

Apr 24, 2020

OEB Issues Decision on Hydro One Transmission Revenue Requirement

By Fred D. Cass

The Ontario Energy Board has issued its decision on an application by Hydro One Networks Inc. for approval of Hydro One's electricity transmission revenue requirement for each year from January 1, 2020 to December 31, 2022. The OEB-approved transmission revenue requirement for Hydro One is used, together with the revenue requirements of other electricity transmitters, in setting Uniform Transmission Rates that apply across the province. The OEB indicated in the Hydro One decision, which was issued on April 23, 2020, that it plans to update the UTRs effective July 1, 2020. The OEB said that it does not expect the current COVID-19 emergency (which occurred after the close of the record in the Hydro One proceeding) to impact its implementation of the Hydro One decision, or its ability to update the UTRs effective July 1, 2020, but that it will continue to monitor the situation closely.

Hydro One's application was based on a Custom Incentive Regulation methodology with a three-year term from 2020 to 2022. The OEB concluded that Hydro One had sufficiently met the requirements for a Custom IR application and it approved the three-year term proposed by Hydro One.

The OEB's decision addressed a wide range of issues. As noted by the OEB, a Custom IR application is considered to be a "rebasing" application, which includes a forecast of costs and volumes and re-establishes the applicant's base revenue requirement. Among the many issues addressed in the decision were Hydro One's customer engagement activities, operations, maintenance and administration costs and capital expenditure budget.

An extensive discussion of the OEB's decision would be necessary in order to provide a meaningful explanation, even in a summary fashion, of all of the elements of the decision. This blog post will discuss one of the noteworthy aspects of the decision, specifically, the OEB's approval of the inclusion of a capital factor (C-Factor) in Hydro One's Custom IR formula. For those interested in all or any of the other issues addressed by the OEB, the decision can be found [here](#).

Hydro One proposed a Custom IR framework based on a revenue cap index. Under Hydro One's proposal, the revenue requirement for 2020 would be rebased on a cost of service basis and annual adjustments would be made for 2021 and 2022 using a revenue cap formula. At the risk of over-simplification, the formula for annual adjustments is based on inflation less productivity, where the latter factor (determined by the OEB to be 0.3%) is made up of both base productivity and a stretch factor. As noted above, Hydro One proposed the addition of a C-Factor to this basic revenue cap formula.

The purpose of the proposed C-Factor was to proxy the additional revenue requirement of forecasted capital expenditures (in-service additions) beyond the level of capital expenditures already factored into the established revenue requirement, as would be adjusted for each of 2021 and 2022 by application of the basic formula. The OEB accepted that Hydro One's transmission business is capital intensive and that capital expenditures represent a large part of the revenue requirement that would escalate beyond the inflation-less-productivity component of the basic revenue cap formula. The OEB also observed that the C-Factor concept has been approved by the OEB in Custom IR plans for electricity distributors, including Hydro One distribution, but this was the first case in which a C-Factor was proposed for an Ontario utility's electricity transmission revenue requirement.

The OEB approved Hydro One's proposed C-Factor with the addition of an incremental capital stretch factor of 0.15% and the removal of a working capital allowance component. The OEB said that the added stretch factor is consistent with its approval for Hydro One's distribution business and is intended to be an incentive for Hydro One to seek additional productivity gains in respect of its forecasted capital plan and budget.

The OEB also made specific reductions to Hydro One's proposed capital expenditures, as discussed in other parts of the decision. (In summary, the OEB reduced Hydro One's proposed capital expenditures for 2020 to 2022 by \$400 million, or approximately 10.4%, due to concerns in a number of areas.) The OEB said that the incremental stretch factor on capital spending of 0.15% was established with due consideration of these specific reductions, as well as other aspects of the decision.

As for the removal of the working capital allowance component of the proposed C-Factor, the OEB said that Hydro One calculates working capital as a percentage of OM&A and it therefore agreed with other parties that the working capital allowance should be excluded from the C-Factor calculation. The OEB pointed out that this is consistent with the C-Factor for Hydro One's distribution operations.

In the decision, the OEB made a number of other adjustments to Hydro One's proposals. The OEB found that, with the adjustments resulting from its decision, the revenue required by Hydro One to provide transmission service is reasonable, and the consequential rate and bill impacts will also be reasonable.

Author



Fred D. Cass
Partner
T 416.865.7742
fcass@airdberlis.com

This communication offers general comments on legal developments of concern to business organizations and individuals and is not intended to provide legal advice. Readers should seek professional legal advice on the particular issues that concern them.