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**BY EMAIL**

February 14, 2018

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
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2300 Yonge Street  
Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: Sioux Lookout Hydro Inc.  
2018 Cost of Service Application  
OEB Staff Report to the Registrar  
Proportionate Review Pilot  
Board File Number: EB-2017-0073**

Please find attached OEB staff's report to the registrar in the above noted proceeding.

Yours truly,

*Original Signed By*

Lawrie Gluck  
Case Manager



# **ONTARIO ENERGY BOARD**

## **OEB Staff Report to the Registrar**

**Sioux Lookout Hydro Inc.**

**2018 Cost of Service Application**

**Proportionate Review Pilot**

**EB-2017-0073**

**February 14, 2018**

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## 1. The Purpose of the Report

Sioux Lookout Hydro Inc. (SLHI) filed a cost of service application on August 28, 2017 for rates effective May 1, 2018. The purpose of this OEB staff report to the Registrar (the Report) is to provide an assessment of SLHI's 2018 cost of service application, for the purpose of identifying issues that should be considered for hearing and the process for the hearing.

With SLHI's consent, the 2018 rebasing application is being used to pilot and test the OEB's proportionate review approach. The objective of this approach is to establish a process whereby OEB staff's initial assessment of an application is leveraged to identify which issues require rigorous testing, and which requests can be accepted as filed having met the OEB's expectations in terms of completeness and quality of information provided, materiality of costs involved, and performance achieved in the subject areas.

OEB staff used a number of different tools and analysis techniques to develop a recommendation for the appropriate process that the OEB should use to address the requests set out in the application. While this is termed a "pilot", it is in fact a formal component of the OEB's review process for this application.

## 2. The Applicant

SLHI serves approximately 2,800 customers in the Municipality of Sioux Lookout (including the communities of Hudson, Benedickson and Pickerel). On a customer count basis, SLHI is one of the smallest distributors operating in the province. The total municipal population is 5,080. The total service area is 538 sq. km (with 533 sq. km classified as rural). SLHI's most recent rebasing application was for 2013 rates<sup>1</sup>.

SLHI is a fully embedded distributor that receives electricity at distribution level voltages from Hydro One Networks Inc. (Hydro One). Therefore, it is charged by Hydro One for low voltage distribution services.

SLHI is entirely owned by the Municipality of Sioux Lookout and has no affiliates.

It is also important to note that SLHI is one of eight electricity distributors for which the Distribution Rate Protection (DRP) program applies. This program is a component of the Ontario government's Fair Hydro Plan. As such, the maximum monthly base distribution cap of \$36.43 applies for all eligible residential customers. This means that no residential customer will pay more than \$36.43 a month for distribution services (excluding rate riders – which amount to a proposed debit of about \$0.14 a month

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<sup>1</sup> [EB-2012-0165](#).

in 2018). Since July 1, 2017, a typical SLHI customer has been paying the DRP maximum of \$36.43 (as the existing base distribution charge is \$40.06 for a residential customer using 750 kWh<sup>2</sup>). For 2018, the proposed base distribution charge, excluding rate riders, for a typical residential customer is \$46.69 / month. Therefore, there will be no base distribution charge impacts arising from this application for residential customers (but other customer classes will still see a distribution-related bill impact). The variance between the residential base distribution charge that is approved as part of this proceeding and the maximum base distribution charge will be financed through the Fair Hydro Plan. OEB staff's analysis of the application is based on the requests made by SLHI (most notably its proposed revenue requirement and load forecast) and is not influenced by the application of DRP program.

### 3. The Assessment Tools

OEB staff used a variety of assessment tools to evaluate SLHI's 2018 cost of service application. The evaluation, using the following tools, is the basis for OEB staff's recommendation with respect to the issues to be heard and the appropriate process that the OEB should apply to address the requests set out in the application.

**Community Meeting and Letters of Comment** – The OEB held a community meeting in Sioux Lookout, Ontario to allow customers of SLHI to learn about the application, ask questions and provide their comments. The comments received from SLHI's customers form part of OEB staff's overall consideration of the application. OEB staff filed a report on November 14, 2017, summarizing the discussion at the community meeting.

**The Initial Triage Model (ITM)** – The ITM includes: (a) a historical Comprehensive Performance Assessment Model (CPAM); (b) a Quantitative Assessment of key metrics arising from the requests in the application; and (c) a Qualitative Assessment of the supporting evidence for the requests in the application. The ITM has been developed in draft form by OEB staff to provide an indicator as to whether a streamlined review could be considered for an application, and guides OEB staff's attention to areas of the application which should be explored further in an effort to identify discrete issues that may require rigorous testing.

As the ITM is still under development, it was not a significant factor in OEB staff's final recommendations. Using the ITM as part of staff's review for this pilot was an opportunity to begin to evaluate the relevance and value of the model.

**OEB Staff Detailed Review** – OEB staff undertook a detailed review of all aspects of the application including the supporting models filed with the application. The purpose of the review was to provide the applicant with the opportunity to rectify any errors and inadvertent non-alignment with OEB policy, and

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<sup>2</sup> [EB-2016-0103, SLHI 2017 Incentive Ratemaking Mechanism \(IRM\) proceeding.](#)

address any areas where the record was insufficient, as well as to determine which issues may require a hearing.

In the future, OEB staff expects to utilize information that may arise from current initiatives under way to establish expectations for corporate governance and enhanced unit and program based benchmarking.

#### **4. The Process**

OEB staff started its review of the application by using the ITM. As noted above, the ITM is intended to provide an initial indicator of whether an application might be a good candidate for a streamlined review and to guide staff's attention to areas of the application that may require adjudication.

After reviewing the results of the ITM, OEB staff performed a detailed review of the application. OEB staff reviewed all aspects of the application and the supporting application models. OEB staff held a conference call with SLHI on September 26, 2017 to discuss the application and sent written questions to SLHI on November 2, 2017. SLHI responded to OEB staff's written questions on November 14, 2017.

OEB staff reviewed the responses to the written questions and held a second conference call with SLHI on December 5, 2017 and sent written follow-up questions. SLHI responded to the written follow-up questions on December 12, 2017.

OEB staff reviewed the responses to the written follow-up questions. In SLHI's responses to both the initial and follow-up questions, it stated that it would file updates to its application to address errors and to reflect the best available information. On that basis, OEB staff sent SLHI a list of what OEB staff believed were the intended updates to the application on December 19, 2017. SLHI filed a letter on January 2, 2018 confirming the listed updates and noting that it had two additional updates that it would make to its application.

SLHI filed its updated application on January 8, 2018. OEB staff reviewed the updated application to confirm that all of the updates were properly reflected. OEB staff had further conference calls with SLHI on January 18, 2018 and February 12, 2018 to ask clarification questions.

All written correspondence between OEB staff and SLHI is available on the public record for this proceeding, along with the original and revised applications filed by SLHI.

In addition, OEB staff attended a community meeting held in Sioux Lookout, Ontario on November 7, 2017. Letters of comment were received after the community meeting and SLHI responded to those letters. A summary of the community meeting is available on the public record of this proceeding.

#### **5. Application Summary**

Date of application: August 28, 2017 (Updated January 8, 2018)

Effective date requested: May 1, 2018

SLHI's 2018 revised cost of service application has the following key features:

- Request for approval to charge rates effective May 1, 2018 to recover a service revenue requirement of \$2,200,916, including a gross revenue deficiency (at existing rates) of \$137,078. This reflects a \$252,060 increase (13%) relative to the 2013 service revenue requirement (\$1,948,856) approved in SLHI's last rebasing.
- Proposed capital expenditures of \$618,329 for 2018. This is a \$298,389 increase (93%) relative to the 2013 approved capital expenditures (\$319,940) approved in SLHI's last rebasing. The change is almost entirely driven by the proposed purchase of a replacement line truck (\$355,000) in 2018.
- Proposed Operations, Maintenance & Administration (OM&A) budget of \$1,572,092 for 2018. This is a \$150,846 increase (11%) relative to the 2013 approved OM&A budget (\$1,421,246) approved in SLHI's last rebasing.
- A Distribution System Plan (DSP).
- Request for approval of the proposed load forecast.
- Request for approval to continue applying the specific service charges as previously approved by the OEB (with minor wording changes to two of the specific service charges).
- Request for approval to remove the Unmetered Scattered Load (USL) rate class.
- Request for approval of the proposed loss factor.
- Request for approval to dispose of specified deferral and variance account balances.

SLHI retained the following assistance for the development and processing of its 2018 rates application:

Legal and Consulting: John Vellone and Bruce Bacon (BLG)

Other Consultants: Costello Utility Consultants

Summary of 2018 Cost of Service Application

	Original Application	Revised Application	Variance	Reason
Net Fixed Assets	\$5,286,047	\$5,286,047	\$0	
Working Capital Allowance	\$885,053	\$697,898	-\$187,155	most up-to-date information
<b>Total Rate Base</b>	<b>\$6,171,100</b>	<b>\$5,983,945</b>	<b>-\$187,155</b>	most up-to-date information
Long-Term Debt Ratio	56%	56%	0%	
Short-Term Debt Ratio	4%	4%	0%	
Equity Ratio	40%	40%	0%	
Long-Term Debt Cost (%)	3.86%	4.24%	0.38%	most up-to-date information
Short-Term Debt Cost (%)	1.76%	2.29%	0.53%	most up-to-date information
Return on Equity (%)	8.78%	9.00%	0.22%	most up-to-date information
Weighted Cost of Capital (%)	5.74%	6.07%	0.33%	most up-to-date information
<b>Total Cost of Capital (\$)</b>	<b>\$354,468</b>	<b>\$362,986</b>	<b>\$8,518</b>	most up-to-date information
<b>OM&amp;A</b>	<b>\$1,572,092</b>	<b>\$1,572,092</b>	<b>\$0</b>	
<b>Depreciation</b>	<b>\$234,839</b>	<b>\$234,839</b>	<b>\$0</b>	
<b>Property and Other Taxes</b>	<b>\$5,394</b>	<b>\$5,394</b>	<b>\$0</b>	
<b>PILs</b>	<b>\$20,762</b>	<b>\$23,005</b>	<b>\$2,243</b>	Technical errors
<b>Other Expenses</b>	<b>\$2,600</b>	<b>\$2,600</b>	<b>\$0</b>	
<b>Service Revenue Requirement</b>	<b>\$2,190,155</b>	<b>\$2,200,916</b>	<b>\$10,761</b>	
<b>Other Revenue</b>	<b>\$135,197</b>	<b>\$121,197</b>	<b>-\$14,000</b>	Technical errors
<b>Base Revenue Requirement</b>	<b>\$2,054,958</b>	<b>\$2,079,719</b>	<b>\$24,761</b>	
<b>Gross Revenue Deficiency</b>	<b>\$112,317</b>	<b>\$137,078</b>	<b>\$24,761</b>	

### Bill Impacts

The bill impacts arising from SLHI's revised 2018 rebasing application, while within policy range to not require mitigation, are not insignificant. The bill impacts set out below do not reflect any government rebates (specifically, the Fair Hydro Plan and the related Distribution Rate Protection program) that are applicable to SLHI's customers (as those are not in the control of the OEB and are subject to change based on government policy). OEB staff's analysis of the bill impacts is set out later in the Report.

Rate Class	Sub-Total A (Distribution excl. pass-through)	Sub-Total C – Delivery	Total Bill
Residential (750 kWh)	\$6.77 (16.91%)	\$7.43 (13.55%)	\$7.80 (6.19%)



<b>Residential (lowest 10<sup>th</sup> percentile) (518 kW)</b>	\$7.40 (19.14%)	\$8.04 (16.38%)	\$8.44 (8.54%)
<b>GS &lt; 50kW</b>	\$7.62 (12.71%)	\$7.13 (7.58%)	\$7.48 (2.53%)
<b>GS &gt; 50kW</b>	-\$12.53 (-2.4%)	-\$277.40 (-17.53%)	-\$317.69 (-2.75%)
<b>Street Lights</b>	-\$3,302.39 (-49.75%)	-\$3,373.27 (-49.16%)	-\$3,811.58 (-40.36%)

Policy Matters

Modified International Financial Reporting Standards (MIFRS) - SLHI filed its 2018 rebasing application on the basis of modified IFRS. SLHI adopted IFRS in 2015 with 2014 being the transition year.

Distribution System Plan (DSP) - SLHI submitted a DSP, which was developed with the assistance of Costello Utility Consultants.

Conservation and Demand Management (CDM) - SLHI applied a manual adjustment to its load forecast, which reflects the impact of 2017 and 2018 CDM programs. In addition, SLHI is seeking the disposition of a LRAMVA balance of \$6,029.

Low Income Energy Assistance Program (LEAP) - SLHI requested \$2,600 for 2018 LEAP funding, based on 0.12% of its service revenue requirement.

## 6. Summary of OEB Staff’s Recommendations

OEB staff is of the view that SLHI filed a comprehensive and well-reasoned application that generally provides sufficient rationale to support its proposal to change rates effective May 1, 2018. OEB staff has made every effort to ensure a sufficient and accurate record upon which the OEB can make a determination as to the issues to be heard and the process for the hearing. OEB staff believes that the revised application, as filed on January 8, 2018, properly reflects a number of corrections and the most up-to-date information available.

Overall, OEB staff believes that the vast majority of SLHI’s proposals are reasonable and should not proceed to hearing, with a few noted exceptions. In OEB staff’s view, the proposals set out in the revised application for which OEB staff has not recommended a hearing reflect a reasonable quantification and value proposition of the utility’s planned outcomes. OEB staff submits that the outcomes arising from the OEB’s approval of these proposals would adequately reflect the public interest, are in accordance with OEB policy, and would result in just and reasonable rates for customers.

OEB staff notes that there are rather large distribution-related bill increases for residential and GS < 50kW customers resulting from SLHI’s application. OEB staff is of the view that there are a few specific requests in the application that are not well supported by the evidence and if the OEB eventually determines that the requests are not reasonable, the bill impacts would be reduced.

OEB staff has identified nine potential issues with the requests set out in SLHI's application and recommends that the following issues proceed to a written hearing:

- 1) Is the proposed 2018 test year capital budget for the planned pole replacement program 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?
- 3)
  - a. Should a deferral account be established to record incremental revenues (and related costs) that may arise if the pulp mill returns to operation during the forecast period?
  - b. If so, how should the account be designed and when should it be disposed?
- 4) Is the proposed 2018 test year budget for bank and merchant fees appropriate?
- 5)
  - a. Is the proposed 2018 test year budget for ongoing regulatory costs associated with resources allocated to regulatory matters appropriate?
  - b. Are the one-time cost of service application related costs appropriate in the context of the regulatory process that is applied to SLHI's application?
- 6)
  - a. Should the proposed reduced allocation of costs to the street lighting rate class be phased in over time?
  - b. If so, what period of time is appropriate?
- 7) Is the proposed wording change to the pole attachment related specific service charge appropriate?
- 8) Should the proposed balances in the commodity variance accounts (1588 and 1589) be disposed at this time?
- 9) Should Account 1575 be discontinued at this time?

OEB staff further recommends that the hearing of the issues in this case be accomplished through the filing of written submissions. SLHI has answered numerous questions from OEB staff and filed a revised application for the OEB's consideration. OEB staff is of the view that the evidentiary record is

sufficient to allow OEB staff, and any other interested parties, to make submissions and to allow the OEB to make well-informed findings.

Depending on the OEB's determination with respect to the noted issues, consequential changes to rate base and certain components of the revenue requirement may be necessary.

OEB staff's recommendations as set out in the Report are respectfully filed for consideration by the OEB.

OEB staff's detailed analysis which supports the recommendations discussed above are set out in the section that follows.

## **7. OEB Staff's Detailed Analysis**

The detailed analysis that follows supports OEB staff's recommendation that nine discrete issues in this application be heard through an abridged written hearing process. Given the information already on the record on all issues and the nature of certain issues, OEB staff recommends that a written hearing can be limited to written submissions for all issues.

### **7.1 Community Meeting and Letters of Comment**

A community meeting was held in Sioux Lookout, Ontario on November 7, 2017. Approximately 12 customers attended the meeting to hear presentations from SLHI and OEB staff. Meeting participants asked questions and made comments. Two letters of comment were also received following the meeting.

Generally, community meeting participants asked questions and made comments related to the following topics:

- the capital plans of SLHI
- how SLHI considered growth in its application
- the impact of the Fair Hydro Plan
- bill impacts
- the need for the payment of shareholder dividends

A summary of a few key comments that were made at the community meeting is set out below:

In general, SLHI provides good service to its customers. However, the overall electricity bill is too high. Further, high rates are unfair and the timing of SLHI's application is opportunistic in the context of the Fair Hydro Plan. The people of Sioux Lookout pay more than their fair share of the overall costs of the electricity system and while the Fair Hydro Plan helps, additional rebates should be granted.

One of the letters of comment that was received made a similar argument and also discussed SLHI's capital plans.

OEB staff notes that the concerns raised by customers at community meetings (and through letters of comment) are used to guide OEB staff's view of the applicant and the application. Comments from customers informed OEB staff's recommendations that are made based on OEB staff's detailed review of the application. Given customer comments in this case, OEB staff paid particular attention to the capital plans of the utility and the consequent impact on rates.

In the Report, OEB staff has provided its analysis of SLHI's capital plan and the bill impacts resulting from the application, which were issues that were specifically discussed at the community meeting.

## **7.2 Initial Triage Model**

SLHI scored reasonably well in many categories of the ITM. SLHI's application scored very well on qualitative metrics with a more moderate score on the quantitative metrics. SLHI's past performance was measured based on the CPAM using five years of historical data for the scorecard measures, and their overall trends. SLHI's past performance is generally strong relative to other distributors and its performance is trending positively. This implies that SLHI's 2018 rates application may be a good candidate for a streamlined review.

However, there are two quantitative metrics where SLHI scored poorly in the ITM. The two metrics are: (a) Pacing of Forecast Capital Investments; and (b) System Reliability (Trend vs. Baseline). These two metrics are discussed in the relevant sections below.

OEB staff notes that the results of the ITM were used to guide OEB staff's review of the applicant and the application. However, as noted earlier, the results of the ITM were not determinative in forming OEB staff's recommendations related to this application. OEB staff's detailed review of the application was the main source for the recommendations in the Report.

## **7.3 OEB Staff Detailed Review**

OEB staff performed a detailed review of the OEB's most recent SLHI rebasing decision, SLHI's past performance, and the 2018 rebasing application.

The information provided regarding SLHI's application and the related recommendations are based on the revised application filed by SLHI on January 8, 2018. SLHI accurately reflected the updates in its refiled application. Many of the updates were made to correct for technical errors that were made in the original application. There were also some changes made to reflect the most up-to-date information (e.g. cost of capital). Some minor transposition errors between the revised supporting models and the body of the application remain.<sup>3</sup> These minor transposition errors have no impact on the rates calculation.

OEB staff also considered SLHI's responses to its questions in its detailed review of the application. Not all responses led to changes in the application. However, these responses provided OEB staff insight with respect to the application.

### **7.3.1 SLHI's Recent Rebasing**

As noted previously, SLHI's most recent rebasing application was for 2013 rates<sup>4</sup>. In that proceeding, there was no settlement agreement and two parties were granted intervenor status (the Vulnerable Energy Consumer Coalition and an individual customer – Mr. Shields). The key findings of the OEB in SLHI's last rebasing proceeding were as follows:

- a change to the effective date due to late filing
- no change to rate base and capital expenditures
- a minor change to the Conservation and Demand Management (CDM) adjustment for load forecasting purposes
- a reduction to the proposed OM&A budget
- a minor change to the revenue to cost ratios

### **OEB Staff Analysis: Previous OEB Decision on Rebasing**

The OEB's decision with respect of SLHI's 2013 rebasing application flagged no major concerns. There were also no directives established that SLHI was required to address as part of the current application.

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<sup>3</sup> For example, at Exhibit 1, p. 35, Table 1-3, the original working capital allowance of \$885,053 is still shown. However, the updated amount of \$697,698 is shown throughout the rest of the application and in the revenue requirement workform (where the rates are actually calculated).

<sup>4</sup> [EB-2012-0165](#).

While not a true directive, the OEB did state in its Decision and Order with respect to SLHI’s 2013 rebasing application, “[t]he Board will not approve the disposal of Account 1508 [Deferred IFRS Transition Costs] at this time, either on a final or interim basis. The Board finds it more appropriate to consider this account in total after the transition to IFRS is complete as described in the Accounting Procedures Handbook.”<sup>5</sup>

**Recommendation:**

There are no direct recommendations arising from OEB staff’s review of the OEB’s decision in SLHI’s most recent rebasing. The review of the previous rebasing decision is used to flag any issues that could have persisted into the current application and ensure that all directives have been properly addressed.

OEB staff found no major persisting issues and there were no directives set out in the OEB’s previous rebasing decision. OEB staff notes that SLHI has sought disposition of the Deferred IFRS Transition Costs account as part of the current proceeding, which is in line with the OEB’s expectation set out in its Decision and Order regarding SLHI’s 2013 rebasing application.

**7.3.2 Incentive Ratemaking and Financial Performance**

SLHI’s applications during the 2014-2017 period were filed under the OEB’s Incentive Ratemaking Mechanism (IRM) framework for electricity distributors. In accordance with the IRM framework, electricity distributors are subject to stretch factors ranging from 0.0% to 0.6%, depending on a distributor’s cost evaluation ranking.

For all of SLHI’s IRM applications (2014-2017), SLHI was placed in Group 3 and assigned a stretch factor of 0.3%.

The table below shows SLHI’s financial ratios from 2012-2016 (left to right).

<b>Financial Performance</b>  Financial viability is maintained; and savings from operational effectiveness are sustainable.	<b>Financial Ratios</b>	Liquidity: Current Ratio (Current Assets/Current Liabilities)	1.15	1.00	0.96	0.95	0.93
		Leverage: Total Debt (includes short-term and long-term debt) to Equity Ratio	0.80	0.71	0.64	0.58	0.51
		Profitability: Regulatory Return on Equity	8.57%	8.98%	8.98%	8.98%	8.98%
		Deemed (included in rates)	9.22%	12.30%	6.38%	7.38%	5.16%
		Achieved					

The result of the cost benchmarking model filed with SLHI’s 2018 application, which serves as a directional indicator of efficiency, is that SLHI is forecast to remain in Group 3.

**OEB Staff Analysis: IRM and Financial Performance**

<sup>5</sup> [EB-2012-0165, Decision and Order, August 22, 2013, p. 18.](#)

SLHI was classified in the Group 3 cohort throughout its most recent IRM period. This means that its actual costs are within 10% (either positive or negative) of its predicted costs, which is considered an average cost evaluation ranking when compared to other distributors in Ontario. This raises no immediate issue.

The liquidity ratio has been falling slightly over the years. However, a 0.93 liquidity ratio is not considered serious as it is very close to the expected 1.0.

SLHI's actual debt to equity ratio has fallen quite significantly over the years. This has occurred due to SLHI paying down its long-term debt and not requiring new debt during the IRM term. SLHI has not incurred any new long-term debt since 2009 and its capital projects over that time period have been self-funded. However, there is new long-term debt requested as part of the current application (with respect to financing the new line truck). A falling debt to equity ratio raises no immediate concerns and the explanation provided by SLHI is consistent with the related aspects of its application.

Finally, SLHI's achieved return on equity (ROE) has varied over the years from higher than the OEB deemed amount in the early years to lower than the OEB deemed amount in the later years. In 2016, SLHI under-achieved relative to the deemed ROE by 3.82%. This is outside the 3% deadband applied by the OEB that could trigger a regulatory review. The information was available in 2017 and a regulatory review was not commenced for the following reasons. First, SLHI was due to rebase for 2018 rates. In addition, the main drivers for the under-earnings were increased OM&A expenses due to vehicle maintenance and consulting fees to prepare the DSP. There were other certain one-time expenses incurred by SLHI in 2016 that explain the under-earnings and led OEB staff to the conclusion that the under earning would not persist and that there was no threat to SLHI's ongoing financial viability.

OEB staff identified no substantive issues related to SLHI's historical financial performance. No flags are raised by the financial ratios and the related discussion provided by SLHI in its scorecard reporting.

OEB staff also notes that the results of the cost benchmarking model show that SLHI is expected to continue to fall in Group 3 for the test year. This results in an average ranking on the forecast test year cost efficiency metric in the ITM.

**Recommendation:**

There are no direct recommendations arising from OEB staff's review of SLHI's historic IRM-related benchmarking and past financial performance nor its forecast of test year cost efficiency. OEB staff observes that distributors should generally be targeting improved performance over time and OEB staff considered this, as well as the historical information and the benchmarking results to guide OEB staff's view of the applicant and the application.

### **7.3.3 Utility-Specific Special Considerations – Low Density & Large Service Territory**

SLHI is one of eight electricity distributors to which the Distribution Rate Protection program applies. This implies that SLHI, on a per-customer basis, is one of the highest cost distributors in the province. This is confirmed by a review of the OEB's 2016 yearbook of electricity distributors. Based on the 2016 yearbook of electricity distributors, SLHI has high OM&A costs per customer of \$549.11<sup>6</sup> relative to the average OM&A per customer of \$323.87.

OEB staff asked that SLHI provide additional information that explains the drivers of its high cost per customer.

SLHI explained that its revenue requirement reflects the costs associated with operating and maintaining a distribution system in a very large service territory (539 sq. km) that has very low customer density (less than 3,000 customers).

SLHI provided an illustrative example of its low density and vast service territory. SLHI noted that its 2016 pole count was just over 2,700 poles and the customer count at the end of 2016 was 2,790. This is a ratio of poles to customers of almost 1:1.

SLHI also noted that the remote nature of parts of its service territory result in higher costs per customer.

SLHI provided a brief comparative analysis of its costs to other utilities with similar sized service territories. SLHI noted that on a revenue per kWh basis, SLHI falls relatively close to other similar sized utilities. However, SLHI acknowledged that its OM&A expenses per customer are higher.<sup>7</sup> SLHI stated that even the utilities that have the most similar territory size have significantly higher customer density, which allows those utilities to spread costs over more customers.<sup>8</sup>

#### **OEB Staff Analysis: Utility-Specific Special Considerations**

SLHI operates a distribution system across a vast service area with very low customer density. SLHI's 539 sq. km service is made up of 533 sq. km of rural territory. The example of a 1:1 pole to customer

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<sup>6</sup> The OM&A costs per customer set out in the 2016 yearbook are different from what SLHI has shown its application for 2016 (\$456.06). The majority of the difference is caused by different customer counts being applied (no street light connections in the yearbook, while street light connections are included in the application).

<sup>7</sup> SLHI compared its revenue per kWh delivered and OM&A per customer metrics to Energy+ Inc. and North Bay Hydro using the OEB's 2016 Yearbook of Electricity Distributors. The analysis highlights that SLHI's revenue per kWh delivered is slightly higher and OM&A per customer is much higher than the noted distributors.

<sup>8</sup> Energy+ Inc. has 64,000 customers and North Bay Hydro has 24,000 customers compared to SLHI's 2,800 customers in similar sized service territories.



ratio is very compelling with respect to highlighting the low density nature of the service territory in which SLHI operates.

OEB staff notes that relative to its 2013 approved OM&A levels, SLHI's proposed OM&A costs have increased at a rate of just over 2% annually. Relatively speaking, SLHI has demonstrated reasonable cost control at close to the rate of inflation. In addition, the OEB has in the past approved SLHI's relatively high OM&A costs per customer recognizing the vast service area and low customer density.

**Recommendation:**

There are no direct recommendations resulting from OEB staff's analysis of the unique circumstances facing SLHI. However, in undertaking its detailed review of the application, OEB staff kept in mind SLHI's low-density service area and the related impacts that this could have on the needs of the utility.

**7.3.4 Customer Engagement**

SLHI communicates with its customers on a daily basis through its Facebook page, phone calls and face-to-face interaction at its office and out in the field. SLHI stated that, as a small utility, it is very well connected to its customers. In fact, it believes that its customers have better access to information than customers of larger utilities.

SLHI conducted generic customer satisfaction surveys in 2014 and 2016. In the 2014 survey, customers indicated that they were generally satisfied with the services provided by SLHI. In the 2016 survey, customers sought lower costs.

In mid-2017, SLHI conducted an investment and bill impact survey, which informed its customers of the main drivers of the capital and OM&A increases (and associated bill impacts) associated with its 2018 rates application. The survey reached about 5,800 people and SLHI received 48 validated responses (2% of its residential and small general service customers).

The results of the survey indicate that about 50% of SLHI's customers do not want SLHI to invest incremental capital or OM&A if it means an increase to rates. SLHI stated that in the survey (and in Facebook correspondence), many of the questions and comments put forth by customers were not related to SLHI's distribution charges. In some cases, the comments related directly to Hydro One. SLHI noted that many of the comments reflected an overall resentment towards electricity costs in the province. However, SLHI is of the view that customers are not separating SLHI's costs from the other aspects of the electricity bill.

In the future, SLHI intends to communicate with its customers, largely online, to educate as to what portion of the bill relates to SLHI's distribution costs.

Nonetheless, SLHI stated that it considered its customers concerns and attempted to keep costs increases as low as possible. SLHI reviewed all of its costs and determined which expenditures were needed to manage the utility on a long-term basis.

### **OEB Staff Analysis: Customer Engagement**

OEB staff notes that SLHI completed customer satisfaction surveys in 2014 and 2016. More recently, SLHI reached out to its customers through a survey in order to receive the necessary input to allow it to align its operational plans with its customers' needs and expectations. The results of the survey were negative towards incremental investment (both capital and OM&A) in the utility. However, based on SLHI's evidence, it seems that there was some misunderstanding in the responses as to what portion of the bill is actually impacted by SLHI's application.

OEB staff is not convinced that the customer engagement activities undertaken by SLHI in advance of filing its rates application were ideal. While surveys are helpful in determining the preferences of customers, more interactive customer engagement is necessary. A town hall meeting, for example, could have cleared up some of the confusion that SLHI's customers had with respect to the electricity bill and allowed SLHI to receive more relevant comments. OEB staff is of the view that customer engagement activities should include substantial educational components.

However, OEB staff is not recommending that the adequacy of SLHI's customer engagement activities be tested in a hearing at this time. In advance of SLHI's next cost-based application, OEB staff expects that SLHI will undertake customer engagement activities that are more comprehensive and interactive. OEB staff will monitor this issue at the time of SLHI's next rebasing application.

With respect to the comments that were received from SLHI's customers through its investment and bill impact survey, OEB staff is cognizant of SLHI's customers' frustration with the overall electricity bill. However, OEB staff does not believe that a position of no incremental investment (capital and OM&A) in the distribution system, as was suggested by a portion of SLHI's customers through the survey, is reasonable. This would lead to negative outcomes in the long run. However, OEB staff identified a few categories of capital and OM&A spending that it believes are overstated and has recommended that these issues proceed to hearing.

### **Recommendation:**

OEB staff considered SLHI's customer engagement activities and customer preferences in the context of its review of the planned expenditures proposed by SLHI throughout its application. Specifically, as noted by the responses to the investment and bill impact survey, customers had concerns with the incremental capital and OM&A spending proposed by SLHI. OEB staff is not recommending that the adequacy of SLHI's customer engagement activities be tested in a hearing at this time. OEB staff identified some areas of the proposed incremental spending that it believes are overstated and should be heard by the OEB (as discussed later in the Report).

### **7.3.5 Rate Base**

SLHI proposed a 2017 rate base of \$5,983,945, with Net Fixed Assets of \$5,286,044 and a working capital allowance of \$697,898.

SLHI provided the following summary of its rate base in its application.

Particulars	2013 Board Approved	2013 Actual	2014 Actual (CGAAP)	2014 Actual (MIFRS)	2015 Actual	2016 Actual	2017 Bridge	2018 Test
Gross Capital Assets in Service								
Opening Balance	8,391,353	8,377,574	8,632,144	8,632,144	8,815,789	9,040,878	9,291,835	9,696,925
Ending Balance	8,617,293	8,632,144	8,908,207	8,815,789	9,040,878	9,291,835	9,696,925	9,989,748
	8,504,323	8,504,859	8,770,176	8,723,967	8,928,334	9,166,357	9,494,380	9,843,337
Accumulated Depreciation								
Opening Balance	3,443,481	3,443,474	3,695,258	3,695,258	3,856,287	4,092,145	4,307,396	4,551,567
Ending Balance	3,695,577	3,695,258	3,913,273	3,856,287	4,092,145	4,307,396	4,551,567	4,563,017
	3,569,529	3,569,366	3,804,266	3,775,773	3,974,216	4,199,771	4,429,482	4,557,292
Net Capital Assets in Service:								
Opening Balance	4,947,872	4,934,100	4,936,886	4,936,886	4,959,502	4,948,733	4,984,438	5,145,358
Ending Balance	4,921,716	4,936,886	4,994,934	4,959,502	4,948,733	4,984,438	5,145,358	5,426,730
<b>Average Balance</b>	<b>4,934,794</b>	<b>4,935,493</b>	<b>4,965,910</b>	<b>4,948,194</b>	<b>4,954,118</b>	<b>4,966,586</b>	<b>5,064,898</b>	<b>5,286,044</b>
Working Capital Allowance	1,179,422	1,161,016	1,216,620	1,216,620	1,245,515	1,320,872	1,593,591	697,898
<b>Total Rate Base</b>	<b>6,114,216</b>	<b>6,096,509</b>	<b>6,182,530</b>	<b>6,164,814</b>	<b>6,199,633</b>	<b>6,287,458</b>	<b>6,658,489</b>	<b>5,983,942</b>

The proposed rate base for 2018 reflects a decrease of \$130,274 (2%) relative to the 2013 OEB-approved rate base.

The working capital allowance is based on 7.5% of Cost of Power plus controllable OM&A, which is in accordance with OEB policy (in the absence of a lead / lag study being completed).

### **OEB Staff Analysis: Rate Base**

As discussed above, SLHI's proposed 2018 rate base is a small decrease of \$130,274 (2%) relative to the 2013 OEB-approved rate base amount. Net fixed assets have increased by \$351,250 (7%) compared to the 2013 OEB-approved amount. The working capital allowance has decreased by \$481,524 (41%) relative to the 2013 OEB-approved amount.

The modest increase in net fixed assets highlights the continued investment that SLHI has made during the recent IRM period. The large reduction to the working capital allowance is a function of the OEB's policy (which reduced the working capital rate from 13% to 7.5%) and the reduced cost of power.

OEB staff asked SLHI a number of questions about its cost of power calculation. In its revised application, SLHI corrected the cost of power calculation in accordance with OEB policy and used the most recent available information. The amount discussed above reflects the corrections made.

OEB staff originally had concerns with the historic overspend on the pole replacement program and asked questions about this issue. As set out in the following table, SLHI provided an explanation for the variances between budget and actual capital spending related to the pole replacement program.

Year	Budget	Actual	Variance	Explanation
2013	\$46,922	\$66,424	\$19,502	Reference page 72 of the DSP: The Winoga Sub Cable project did not go ahead, therefore more capital was spent on pole replacements and a voltage conversion project.
2014	\$90,325	\$111,358	\$21,033	Reference page 73 of the DSP: The overage was in response to cancelling or putting on hold other planned capital projects.
2015	\$25,000	\$34,940	\$9,940	This overage is not material
2016	\$25,000	\$76,244	\$51,244	Reference page 74 of the DSP: The overage was as a result of the Asset Condition Assessment conducted.

SLHI also stated that poles are tested prior to replacement and only poles for which the useful lives cannot be extended are replaced.

While OEB staff is of the view that the test year pole replacement program is an issue, OEB staff believes that the historic capital overspend, relative to budget, on pole replacements was reasonable based on SLHI's responses. The explanation provided by SLHI highlights that it moved additional spending into this category in years where there was underspending relative to budget (2013 and 2014) in other categories (largely due to project delays). Additional investment in pole replacement was undertaken as management realized there was a need for greater investment in pole replacements during those years and there were resources available to complete the work. The overspend in 2016 was explained by the Asset Condition Assessment, which identified to SLHI management that there was a need for more pole replacements than SLHI had originally planned. SLHI confirmed that poles are tested prior to replacement (and age information is not the only indicator considered).

**Recommendation:**

Overall, OEB staff has identified no issues that need to be further explored with the calculation of the rate base amount or the historic capital spending.

OEB staff is of the view that the issue of rate base does not need to be heard. There are no direct issues remaining in this category. OEB staff believes the record is sufficient and is satisfied that the historic capital spending and the rate base calculation are reasonable. However, depending on the OEB's decision with respect to certain other issues, consequential changes may be required to the test year rate base amount (due to potential issues with the test year capital expenditure budget and the test year OM&A expenditures which impact the working capital allowance).

**7.3.6 Distribution System Plan and Capital Expenditures**

The DSP evidence was presented on a stand-alone basis, and followed the sequence and format of Chapter 5 of the OEB's filing requirements. The specific investment drivers for each category are described below. SLHI stated that its capital expenditure plan is designed to meet the objectives of the OEB's Renewed Regulatory Framework.

System Access – Capital investments in the system access category over the forecast period are driven by customer requests and mandated service obligations under the Distribution System Code (DSC). Capital spending in this category allows SLHI to satisfy its asset management objective of meeting the needs of customers and regulatory requirements. SLHI budgeted for new connections (\$60,000) and general upgrades (\$40,000) in the test year. Overall, SLHI forecasted \$100,000 of system access related capital expenditures in the test year.

System Renewal – Capital investments in the system renewal category include all like for like replacement costs related to the renewal of major assets (poles, switches, etc.) due to failure, serious damage, or end of useful life during the forecast period. SLHI has pole replacement and transformer replacement programs. Overall, SLHI forecasted \$154,000 of system renewal related capital expenditures in the test year.

System Service – System service projects are designed to improve reliability, automation and / or contingency performance. Examples of projects that would fall in this category are smart grid development and outage management systems. SLHI noted that its customers have not shown any interest in incremental spending on smart grid upgrades and SLHI has no expectations of future microFIT or FIT projects in the next five years. In addition, as is noted below, SLHI's reliability indicators are satisfactory. As such, SLHI does not have any budgeted expenditures in this category.

General Plant – Capital investments in the general plant category are designed to ensure that adequate tools as well as vehicle fleet requirements are maintained in order to meet the day-to-day operations of the utility. The major driver of SLHI's proposed test year spending is its vehicle replacement program (\$355,000) as SLHI has requested approval of the capital costs associated with the purchase of a new bucket truck in 2018. SLHI forecasted \$364,000 of general plant capital expenditures in the test year.

The total 2018 capital budget for 2018 is \$618,329. This reflects a \$298,389 increase (93%) relative to the 2013 capital expenditure budget approved in SLHI's last rebasing proceeding. However, removing the one-time increase related to the purchase of a new bucket truck (which is a very significant expenditure for a utility of SLHI's size) from the test year capital expenditure budget, the difference between 2018 proposed and 2013 approved is a \$56,611 (18%) reduction.

The following table provides SLHI's historical and forecast (2013-2022) capital expenditures by category.

CATEGORY	Historical Period (previous plan <sup>1</sup> & actual)												Forecast Period (planned)							
	2013			2014			2015			2016			2017			2018	2019	2020	2021	2022
	Plan	Actual	Var	Plan	Actual	Var	Plan	Actual	Var	Plan	Actual	Var	Plan	Actual <sup>2</sup>	Var					
\$ '000			\$ '000			\$ '000			\$ '000			\$ '000			\$ '000					
System Access	97,818	143,384	46.6%	113,000	130,459	15.5%	102,700	132,809	29.3%	102,700	110,154	7.3%	312,842		-100.0%	100,000	101,800	103,632	105,498	107,397
System Renewal	119,122	69,491	-41.7%	105,325	133,306	26.6%	80,000	73,400	-8.3%	50,000	112,481	125.0%	145,812		-100.0%	154,329	220,456	138,836	141,335	143,879
System Service		10,254	--	37,000		-100.0%	116,140	95,645	-17.6%	48,126	52,039	8.1%	48,000		-100.0%					
General Plant	103,000	96,814	-6.0%	108,500	106,668	-1.7%	39,000	30,554	-21.7%	36,900	21,011	-43.1%	69,000		-100.0%	364,000	79,000	315,000	44,000	9,000
<b>TOTAL EXPENDITURE</b>	319,940	319,943	0.0%	363,825	370,433	1.8%	337,840	332,408	-1.6%	237,726	295,685	24.4%	595,654		-100.0%	618,329	401,256	557,468	290,833	260,276
System O&M		\$750,206	--		\$772,525	--		\$686,231	--		\$769,028	--		\$777,712	--	\$742,406	\$767,525	\$746,462	\$752,364	\$768,225

The table below highlights SLHI's historic system reliability statistics.

Index	Including outages caused by loss of supply					Excluding outages caused by loss of supply					Excluding Major Event Days				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
SAIDI	0.530	4.730	6.180	11.220	25.280	0.470	0.230	1.280	0.680	1.740	0.470	0.230	1.280	0.680	0.670
SAIFI	1.180	1.280	3.690	2.360	5.180	0.170	0.280	0.740	0.360	1.180	0.170	0.280	0.740	0.360	0.570

5 Year Historical Average

SAIDI						9.588					0.880					0.666
SAIFI						2.738					0.546					0.424

SAIDI = System Average Interruption Duration Index  
SAIFI = System Average Interruption Frequency Index

The table below highlights SLHI's historic service quality statistics.

Indicator	OEB Minimum Standard	2012	2013	2014	2015	2016
Low Voltage Connections	90.0%	96.4%	95.0%	100.0%	100.0%	100.0%
High Voltage Connections	90.0%	n/a	n/a	n/a	n/a	n/a
Telephone Accessibility	65.0%	98.1%	99.0%	100.0%	96.0%	94.0%
Appointments Met	90.0%	92.9%	98.5%	98.2%	96.2%	91.7%
Written Response to Enquires	80.0%	100.0%	97.0%	100.0%	98.0%	100.0%
Emergency Urban Response	80.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Emergency Rural Response	80.0%	100.0%	100.0%	100.0%	100.0%	n/a
Telephone Call Abandon Rate	10.0%	0.6%	0.0%	0.0%	2.0%	2.8%
Appointment Scheduling	90.0%	100.0%	100.0%	98.0%	100.0%	93.3%
Rescheduling a Missed Appointment	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Reconnection Performance Standard	85.0%	100.0%	100.0%	100.0%	100.0%	100.0%

### OEB Staff Analysis: DSP and Capital Expenditures

#### DSP

Overall, in OEB staff's view SLHI filed a well-written and comprehensive DSP. OEB staff notes that the DSP is well supported by a detailed asset management plan. In OEB staff's opinion, the DSP provides sufficient rationale for most of the capital spending proposed throughout the forecast period.

SLHI participated in a number of regional planning consultations leading up to the filing of its 2018 rates application.<sup>9</sup> SLHI considered the regional planning issues when developing its DSP, but there were no direct impacts that arose from the consultations that SLHI needed to address in its DSP. OEB staff is of

<sup>9</sup> SLHI participated in consultations with Hydro One and the Independent Electricity System Operator (IESO). SLHI was also involved in the West of Thunder Bay Regional Planning Process and holds regular meetings with developers operating in the region.

view that SLHI adequately considered whether regional planning issues needed to be addressed in its DSP.

SLHI's interactions with its customers were also considered in the development of its DSP. As an example, SLHI's customers stated that they would not support an increase to rates in order to have improved communication options during outages, and SLHI is not pursuing those options as part of its DSP.

With respect to SLHI's planned pole replacement program, originally OEB staff was concerned that only age information was being used. However, through discussions with SLHI and its responses to OEB staff's questions<sup>10</sup>, it is clear that age information is used only as starting point to consider whether a pole replacement may be required. Additional testing with respect to the actual condition of older poles is then performed to determine whether a pole replacement is required.

OEB staff was also concerned that pole refurbishment was not considered by SLHI as an alternative to pole replacement. SLHI explained that, while refurbishment is rare, it is considered in certain situations where appropriate.

OEB staff also confirmed with SLHI that a run-to-fail strategy is used with respect to transformers and meters, which is an appropriate strategy for those categories of capital spending in the context of SLHI's distribution system.

OEB staff believes that the responses provided by SLHI sufficiently explained how it considers the need for capital spending and highlighted that its decision making process is driven by asset condition (and not simply asset age).

### Capital Expenditures

For the forecast period (2018-2022), OEB staff is of the view that the proposed capital expenditure budget is largely reasonable. There is a movement of spending away from system access and system service categories largely into the general plant category (to meet vehicle replacement requirements) to reflect SLHI's planned need for capital expenditures.

OEB staff notes that SLHI received an average score on most of the quantitative metrics associated with capital expenditures in the ITM. On the pacing of investments (forecast) metric, SLHI received an unsatisfactory score, which is explained by the vehicle replacement program having a very substantial impact on SLHI's overall capital budget (as discussed in more detail later). However, even with the understanding that it is the vehicle replacement program impacting the pacing of investments, this issue is a concern for OEB staff.

### *Specific Project Review*

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<sup>10</sup> [SLHI responses to OEB staff questions, November 14, 2017, p. 18.](#)

OEB staff reviewed the individual projects that comprise the proposed capital expenditures in the test year and the forecast period. The following is a more detailed list of the capital expenditures proposed for the forecast period.

Investment Category	Project	Forecast Years				
		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
<b>Total:</b>		<b>100,000</b>	<b>101,800</b>	<b>103,632</b>	<b>105,498</b>	<b>107,397</b>
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			
<b>Total:</b>		<b>154,329</b>	<b>220,456</b>	<b>138,836</b>	<b>141,335</b>	<b>143,879</b>
<b>System Service</b>						
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			
<b>Total:</b>		<b>364,000</b>	<b>79,000</b>	<b>315,000</b>	<b>44,000</b>	<b>9,000</b>
<b>Total:</b>		<b>618,329</b>	<b>401,256</b>	<b>557,468</b>	<b>290,833</b>	<b>260,276</b>

OEB staff originally had concerns with three programs / projects proposed for the forecast period.

First, with respect to the planned 2019 underground cable replacement project, OEB staff asked questions about the need for this project. SLHI explained that while the cables are considered to be in “fair” condition this actually means that there is a moderate risk of failure due to water treeing. As such, SLHI believes that there is a risk of cable failure and given the consequences of failure in the winter it is important to proactively replace these cables. After more information<sup>11</sup> was provided about the project and the potential consequences, OEB staff believes no issues remain with respect to this project.

Second, OEB staff reviewed the vehicle replacement program in some detail as it is a major driver of the overall increase in proposed capital expenditures during the test year and the forecast period. The vehicle replacement scheduled for 2018 (\$355,000) is related to the replacement of a 2001 Freightliner truck. The existing truck is 17 years old and is considered to be in replacement condition. SLHI filed a letter from the chief mechanic of Sioux Lookout’s public works department recommending replacement of the vehicle. OEB staff notes that the vehicle has moderate mileage on it but has a large number of service hours. The annual maintenance expenses on this truck have increased from about \$7,000 in 2011 to \$22,000 in 2016. In OEB staff’s view, this is an indicator that replacement is a cost-efficient option. Therefore, OEB staff believes that the replacement of this vehicle does not raise any issues that need to go to hearing.

<sup>11</sup> [SLHI responses to OEB staff questions, November 14, 2017, p. 19.](#)



OEB staff also reviewed, and asked questions, regarding the vehicle replacement scheduled for 2020. The 2020 vehicle replacement is related to a 2013 Altec bucket truck. This truck has relatively low mileage, modest hours of operation and is considered to be in good condition. However, in its responses to OEB staff's questions, SLHI highlighted that the annual maintenance costs have increased from about \$6,000 in 2015 to \$15,000 in 2017. Most importantly, this truck was acquired on a 7-year lease, which expires in 2020. SLHI noted that it has had problems with the truck since acquisition. In the context that 2020 is the expiry year for the lease and the truck has had problems throughout its history, OEB staff is of the view that there is no compelling reason to buy out the existing truck at the end of the lease (and likely incur ever increasing maintenance costs). As such, the replacement of the existing 2013 Altec bucket truck with the purchase of a new truck seems reasonable.

Finally, with respect to the pole replacement program (including planned primary and secondary pole replacements and unplanned pole replacements), OEB staff is of the view that the proposed test year spending is not appropriate. For 2018, SLHI proposed \$130,000 in pole replacements. During the historic period (2013-2017)<sup>12</sup>, the average annual expenditure for pole replacements was about \$79,000. OEB staff understands that an incremental amount above the historic period average for the test year could be appropriate but \$51,000 seems excessive. The average annual expenditure for pole replacements for the forecast period (excluding the test year) 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). However, OEB staff is the view that a reduced budget for the test year would adequately support the planned replacement of both primary and secondary poles and necessary unplanned replacements.

#### *Comparison of Proposed Forecast Period Capital Budget to Historic Capital Budget*

Comparing capital expenditures between the 2013-2017 historic period (average \$382,824 annually) and the forecast 2018-2022 period (average \$425,632 annually) highlights that forecast capital expenditures have increased by \$42,808 (11%) on an average annual basis.

As discussed previously, it is the vehicle replacement program that is driving the overall capital budget increase. Removing the impact of the capital costs of the two major vehicle replacements (\$355,000 in 2018 and \$300,000 in 2020), results in an average annual capital budget for the forecast period of \$294,632. This reflects a reduction compared to the historic period average of \$88,192 (23%).

OEB staff also compared the historic and forecast periods by removing all vehicle replacements in both periods to understand the change in spending across all non-vehicle replacement programs. This analysis highlights that the average expenditures for the forecast period are about \$70,000 (20%) lower

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<sup>12</sup> 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.

than the 2013-2017 historic period capital expenditures. This decrease is largely caused by there being no proposed spending on system service projects in the forecast period, whereas in the historical period a number of distinct system service projects were completed. SLHI explained that it has no system service projects that it needs to complete during the forecast period as its customers are not interested in incremental spending on smart grid upgrades and it has no MicroFIT or FIT connections expected in the next five years. In addition, OEB staff did not identify any major issues with system reliability as discussed later in the Report.

OEB staff has identified no issues with the overall level of capital spending proposed during the forecast period, with the exception of the pole replacement program discussed previously.

### *Pacing of Investments*

SLHI's proposed annual capital budgets during the forecast period (2018-2022) are not well paced on an aggregate basis. However, 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 in-service during a single year cause unavoidable instability in the pacing of capital expenditures. The vehicle replacement program is also the cause of the unsatisfactory score on the pacing of forecast capital investments metric in the ITM.

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 (and this explains the poor score on the relevant metric in the ITM).

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 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). As such, OEB staff is of the view that it may be 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.

### System Reliability and Service Quality

SLHI’s overall system reliability trend is higher than its five-year historic baseline average (resulting in a poor score on the system reliability trend vs. baseline metric in the quantitative component of the ITM). This is due to two years (2014 and 2016) where SLHI’s system reliability metrics were higher than the five-year average (when reviewing the reliability performance excluding loss of supply and major events). In its evidence, SLHI explained that in those two years there was increased storm activity, which led to increased outages caused by tree contact.

SLHI stated that it has a robust tree trimming program (\$65,000 proposed for 2018 and an average of \$73,000 over the historic period on an actual basis) and OEB staff agrees. However, due to the characteristics of its service territory (low-density and rural) and the unpredictability of weather, the SAIDI and SAIFI measures fluctuate year-to-year. When looking at tree contact as a cause for service interruptions (table copied below – 2012-2016 left to right), it is clear that tree contact is quite volatile. In 2014 & 2016 tree contacts are high and in 2013 & 2015 they are low. This leads to the conclusion that storm activity is key driver of tree contact related service interruptions. While a good vegetation management program is useful to avoiding tree contact based interruptions, storm activity can still have a large impact.

<b>Tree Contacts</b>	# of Interruptions	-	6	17	6	15
	# of Customer Interruptions	-	208	1,490	52	2,098
	# of customer Hours of Interruptions	-	156.93	2,526.95	65.72	3,513.30

Overall, while SLHI scored poorly on the service reliability trend in the quantitative model in the ITM, the reasons for that performance are well explained by SLHI, in OEB staff’s view. OEB staff expects that SLHI’s reliability performance will continue to be volatile year-to-year but is overall not an issue given the area SLHI serves. OEB staff will continue to assess reliability performance on an ongoing basis and also in the next cost-based application. If any major problems with system reliability become known to OEB staff through the reporting that SLHI is required to file annually, the OEB can address the issue as appropriate.

With respect to service quality, OEB staff notes that SLHI has surpassed the OEB’s minimum standards in all categories and all years. Therefore, there are no issues with service quality.

**Recommendation:**

OEB staff is of the view that for most of the issues in this category, the record is sufficient to allow the OEB to make a finding as to the prudence of the proposed capital expenditures. The DSP provides sufficient rationale supporting the majority of the capital spending proposed for the forecast period. OEB staff believes that all of the test year capital expenditures are reasonable, with the exceptions of two issues discussed below. OEB staff also believes that no issues need to go to hearing regarding SLHI’s historic service quality and reliability performance.

OEB staff recommends that only two narrow issues with respect to the capital expenditure budget should proceed to a written hearing:

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

OEB staff suggests that no further discovery of these issues is necessary, as the application and SLHI's written responses create an adequate record. OEB staff believes that these two narrow issues can be dealt with through written argument. If the OEB were to adjust the capital expenditures from the proposals in the revised application, certain changes to the test year rate base amount and resulting revenue requirement would be required. There are no other issues related to the DSP or proposed capital expenditures for which OEB staff believe that a hearing is required.

### **7.3.7 Load Forecast and Other Revenue**

SLHI used the same regression methodology as was used in its 2013 rebasing proceeding as the starting point to prepare its weather normalized load and customer / connection forecast. The analysis utilized data from the 2007-2016 period. The analysis used all of the same variables as were used in the 2013 rebasing proceeding with the exception of Ontario Real GDP and Cooling Degree Day variances as they were not found to be statistically significant. Also, a Spring / Fall flag was added as it was deemed to be statistically significant. SLHI noted that the regression analysis used in its application is the same as was used by a number of other distributors in recent cost of service rebasing proceedings.

Overall, as shown in the table below, the total customer / connection count has increased by 79 customers (2.4%) between 2018 forecast and 2013 OEB-approved. The load forecast has decreased by 13,303 kWhs (<0.001%) relative to 2013 OEB-approved. Therefore, the load forecast for 2018 is basically unchanged when compared to the 2013 OEB-approved forecast. However, when comparing the 2018 load forecast to 2013 - 2015 actuals, there is a relatively large reduction (about 9%-16%). This reflects the fact that a pulp mill was in operation in 2013 to 2015 and is not expected to be in operation in 2018.

	2012 Actual	2013 Board Approved	2013 Actual	2014 Actual	2015 Actual	2016 Actual	2017 Bridge Normalized	2018 Normalized
Actual kWh Purchases	75,601,634		87,692,323	89,519,317	83,393,451	75,446,075		
Predicted kWh Purchases before CDM Adjustment	74,011,078		83,909,767	83,421,893	78,970,189	77,515,297	76,703,579	76,703,579
% Difference	-2.1%		-4.3%	-6.8%	-5.3%	2.7%		
Losses							(3,585,479)	(3,585,479)
CDM Adjustment Billed							(353,500)	(1,054,000)
Billed kWh After CDM	71,922,866		83,168,941	85,548,133	79,338,527	70,815,698	72,764,601	72,064,101
By Class								

**Sioux Lookout Hydro Inc.**  
**2018 Cost of Service**  
**EB-2017-0073**

<b>Residential</b>								
Customers	2,344	2,323	2,346	2,356	2,357	2,374	2,380	2,386
kWh	32,285,778	35,413,349	36,371,059	37,207,390	33,751,334	32,668,225	33,524,773	32,918,746
<b>GS&lt;50</b>								
Customers	395	386	400	404	404	402	402	402
kWh	11,883,435	13,104,863	12,926,388	13,500,466	12,579,056	11,845,271	12,143,659	11,931,508
<b>GS&gt;50</b>								
Customers	52	51	53	52	51	51	52	53
kWh	27,280,733	23,046,182	33,352,062	34,318,921	32,657,665	26,151,605	26,945,572	27,063,250
kW	66,215	58,143	92,251	99,288	94,899	66,975	71,869	72,183
<b>Streetlights</b>								
Connections	532	531	532	534	532	531	531	531
kWh	468,216	501,465	517,279	519,121	348,985	150,597	150,597	150,597
kW	1,447	1,512	1,450	1,454	1,104	420	420	420
<b>USL</b>								
Connections	2	2	1	1	1	0	0	0
kWh	4,705	11,545	2,154	2,235	1,488	0	0	0
<b>Total of Above</b>								
Customer/Connections	3,325	3,293	3,332	3,347	3,344	3,358	3,365	3,372
kWh	71,922,866	72,077,404	83,168,941	85,548,133	79,338,527	70,815,698	72,764,601	72,064,101
kW from applicable classes	67,662	59,655	93,701	100,742	96,003	67,395	72,289	72,603

The total proposed other revenue amount is \$121,197 and is detailed in the following table.

USoA #	USoA Description	2013 Actual <sup>2</sup>	2014 Actual <sup>2</sup>	2014 Actual <sup>2</sup>	2015 Actual <sup>2</sup>	2016 Actual <sup>2</sup>	Bridge Year	Test Year
		CGAAP	CGAAP	2014 MIFRS	2015 MIFRS	2016 MIFRS	2017 MIFRS	2018 MIFRS
	<b>Reporting Basis</b>							
4235	Specific Service Charges	\$ 17,685	\$ 18,275	\$ 18,275	\$ 17,770	\$ 17,965	\$ 18,000	\$ 18,000
4225	Late Payment Charges	\$ 38,447	\$ 52,424	\$ 52,424	\$ 46,091	\$ 48,897	\$ 47,656	\$ 49,498
4086	SS Revenue	\$ 8,140	\$ 8,049	\$ 8,049	\$ 7,901	\$ 8,135	\$ 8,463	\$ 8,484
4210	Rent from Electric Property	\$ 42,859	\$ 42,949	\$ 42,949	\$ 47,261	\$ 45,333	\$ 49,413	\$ 50,247
4215	Other Utility Operating Income	\$ -	\$ 1,000	\$ 1,000				
4245	Gov't Assist Directly Credit to Income	\$ -	\$ -	\$ 1,293	\$ 2,497	\$ 2,477	\$ 4,955	\$ 7,468
4360	Loss on Disposition of Utility & Other Property	-\$ 1,167	-\$ 6,074	-\$ 6,074				
4362	Loss on Retirement of Utility & Other Property				-\$ 2,042	-\$ 1,337	-\$ 1,690	-\$ 16,000
4375	Revenue from Non-Utility Operations	\$ 85,375	\$ 145,790	\$ 145,790	\$ 219,152	\$ 87,633		
4380	Expense from Non-Utility Operations	-\$ 85,375	-\$ 145,790	-\$ 145,790	-\$ 174,458	-\$ 87,366		
4385	Non-Utility Rental Income	\$ 10,951	\$ 10,952	\$ 10,952	\$ 10,724	\$ 11,365	\$ 10,989	\$ 11,500
4405	Interest and Dividend Income	\$ 4,762	\$ 3,055	\$ 3,055	\$ 2,138	\$ 2,578	\$ 3,133	\$ 3,500
	<b>Specific Service Charges</b>	\$ 17,685	\$ 18,275	\$ 18,275	\$ 17,770	\$ 17,965	\$ 18,000	\$ 18,000
	<b>Late Payment Charges</b>	\$ 38,447	\$ 52,424	\$ 52,424	\$ 46,091	\$ 48,897	\$ 47,656	\$ 49,498
	<b>Other Operating Revenues</b>	\$ 50,998	\$ 51,998	\$ 53,290	\$ 57,658	\$ 55,945	\$ 62,831	\$ 66,199
	<b>Other Income or Deductions</b>	\$ 3,595	-\$ 3,019	-\$ 3,019	\$ 44,790	\$ 1,508	\$ 1,444	-\$ 12,500
	<b>Total</b>	\$ 110,725	\$ 119,677	\$ 120,970	\$ 166,309	\$ 124,315	\$ 129,931	\$ 121,197

The proposed 2018 other revenue amount reflects a decrease of \$7,828 (6%) relative to 2013 OEB-approved and an increase of \$10,472 (9%) relative to 2013 actual.

**OEB Staff Analysis: Load Forecast and Other Revenue**

**Load Forecast**

OEB staff is of the view that the load forecast provided by SLHI is reasonable. The customer / connection and weather normalized load forecast developed by SLHI is based on an acceptable methodology. OEB staff is also of the view that the manual CDM adjustment was applied correctly in the load forecast.

OEB staff was originally concerned that a regression for each rate class was not undertaken. OEB staff asked SLHI about the potential to run a regression for each rate class (as opposed to on a utility-wide basis). SLHI explained that it did perform a separate regression for each rate class in its 2013 rebasing application. However, based on the statistical results of the rate class specific regression analysis that was performed at that time, SLHI concluded that a rate class-specific regression is not as accurate as the utility-wide regression. As there were no significant changes between 2013 and 2018, SLHI stated that there is no reason that the conclusion would change. OEB staff is satisfied by the response and believes that the methodology used by SLHI is reasonable in the circumstances.

OEB staff remains concerned about the potential for the pulp mill related load to come back online during the forecast period as this would have a significant impact on the load forecast. OEB staff notes that the 2013 load forecast approved by the OEB as part of SLHI's last rebasing proceeding reflected the pulp mill not being in service. However, the mill did return to service in early 2013 at a reduced capacity and continued to operate until mid-2015.

SLHI stated, in response to an OEB staff question, that there is no expectation that the load from the mill will come online during the forecast period. However, it noted that it would be willing to track any revenues that do occur due to the mill returning to service for eventual disposition to customers in a future proceeding<sup>13</sup>.

### Other Revenues

OEB staff has found no issues with the proposed other revenue amount. OEB staff notes that the proposed other revenue amount reflects a small increase of \$10,472 relative to 2013 actual amount. It also properly reflects the correction of an error related to the treatment of a loss on disposal of assets.<sup>14</sup>

### **Recommendation:**

OEB staff is of the view that the record for the issues of load forecast and other revenue is sufficient, and that the record demonstrates that the proposals are reasonable. OEB staff notes that SLHI offered to establish a deferral account to capture incremental revenues that may arise if the pulp mill returns to operation during the forecast period. OEB staff is of the view that the OEB needs to determine whether the account should be established (and how it should be designed) as it does not form part of the formal proposals set out in SLHI's application. As such, OEB staff recommends that the following issue proceed to a written hearing:

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<sup>13</sup> [SLHI responses to OEB staff questions, November 14, 2017, p. 22.](#)

<sup>14</sup> [SLHI responses to OEB staff questions, November 14, 2017, p. 8.](#)

- 1)
- a. Should a deferral account be established to record incremental revenues (and related costs) that may arise if the pulp mill returns to operation during the forecast period?
  - b. If so, how should the account be designed and when should it be disposed?

OEB staff recommends that no further discovery of this issue is necessary, as the application and SLHI's written responses create an adequate record. OEB staff is of the view that this issue can be dealt with through written argument. There are no other issues related to load forecasting or other revenue for which OEB staff believe that a hearing is required.

### 7.3.8 Operating Costs

SLHI proposed OM&A expenses of \$1,580,086 for 2018 (including property taxes and LEAP funding). The following table contains the OM&A amounts for 2013 OEB-approved, 2013 to 2016 actual, the 2017 bridge year and the 2018 test year. Overall, there is an increase of \$158,840 (11%) relative to the 2013 OEB-approved OM&A amount.

	Last Rebasing Year (2013 Board- Approved)	Last Rebasing Year (2013 Actuals)	2014 Actuals	2015 Actuals	2016 Actuals	2017 Bridge Year	2018 Test Year
Operations	\$ 543,617	\$ 535,159	\$ 581,576	\$ 526,730	\$ 574,153	\$ 540,346	\$ 514,586
Maintenance	\$ 201,605	\$ 215,047	\$ 190,949	\$ 159,501	\$ 194,875	\$ 236,866	\$ 226,447
Billing and Collecting	\$ 316,965	\$ 296,239	\$ 310,022	\$ 329,917	\$ 351,771	\$ 350,791	\$ 355,718
Community Relations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Administrative and General	\$ 359,059	\$ 374,136	\$ 357,354	\$ 404,099	\$ 410,646	\$ 499,606	\$ 483,335
<b>Total</b>	<b>\$ 1,421,246</b>	<b>\$ 1,420,581</b>	<b>\$ 1,439,901</b>	<b>\$ 1,420,247</b>	<b>\$ 1,531,445</b>	<b>\$ 1,627,609</b>	<b>\$ 1,580,086</b>
%Change (year over year)			1.3%	0.0%	7.8%	6.3%	-2.9%

SLHI provided a summary analysis of the contributing drivers for the increase in OM&A. SLHI set out a large number of reasons for its proposed increase to the OM&A expense in the test year (as compared to the 2013 approved amount). These incremental OM&A expenses include (but are not limited to):

- Increased mapping expenditures
- Additional maintenance of overhead wires (including tree trimming)
- Additional billing costs (including bank and merchant fees)
- Additional other administrative and general expenses

SLHI's unitized costs per customer are set out in the following table.

	Last Rebasing Year - 2013- Board Approved	Last Rebasing Year - 2013- Actual	2014 Actuals	2015 Actuals	2016 Actuals	2017 Bridge Year	2018 Test Year
<b>Reporting Basis</b>	<b>CGAAP</b>	<b>CGAAP</b>	<b>MIFRS</b>	<b>MIFRS</b>	<b>MIFRS</b>	<b>MIFRS</b>	<b>MIFRS</b>
OM&A Costs							

O&M	\$ 707,676	\$ 750,206	\$ 772,525	\$ 686,231	\$ 769,028	\$ 777,212	\$ 741,033
Admin Expenses	\$ 713,570	\$ 670,375	\$ 667,376	\$ 734,016	\$ 762,417	\$ 850,397	\$ 839,053
Total Recoverable OM&A from Appendix 2-JB <sup>5</sup>	\$ 1,421,246	\$ 1,420,581	\$ 1,439,901	\$ 1,420,247	\$ 1,531,445	\$ 1,627,609	\$ 1,580,086
Number of Customers <sup>2,4</sup>	3,293	3,332	3,347	3,345	3,358	3,365	3,372
Number of FTEs <sup>3,4</sup>	9	9	9	9.35	9.35	9.06	8.35
Customers/FTEs	365.89	370.22	371.89	357.75	359.14	371.41	403.83
OM&A cost per customer							
O&M per customer	214.90	225.15	230.81	205.15	229.01	230.97	219.76
Admin per customer	216.69	201.19	199.40	219.44	227.04	252.72	248.83
Total OM&A per customer	431.60	426.34	430.21	424.59	456.06	483.69	468.59
OM&A cost per FTE							
O&M per FTE	78,630.67	83,356.22	85,836.11	73,393.69	82,248.98	85,784.99	88,746.47
Admin per FTE	79,285.56	74,486.11	74,152.89	78,504.39	81,541.93	93,862.80	100,485.39
Total OM&A per FTE	157,916.22	157,842.33	159,989.00	151,898.07	163,790.91	179,647.79	189,231.86

The OM&A per customer increased by \$36.99 (9%), the number of customers per FTE increased by 37.94 (10%), and the OM&A per FTE increased by \$31,316 (20%) as compared to the 2013 OEB-approved amounts. The FTE-related increases are due to the small number of staff and the fact that there is one less employee forecast for 2018 compared to its most recent rebasing.

SLHI forecast eight staff members for 2018 and at the time of its last rebasing it had nine staff members. SLHI had two employees retire partway through 2017 and hired one replacement employee (apprentice lineman) during that same year.

Over the historical period, increases in compensation costs were largely associated with: (a) annual inflationary increases to wages for both union and non-union employees; and (b) employees progressing through their apprenticeship programs. Overall, compensation expenses forecast for 2018 reflect an increase of \$40,270 (5%) relative to 2013 OEB-approved.

A summary of SLHI's employee count and compensation costs are set out in the table below.

	Last Rebasings Year - 2013- Board Approved	Last Rebasings Year - 2013- Actual	2014 Actuals	2015 Actuals	2016 Actuals	2017 Bridge Year	2018 Test Year
<b>Number of Employees (FTEs including Part-Time) <sup>1</sup></b>							
Management (including executive)	2	2	2	2	2	2	1
Non-Management (union and non-union)	7.00	7.00	7.00	7.35	7.35	7.35	7.35
Total	9	9	9	9	9	9	8
<b>Total Salary and Wages including overtime and incentive pay</b>							
Management (including executive)							
Non-Management (union and non-union)	\$ 641,205	\$ 663,689	\$ 690,077	\$ 731,695	\$ 764,396	\$ 727,718	\$ 672,391
Total	\$ 641,205	\$ 663,689	\$ 690,077	\$ 731,695	\$ 764,396	\$ 727,718	\$ 672,391
<b>Total Benefits (Current + Accrued) <sup>2</sup></b>							
Management (including executive)							
Non-Management (union and non-union)	\$ 144,240	\$ 118,919	\$ 119,138	\$ 133,851	\$ 154,266	\$ 156,758	\$ 153,324
Total	\$ 144,240	\$ 118,919	\$ 119,138	\$ 133,851	\$ 154,266	\$ 156,758	\$ 153,324
<b>Total Compensation (Salary, Wages, &amp; Benefits)</b>							
Management (including executive)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Non-Management (union and non-union)	\$ 785,445	\$ 782,608	\$ 809,215	\$ 865,546	\$ 918,662	\$ 884,476	\$ 825,715
Total	\$ 785,445	\$ 782,608	\$ 809,215	\$ 865,546	\$ 918,662	\$ 884,476	\$ 825,715

The 2018 test year OM&A expenses include one-fifth of the one-time regulatory costs associated with the 2018 cost of service application. SLHI is forecasting one-time regulatory costs of about \$120,000, which will be recovered over a 5-year period in accordance with OEB policy. As such, SLHI included about \$24,000 in the test year OM&A expenses.



SLHI also included \$2,600 in its other OM&A budget for LEAP funding. The amount is based on 0.12% of the proposed revenue requirement in accordance with OEB policy.

SLHI set out its formal capitalization policy in its application. SLHI converted to IFRS on January 1, 2015 (with 2014 being the transition year). SLHI also filed the necessary depreciation and amortization expense schedules to support its proposed depreciation expense of \$234,839.

SLHI has two categories of assets (overhead conductors & devices and current & potential transformers) for which the useful lives used in the depreciation calculation fall outside the Kinectrics Report range. SLHI noted that the useful lives applied to these asset categories were previously approved by the OEB.

SLHI's 2018 grossed-up tax amount is calculated at \$23,000 and SLHI filed the PILs workform.

### **OEB Staff Analysis: Operating Costs**

OEB staff is of the view that overall, the requested increase to the OM&A budget is moderate. It reflects a modest increase of \$158,840 (11%) relative to the 2013 OEB-approved budget and an increase of \$48,641 (3%) compared to the 2016 actual amount. For the most part, SLHI provided detailed rationale supporting the proposed changes to its OM&A budget. SLHI also scored reasonably well on the ITM metrics associated with operating costs.

The decrease in employee compensation between 2018 and 2017 is driven by a retirement offset by a relatively standard 2% increase in wages (which is based on the likely outcome of the collective agreement negotiation).

SLHI has no affiliates and therefore there are no issues associated with shared services or corporate cost allocation.

OEB staff was concerned with a lack of support in the application for a few areas of the OM&A budget and asked for additional details. OEB staff was satisfied with the responses with respect to the tree trimming budget, underground cable maintenance budget, monthly billing system charges applied by Thunder Bay Hydro, and the other administration and general cost category.

However, OEB staff believes issues remain for the proposed budget increases in the following categories: (a) bank and merchant fees; (b) ongoing regulatory costs associated with resources allocated to regulatory matters; and (c) one-time costs related the 2018 cost of service application.

The bank and merchant fees have increased from \$50,197 in 2013 (actual) to \$84,068 in 2018 (proposed). This reflects an increase of \$33,871 (67%) in 5 years. 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. OEB staff is of the view that the containment of cost increases associated with third-party vendors is the responsibility of the utility. OEB staff is of the view that the proposed amount requested for bank and merchant fees should be further addressed.

SLHI proposed an ongoing regulatory cost budget for the 2018 test year of \$40,000. When asked about this request, SLHI stated that it will cost at least \$40,000 in consulting fees a year in order to meet incremental regulatory policy direction. The small number of employees that SLHI has means that more often than not outside assistance is required to prepare information or implement new policies. As an example, SLHI noted that it does not have the internal expertise required to deal with new cyber security requirements. SLHI also mentioned bill redesign, net metering and the Green Button Initiative as potential drivers of the requested incremental funding.

SLHI provided the following table highlighting its actual historic costs in this category of proposed spending.

	<b>2015</b>
OESP implementation	<b>\$10,931</b>
Consulting fees - Asset Condition Assessment (ACA)	<b>\$19,000</b>
Total	<b>\$29,931</b>
	<b>2016</b>
Consulting fees - DSP and ACA	<b>\$17,865</b>
Public Safety Awareness Survey	<b>\$7,875</b>
Total	<b>\$25,740</b>
	<b>2017 (To date)</b>
OFHP inserts and billing changes	<b>\$675</b>
Consulting fees - DSP	<b>\$28,749</b>
Consulting fees - COS Application	<b>\$10,382</b>
Total	<b>\$39,806</b>

SLHI confirmed that the consulting fees related to the Asset Condition Assessment and the DSP are included in the current application as part of the one-time costs related to the 2018 cost of service application. Therefore, OEB staff notes that SLHI has never spent more than about \$11,000 in a single year for ongoing regulatory costs (that are not related to a cost of service application).

SLHI acknowledged that it is hard to forecast costs in this category of OM&A expenses but it does believe that there will be a need for incremental funding for these types of activities in the future. OEB staff agrees that some level of incremental funding is likely appropriate but \$40,000 does not seem reasonable.

With respect to the one-time costs associated with SLHI's cost of service application, SLHI stated that these costs may be reduced depending on the regulatory process that is eventually applied to the application. Specifically, SLHI noted that its legal and intervenor costs could be decreased relative to its

proposed budget. OEB staff is of the view that the issue of the appropriate one-time costs associated with this cost of service application should proceed to a written hearing. These costs will be subject to change depending on the OEB's decision on the scope of issues to proceed to hearing, the procedural steps that will be applied, and the determination as to whether cost eligibility for intervenors will be granted.

OEB staff notes that it identified no issues with the proposed LEAP funding amount, the depreciation expense or the PILs calculation. OEB staff notes that the grossed-up tax amount was updated in the revised application due to some technical errors that were present in the originally filed application.

**Recommendation:**

OEB staff has identified only a few issues with the proposed operating costs for the 2018 test year. OEB staff is of the view that, for the most part, the proposed OM&A budget is well supported by the evidence in the revised application and the responses to OEB staff's questions.

However, OEB staff recommends that the following two discrete issues proceed to a written hearing:

- 1) Is the proposed 2018 test year budget for bank and merchant fees appropriate?
- 2)
  - a. Is the proposed 2018 test year budget for ongoing regulatory costs associated with resources allocated to regulatory matters appropriate?
  - b. Are the one-time costs related to this cost of service application appropriate in the context of the regulatory process that is applied to SLHI's application?

OEB staff believes the evidentiary record is sufficient on these issues and recommends that these issues be dealt with through written argument. There are no other issues related to operating costs for which OEB staff believe that a hearing is required.

OEB staff notes that certain adjustments to the proposed tax amount and the proposed depreciation expense would be required if the OEB changes other aspects of the application after a hearing.

**7.3.9 Cost of Capital**

SLHI's proposed cost of capital is set out in the following table.

		Year: 2018			
Line No.	Particulars	Capitalization Ratio		Cost Rate	Return
		(%)	(\$)	(%)	(\$)
	<b>Debt</b>				
1	Long-term Debt	58.00%	\$3,351,009	4.24%	\$142,083
2	Short-term Debt	4.00% (1)	\$239,358	2.29%	\$5,481
3	<b>Total Debt</b>	<b>60.0%</b>	<b>\$3,590,367</b>	<b>4.11%</b>	<b>\$147,564</b>
	<b>Equity</b>				
4	Common Equity	40.00%	\$2,393,578	9.00%	\$215,422
5	Preferred Shares		\$ -		\$ -
6	<b>Total Equity</b>	<b>40.0%</b>	<b>\$2,393,578</b>	<b>9.00%</b>	<b>\$215,422</b>
7	<b>Total</b>	<b>100.0%</b>	<b>\$5,983,945</b>	<b>6.07%</b>	<b>\$362,986</b>

SLHI used the OEB-approved deemed capital structure, the current OEB-approved deemed short-term debt rate and the current OEB-approved return on equity (ROE) in its revised application. The long-term debt rate is calculated as a weighted average of SLHI's actual and forecast long-term debt.

### **OEB Staff Analysis: Cost of Capital**

SLHI calculated the cost of capital for 2018 in accordance with OEB policy (using the deemed capital structure, deemed short-term debt rate, deemed ROE, and a weighted average of actual and forecast long-term debt). OEB staff identified no issues with SLHI's calculation of the cost of capital.

OEB staff notes that SLHI updated its application using a revised weighted average cost of long-term debt to reflect the most up-to-date information related to its CIBC loan and the renegotiated rate for its 2018 bucket truck loan. The updated CIBC loan has an interest rate of 4.1% and the renegotiated bucket truck loan has an interest rate of 4.5% (which is reduced from the original rate of 5.1%). OEB staff has not identified an issue with the updated interest rates. These are third party loans and are not capped at the OEB's deemed long-term interest rate for 2018 (4.16%). However, OEB staff notes that the rates appear reasonable as they are largely in line with the deemed debt rate.

### **Recommendation:**

OEB staff has not found any issues directly related to the cost of capital calculation (i.e. capital structure, debt rates and ROE) that need to proceed to hearing. OEB staff notes that the cost of capital amount would change if the findings on issues that go to hearing impact rate base. However, the methodology used to calculate the amount would remain unchanged.

### **7.3.10 Revenue Sufficiency / Deficiency**

The revenue deficiency arising from SLHI's application is set out in the following table.

Service Revenue Requirement	2013 Board Approved (A)	2018 Revenue at Existing Rates Allocated in Proportion of 2013 Board Approved (B)	2018 Proposed (C)	Revenue Deficiency (D) = (C) - (B)
OM&A	1,413,919	1,497,341	1,572,092	74,751
LEAP	2,340	2,478	2,600	122
Property Tax	4,986	5,280	5,394	114
Depreciation	182,961	193,756	234,839	41,083
Return on Rate Base	342,469	362,675	362,986	311
PILs	2,180	2,309	23,005	20,696
<b>Total</b>	<b>1,948,855</b>	<b>2,063,838</b>	<b>2,200,916</b>	<b>137,078</b>

Overall, the proposed service revenue requirement for the 2018 test year is \$252,061 (13%) higher than the 2013 OEB-approved amount. The revenue deficiency is \$137,078.

**OEB Staff Analysis: Revenue Sufficiency / Deficiency**

OEB staff is of the view that the revenue deficiency of \$137,078 is modest and notes that it reflects approximately 6.6% of the proposed base revenue requirement. This results in an average score on the relevant metric in the ITM.

**Recommendation:**

There are no direct recommendations resulting from OEB staff's review of the revenue deficiency. The revenue deficiency amount is simply a result of all the requests that were made by SLHI in its revised application, which OEB staff discusses in other sections of this Report. The level of the revenue deficiency relative to the base revenue requirement provides a general understanding of the magnitude of the total rate increase requested in the application.

OEB staff notes that the revenue deficiency amount would change if the OEB makes findings on the application that impact the revenue requirement.

**7.3.11 Cost Allocation**

The table below highlights the costs allocated to each rate class in the OEB-approved 2013 cost allocation study and the updated 2018 cost allocation study.

Table 7.8: Allocated Cost - ( Consistent with RRWF, Tab 11, Allocated Costs)				
Rate Class	2013 Board Approved Cost Allocation Study with new CGAAP Depreciation	%	Cost Allocated in the 2018 Study	%

Residential	1,261,200	64.7%	1,523,175	69.2%
GS < 50 kW	282,985	14.5%	363,705	16.5%
GS 50 to 4,999 kW	264,820	13.6%	286,712	13.0%
Street Lighting	139,019	7.1%	27,324	1.2%
Unmetered Scattered	830	0.0%	0	0.0%
<b>Total</b>	<b>1,948,854</b>	<b>100%</b>	<b>2,200,916</b>	<b>100%</b>

The most significant change on a percentage basis is the reduction to the costs that are allocated to the street lighting rate class. SLHI stated that in the context of the OEB's Cost Allocation Policy for Unmetered Loads<sup>15</sup> and the street lighting LED conversion that took place in 2015, the street lighting rate class is significantly over-contributing towards the revenue requirement using the current rate structure.

The following table highlights the revenue to cost ratios based on the 2013 cost allocation study, the 2018 updated cost allocation study and also shows the 2018 proposed ratios.

Class	2014 Board Approved - Cost Allocation Study	2018 Updated Cost Allocation Study	2018 Proposed Ratios	2019 & 2020 Proposed Ratios	Board Targets - Min to Max	
Residential	96.35%	91.02%	95.88%	95.88%	85.00%	115.00%
GS < 50	109.85%	95.80%	100.00%	100.00%	80.00%	120.00%
GS 50 to 4,999 kW	115.80%	131.57%	120.00%	120.00%	80.00%	120.00%
Street Lighting	83.08%	325.34%	120.00%	120.00%	80.00%	120.00%
Unmetered Scattered Load	81.30%	0.00%	0.00%	0.00%	80.00%	120.00%

The 2018 cost allocation study indicates that the ratios for the GS > 50kW and street lighting rate classes are outside the OEB's policy range. Therefore, SLHI proposed to bring the ratio for those two classes to the maximum of the range (120%). The ratios for the residential and GS < 50kW classes were revised upwards to maintain revenue neutrality (and the level of adjustments were selected to minimize rate impacts as effectively as possible).

SLHI did not propose any new rate classes. However, it requested the elimination of the unmetered scattered load rate class as there are no customers in the rate class. SLHI also stated that it will not be allowing any new unmetered scattered loads in the future (all future customers will need to be metered).

**OEB Staff Analysis: Cost Allocation**

OEB staff is of the view that SLHI's cost allocation proposals are largely reasonable and in accordance with OEB cost allocation principles. However, OEB staff has identified an issue with respect to the street lighting rate class cost reallocation.

<sup>15</sup> [EB-2012-0383](#).

The biggest change between the 2013 rebasing and the current proceeding is that the street lighting class is now allocated significantly less costs. SLHI explained that this change, which results in less costs allocated to the street lighting rate class with a related increase to the costs allocated to the other classes (all else being equal), is due to the OEB's Cost Allocation Policy for Unmetered Loads and the street lighting LED conversion that occurred during the previous IRM term. OEB staff believes the proposed reduced allocation to the street lighting rate class is appropriate in accordance with OEB policy. However, OEB staff questioned whether a phased approach to reallocation would be more appropriate from a rate mitigation perspective for SLHI's other rate classes.

SLHI asked its street lighting customer if a phased approach (over 3 years) would be satisfactory. The customer replied that it would not be and SLHI noted that the difference between a phased approach and implementing entirely in 2018 is about \$1.11 per month (or 0.8% on a total bill basis) for residential customers. A phased approach would also reduce the costs allocated to the GS < 50kW rate class and therefore reduce the bill impacts for that class. OEB staff is of the view that the OEB may wish to consider a phased approach to the reallocation of costs to the street lighting rate class for rate mitigation purposes, especially for the GS < 50kW rate class that is not protected by the DRP program.

OEB staff notes that SLHI's proposed revenue to cost ratio for the GS < 50kW rate class as set out in its original application moved above unity (100%) as part of SLHI's balancing process, which does not conform with OEB policy. In the revised application, SLHI addressed this issue and now the revenue to cost ratio for that rate class stops at unity. OEB staff notes that the revenue to cost ratios for all rate classes now fall within the OEB policy range.

Finally, OEB staff sees no issue with SLHI's proposal to close the unmetered scattered load rate class as there are no existing customers in the class and SLHI is not forecasting any new customers.

**Recommendation:**

OEB staff has identified only one issue with the proposed cost allocation for the 2018 test year. OEB staff is of the view that, for the most part, the cost allocation proposals are well supported by the evidence in the revised application and the responses to OEB staff's questions.

However, OEB staff recommends that the following issue proceed to a written hearing:

- 1)
  - a. Should the proposed reduced allocation of costs to the street lighting rate class be phased in over time?
  - b. If so, what period of time is appropriate?

OEB staff believes the evidentiary record is sufficient on this issue and recommends that this issue be dealt with through written argument. There are no other issues related to cost allocation for which OEB staff believe that a hearing is required.

OEB staff notes that the allocated costs are subject to change if the OEB makes findings changing the proposals in the application.

### **7.3.12 Rate Design**

The following tables highlight SLHI's proposed fixed / variable revenue proportions.

<b>Table 8.4: Proposed Monthly Service Charge</b>					
Rate Class	Total Base Revenue Requirement	Fixed Revenue Proportion	Fixed Revenue	Annualized Customers/Connections	Proposed Monthly Service Charge
Residential	\$1,375,454	91.88%	\$1,263,767	28,632	\$44.14
General Service < 50 kW	\$344,927	65.03%	\$224,306	4,824	\$46.50
General Service 50 to 4,999 kW	\$329,446	72.66%	\$239,375	636	\$376.38
Street Lighting	\$29,893	84.41%	\$25,233	6,372	\$3.96
<b>Total</b>	<b>\$2,079,720</b>		<b>\$1,752,681</b>	<b>40,464</b>	

<b>Table 8.6: Proposed Distribution Volumetric Charge</b>						
Rate Class	Total Base Revenue Requirement	Variable Revenue Proportion	Variable Revenue	Annualized kWh or kW as Required	Unit of Measure	Proposed Distribution Volumetric Charge Before Transformer Allowance
Residential	\$1,375,454	8.12%	\$111,687	32,918,746	kWh	0.0034
General Service < 50 kW	\$344,927	34.97%	\$120,621	11,931,508	kWh	0.0101
General Service 50 to 4,999 kW	\$329,446	27.34%	\$90,071	72,183	kW	1.2478
Street Lighting	\$29,893	15.59%	\$4,660	420	kW	11.0960
<b>Total</b>	<b>\$2,079,720</b>		<b>\$327,039</b>			

The only substantive change to the fixed / variable splits, compared to SLHI's current ratios, is to the residential class. The update to the fixed / variable split for the residential class was made by SLHI in accordance with the OEB's policy on residential rate design.<sup>16</sup> 2018 reflects year three of the transition to fully fixed rates for SLHI. The increase in the fixed rate for 2018 due to the residential rate design policy is \$3.91. This is below \$4.00, which would trigger the expectation that SLHI would consider the need to add an additional year to the transition period.

SLHI completed the OEB's 2018 Retail Transmission Service Rates (RTSRs) workform to calculate its 2018 RTSRs. SLHI is fully embedded in Hydro One's sub-transmission system. Hydro One is the transmission customer of the IESO for all of SLHI's load. Hydro One pays the IESO wholesale transmission charges calculated based on the Uniform Transmission Rates (UTRs) and passes those costs onto SLHI.

<sup>16</sup> [EB-2012-0410](#).



SLHI estimated its 2018 low voltage charges to be \$321,927 based on a three-year average of historical volumes and Hydro One’s most recently approved Sub-Transmission rates<sup>17</sup>.

SLHI proposed no changes to its existing retail service charges and its regulatory charges are in accordance with previous OEB orders.<sup>18</sup>

SLHI also proposed no changes to the dollar amount of its existing specific service charges. However, SLHI proposed two minor wording changes. First, SLHI proposed to change the wording to the specific service charge entitled “Returned Cheque (plus bank charges)” to “Returned Item (plus bank charges)”. This change is being made to better reflect how bills are paid. Second, 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)”. This wording change is proposed to make the description more inclusive.

SLHI proposed a total loss factor (TLF) of 1.0892, using the historical average of the previous five years. The proposed TLF represents a small decrease from the currently approved TLF of 1.0897. The distribution-related loss adjustment factor is 1.0534. This is consistent with the current approved distribution-related loss adjustment factor of 1.0539. The loss factor calculation is set out in the following table.

		Historical Years					5-Year Average
		2012	2013	2014	2015	2016	
<b>Losses Within Distributor's System</b>							
<b>A(1)</b>	"Wholesale" kWh delivered to distributor (higher value)	75,859,029	87,948,723	89,786,000	83,643,508	75,653,709	82,578,194
<b>A(2)</b>	"Wholesale" kWh delivered to distributor (lower value)	75,601,634	87,692,323	89,519,317	83,393,450	75,446,075	82,330,560
<b>B</b>	Portion of "Wholesale" kWh delivered to distributor for its Large Use Customer(s)						-
<b>C</b>	Net "Wholesale" kWh delivered to distributor = <b>A(2) - B</b>	75,601,634	87,692,323	89,519,317	83,393,450	75,446,075	82,330,560
<b>D</b>	"Retail" kWh delivered by distributor	71,922,866	83,168,941	85,548,133	79,338,527	70,815,698	78,158,833
<b>E</b>	Portion of "Retail" kWh delivered by distributor to its Large Use Customer(s)						-
<b>F</b>	Net "Retail" kWh delivered by distributor = <b>D - E</b>	71,922,866	83,168,941	85,548,133	79,338,527	70,815,698	78,158,833
<b>G</b>	Loss Factor in Distributor's system = <b>C / F</b>	1.0511	1.0544	1.0464	1.0511	1.0654	1.0534
<b>Losses Upstream of Distributor's System</b>							
<b>H</b>	Supply Facilities Loss Factor	1.0340	1.0340	1.0340	1.0340	1.0340	1.0340
<b>Total Losses</b>							
<b>I</b>	Total Loss Factor = <b>G x H</b>	1.0869	1.0902	1.0820	1.0868	1.1016	1.0892

<sup>17</sup> [EB-2016-0081](#).

<sup>18</sup> [EB-2017-0333](#) and [EB-2012-0100 / EB-2012-0211](#).

SLHI's five-year average loss adjustment factor is greater than 5%. As such, SLHI provided a detailed explanation of its distribution loss adjustment factor in accordance with the OEB's Chapter 2 filing requirements. SLHI noted that it completed some voltage conversions since its last cost of service but the impact was minimal due to the large service territory and low density. SLHI also explained that the 1.4% increase in line losses in 2016 is likely explained by the change to true monthly billing at the end of 2015. SLHI also stated that there are some preliminary plans to undertake a study to explore smart grid options in the future to reduce line losses.

As previously set out, the bill impacts resulting from SLHI's revised application are as follows:

Rate Class	Sub-Total A (Distribution excl. pass-through)	Sub-Total C – Delivery	Total Bill
Residential (750 kWh)	\$6.77 (16.91%)	\$7.43 (13.55%)	\$7.80 (6.19%)
Residential (lowest 10 <sup>th</sup> percentile) (518 kW)	\$7.40 (19.14%)	\$8.04 (16.38%)	\$8.44 (8.54%)
GS < 50kW	\$7.62 (12.71%)	\$7.13 (7.58%)	\$7.48 (2.53%)
GS > 50kW	-\$12.53 (-2.4%)	-\$277.40 (-17.53%)	-\$317.69 (-2.75%)
Street Lights	-\$3,302.39 (-49.75%)	-\$3,373.27 (-49.16%)	-\$3,811.58 (-40.36%)

With the exception of the street lights rate class, all classes have bill impacts of less than 10% on a total bill basis. In the case of street lights, the bill impact is a reduction of 40.36%. SLHI did not propose any mitigation as it is a bill reduction.

### **OEB Staff Analysis: Rate Design**

OEB staff is of the view that SLHI's rate design proposals are reasonable and are in accordance with general rate design principles.

The fixed / variable splits are largely unchanged from the previously approved ratios with the exception of the residential rate class, which is changed based on the OEB's policy on residential rate design. Also, in the original application, the fixed charge for the GS < 50kW rate class was above the ceiling set out in the cost allocation model. SLHI corrected this issue in its revised application. OEB staff did not identify any issues with the proposed fixed / variable ratios for any rate class as set out in the revised application.

OEB staff identified no issues with the proposed RTSRs and low voltage charges. OEB staff is of the view that these charges were calculated correctly.

OEB staff also believes that SLHI calculated the loss factors appropriately. OEB staff notes that the proposed distribution-related loss adjustment factor is basically unchanged from its current approved factor, and SLHI provided a reasonable explanation as to why the loss adjustment factor has not significantly improved since the last rebasing. OEB policy requires that a utility have a plan to reduce distribution line losses that are above 5%, and SLHI stated that it is in the preliminary stages of considering a study to determine whether there are smart grid options available to reduce line losses.

For the reasons discussed above, OEB staff does not believe that the proposed loss adjustment factor should be an issue in this proceeding.

OEB staff also believes no issues arise from SLHI's proposal to make no changes to the dollar amounts of its existing retail service charges and specific service charges and to apply the OEB-approved regulatory charges.

OEB staff also believes there is no issue with the proposed minor wording change to the specific service charge entitled "Returned Cheque (plus bank charges)" to "Returned Item (plus bank charges)".

However, with respect to the second wording change proposed by SLHI, OEB staff believes that the change should not occur at this time. 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)". OEB staff notes that there is currently a policy consultation ongoing regarding a framework for determining wireline pole attachment charges.<sup>19</sup> 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. As such, OEB staff believes that this issue should proceed to hearing.

Finally, OEB staff notes that the total bill impacts arising from SLHI's revised 2018 rebasing application are not insignificant but are within the policy range to not require mitigation. The bill impacts may be reduced if the OEB lowers any of the costs that SLHI proposes to include in its revenue requirement and / or the cost allocation to the street lighting class is revised.

**Recommendation:**

OEB staff has identified only one issue with the proposed rate design for the 2018 test year. OEB staff is of the view that, for the most part, the rate design proposals are well supported by the evidence in the revised application and the responses to OEB staff's questions.

However, OEB staff recommends that the following issue proceed to a written hearing:

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

OEB staff believes the evidentiary record is sufficient on this issue and recommends that this issue be dealt with through written argument. There are no other issues related to rate design for which OEB staff believe that a hearing is required.

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<sup>19</sup> [EB-2015-0304](#).

The rates resulting from the rate design process are subject to change if the OEB changes any costs SLHI proposes to include in its revenue requirement or changes the allocation of the revenue requirement. However, the rate design methodology will remain unchanged.

### **7.3.13 Deferral and Variance Accounts**

SLHI proposed to dispose of a credit of \$144,948 related to Group 1 and Group 2 accounts (including other accounts). This credit includes interest up to and including April 30, 2018. The Group 1 accounts reflect one year of accumulated balances and the Group 2 accounts have not been disposed of since the last cost of service proceeding (2013). The deferral and variance account balances are set out in the following table.

Account Description	USoA #	Total Principle & Interest (Dec 31, 2016)	2017 Disposition (Principle & Interest)	Projected Interest from January 1, 2017 to April 30, 2018	Total Claim
<b>Group 1 Accounts</b>					
LV Variance Account	1550	\$65,645	\$22,807	\$621	\$43,459
Smart Metering Entity Charge Variance Account	1551	\$1,238	\$1,180	\$1	\$59
RSVA - Wholesale Market Service Charge	1580	-\$31,967	-\$15,727	-\$229	-\$16,469
RSVA - Retail Transmission Network Charge	1584	-\$10,531	-\$19,182	\$125	\$8,776
RSVA - Retail Transmission Connection Charge	1586	\$8,206	-\$698	\$131	\$9,035
RSVA - Power (excluding Global Adjustment)	1588	-\$341,649	-\$92,500	-\$3,628	-\$252,777
RSVA - Global Adjustment	1589	-\$48,738	\$28,881	-\$1,135	-\$78,754
Disposition and Recovery/Refund of Regulatory Balances (2011)	1595	\$9	\$9		
Disposition and Recovery/Refund of Regulatory Balances (2012)	1595	\$2,222	\$2,220		
Disposition and Recovery/Refund of Regulatory Balances (2013)	1595	\$936	\$732		
Disposition and Recovery/Refund of Regulatory Balances (2014)	1595	\$23,227		\$392	\$23,619
Disposition and Recovery/Refund of Regulatory Balances (2015)	1595	\$5,636		-\$971	\$4,665
Disposition and Recovery/Refund of Regulatory Balances (2016)	1595	-\$61,798		-\$1,680	
<b>Subtotal Group 1 Accounts(Including Account 1589 - Global Adjustment)</b>		<b>-\$387,565</b>	<b>-\$72,278</b>	<b>-\$6,373</b>	<b>-\$258,387</b>
<b>Subtotal Group 1 Accounts(Excluding Account 1589 - Global Adjustment)</b>					<b>-\$179,633</b>
RSVA - Global Adjustment					-\$78,754
<b>Group 2 Accounts</b>					
Other Regulatory Assets - Sub-Account - Deferred IFRS Transition Costs	1508	\$45,692		\$645	\$46,337
Retail Cost Variance Account – Retail	1518	-\$7,730		-\$109	-\$7,839
Retail Cost Variance Account – STR	1548	-\$132		-\$1	-\$133
<b>Subtotal Group 2 Accounts</b>		<b>\$37,829</b>	<b>\$0</b>	<b>\$535</b>	<b>\$38,364</b>
<b>Other Accounts</b>					
Smart Meter Capital and Recovery Offset Variance - Sub-Account - Stranded Meter Costs	1555	-\$64			
LRAM Variance Account	1568	\$6,030			\$6,030
IFRS-CGAAP Transition PP&E Amounts Balance + Return Component	1575	\$69,045			\$69,045
<b>Subtotal Other Accounts</b>		<b>\$75,075</b>	<b>\$0</b>	<b>\$0</b>	<b>\$75,075</b>
<b>Total</b>		<b>-\$274,661</b>			<b>-\$144,948</b>

SLHI proposed to dispose of all of the deferral and variance account balances over a one-year period with the exception of the IFRS-CGAAP transition account for which SLHI proposed a five-year disposition.

The table below lists SLHI's proposal with respect to the continuation / discontinuation of each of the Group 2 accounts.

Account Description	USoA #		Explanation
<b>Group 2 Accounts - Continue</b>			
Retail Cost Variance Account – Retail	1518	Continue	On-going use
Retail Cost Variance Account – STR	1548	Continue	On-going use
LRAM Variance Account	1568	Continue	On-going use
<b>Group 2 Accounts Discontinue</b>			

Other Regulatory Assets - Sub-Account - Deferred IFRS Transition Costs	1508	Discontinue	No Longer needed as SLHI has fully transitioned to IFRS
Smart Meter Capital and Recovery Offset Variance - Sub-Account - Stranded Meter Costs	1555	Discontinue	Recovery completed and Smart meter implementation complete
IFRS-CGAAP Transition PP&E Amounts Balance + Return Component	1575	Discontinue	No Longer needed as SLHI has fully transitioned to IFRS

**OEB Staff Analysis: Deferral and Variance Accounts**

**Results of OEB Staff Detailed Review:**

OEB staff asked SLHI numerous questions regarding its deferral and variance account balance calculations. OEB staff is satisfied that the deferral and variance account balances have been calculated correctly in the revised application with the exception of the power accounts (Accounts 1588 and 1589). In response to OEB staff’s questions, SLHI made a correction to the balance in the IFRS-CGAAP transition account and made other minor corrections for technical errors.

The IFRS-CGAAP transition account includes costs associated with losses on the disposal of pooled assets at the transition date (January 1, 2014) along with minor differences due to the amortization calculation. OEB staff has identified no issue with the amounts recorded in the account.

In addition, OEB staff has identified no issues with the LRAMVA. The LRAMVA has a \$6,000 balance, which was properly calculated using the LRAMVA workform, and is based on the conservation results for the years 2011 to 2015.

OEB staff 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. Based on discussions with SLHI, 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 and these are underpinned by a \$314,140 credit adjustment to account 1588 with an offsetting debit to account 1589. SLHI made this adjustment in order to address deficiencies in their settlement process with 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. 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 to determine whether SLHI has addressed the gaps in its settlement process adequately. This type of review is generally not practical to conduct as part of an application. However, the appropriate next steps in the disposition of these accounts is a matter that the OEB could consider as part of the hearing of this application.

OEB staff also identified no issues with the proposed disposition periods and the proposed discontinuance of the specified Group 2 accounts, with one exception. With respect to the request for the discontinuance of the IFRS-CGAAP Transition PP&E Amounts account (Account 1575), OEB staff does not believe that this is appropriate at this time. OEB staff notes that there will continue to be

transactions that occur in the account until such time that the associated rate rider ceases to be in effect. As such, OEB staff is of the view that this issue should go to hearing.

**Recommendation:**

OEB staff has identified only two issues with respect to the proposed deferral and variance account disposition. OEB staff is of the view, that for the most part, the proposed disposition of SLHI's deferral and variance accounts is well supported by the evidence in the revised application and the responses to OEB's staff questions.

OEB staff recommends that the following two issues proceed to a written hearing:

- 1) Should the proposed balances in the commodity variance accounts (1588 and 1589) be disposed at this time?
- 2) Should Account 1575 be discontinued at this time?

OEB staff believes the evidentiary record is sufficient on these issues and recommends that this issue be dealt with through written argument. There are no other issues related to the deferral and variance accounts for which OEB staff believes that a hearing is required.