Ontario Energy Board | Commission de l'énergie de l'Ontario

BY EMAIL

September 2, 2022

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Marconi:

Re: Ontario Energy Board (OEB) Staff Submission
Milton Hydro Distribution Inc.
Cost of Service
OEB File Number: EB-2022-0049

Please find attached OEB staff's submission in the above referenced proceeding, pursuant to Procedural Order No. 1.

Yours truly,

Original Signed By Shuo Zhang Digitally signed by Shuo Zhang Date: 2022.09.02 11:27:04 -04'00'

Shuo Zhang
Senior Advisor – Electricity Distribution: Major Rate Applications & Consolidations

Encl.

cc: All parties in EB-2022-0049

ONTARIO ENERGY BOARD

OEB Staff Submission

Milton Hydro Distribution Inc.

Cost of Service Application

EB-2022-0049

September 2, 2022

Introduction

Milton Hydro Distribution Inc. (Milton Hydro) filed a Cost of Service application with the Ontario Energy Board (OEB) on April 18, 2022, under section 78 of the *Ontario Energy Board Act, 1998* seeking approval for the rates that Milton Hydro charges for electricity distribution, effective January 1, 2023.

The OEB issued an approved issues list for this proceeding on June 29, 2022. A settlement conference took place on August 2-3, and August 5, 2022. Milton Hydro filed a settlement proposal representing a complete settlement of all issues on August 26, 2022. The parties to the settlement proposal are Milton Hydro and the approved intervenors in the proceeding: Consumers Council of Canada, School Energy Coalition, Vulnerable Energy Consumers Coalition, and J.O.L. Shewchun (the Parties).

If the settlement proposal is approved, a typical residential customer with a monthly consumption of 750 kWh would see a distribution charge increase of $1.40, or 4.59%. A typical residential customer would see a total bill impact of $4.54, or 3.57% per month for 2023.

This submission is based on the status of the record at the time of the filing of the settlement proposal and reflects observations that arise from OEB staff's review of the evidence and the settlement proposal. It is intended to assist the OEB in deciding on whether to approve the settlement proposal.

Settlement Proposal

OEB staff has reviewed the settlement proposal in the context of the objectives of the *Renewed Regulatory Framework*[1] (RRF), the *Handbook for Utility Rate Applications*[2], applicable OEB policies, relevant OEB decisions, and the OEB's statutory obligations. OEB staff submits that the settlement proposal reflects a reasonable evaluation of Milton Hydro's planned outcomes in this proceeding, appropriate consideration of the relevant issues and ensures that there are sufficient resources to allow Milton Hydro to achieve its identified outcomes in the five years of the plan from 2023 to 2027.

OEB staff further submits that the explanations and rationale provided by the Parties support the settlement proposal and that the outcomes arising from the OEB's approval of the settlement proposal would reflect the public interest and would result in just and reasonable rates for customers.

Below, OEB staff provides specific submissions on certain issues established by the OEB:

- Issue 1.1 – Capital
- Issue 1.2 – Operating, Maintenance and Administration
- Issue 2.0 – Revenue Requirement
- Issue 3.0 – Load Forecast, Cost Allocation and Rate Design
- Issue 4.0 – Accounting
- Issue 5.1 – Effective Date
- Issue 5.2 – Bringing the Disallowed Office Building Space into the 2023 Revenue Requirement
- Issue 5.3 – Minimum Distribution Charge

Issue 1.1 – Capital

In its application, Milton Hydro proposed a total net capital expenditure of $9.9 million for the 2023 test year. As part of the settlement proposal, the Parties agreed to an envelope reduction of $1.0 million (approximately 10%) to the proposed net capital expenditure.

OEB staff supports the agreement reached by the Parties. The agreement represents a

[1] Report of the Board – Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, October 18, 2012.
[2] Handbook for Utility Rate Applications, October 13, 2016.

levelized amount of spending over the five-year planning period. OEB staff notes that the proposed settlement of 2023 capital expenditure amount is $718k (8.8%) higher than the 2016 OEB-approved capital expenditure amount. Compared to the average actual annual capital expenditures in 2016-2020, the proposed settlement of 2023 capital expenditure amount represents an increase of $475k (5.7%).

Issue 1.2 – Operation, Maintenance and Administration (OM&A)

Milton Hydro proposed total OM&A spending of $15.2 million for the 2023 test year in its original application. This represented an increase of 57% from the 2016 actual OM&A spending, or a compound annual growth rate of 6.7%. In its application evidence, Milton Hydro indicated that the rise in OM&A spending is mainly driven by higher staffing levels and wage and benefits increases.

The Parties agreed to an OM&A envelope reduction of $1.9 million (approximately 12.5%) to Milton Hydro's proposed OM&A for a revised budget of $13.3 million. The revised OM&A amount included in the settlement proposal would result in an increase of 37% from 2016 actual OM&A spending, or a compound annual growth rate of 4.6%. Milton Hydro was in Efficiency Assessment Cohort 2 (the second most efficient cohort) for the 2020-2022 rate years per the Pacific Economics Group's annual benchmarking study.[3] Milton Hydro forecasts to maintain in Efficiency Assessment Cohort 2 or move to Cohort 1 (the most efficient cohort) during the period of 2023-2027.

OEB staff supports the revised OM&A budget of $13.3 million. In OEB staff's view, the revised OM&A envelope provides Milton Hydro a reasonable budget to serve its growing customer base while sets a target to maintain the top-half ranking in OM&A cost per customer in peer group comparison. The Parties have provided a breakdown of the reduction in Table 1.2B – Summary of OM&A Expenses with Changes of the settlement proposal.

Issue 2.0 – Revenue Requirement

The Parties agreed to a service revenue requirement of $25.1 million and a base revenue requirement of $22.9 million. These values reflect a reduction of $1.0 million in 2023 capital expenditures and a reduction of $1.9 million from OM&A compared to Milton Hydro's application proposal. This also reflects changes to depreciation, cost of capital, working capital allowance and payments in lieu of taxes. Table 2.2A – 2023 Revenue Requirement of the settlement proposal shows the change in revenue

[3] For example, Report to the Ontario Energy Board – "Empirical Research in Support of Incentive Rate-Setting: 2020 Benchmarking Update", prepared by Pacific Economics Group LLC., August 2021.

requirement between Milton Hydro's original application and the settlement proposal.

Cost of Capital

Milton Hydro is not proposing any changes to its deemed capital structure, which is 56% long-term debt, 4% short-term debt and 40% equity. This remains compliant with the OEB's policy as documented in the Report of the Board on the Cost of Capital for Ontario's regulated utilities (The Cost of Capital Report).[4]

The Parties agreed to a weighted average long-term debt rate of 3.72% after Milton Hydro updated the rate of its new long-term debt instruments it recently secured from a commercial bank. The Parties also agreed to a short-term debt rate of 1.17% in accordance with the OEB's deemed rate for 2022. OEB staff notes that the 2022 deemed short-term debt rate was established prior to increases in the Bank of Canada's overnight rate, which began in January 2022. However, considering the small impact of short-term debt on the revenue requirement, OEB staff considers that this proposal poses no material risk to Milton Hydro's financial viability. In the context of the settlement proposal, OEB staff does not take issue with the proposed treatment of the short-term debt.

With respect to return on equity (ROE), the Parties agreed that Milton Hydro use the OEB's allowed 2022 ROE of 8.66% for setting rates for the 2023 test year.

OEB staff notes that the 8.66% is the OEB-issued allowed ROE for 2022. As discussed above with respect to short-term debt, the 2022 value was calculated prior to increases in the overnight rate by the Bank of Canada to curtail persistent inflation outside of the 1% to 3% target range since the second half of 2021 and other factors (e.g., demand-supply imbalances and increases in job vacancies). It is possible that the OEB's ROE formula might produce a higher ROE for 2023 given the current socioeconomic environment of higher inflation and interest rates. However, this will only be known when the OEB calculates and publishes updated cost of capital parameters for 2023 in the fall of 2022, once the necessary data are available.

Nevertheless, OEB staff takes no issue with the proposed adoption of the 2022 allowed ROE of 8.66%. Under the policy in the Cost of Capital Report, a utility can propose an ROE up to the OEB-issued allowed ROE for the rate year. Based on the above discussion, OEB staff considers it unlikely that 8.66% will exceed the OEB-issued ROE for 2023 when the latter is announced. Further, in the context of the settlement, OEB

[4] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009

staff does not consider that Milton Hydro's financial viability is at risk by agreeing to this ROE. In OEB staff's view, setting ROE at 2022 level, in the context of this proposed settlement, is an appropriate approach that balances the uncertainty in the macroeconomic conditions over the plan term while maintaining Milton Hydro's financial viability during the forthcoming incentive rate-setting mechanism (IRM) term.

Payment in Lieu of Corporate Taxes (PILS) – Accelerated Capital Cost Allowance

Bill C-97 introduced the Accelerated Investment Incentive program (AIIP), which provides for a first-year increase in capital cost allowance (CCA) deductions on eligible capital assets acquired after November 20, 2018. The AIIP is expected to be phased out starting in 2024, and fully phased out in 2028.

In its July 25, 2019, letter (CCA Letter) titled Accounting Direction Regarding Bill C-97 and Other Changes in Regulatory or Legislated Tax Rules for Capital Cost Allowance, the OEB provided accounting direction on the treatment of the impacts from accelerated CCA resulting from the AIIP. The OEB established a separate sub-account, Account 1592 - PILs and Tax Variances, Sub-account CCA Changes to track the impact of any differences that result from the CCA change to the tax rate or rules that were used to determine the tax amount that underpins rates.

The Parties agreed to Milton Hydro's calculation of the CCA differences that are accumulated in Account 1592, Sub-account CCA Changes, from November 21, 2018, to December 31, 2021, by comparing the CCA on the actual (or forecast, as applicable) capital additions in the respective period under the legacy rule to the accelerated CCA on the same capital additions in the respective period under the AIIP. The calculated sub-account credit balance of $995,185 represents the full revenue requirement impact of the application of accelerated CCA as of December 31, 2021, including interest to December 31, 2022.

The Parties agreed that 100% of the revenue requirement impact is to be returned to Milton Hydro's ratepayers. OEB staff does not object to this approach, given the CCA Letter states that "determinations as to the appropriate disposition methodology will be made at the time of each Utility's cost-based application". In addition, OEB staff notes that a refund of 100% of the sub-account to ratepayers has previously been approved by the OEB in a prior proceeding[5] and accepted by the OEB in settlement proposals of

[5] Enbridge Gas Inc. Deferral and Variance Account Disposition and Earnings Sharing Mechanism Decision and Order, May 6, 2021, EB-2020-0134.

various proceedings.[6]

The CCA Letter also indicated that utilities were to reflect any impacts arising from CCA rule changes in their cost-based applications for 2020 rates and beyond and that the OEB may consider a smoothing mechanism to address any timing differences that could lead to volatility in tax deductions over the rate-setting term. The Chapter 2 Filing Requirements for Electricity Distributors further state that the OEB will assess smoothing proposals on a case-by-case basis and if the OEB is satisfied with the smoothing proposals, the distributor's use of (or access to) Account 1592, to record the impacts of the specific CCA changes contemplated in the smoothing proposal, will no longer be applicable.[7]

In the current application, Milton Hydro proposed a five-year smoothing adjustment to CCA that is reflected in PILs to address the phasing out of AIIP. The Parties agreed to the proposed smoothing adjustment of $773,421 which is added to net income before taxes, where the adjustment is calculated as the average of the annual difference between i) CCA using the accelerated CCA equal to three times the legacy CCA and ii) the CCA using the CCA rule anticipated to be in place for the respective year (i.e. reflecting the phase-out of AIIP starting in 2024, equaling two times the legacy CCA rule). The CCA in the adjustment is calculated using the test-year additions for each year from 2023 to 2027. In OEB staff's view, the agreed-upon smoothing adjustment calculation is one of the appropriate methods to calculate a smoothing adjustment to address the phase-out of AIIP. The total five-year difference between i) and ii) noted above, is ultimately forecasting the potential balance that would be recorded in the 1592 sub-account in the 2022 to 2026 period by comparing the CCA rule ultimately embedded in rates to the CCA rule actually in place in each year. Adding one fifth of the total (i.e., the average of annual differences) to the net income before taxes is providing Milton Hydro with recovery of the forecasted 1592 sub-account through PILs. Therefore, OEB staff agrees with the smoothing adjustment calculation.

The Parties also agreed that Milton Hydro's continued use of the 1592 sub-account during 2023 to 2027 will be limited to capture the impact of any changes in CCA rules, other than those contemplated in the AIIP (i.e., further CCA rule changes from the phase out of accelerated CCA rules expected to be in place during the IRM period). OEB staff agrees with this approach. In OEB staff's view, the intent of a smoothing adjustment is to address the change in CCA rules resulting from Bill C-97 upfront in the

[6] Hydro Ottawa 2021 Custom IR Decision and Order, EB-2019-0261, November 19, 2020, and Waterloo North Hydro Inc. 2021 Cost of Service Decision and Rate Order, EB-2020-0059, December 10, 2020, Brantford Power 2022 Cost of Service Decision and Rate Order EB-2021-0009.
[7] Chapter 2 Filing Requirements for Electricity Distribution Rate Applications – 2021 Edition for 2022 Rate Applications, April 18, 2022, Page 40

current application, instead of capturing the impact of any further change in rules as they occur during the IRM period. Therefore, the 1592 sub-account would no longer be needed for the 2022 to 2026 period, unless there are further changes to CCA rules that were not contemplated in the calculation of the smoothing adjustment.

Issue 3.0 Load Forecast, Cost Allocation and Rate Design

Load Forecast

The Parties agreed to the proposed load forecast subject to the following changes:

1. The most recent Toronto FTEs (seasonally adjusted)[8] forecast for 2022 and 2023 will be used as an economic variable in the General Service 50 to 999 kW Class regression analysis
2. For the General Service 1,000 to 4,999 kW Class, the 2021 average annual consumption per customer will be used as the basis for 2023 volumes
3. For the kW/kWh Ratio, the 5-year average will be used for both General Service Classes affected to ensure consistency

OEB staff does not have any concerns with the proposed load forecast of 924,940 MWh, 1,141,196 kW, and 46,809 customers and connections as shown in Table 3.1A of the settlement proposal. Relative to the initial application amounts, this reflects an increase of 21,129 MWh and 45,775 kW. OEB staff submits that the agreed-upon load and customer connection forecasts are appropriate.

Conservation and Demand Management (CDM)

For the CDM adjustment, the Parties agreed that only 2023 CDM program savings will be included in the test year. The Parties agreed to an updated CDM adjustment of 8.9 GWh, which reflects using only the 2023 CDM program savings rather than savings over the 2023-2027 period, as originally proposed in the application. OEB staff has no concerns with the proposed CDM adjustment as it would include only the savings associated with the 2023 test year.

Cost Allocation

The Parties agreed that Milton Hydro would update its load profiles for each customer class in its next rebasing application.

[8] Milton Hydro used seasonally adjusted full-time equivalents in the Toronto region from Statistics Canada as an explanatory variable. The seasonally adjusted data eliminates seasonal movements caused by annual events such as climate, holidays, vacation periods, etc.

It was agreed that the revenue-to-cost ratio for the Sentinel Lighting rate class would be increased to 80%, the minimum target for that rate class.

OEB staff has no concern with the cost allocation agreed to by the Parties.

Rate Design

The Parties agreed that Milton Hydro will maintain the fixed rates at current level where they exceed the ceiling[9] and increase the variable rate to fully allocate the Distribution Revenue Requirement. Milton Hydro has maintained the fixed rates at the current level for the following rate classes:

- General Service 50 to 999 kW
- General Service 1,000 to 4,999 kW
- Large User
- Street Lighting

OEB staff has no concern with the proposed rate design.

Retail Transmission Service Rates (RTSRs)

The Parties agreed that Milton Hydro will use the RTSRs as calculated based on the 2021 loads.

OEB staff does not have any concerns with respect to the proposed RTSRs and low voltage rates as shown in Tables 3.4A and 3.4B of the settlement proposal.

Issue 4.0 Accounting

The Parties agreed that all impacts of past changes in accounting standards, policies, estimates and adjustments have been properly identified and recorded, and the rate-making treatment of each of these impacts is appropriate.

OEB staff supports the settlement proposal reached by the Parties.

Group 1 Accounts

In its pre-filed evidence, Milton Hydro proposed to dispose of its debit Group 1 Deferral

[9] The minimum system with peak load carrying capability from the cost allocation model, which is commonly referred to as the ceiling for fixed charges.

and Variance Accounts (DVA) balances of $1,860,501 as of December 31, 2021 and forecasted interest through to December 31, 2022. Milton Hydro is proposing to dispose of the debit balances of Group 1 DVAs excluding account 1589 – Global Adjustment over a 24-month period for the rate riders to help reduce the impact on customers. In addition, Milton Hydro proposed to dispose of the Global Adjustment credit balance of $536,362 over a 12-month period to all Non-RPP customers.

In the settlement proposal, the Parties agreed to dispose of the Group 1 DVA balances as proposed by Milton Hydro. OEB staff supports the disposition of Group 1 DVA balances as proposed.

<u>Group 2 Accounts</u>

In the current application, Milton Hydro proposed to dispose of its Group 2 DVAs account balances (credit of $891,030) over a 12-month period. In the settlement proposal, the Parties agreed that Milton Hydro’s proposals including the balances in the existing accounts and their disposal, requests for discontinuation of accounts, and the continuation of existing accounts, are appropriate.

The Parties further agreed to the following:

Account 1508, Pole Attachment Revenue Variance Account

As part of the settlement proposal, Milton Hydro has updated the number of poles used in its forecast, and updated the forecasted amount recorded in the account to the end of December 31, 2022 and requested to dispose the balance of the account on a final basis and to discontinue using the account after it clears the final balance to sub-account 1595 (2023). Milton Hydro will request a new variance account, if and when appropriate, to record Pole Attachment Revenues Variances if the OEB makes changes to the Pole Attachment Rates beyond changes due to inflation.

Account 1509, Impacts Arising from the COVID-19 Emergency

Milton Hydro will not be seeking recovery of the $103,751 balance in this account as it is below the materiality threshold. This account will be discontinued.

Account 1508, OEB Cost Assessment Variance

Milton Hydro will dispose of the balance of this account over a two-year period to help mitigate the bill impacts to customers.

Green Button Initiative

Milton Hydro originally proposed a new deferral account to capture the revenue requirement impacts of one-time or ongoing capital or OM&A costs associated with the Green Button Initiative.

The OEB established a generic deferral account for rate regulated distributors to record the incremental costs directly attributable to the implementation of the Green Button. In a letter dated November 1, 2021, the OEB has confirmed that the generic account "is to record the incremental costs directly attributable to the implementation of the Green Button initiative but is not intended to record ongoing costs related to Green Button beyond the initial implementation of the program."[10]

Milton Hydro clarified that it has not recorded any incremental costs directly attributable to the implementation of Green Button in the generic account.

With respect to potential ongoing operating costs associated with the implementation of Green Button, the Parties agreed that Milton Hydro will use the OEB's generic account for ongoing costs if the OEB establishes one or may request its own account if it meets the OEB causation, materiality, and prudence criteria for establishing new accounts.

OEB staff has no concerns with the agreement since it's consistent with the OEB's guidance as articulated in the November 2021 Green Button letter.

OEB staff supports the settlement proposal reached by Parties regarding Group 2 DVA balances.

<u>Lost Revenue Adjustment Mechanism (LRAM)</u>

Milton Hydro is proposing to dispose of its LRAMVA balance of $537,702, including carrying charges. The balance is comprised of persistence of 2015-2020 program activity into 2021 and 2022, as well as a small amount related to 2021 and 2022 program activity. In the settlement proposal, the Parties agreed to dispose of the LRAMVA balance as proposed by Milton Hydro. If disposition is approved, Milton Hydro would have a zero balance in the LRAMVA. Milton Hydro does not request to use the LRAMVA for any CDM activities, but requests that the account not be discontinued, in case Milton Hydro is eligible to use this account in the future.

OEB staff has no concerns with the LRAMVA balance proposed for disposition. OEB

[10] EB-2021-0183 Green Button Implementation – OEB Staff Guidance, November 1, 2021.

staff also takes no issue with LRAMVA remaining open. OEB staff notes that, to align with the OEB's 2021 CDM Guideline, Milton Hydro should not make further entries to the LRAMVA without first requesting the use of the LRAMVA for a CDM activity with the OEB. The future use of the LRAMVA for CDM activities will be determined by the OEB on a case-by-case basis.

Issue 5.1 – Effective Date

The Parties agreed that an effective date of January 1, 2023 is appropriate.

OEB staff has no concerns with an effective date of January 1, 2023.

Issue 5.2 – Bringing the Disallowed Office Building Space into the 2023 Revenue Requirement

In its decision on Milton Hydro's 2016 Cost of Service rate application, the OEB did not allow certain portions of the new office building at 200 Chisholm Drive to be included in rate base. The OEB found that certain portions of the office space exceeded Milton Hydro's reasonable requirements over the planning horizon.

In this application, Milton Hydro explained that since the 2016 proceeding, its requirements and utilization of the building space have evolved to meet the needs of its growing customer base. Milton Hydro provided its plan of optimizing its current and future office space to accommodate the customer and staff growth, including building an in-house system control room located in the previously disallowed space.

The Parties agreed to bring the disallowed capital and OM&A costs associated with the office building at 200 Chisholm Drive into the determination of the 2023 revenue requirement. The Parties also agreed that Milton Hydro will not include capital additions related to the proposed control room in determining the 2023 rate base.

OEB staff has no concerns with the agreement. OEB staff notes that the Parties also agreed to an envelope reduction of $1.0 million in capital additions for the 2022 bridge year. In OEB staff's view, the agreement provides a balanced outcome that allows Milton Hydro to undertake its facility plan as it sees fit while protecting ratepayers from a higher increase in rate base as proposed in the original application.

Issue 5.3 – Minimum Distribution Charge[11]

The Parties agreed that Milton Hydro will eliminate and no longer use the Minimum Distribution Charge. It is a legacy charge from a prior ratemaking structure and has not had any material impact on revenues in any recent years. No minimum distribution revenue is forecast for 2022 and 2023 and no subsequent adjustments were made in the cost allocation model to account for these revenues.

OEB staff has no concerns with this agreement.

~All of which is respectfully submitted~

[11] This issue was not included in the Approved Issues List. For presentation purpose, the Parties agreed to summarize the agreement on this matter as a separate issue in the Settlement Proposal.