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

Ontario

Ontario Energy Board

Filing Requirements For
Electricity Distribution Rate Applications
- 2016 Edition for 2017 Rate Applications -

Chapter 3

Incentive Rate-Setting Applications

July 14, 2016

Table of Contents

Chapter 3 Filing Requirements for Incentive Rate-Setting Applications subject to the OEB's Index Adjustments

3.1 Introduction

On October 18, 2012, the Ontario Energy Board (OEB) issued its *Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* (the RRFE Report). The RRFE Report provides a comprehensive performance-based approach to regulation and sets out three rate-setting methods: 4th generation incentive rate-setting (Price Cap IR), custom incentive rate-setting (Custom IR) and the annual incentive rate-setting index (Annual IR Index).

The RRFE Report also established a transition plan to facilitate the adoption of the three new rate-setting methods. Those distributors who are within the term of their current 3rd generation IR will continue to have their rates adjusted annually for the remaining years of their 3rd generation IR. The annual adjustment mechanism and other potential rate adjustments will be the Price Cap IR mechanism. Distributors may opt for the Annual IR Index at any time.

These filing requirements set out the OEB's expectations for electricity distributors' annual rate adjustment applications under Price Cap IR or the Annual IR Index. These filing requirements replace the 2015 edition of the Filing Requirements for Electricity Distribution Rate Applications, dated July 16, 2015.

The key elements for the three rate-setting methods were set out in the RRFE report in the following table:

Table 1: Rate-Setting Overview – Elements of the Three Methods[1]

<table>
<tr><th colspan="2"></th><th>4th Generation IR</th><th>Custom IR</th><th>Annual IR Index</th></tr>
<tr><td colspan="5">Setting of Rates</td></tr>
<tr><td colspan="2">“Going in” Rates</td><td>Determined in single forward test-year cost of service review</td><td>Determined in multi-year application review</td><td>No cost of service review, existing rates adjusted by the Annual Adjustment Mechanism</td></tr>
<tr><td colspan="2">Form</td><td>Price Cap Index</td><td>Custom Index</td><td>Price Cap Index</td></tr>
<tr><td colspan="2">Coverage</td><td colspan="3">Comprehensive (i.e., Capital and OM&A)</td></tr>
<tr><td rowspan="2">Annual Adjustment Mechanism</td><td>Inflation</td><td>Composite Index</td><td rowspan="3">Distributor-specific rate trend for the plan term to be determined by the Board, informed by: (1) the distributor’s forecasts (revenue and costs, inflation, productivity); (2) the Board’s inflation and productivity analyses; and (3) benchmarking to assess the reasonableness of the distributor’s forecasts</td><td>Composite Index</td></tr>
<tr><td>Productivity</td><td>Peer Group X-factors comprised of: (1) Industry TFP growth potential; and (2) a stretch factor</td><td>Based on 4th Generation IR X-factors</td></tr>
<tr><td colspan="2">Role of Benchmarking</td><td>To assess reasonableness of distributor cost forecasts and to assign stretch factor</td><td>n/a</td></tr>
<tr><td colspan="2" rowspan="2">Sharing of Benefits</td><td colspan="3">Productivity factor</td></tr>
<tr><td>Stretch factor</td><td>Case-by-case</td><td>Highest 4th Generation IR stretch factor</td></tr>
<tr><td colspan="2">Term</td><td>5 years (rebasing plus 4 years).</td><td>Minimum term of 5 years.</td><td>No fixed term.</td></tr>
<tr><td colspan="2">Incremental Capital Module</td><td>On application</td><td>N/A</td><td>N/A</td></tr>
<tr><td colspan="2">Treatment of Unforeseen Events</td><td colspan="3">The Board’s policies in relation to the treatment of unforeseen events, as set out in its July 14, 2008 EB-2007-0673 Report of the Board on 3rd Generation Incentive Regulation for Ontario’s Electricity Distributors, will continue under all three menu options.</td></tr>
<tr><td colspan="2">Deferral and Variance</td><td>Status quo</td><td>Status quo, plus as needed to track capital spending against plan</td><td>Disposition limited to Group 1
Separate application for Group 2</td></tr>
<tr><td colspan="2">Performance Reporting and Monitoring</td><td colspan="3">A regulatory review may be initiated if a distributor’s annual reports show performance outside of the ±300 basis points earnings dead band or if performance erodes to unacceptable levels.</td></tr>
</table>

[1] *RRFE Report, Page 13*

3.1.1 Key References

The documents listed below are key to understanding these Filing Requirements:

- *Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach - October 18, 2012*
- *Report of the Board: Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors - corrected December 4, 2013*
- *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities - December 11, 2009*
- *Guidelines for Electricity Distributors' Conservation and Demand Management - April 26, 2012 (2012 CDM Guidelines)*
- *Guidelines for Electricity Distributors' Conservation and Demand Management - December 19, 2014 (2014 CDM Guidelines)*
- *Report of the Board: New Policy Options for the Funding of Capital Investments: The Advanced Capital Module - September 18, 2014*
- *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors - July 14, 2008*
- *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors - September 17, 2008*
- *Addendum to the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors - January 28, 2009*
- *Guideline (G-2008-0001) on Retail Transmission Service Rates - October 22, 2008 (Revision 3.0 June 22,2011 and any subsequent updates)*
- *Guideline G-2011-0001: Smart Meter Funding and Cost Recovery - Final Disposition, December 15, 2011*
- *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR) - July 31, 2009*
- *Chapter 5 - Filing Requirements for Electricity Transmission and Distribution Applications: Consolidated Distribution System Plan Filing Requirements - March 28, 2013*
- *Report of the Board on Transition to International Financial Reporting Standards (EB-2008-0408) - July 28, 2009*
- *Addendum to Report of the Board EB-2008-0408 - Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment - June 13, 2011*
- *Report of the Board - Performance Measurement for Electricity Distributors: A Scorecard Approach - March 5, 2014*
- *Board Policy (EB-2012-0410) - A New Distribution Rate Design for Residential Electricity Customers - April 2, 2015*

Additions for 2016:

- *Report of the Ontario Energy Board - Defining Ontario's Typical Electricity Customer – April 14, 2016*
- *Report of the Ontario Energy Board - New Policy Options for the Funding of Capital Investments: Supplemental Report – January 22, 2016*
- *Report of the Ontario Energy Board - Updated Policy for the Lost Revenue Adjustment Mechanism Calculation: Lost Revenues and Peak Demand Savings from Conservation and Demand Management Programs – May 19, 2016*

3.1.2 Grouping for Filings

Distributors that are seeking rate adjustments effective January 1, 2017 under an incentive rate-setting mechanism (IRM) will be required to file their application by August 15, 2016. The OEB has assigned distributors seeking IRM rate adjustments effective May 1, 2017 to one of three application groupings noted below based on the expected level of complexity of the application. The length of time required to review an application is commensurate with its level of complexity. Applications of greater complexity will be expected to be filed first.

The OEB conducted a survey in June 2016 to identify the expected elements of an applicant's IRM application for the assignment of IRM filing deadlines. If a distributor expects that its application will be significantly more complex than it disclosed during the survey, it should advise the OEB and is encouraged to file in an earlier grouping.

Distributors filing under the Annual IR Index method will generally be placed in the last grouping. Staggering the applications allows the OEB and other stakeholders to schedule resources to allow for adequate review of the applications. The deadlines for filing an IRM application have been determined so that, in the normal course of events, a decision and order will be issued in time for a May 1 implementation date.

The application deadlines are as follows:

- September 26, 2016
- October 17, 2016
- November 7, 2016

The assignment of distributors to these filing dates has been detailed in the cover letter accompanying these filing requirements.

3.1.3 Components of the Application Filing

Whether filing under Price Cap IR or the Annual IR Index, each application must include:

- A manager's summary thoroughly documenting and explaining all rate adjustments applied for
- The contact information for the application - the primary contact for the application may be a person within the applicant's organization other than the primary licence contact. The OEB will communicate with this person during the course of the application. After completion of the application, the OEB will revert communication to the primary licence contact

- A completed rate generator model[2] and supplementary work forms[3] as applicable, provided by the OEB, both in electronic (i.e. Excel) and Adobe PDF format
- A PDF copy of the current tariff sheet
- Supporting documentation cited within the application (e.g. excerpt of relevant past decisions and/or settlement agreements, relevant reporting and record-keeping requirements (RRR) data and Revenue Requirement Work Form (RRWF))[4]
- A statement as to who will be affected by the application
- A statement confirming the accuracy of the billing determinants for pre-populated models
- A text-searchable Adobe PDF format for all documents

3.1.4 Applications and Electronic Models

The models issued by the OEB are intended to assist the applicant in filing a rate application and to provide formatting consistency across all distributors for greater review process efficiency.

For 2017 IRM applications, the OEB has taken further steps to streamline the process by pre-populating its models with distributor-specific RRR data. The 2017 rate generator models will be populated with a distributor's most recent tariff of rates and charges, load and customer data and Group 1 balances as reported through RRR. Distributors will be required to confirm the accuracy of the data. Remaining inputs will be marked with green input cells.

The OEB will provide passwords to distributors filing a 2017 Price Cap or Annual Index IR to access their distributor-specific rate generator model through the OEB's website. Any distributor that did not receive an individual password, but wishes to file an IR application for the 2017 rate year, shall notify the OEB as soon as possible.

The rate generator model will update base rates, retail transmission service rates and, if applicable, shared tax saving adjustments. It will also calculate rate riders for the disposition of deferral and variance account balances.

The rate generator model continues to include a bill impact calculation by rate class, in which commodity rates based on time-of-use and regulatory charges are held constant. These will be based on the regulated price plan (RPP) prices at the time the rate generator model was published. A typical residential customer has now been defined

[2] The Rate Generator is a Microsoft Excel workbook that calculates a distributor's proposed tariff of rates and charges in a Price Cap IR or Annual IR Index Application.
[3] Includes the Revenue Cost Ratio Adjustment Work form and the Incremental Capital Module/Advanced Capital Module (ICM)(ACM) Work form, as applicable.
[4] The Revenue Requirement Work Form was filed as part of the draft rate order in the last cost of service application.

as consuming 750 kWh as per *Report of the Board – Defining Ontario's Typical Residential Customer*.

Additional models are required when applications involve certain additional requests.

A distributor seeking a revenue-to-cost ratio adjustment due to a previous OEB decision must continue to file the OEB's revenue-to-cost ratio adjustment work form in addition to the rate generator model.

For an incremental or advanced capital module (ICM/ACM) cost recovery, a distributor must file the incremental capital work form as well as the incremental capital projects summary work form.

The OEB expects an applicant to ensure the application is complete and accurate. The applicant must also ensure the accuracy and appropriateness of all of the model input and output data used to support its application. The applicant shall advise the OEB of any concerns regarding calculations flowing from the models as well as any changes that the applicant may have made to the models to address its own circumstances. The use of an OEB model does not guarantee that the OEB will approve the results.

3.2 Elements of the Price Cap IR and the Annual IR Index Plan

3.2.1 Annual Adjustment Mechanism

The annual adjustment follows an OEB-approved formula that includes components for inflation and the OEB's expectations of efficiency and productivity gains[5]. The components in the formula are also approved by the OEB annually. The formula is an *inflation minus X-factor* rate adjustment.

Inflation Factor
In its *Report of the Board: Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* the OEB adopted a 2-factor industry-specific price index methodology. The inflation factor is based on two weighted price indicators (labour and non-labour) which provide an input price that reflects Ontario's electricity industry.

X-Factor
The X-factor has two parts: a productivity factor and a stretch factor. The OEB has determined that the appropriate value for the productivity factor (industry total factor productivity) for the Price Cap IR and Annual IR Index is zero. For the stretch factor, distributors will be assigned into one of five groups ranging from 0.0% to 0.6%. The most efficient distributor, based on the cost evaluation ranking, would be assigned the

[5] *Report on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors (December 4, 2013)*

lowest stretch factor of 0.0%. All Annual IR Index applicants will be assigned a stretch factor of 0.6%.

Distributors shall use the 2016 rate-setting parameters as a placeholder until the stretch factor assignment and inflation factor for 2017 are issued by the OEB. OEB staff will update each distributor's rate generator model with the 2017 price cap parameters once they are available. Distributors will have an opportunity to comment on the accuracy of OEB staff's update as part of the application process.

3.2.1.1 Application of the Annual Adjustment Mechanism

The annual adjustment mechanism will apply to distribution rates (fixed and variable charges) uniformly across customer rate classes.

The annual adjustment mechanism will not be applied to the following components of delivery rates:

- Rate Adders
- Rate Riders
- Low Voltage Service Charges
- Retail Transmission Service Rates
- Wholesale Market Service Rate
- Rural and Remote Rate Protection Benefit and Charge
- Standard Supply Service – Administrative Charge
- MicroFIT Service Charge
- Specific Service Charges
- Transformation and Primary Metering Allowances[6]
- Smart Metering Entity Charge

3.2.2 Revenue-to-Cost Ratio Adjustments

OEB Decisions regarding cost of service rate applications may sometimes prescribe a phase-in period to adjust the revenue-to-cost ratios. The OEB's revenue-to-cost ratio adjustment work form and rate generator model include schedules for a distributor to adjust the revenue-to-cost ratio if previously approved by the OEB. The process will adjust base distribution rates before the application of the price cap adjustment.

3.2.3 Rate Design for Residential Electricity Customers

On April 2, 2015, the OEB released its *Board Policy: A New Distribution Rate Design for Residential Electricity Customers (EB-2014-0210)*, which stated that electricity distributors will transition to a fully fixed monthly distribution service charge for

[6] And any other allowances the OEB may determine.

residential customers. The transition began in 2016 and in most cases will be implemented over a period of four years.

The OEB issued decisions affecting 2016 rates for Price Cap IR and Annual Index IR applicants consistent with this policy. In this second year of transition, the distributor must follow the approach set out in sheet 16 of the rate generator model.

Distributors are expected to propose a fully fixed rate design for new charges applicable to the residential class provided that those charges are specifically related to the distribution of electricity.[7] Pass-through costs (e.g. transmission rates, LV charges, and Group 1 DVAs) and LRAMVA amounts are to continue to be recovered as variable charges because they predominantly relate to energy charges. Distribution-specific charges (or rate riders) already on a distributor's tariff should remain unchanged until they expire.

Residential Rate Design– Exceptions and Mitigation

In order to support the initial transition to fully fixed distribution rates, the OEB designed two tests to determine when mitigation should be proposed – a threshold test for the change in the fixed charge, and an overall bill impact test. The OEB is requiring distributors once again to calculate and report on the rate impacts of the change in 2017 so that mitigation strategies may be employed to smooth the transition for the customers most impacted, such as those that consume less electricity.

In 2017, a distributor is expected to apply to extend its OEB-approved transition period if necessary, to continue to comply with the policy. For 2017, the monthly service charge would have to rise more than $4 per year in order to affect the length of the transition to fixed rates. It is expected that in most cases, only an additional transition year would be required to make the changes within the $4 impact threshold identified in the policy. A distributor shall propose an alternative or additional strategy in the event that an additional transition year is insufficient. Consistent with OEB policy regarding mitigation, a distributor may propose as part of its application that no extension is necessary; such a position must be substantiated with reasons.

While the rate design is revenue neutral across the residential class, the impact on individual customers will vary with consumption. The OEB requires distributors to calculate the combined impact of the fixed rate increase and any other changes in the cost of distribution service for those residential RPP customers who are at the 10th percentile of overall consumption.[8] That is, 10% of a distributor's residential customers consume at or less than this level of consumption on a monthly basis. Sorting or segmentation of residential class data by consumption level will be required. Distributors must provide a description of the method they used to derive the 10th consumption percentile. The description should include a discussion regarding the nature of the data

[7] Examples of distribution-specific charges include: Shared Tax Savings, Z-Factors, ACM and ICM rate riders.
[8] To a minimum of 50 kWh per month.

that was used (e.g. was the source data for all residential customers or a representative sample of residential customers).

If the total bill impact of the elements proposed in this application is 10% or greater for RPP customers consuming at the 10th percentile, a distributor must file a plan to mitigate the impact for the whole residential class or indicate why such a plan is not required. The distributor will have the ability to propose the approach to mitigation, including, but not limited to, the option to extend the transition to fixed rates over a longer period. A detailed rationale must be provided.

It is the OEB's expectation that for mitigation as a result of the transition to fixed rates, distributors will propose strategies that target only the residential class, to avoid any material cross-subsidy between classes.

Beyond the issue of residential rate design specifically addressed in this section, distributors are reminded that they must file a mitigation plan if total bill increases for any customer class exceed 10%.

3.2.4 Electricity Distribution Retail Transmission Service Rates

In preparing its application, the distributor should refer to the OEB's *Guideline G-2008-0001: Electricity Distribution Retail Transmission Service Rates (RTSR), Revision 4.0, issued June 28, 2012*[9].

The OEB's rate generator model will assist in calculating the distributor's class-specific RTSRs. The rate generator model will reflect the most recent uniform transmission rates (UTRs) approved by the OEB (EB-2015-0311, issued on January 14, 2016 and effective January 1, 2016). Once any January 1, 2017 UTR adjustments have been determined, OEB staff will adjust each distributor's 2017 RTSR section of the rate generator to incorporate these changes where applicable. The rate generator model will also reflect the most recent sub-transmission rates approved by the OEB (EB-2015-0079 issued on January 14, 2016 and effective January 1, 2016). Likewise, OEB staff will update these rates as they become available. Distributors will have an opportunity to comment on the accuracy of OEB staff's updates.

3.2.5 Review and Disposition of Group 1 Deferral and Variance Account Balances

The Report of the Board on Electricity Distributors' Deferral and Variance Account Review Report (EDDVAR) provides that under the Price Cap IR or the Annual IR Index, the distributor's Group 1 audited account balances will be reviewed, and disposed if the pre-set disposition threshold of $0.001 per kWh (debit or credit) is exceeded. The onus is on the distributor to justify why any account balance in excess of the threshold should

[9] Originally issued October 22, 2008.

not be disposed. Consistent with a letter from the OEB on July 25, 2014, distributors may elect to dispose of Group 1 account balances below the threshold. Distributors should assess the practicality of disposing what may be small balances for one or more classes; for further guidance on considerations relevant to rate riders, see Appendix B.

In their application, distributors must include Group 1 balances as of December 31, 2015 to determine if the threshold has been exceeded. A continuity schedule, found on sheet 3 of the rate generator model, must be completed as part of the application.

Group 1 consists of the following Uniform System of Accounts (USoA):

- 1550 Low Voltage Account;
- 1580 RSVA Wholesale Market Service Charge Account;
- 1584 RSVA Retail Transmission Network Charges Account;
- 1586 RSVA Retail Transmission Connection Charge Account;
- 1588 RSVA Power Account;
- 1589 RSVA Global Adjustment Account; and
- 1590 Recovery of Regulatory Asset Balances Account (if applicable); and
- 1595 Disposition and Recovery/Refund of Regulatory Balances Account.

Distributors must provide an explanation if the account balances on *Tab 3. Continuity Schedule* differ from the account balances in the trial balance reported through the RRR and the audited financial statements and which have been reflected in the prepopulated rate generator model.

The OEB expects that no adjustments will be made to any deferral and variance account balances previously approved by the OEB on a final basis. Distributors must make a statement in their application as to whether or not any such adjustments were made. If adjustments have taken place, a distributor must provide explanations in its application for the nature and amounts of the adjustments and include supporting documentation under a section titled “Adjustments to Deferral and Variance Accounts.”

If adjustments to the RRR balances have been made to any deferral and variance account balances on *Tab 3. Continuity Schedule* the distributor must file with the earliest possible filing tranche appropriate to the rate year, regardless of any tranche assignment the OEB may have identified.

The rate generator model will calculate the deferral and variance account (DVA) disposition threshold using the last full year of actual load data as reported through the RRR. The default billing determinants used in the calculation of the Group 1 DVA rate riders will also be based on recent load data. The use of recent actuals should reduce residual variances by reflecting changes in customer class composition. A distributor may propose an alternative method with supporting rationale. In that case, revisions to the rate generator model may be required.

All global adjustment (GA) rate riders will be calculated on an energy basis (kWh) – (see further discussion at section 3.2.5.2).

EDDVAR states that the default disposition period to clear the Group 1 account balances by means of a rate rider should be one year. However, a distributor could propose a different disposition period to mitigate rate impacts or address any other applicable considerations, where appropriate.

3.2.5.1 Wholesale Market Participants

A wholesale market participant (WMP) refers to any entity that participates directly in any of the IESO-administered markets. These participants settle commodity and market-related charges with the IESO even if they are embedded in a distributor's distribution system. As a consequence, a distributor must not allocate any account balances in Account 1588 RSVA - Power, Account 1580 RSVA - Wholesale Market Services Charge and Account 1589 RSVA - Global Adjustment to a WMP.

A distributor must also ensure that rate riders are appropriately calculated for the following remaining charges that are still settled with a distributor. These include Account 1584 RSVA – Retail Transmission Network Charge, Account 1586 RSVA – Retail Transmission Connection Charge and Account 1595 – Disposition/Refund of Regulatory Balances.

3.2.5.2 Global Adjustment

Most customers pay the GA charge based on the amount of electricity they consume in a month (kWh). These customers are referred to as Class B. Customers who participate in the Industrial Conservation Initiative, referred to as Class A, pay GA based on their percentage contribution to the top five peak Ontario demand hours (i.e. peak demand factor) over a year-long period[10]. Distributors that settle GA costs with Class A customers on the basis of actual (i.e. non-estimated) costs, shall allocate no GA variance balance to these customers for the period that customers were designated Class A.

For Class B customers, the GA variance account (Account 1589) captures the difference between the amounts billed (or estimated to be billed) to non-RPP customers by the distributor and the actual amount paid by the distributor to the IESO (or host distributor) for those customers.

[10] As of July 1, 2015, per O.Reg 429/04, an eligible customer with a maximum hourly demand over three megawatts, but less than five megawatts, can elect to become a Class A for an applicable adjustment period of one year.

When clearing balances from the GA variance account, distributors must establish a separate rate rider included in the delivery component of the bill that would apply prospectively to non-RPP customers. Effective in 2017, the billing determinant and all the rate riders for the GA will be calculated on an energy basis (kWhs) regardless of the billing determinant used for distribution rates for the particular class. The rate generator model contains a new *Tab 6. GA calculation* that will calculate the GA rate riders on an energy basis.

Another new addition to the rate generator model for 2017 is Tab 6.a GA allocation_Class A. This tab will allocate the GA balance to former Class B customers who contributed to the GA balance but are now Class A customers. The model calculates specific amounts for each customer who made the change. Consistent with decisions for 2016 rates, distributors are generally expected to settle the amount through 12 equal adjustments to bills, consistent with EDDVAR. A one-time settlement is acceptable if the affected customer has expressed a clear preference for this approach.

A distributor must also support their GA claims with a description of their settlement process with the IESO or host distributor. It must specify the GA rate it uses when billing its customers (1st estimate, 2nd estimate or actual) for each rate class, itemize its process for providing consumption estimates to the IESO, and describe the true-up process to reconcile estimates of RPP and non-RPP consumption once actuals are known. The description should detail the distributor's method for estimating RPP and non-RPP consumption, as well as its treatment of embedded generation or any embedded distribution customers. Distributors are reminded that they are expected to use accrual accounting.

3.2.5.3 Capacity Based Demand Response (CBDR)

Distributors should follow accounting guidance on the disposition of CBDR variances. The IRM rate generator model will be able to support disposition of CBDR balances for Class B customers.

3.2.6 LRAM Variance Account (LRAMVA)

The OEB established Account 1568 as the Lost Revenue Adjustment Mechanism Variance Account (LRAMVA) to capture the variance between the OEB-approved Conservation and Demand Management (CDM) forecast and the actual results at the customer rate class level. Accounting guidelines regarding the LRAMVA can be found in Appendix B of the 2012 CDM Guidelines. Distributors should refer to the CDM Guidelines for further details.

In 2016, OEB staff held a consultation and updated its policy on the calculation of the LRAMVA in respect of peak demand savings. In a report issued May 19, 2016, the OEB determined that:

- Distributors should multiply the peak demand (kW) savings amounts from energy efficiency programs included in the IESO Final Results by the number of months the IESO has indicated those savings take place throughout the year (generally all 12 months)

- No peak demand (kW) savings from Demand Response (DR) programs should generally be included within the LRAMVA calculation. A distributor that wants to present empirical evidence to support DR savings in the LRAMVA can only do so as part of a cost of service or Custom IR application

- Distributors can use the information included within the IESO-approved 2015-2020 CDM plan when developing its CDM manual adjustment for load forecast purposes

No request for approval of lost revenues related to peak demand savings from demand response programs will be evaluated in an IRM rate application.

The distributor shall compare the OEB-approved CDM adjustment to the load forecast with the actual CDM results. The variance calculated from this comparison shall be recorded in separate sub-accounts for the applicable customer rate classes.

Distributors must continue to track the variances between the OEB-approved CDM adjustment to their load forecasts and the actual CDM results in the LRAMVA for the 2015-2020 period.

3.2.6.1 Disposition of the LRAMVA

At a minimum, distributors must apply for the disposition of the balance in the LRAMVA as part of their cost of service applications. Distributors may apply for the disposition of the balance in the LRAMVA on an annual basis, as part of their IRM rate applications, if the balance is deemed significant by the applicant.

A new LRAMVA work form has been created to provide information from distributors that are seeking to dispose of their LRAMVA. Distributors must provide this work form in a working Microsoft Excel file and also provide the following information:

- A statement indicating that the distributor has used the most recent input assumptions available at the time of the program evaluation when calculating its lost revenue amount
- A statement indicating that the distributor has relied on the most recent and appropriate final CDM evaluation report from the IESO in support of its lost revenue calculation and include a copy of this report
- For OEB-approved programs, a third party report, in accordance with the IESO's EM&V Protocols as set out in Section 6.1 of the CDM Code, that provides a review and verification of the distributor's lost revenue calculations, including:

- Confirmation of the use of correct input assumptions and lost revenue calculations
- Verified participation amounts
- The net and gross kW and kWh impacts of each program and by each customer class, both gross and net of free riders, separated by year
- Verification of any carrying charges requested.

A separate third party review of the distributor's IESO-contracted Province-Wide CDM programs is not required.

An application to dispose of the balance in an LRAMVA may only be filed as part of an Annual IR Index application if the OEB's decision for the distributor's last cost of service (or settlement agreement approved by the OEB) has a clear description of class-specific CDM adjustments made to the load forecast to be used in the calculation of the LRAMVA balance. Any LRAMVA applications determined by the OEB to be more complicated than appropriate for an Annual IR Index application will be bifurcated and heard separately from the Annual IR Index application.

3.2.7 Tax Changes

OEB policy, as described in the OEB's 2008 report entitled Supplemental Report of the *Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the Supplemental Report), prescribes a 50/50 sharing of impacts of legislated tax changes from distributors' tax rates embedded in its OEB approved base rate known at the time of application. These amounts will be refunded to or recovered from customers over a 12-month period. If applicable, applicants must complete sheets 8 and 9 of the rate generator model. The rate generator model will calculate an applicable rate rider using the appropriate customer class data underlying the OEB approved rates. A rate rider to four decimal places must be generated for all applicable customer classes in order to dispose of the amounts. If one or more customer classes does not generate a rate rider to the fourth decimal place, the entire 50/50 sharing amount will be transferred to Account 1595 for disposition at a future date.

3.2.8 Z-factor Claims

Price Cap IR applicants have the ability to include in their application a request to recover costs associated with unforeseen events that are outside the control of a distributor's ability to manage, such as damage that is the result of a storm. The cost to a distributor must be material and its causation clear. Costs are to be recorded in Account 1572, Extraordinary Events Costs. To recover these amounts, a distributor must follow the guidelines discussed in section 2.6 of the *Board's Report on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* – July 14, 2008. The materiality thresholds, described in the OEB's Policy Manual, must be met on an individual event basis in order for the distributor to apply for recovery of the relevant costs.

3.2.8.1 Z-factor Filing Guidelines

A distributor must submit evidence that the costs incurred meet the three eligibility criteria. A distributor must also:

- Notify the OEB promptly by letter to the Board Secretary of all Z-factor events. Failure to notify the OEB within six months of the event may result in disallowance of the claim.

- Apply to the OEB for any cost recovery of amounts recorded in the OEB-approved deferral account claimed under Z-factor treatment. This will allow the OEB and any affected distributor the flexibility to address extraordinary events in a timely manner. Subsequently, the OEB may review and prospectively adjust the amounts for which Z-factor treatment is claimed.

- Provide a clear demonstration that the management of the distributor could not have been able to plan and budget for the event and that the harm caused by extraordinary events is genuinely incremental to their experience or reasonable expectations.

- Demonstrate that the costs are incremental to those already being recovered in rates as part of ongoing business exposure risk.

3.2.8.2 Z-factor Accounting Treatment

The distributor will record eligible Z-factor cost amounts in Account 1572, Extraordinary Event Costs, of the OEB's USoA contained in the Accounting Procedures Handbook (APH) for electricity distributors. Monthly carrying charges shall be recorded in Account 1572. Carrying charges are calculated using simple interest applied to the monthly opening balances in the account and recorded in a separate sub-account of this account. The rate of interest shall be the rate prescribed by the OEB for deferral and variance accounts for the respective quarterly period published on the OEB's web site.

3.2.8.3 Recovery of Z-Factor Costs

As part of its claim, a distributor must outline the manner in which it intends to allocate the incremental revenue requirement to the various customer rate classes, the rationale for the selected approach and a discussion of the merits of alternative allocation methods. Recovery will be through a rate rider[11]. The request must specify whether the rate rider(s) will apply on a fixed or variable basis or a combination thereof, and the length of the disposition period and a rationale for this proposal. As discussed at section 3.2.3, any new rate riders that apply to residential classes must only be applied on a

[11] See Appendix B

fixed basis. A detailed calculation of the incremental revenue requirement and resulting rate rider(s) must be provided.

3.3 Elements Specific only to the Price Cap IR Plan

3.3.1 Advanced Capital Module

On September 18, 2014, the OEB issued the *Report of the Board - New Policy Options for the Funding of Capital Investments: The Advanced Capital Module (*EB-2014-0219*)* (ACM Report). The advanced capital module (ACM) describes the OEB's new policy with respect to incremental capital funding available to distributors during the Price Cap IR period. The ACM reflects an evolution of the Incremental Capital Module (ICM) adopted by the OEB in 2008. The ACM approach seeks to increase regulatory efficiency during the Price Cap IR term and provides a distributor with the opportunity to smooth out its capital program over the five year period between cost of service applications.

A distributor must make any ACM requests as part of a cost of service application. At that time, the need for and prudence of any such requests will be determined. Cost recovery (i.e. rate riders) for qualifying ACM projects will be determined in the subsequent Price Cap IR application for the year in which the capital investment will come into service.

While an ACM request must be made in a cost of service application, a Price Cap IR application is the vehicle in which an applicant may calculate the rate rider to recover the amounts approved in a cost of service application. A distributor seeking cost recovery through a Price Cap IR application should carefully review the ACM Report before making such a request.

A distributor approved for an ACM in its most recent cost of service application must file its most recent calculation of its regulated return (RRR 2.1.5.6) at the time of the applicable Price Cap IR application in which funding for the project, and recovery through rate riders, would commence. If the regulated return exceeds 300 basis points above the deemed return on equity embedded in the distributor's rates, the funding for any incremental capital project will not be allowed. Therefore, any approvals provided for an ACM in a cost of service application will be subject to the distributor passing the means test in order to receive its funding during the IR term. The same means test shall also apply going forward for new projects proposed as ICMs during the Price Cap IR term.

A distributor meeting this requirement must provide for the relevant project or projects updated cost projections, confirmation that the project or projects are on schedule to be completed as planned and an updated ACM/ICM module in Excel format. If the proposed cost recovery differs significantly from the pre-approved amount, the distributor must provide a detailed explanation. Any changes in the scope or timing of the project must be clearly explained and justified.

If the updated cost projections are 30% greater than the pre-approved amount, the distributor must treat the project as a new ICM project and re-file the business case and other relevant material in the applicable IR year.

As part of the distributor's subsequent rebasing application, the OEB will carry out a prudence review of the actual costs to determine the amounts to be incorporated in rate base. At that time, the OEB will also make a determination regarding the treatment of differences between forecast and actual spending during the remainder of the IRM plan term.

On January 22, 2016, the OEB issued the *Report of the OEB on New Policy Options for the Funding of Capital Investments: Supplemental Report*. This report made changes to the materiality threshold on which ACM and ICM proposals are assessed, but otherwise does not alter the requirements for ACM and ICM proposals by an applicant. The Supplemental Report also reaffirms the applicability of the half-year rule for determining the return of and return on capital in the first year that assets enter service.

An associated and updated Capital Funding Module to reflect the changes to the materiality threshold was also issued along with the Supplemental Report, and is available on the OEB's website. A distributor filing for ACM/ICM rate riders must use the current model.

3.3.2 Incremental Capital Module

The ICM remains available to electricity distributors opting for Price Cap IR. The ICM is intended to address the treatment of capital investment needs that arise during the rate-setting plan which are incremental to the materiality threshold defined below. The ICM is available for discretionary and non-discretionary projects. The ICM is also available for capital projects that were not included in the distributor's last filed Distribution System Plan. Even for approved ACM projects, an ICM is available if an updated ACM budget exceeds the approved ACM budget by 30%. Distributors with multiple capital projects should consider the Custom IR option to address capital needs in the context of their Distribution System Plan, rather than submit multiple ICM applications.

The ICM is not available for incremental funding if a distributor's regulated return exceeds 300 basis points above the deemed return on equity embedded in the distributor's rates.

The requested amount for an ICM claim must be incremental to a distributor's capital requirements within the context of its financial capacities underpinned by existing rates and satisfy the eligibility criteria of materiality, need and prudence set out in section 4.1.5 of the ACM Report.

Criteria	Description
Materiality	A capital budget will be deemed to be material, and as such reflect eligible projects, if it exceeds the OEB-defined materiality threshold. Any incremental capital amounts approved for recovery must fit within the total eligible incremental capital amount (as defined in this ACM Report) and must clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing. Minor expenditures in comparison to the overall capital budget should be considered ineligible for ACM or ICM treatment. A certain degree of project expenditure over and above the OEB-defined threshold calculation is expected to be absorbed within the total capital budget.
Need	The distributor must pass the Means Test (as defined in the ACM Report). Amounts must be based on discrete projects, and should be directly related to the claimed driver. The amounts must be clearly outside of the base upon which the rates were derived.
Prudence	The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

3.3.2.1 ICM Filing Requirements

The OEB requires that a distributor requesting relief for incremental capital during the IRM plan term include comprehensive evidence to support the need, which should include the following:

- An analysis demonstrating that the materiality threshold test has been met and that the amounts will have a significant influence on the operation of the distributor

- Justification that the amounts to be incurred will be prudent. This means that the distributor's decision to incur the amounts represents the most cost-effective option (but not necessarily the least initial cost) for ratepayers

- Justification that amounts being sought are directly related to the cause, which must be clearly outside of the base upon which current rates were derived

- Evidence that the incremental revenue requested will not be recovered through other means (e.g., it is not, in full or in part, included in base rates or being funded by the expansion of service to include new customers and other load growth)

- Details by project for the proposed capital spending plan for the expected in-service year
- A description of the proposed capital projects and expected in-service dates
- Calculation of the revenue requirement (i.e. the cost of capital, depreciation, and PILs) associated with each proposed incremental capital project
- Calculation of each incremental project's revenue requirements that will be offset by revenue generated through other means (e.g. customer contributions in aid of construction)
- A description of the actions the distributor would take in the event that the OEB does not approve the application
- Calculation of a rate rider to recover the incremental revenue from each applicable customer class. The distributor must identify and provide a rationale for its proposed rider design, whether variable, fixed or a combination of fixed and variable riders. As discussed at section 3.2.3, any new rate rider for the residential class must be applied on a fixed basis

3.3.2.2 ACM/ICM Materiality Threshold

The ACM/ICM materiality threshold is discussed in section 4.5 of the supplemental report.

The OEB determined that the following formula is to be used by a distributor to calculate the materiality threshold:

$$Threshold\ Value\ (\%) = \left(1 + \left[\left(\frac{RB}{d}\right) \times \left(g + PCI \times (1 + g)\right)\right]\right) \times \left((1 + g) \times (1 + PCI)\right)^{n-1} + X\%$$

where n is the number of years since the cost of service rebasing. Many of the parameters remain unchanged from the original formula except for the following:

- the growth factor g is annualized
- the dead band X has been reduced to 10%
- the stretch factor used in the PCI will be the factor assigned to the middle cohort (currently 0.3%) for all distributors

3.3.2.2 Eligible Incremental Capital Amount

In the ACM report, the OEB retained its determination that the eligible incremental capital amount sought for recovery should be capital in excess of the ACM/ICM materiality threshold. This is in effect a capital expenditure threshold which serves to demonstrate the level of capital expenditures that a distributor should be able to manage with its current rates, growth in demand and normal volatility in business conditions. Accordingly, the materiality threshold value, as calculated using the formula discussed in section 4 of the ACM report, establishes eligibility for incremental capital spending and also marks the base from which to calculate the maximum amount eligible for recovery. A distributor applying for recovery of incremental capital should calculate the maximum allowable capital amount by taking the difference between the forecasted 2016 total capital expenditures and the ACM/ICM materiality threshold.

3.3.2.3 Application of the Half-Year Rule

The OEB's general guidance on the application of the half-year rule was originally provided in the supplemental report. In this report the OEB determined that the half-year rule should not apply so as not to build a deficiency for the subsequent years of the IRM plan term. This approach is unchanged in the new ACM/ICM policy. However, the OEB's approach in decisions has been to apply the half-year rule in cases in which the ICM request coincides with the final year of a distributor's IRM plan term[12].

3.3.2.4 ACM/ICM Accounting Treatment

The distributor will record eligible ICM amounts in Account 1508 – Other Regulatory Asset, sub-account Incremental Capital Expenditures, subject to the assets being used and useful. For incremental capital assets under construction, the normal construction work in progress (CWIP) accounting treatment will apply until these assets go into service and are eligible to be recorded in the 1508 sub-accounts listed below.

Distributors shall record actual amounts in the following sub-accounts of Account 1508 – Other Regulatory Assets:

- Account 1508 – Other Regulatory Assets, Sub-account Incremental Capital Expenditures
- Account 1508 – Other Regulatory Assets, Sub-account Depreciation Expense
- Account 1508 – Other Regulatory Assets, Sub-account Accumulated Depreciation
- Account 1508 – Other Regulatory Assets, Sub-account Incremental Capital Expenditures Rate Rider Revenues

[12] EB-2010-0130, Guelph Hydro Electric Systems Inc., Decision and Order, p. 15

The distributor shall also record monthly carrying charges in the following sub-accounts. Carrying charge amounts are calculated by applying simple interest to the monthly opening balances:

- Account 1508 – Other Regulatory Assets, Sub-account Incremental Capital Expenditures, Carrying charges
- Account 1508 – Other Regulatory Assets, Sub-account Incremental Capital Expenditures Rate Rider Revenues, Carrying Charges

The applicable rate of interest for deferral and variance accounts for the respective quarterly period is prescribed by the OEB and published on the OEB's web site.

All of these sub-accounts should be used for both approved ACM and ICM projects. If the OEB approves the true-up of any variances for ACM/ICM projects at the next cost of service application, the recalculated revenue requirement relating to the actual ACM/ICM capital expenditures should be compared to the rate rider revenues collected in the same period, plus the carrying charges in the respective sub-accounts. These variances would then be refunded to, or collected from, customers through rate riders.

3.3.2.5 Rate Generator and Supplemental Filing Module for ACM/ICM

The supplemental filing module for ACM/ICM supporting the rate generator model will assist the distributor in calculating the distributor's threshold. The distributor will then tabulate the value of its eligible investments and compare this to the threshold result to determine the amount that would be eligible for recovery. Other calculation work forms will be provided to calculate the revenue requirement for each project proposed for inclusion in the ICM request in the supplemental filing module. Once all work forms are completed and listed in the supplemental module, the tabulated revenue requirement will be converted into class-specific rate riders. The rate riders will need to be added to Tab 18 of the rate generator model in order for them to be displayed on the Tariff of Rates and Charges.

3.3.3 Treatment of Costs for 'eligible investments'

On March 28, 2013, the OEB issued *Filing Requirements for Electricity Transmission and Distribution Applications – Chapter 5: Consolidated Distribution System Plan Filing Requirements* (Chapter 5). As noted in section 5.0.5, Chapter 5 supersedes the *Filing Requirements: Distribution System Plans - Filing under Deemed Conditions of Licence*.

As indicated in the cover letter to Chapter 5 dated March 28, 2013, distributors who have yet to file under Chapter 5 will continue to be able to record renewable energy generation costs and smart grid demonstration costs in the deferral accounts that were established for that purpose. However, no new deferral accounts for these types of expenditures will be established. Distributors under Price Cap IR who have yet to file a cost of service application containing a consolidated capital plan pursuant to Chapter 5 will continue to be able to request advance funding through a funding adder for renewable generation connection costs and smart grid development costs. Where a distributor seeks a funding adder, sufficient information must be provided to allow the OEB to assess the need for the mechanism and the nature and quantum of the costs to be collected from ratepayers and the basis for calculating the funding adder. The costs recovered through the funding adder will be subject to a prudence review in the first cost of service application following the implementation of the funding adder.

Distributors proposing to file an Annual IR Index application must make a Chapter 5 filing within five years of the date of the most recent OEB decision approving their rates in a cost of service proceeding and are required to do so at five year intervals thereafter while using the Annual IR Index method.

3.3.4 Conservation and Demand Management Costs for Distributors

CDM activity is funded either through IESO Contracted Province Wide CDM Programs, or through an OEB-approved CDM program. Both of these approaches fund the programs through the GA mechanism, and therefore must not be included in distribution rates.

3.3.5 Off-ramps

For each of the OEB's three rate-setting options, a regulatory review may be triggered if a distributor's earnings are outside of a dead band of +/- 300 basis points from the OEB-approved return on equity. The OEB monitors results filed by distributors as part of their reporting and record-keeping requirements and determines if a regulatory review is warranted. Any such review will be prospective, and could result in modifications, termination or the continuation of the respective Price Cap IR or Annual IR Index plan for that distributor.

A distributor whose earnings are in excess of the dead band is expected to refrain from seeking an adjustment to its base rates through a Price Cap IR or Annual IR Index plan. If a distributor whose earnings are in excess of the deadband nevertheless applies for an increase to its base rates, the OEB expects it to substantiate its reasons for doing so. The applicant should anticipate that the level of earnings will be raised as an issue in the application.

A distributor may choose to file only for disposition of Group 1 deferral and variance account balances in accordance with OEB policies, without applying for adjustments to its base rates.

3.4 Specific Exclusions from Price Cap IR or Annual IR Index Applications

The IRM application process is intended to be mechanistic in nature. For this reason, the OEB has determined that the IRM process is not the appropriate way for a distributor to seek relief on issues which are specific to only one or a few distributors, more complicated relative to issues typical of an IRM application, or potentially contentious. The following are examples of specific exclusions from the IRM rate application process:

- Rate Harmonization, other than that pursuant to a prior OEB decision
- Disposition of the balance of Account 1555 – Smart Meter Capital Costs, sub-account Stranded Meter Net book Value
- Changes to revenue-to-cost ratios, other than pursuant to a prior OEB decision
- Loss Factor Changes
- Establishing or changing Specific Service Charges
- Loss Carry Forward Adjustments to PILs/taxes
- Disposition of Group 2 Deferral and Variance Accounts
- Loss of Customer Load

These items are to be addressed in the distributor's next cost of service application. The exclusions above also apply to the Annual IR Index plan. In addition, distributors seeking adjustments that are inconsistent with OEB policy should consider whether one of the other rate-setting options is more appropriate. As indicated in the RRFE report, distributors filing under the Annual IR Index plan must file a separate, stand-alone application for the review and disposition of Group 2 Deferral and Variance Accounts.

Appendix A: Application of Recoveries in Account 1595

When final approval for disposition of deferral and variance account balances is received from the OEB, the final approved amounts of principal and interest carrying charges is transferred to Account 1595.

The cumulative principal balance transferred to Account 1595 is drawn down by the rate rider recoveries first, before the interest balance transferred to Account 1595 is drawn down. Interest carrying charges are applied to the principal balance net of recoveries.

The following approach is used for the application of recoveries (via rate riders) to the transferred amounts under two scenarios:

Scenario 1: Rate Rider ceases with Principal amount remaining.

If the rate rider ends before the principal is fully drawn down, the principal balance is held static and interest carrying charges are applied to the remaining principal balance. The approved rate rider flowing from the next application to dispose of deferral and variance accounts should include the remaining principal and interest carrying charges.

Scenario 2: Rate Rider ceases with no Principal amount remaining but with Interest Carrying Charges remaining.

The approved rate rider flowing from the next application to dispose of deferral and variance account balances should include the cumulative interest carrying charge amounts.

Appendix B: Rate Adder versus Rate Rider

Rate Adder

A rate adder (or funding adder) is a tool designed to provide advance funding on an interim basis to distributors for certain investments or expenses as prescribed by the OEB and to mitigate or smooth the anticipated rate impact when recovery of these costs are approved by the OEB. Approval of a rate adder does not constitute regulatory approval of any costs actually incurred. The prudence of incurring such costs is examined, and the costs may be approved in whole or in part, at the time at which the distributor brings the matter forward for regulatory review.

Rate adders are identified and listed separately on a distributor's tariff of rates and charges and may have a termination date.

Rate Rider

A rate rider differs from a rate adder in that it is designed to recover or refund OEB-approved amounts following a review of the proposed costs to determine that it is reasonable for the distributor to incur and recover them. Rate riders are identified and listed separately on a distributor's tariff of rates and charges, with an explicit termination date.

Treatment of Negligible Rate Adders and Rate Riders

Rate adders and rate riders normally apply to one or more select rate classes on a fixed basis, a volumetric basis or a combination of both. A rate adder or rate rider is usually determined by dividing the OEB-approved allocated amounts by the OEB-approved forecast or historical energy use or demand.

Occasionally, the calculated rate adders or rate riders for one or more rate classes may be negligible. In the event where the calculation of any rate adder or rate rider results in a volumetric rate rider that rounds to zero at five significant digits (i.e., the fourth decimal place) per kWh or per kW, the entire OEB-approved amount for recovery or refund will typically be recorded in a USoA account to be determined by the OEB for disposition in a future rate setting. Distributors may propose alternatives to this approach in the event that there is a significant discrepancy in the size of the riders among classes (e.g., if a rider is of a non-negligible size for one or more classes, but negligible or insignificant for another class).