. Staff argue that SLHI’s test year capital expenditures should be reduced from \$618,329 to \$422,000, a reduction of \$196,329. Staff does not argue that this reduction is needed because SLHI is proposing a capital program that is not prudent or needed. Staff does not argue that this reduction is needed because the evidence demonstrates that the money won’t be spent or the assets won’t be used and useful. Rather, Staff use a novel argument that this reduction is required “to better reflect the average capital expenditures expected to be incurred over the entire forecast period in the test year rate base amount.”
32. SLHI disagrees for two reasons.
33. First, this is not how rates are set in a forward test-year cost of service application like the one filed by SLHI. Indeed, Staff’s proposed normalization approach has been expressly rejected by the Ontario Energy Board in the past.
34. SLHI would refer the Board to its Revised Decision and Order dated September 22, 2016 in EB-2015-0072 at page 5:

“The OEB finds that the normalization of costs over the next 5 years would be typical of a custom application; however, a cost of service application for the test year should include only the planned expenses in that year. Accordingly, the filing expectations for a custom application are more extensive and there is no indication that Grimsby Power was making a custom filing. The OEB is approving only the forecast expenditures in 2016.”

35. SLHI has not filed a Custom IR application, nor has there been any indication that SLHI was making a custom filing. Rather, SLHI has filed a forward test year cost of service application under the Board’s 4th Generation Incentive Regulation Plan (“4GIRM”). Consequently, this Board is only approving forecasted capital expenditures in the 2018 test year.
36. Second, Staff’s suggestion that some type of smoothing is required to address the “lumpiness” caused by SLHI’s vehicle replacement program is not only novel – it is both unjust and unreasonable. Ratepayers never pay the full value of a vehicle replacement (or any other capital expenditure) in the year it occurs. Smoothing already happens because capital assets are included in rate base and ratepayers only pay the cost of capital and depreciation associated with that capital investment. The value of the asset itself is depreciated over its predicted useful life in accordance with the Board’s standard policies. This process automatically smooths out any lumpiness caused by capital expenditures, whether caused by vehicle replacements or otherwise.
37. In this context, Staff’s proposed change results instead in an arbitrary reduction in in rate base that is neither just nor reasonable. As a small utility, SLHI expects the Board to provide regulatory certainty to ensure that if SLHI invests in material capital assets in a prudent way and those assets are otherwise used and useful, SLHI will be entitled to recover the costs of those assets in rate base. Staff’s proposal represents a fundamental departure from this fundamental regulatory principle of ensuring cost recovery of prudent investments. Staff’s proposal fundamentally changes the regulatory compact.
38. SLHI has provided detailed evidence on the need and rational for replacing its 2001 freightliner truck in the test year in its DSP.⁵ The truck will be over 17 years old in 2018.

⁵ Exhibit 2, Appendix 2A – Distribution System Plan, at Section 5.4.5.2 at pages 78-80.

The typical useful life for a heavy vehicle is fifteen (15) years. The vehicle replacement assessment for this truck is clear, objective and logical.⁶ It is supported by a memorandum from the Chief Mechanic at the Municipality of Sioux Lookout dated March 16, 2018 recommending replacement due to “*a great deal of rust and scale on the frame rails (cab back) and auger deck underside [...] to the point that the metal is coming off in pieces. The deck support beams are getting thin. Possibly by next year, there could be perforation through them.*”⁷ The evidence clearly shows that as this truck has depreciated past its useful life, the annual vehicle maintenance expenses for this particular truck have increased astronomically (by 4 times!) from \$5,642.76 in 2012 to \$22,001.24 in 2016.⁸

39. There should be no question that this truck needs to be replaced in the test year. By completing this replacement, ratepayers will benefit from use of a new, safe truck and lower vehicle maintenance costs in future years. To replace this truck, SLHI must spend \$355,000 in the test year. This is both a prudent and rational decision. In addition, there can be no question whether the truck will in-fact be replaced in the test year or whether the money will be spent. That is because the vehicle was ordered in 2017, it was delivered in February of 2018, and it is already being used to provide useful services to SLHI residents.
40. By simple operation of the Board’s rate making policies (and in particular the half-year rule) only \$177,500 of the value of this new truck will be included in rate base in the test year. That is to say, ratepayers will only have to pay the cost of capital and associated depreciation, on half of the value of the truck (\$177,500) until the next rebasing. These same ratepayers will get the benefit of the entire truck (not half a truck) every year until the next rebasing.
41. Under the Board’s 4GIRM formula, SLHI will not get the benefit of the other half of the value of the new truck (\$177,500), or half of the value of its other test year capital expenditures (\$131,665), or any of its other capital expenditures in the 2019-2022 forecast period in excess of depreciation (totalling \$564,000, which is approx. \$1.5 million in

⁶ Exhibit 2, Appendix 2A – Distribution System Plan, at Appendix H – Fleet Information.

⁷ Exhibit 2, Appendix 2A – Distribution System Plan, at Appendix H – Fleet Information.

⁸ Exhibit 2, Appendix 2A – Distribution System Plan, at Section 5.4.5.2 at pages 78-80.

capital expenditures less \$936,000 in depreciation), in rate base until its next rebasing application (i.e. 2023).

42. SLHI is not contesting the Board's standard ratemaking methodology, including the application of the half-year rule. The half-year rule is a helpful tool in a forward test-year cost of service application aimed at addressing the question of when in the test year will capital assets be assumed to become used and useful. However, the half-year rule is logically inconsistent with a normalization methodology proposed by Staff.
43. In this context, Staff's suggestion to reduce SLHI's test year capital expenditures by further \$196,329 using a "normalization" methodology is not only arbitrary, it is also unjust and unreasonable. The normalization methodology is logically inconsistent with the rationale for the application of the half-year rule.
44. By applying both the half-year rule and a normalization methodology, Staff's proposal results in an unjust penalty being imposed on SLHI. This is a penalty on money that is spent by SLHI in the test year, for assets that are both used and useful, that ratepayers will benefit from.

C. OM&A

C.1 *Is the proposed 2018 test year budget for bank and merchant fees appropriate?*

45. SLHI agrees with Staff Submission (page 5) to reduce the bank and merchant fees by \$19,000 to \$65,000.
46. Subsequent to the submission of the Application, and in consideration of Staff's concerns, SLHI investigated different options for point of sale (POS) transactions. Following this investigation, SLHI has switched providers to reduce fees charged for accepting interac and credit card transactions for hydro payments. SLHI implemented the new POS half way through June, and will be monitoring the fees charged going forward. Consequently, SLHI believes that the reduction of bank and merchant fees proposed by Staff is appropriate in light of this factual development.

D. RATE DESIGN

D.1 *Is the proposed wording change to the pole attachment related specific service charge appropriate?*

47. In view of the submissions made by Staff on this issue, SLHI is willing to withdraw this request.

E. ACCOUNTING

E.1 *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?*

48. SLHI understands the concerns surrounding the large credit balance in account 1588 relative to the size of the utility, and agrees with Staff that an interim disposition in order to review the settlement process is appropriate.

49. SLHI will cooperate in any such review. SLHI notes at the outset that the only process that has changed is related to the Global Adjustment. If this change was not made, the balance in account 1589 would have contained the large balance. The current RPP settlement process using Form 1598, which was audited by the IESO in 2009, is tried up each month based on actual billed results of RPP and GA, and would not be affected by the estimation used to determine the split of RPP and Non-RPP GA paid by SLHI to Hydro One. SLHI looks forward to working together to resolve this matter on a timely basis.

All of which is respectfully submitted this 18th day of July, 2018.

Original signed by John A. D. Vellone

John A.D. Vellone

TOR01: 7481478: v1