MARITIME ELECTRIC
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The Island Regulatory and Appeals Commission

March 8, 2019

Ms. Cheryl Mosher
Island Regulatory & Appeals Commission
PO Box 577
Charlottetown PE C1A 7L1

Dear Ms. Mosher:

General Rate Application - Docket UE20944
Revised IR-45 Response to Interrogatories from Commission Staff

Please find attached the Company's revised IR-45 response to Interrogatories from Commission Staff with respect to the General Rate Application filed on November 30, 2018.

Yours truly,

MARITIME ELECTRIC

Gloria Crockett

Gloria Crockett, CPA, CA
Manager, Regulatory & Financial Planning

GCC20
Enclosure

IR-45 Please advise which Canadian regulators have allowed an earnings sharing mechanism and which have disallowed it. For those regulators that have allowed an earnings sharing mechanism, please provide full details of the approved earnings sharing mechanism.

Response ***– Revised March 8, 2019***

The Concentric report filed with the Company's application states that the primary purpose of an Earnings Sharing Mechanism ("ESM") is to share with customers earnings that deviate in a meaningful way from the level of earnings associated with the authorized ROE. Although the terminology or description will differ across jurisdictions, ESMs are characterized by two key parameters: i) the size of the allowed range of ROE, and 2) the percentage of sharing of the earnings outside the allowed range between the utility and customers.

In its 2006 General Rate Application, Maritime Electric proposed the establishment of an allowed range of ROE around the authorized ROE. Although the Commission did not specifically deny the request by Order, the Commission's decision in its Order on the application did not address or allow the proposed range of ROE. In addition, a range of ROE around the authorized ROE was proposed in the 2015 General Rate Application filing. However, this application was replaced by the General Rate Agreement approved in Order UE16-04. The Company has not been able to identify applications in other jurisdictions in Canada where a request for an ESM has been denied.

The following information, by Province, comprises the details of the ROE banding and earnings sharing parameters that the Company has identified.

British Columbia

In 2014, the British Columbia Utilities Commission ("BCUC") approved the Multi-year Performance Based Ratemaking ("PBR") Plan for 2014 through 2018 for FortisBC Inc. The relevant pages from the BCUC's decision related to the allowed range of ROE and earnings sharing are included with this response as IR-45 – Attachment 1.

In its decision, the BCUC discusses the earnings sharing methodology in Section 2.2.1 – Earnings Sharing Mechanism (Pages 119-121) and the banding parameters (or off-ramps) around the ROE in Section 2.2.24 – Off Ramps (Pages 151-155). Under the approved formula, earnings are shared 50 : 50 with customers around an ROE range of ± 200 basis points on a post-sharing basis in one year or if the average earnings for two consecutive years vary ± 150 basis points on a post-sharing basis.

Alberta

In 2016, the Alberta Utilities Commission ("AUC") issued its decision on a PBR plan for the 2018 – 2022 period for four electric and two gas utilities in Alberta. The relevant pages from the AUC's decision related to the allowed range of ROE are included with this response as IR-45 – Attachment 2.

In Section 7 – Calculation of Returns for Reopener Purposes (Pages 71 – 79) of the AUC decision, the AUC establishes the band around the utility's ROE that must be exceeded, either above or below, before the AUC will consider reopening the PBR plan to address variations in the ROE. The AUC, in its decision, stated that it will continue to use a ± 500 basis points threshold in a single year and a ± 300 basis points threshold for two consecutive years as the level at which it would consider reviewing the PBR plan in relation to the achieve ROEs.

Maritime Electric has not identified any previous decisions of the AUC with regard to any sharing of earnings outside the prescribed ROE bands. However, in June 2018, the AUC did establish a proceeding to determine whether or not to re-open, or review, the achieved ROEs for ATCO Electric and ATCO Gas for 2016 and 2017. To date, the AUC has not issued a decision on this proceeding.

Saskatchewan

SaskPower and Manitoba Hydro are provincially owned utilities. The Company has no application to indicate any form of an ESM in place in these jurisdictions.

Ontario

The Ontario Energy Board ("OEB") uses incentive based rate setting for electricity distribution utilities in Ontario. On July 12, 2018, the OEB released its guidelines for applications, included with this response as IR-45 – Attachment 3.

In Section 3.3.5 – Off-Ramp (Page 30) of the OEB guidelines, the OEB states that a regulatory review may be triggered if the achieved earnings are outside a ± 300 basis points threshold or deadband. Since the review is not automatic, there are no guidelines specified with respect to the disposition of any excess earnings outside the deadband.

In consultation with FortisOntario, an electric distribution utility in Ontario, Maritime Electric has not identified any instances where earnings have been outside the ± 300 basis points deadband and the OEB has ordered sharing with customers. The Company therefore concludes that the utilities have either not had earnings outside the deadband or have, in accordance with the application of the OEB guidelines, refrained from seeking prospective adjustments to base rates.

IR Update to Reponse – March 8, 2019

On March 7, 2019, the OEB issued Decision and Order EB-2017-0049 with respect to an application by Hydro One Networks Inc. for approval of electricity transmission and distribution rates for the period January 1, 2018 to December 31, 2022. At Section 3.2.7 – Earnings Sharing Mechanism (Issue 15), included with this response as IR-45 – Attachment 8, the OEB approved an ESM that will share regulated earnings outside a ±100 basis threshold around the OEB approved ROE on a 50:50 basis between the utility and its customers.

In its decision, the OEB notes that the approved ESM based an actual regulated earnings:

i. provides the appropriate protection for customers if Hydro One has excess earnings;
ii. provides an appropriate range of return to incent the utility to achieve productivity improvements; and
iii. is a simpler approach (using actual regulated earnings) to assessing the earnings to be shared.

Quebec and New Brunswick

Hydro Quebec and New Brunswick Power are provincially owned utilities. The Company has no application to indicate any form of an ESM in place in these jurisdictions.

Nova Scotia Power

Nova Scotia Power Inc. (“NSPI”) has had an allowable range of ROE (or deadband) since its privatization in 1992. At that time, the allowable range was established by the Nova Scotia Utility and Review Board (“NSUARB”) to be 50 basis points (± 25 basis points) which remains in place today.

The NSUARB’s decision on NSPI’s 2009 General Rate Application, included with this response as IR-45 – Attachment 4, describes the ± 25 basis points range and the NSUARB’s views on the disposition of any excess earnings in paragraphs 110 – 115. At that time, paragraph 110 states that excess earnings will be applied to reduce two deferral accounts. In consultation with a representative at NSPI, the Company has been informed that, through a 2012 settlement agreement, this approval remains in place with any excess earnings to be credited for the benefit of customers to the Fuel Adjustment Mechanism deferral account.

Newfoundland

The Newfoundland Public Utilities Board (“PUB”) requires Newfoundland Power Inc. (“NP”) to use an Excess Earnings Account that is to be credited with any earnings in excess of the upper limit of the allowed return on rate base as approved by the PUB. The upper limit of NP’s allowed return on rate base was set at 0.18% above the rate of return on rate base used for rate making by Order P.U.19 (2003), Pages 75 – 76, included with this response as IR-45 – Attachment 5.

PUB Order P.U.19 (2003) establishes the allowed range of return on rate base at 36 basis points (± 18 basis points). This 18 basis points return on rate base upper limit represents a 40 – 50 basis points upper limit in NP’s return on equity as discussed in its response to Request for Information CA-NP-092 included with this response as IR-45 – Attachment 6.

Any earnings in excess of the upper limit are credited to the Excess Earnings Account and are then subject to disposition by order of the PUB. Where the amounts are material, the balance has typically been disposed of via a refund to customers, as illustrated in PUB Order P.U.37 (2000 – 2001) included with this response as IR-45 – Attachment 7. NP has indicated that where the amounts are immaterial, they have been deferred and used to offset revenue requirement in a future year.

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

DECISION AND ORDER

EB-2017-0049

HYDRO ONE NETWORKS INC.

Application for electricity distribution rates beginning January 1, 2018 until December 31, 2022

BEFORE: Ken Quesnelle
Presiding Member

Emad Elsayed
Member

Lynne Anderson
Member

March 7, 2019

As part of the integration, Hydro One has proposed to create six new rate classes for the customers of the Acquired Utilities.

Findings

Under Issue 56, the OEB has determined that the Acquired Utilities will not be integrated into the revenue requirement of the rest of Hydro One during the plan term. For this reason, there is no need to create new rate classes for the customers of the Acquired Utilities. The rates for the Acquired Utilities will be based on the Price Cap IR approach once the deferred rebasing period concludes.

The rationale for extending the deferred rebasing period for the Norfolk service area is no longer relevant. Hydro One may either extend the deferred rebasing period by the one year as planned, or apply to move to the Price Cap IR approach.

3.2.7 Earnings Sharing Mechanism (Issue 15)

Issue 15. Is the proposed Earnings/Sharing mechanism appropriate?

Hydro One proposed an earnings sharing mechanism (ESM) that would apply to all years of the Custom IR plan.[85] The proposed ESM is asymmetrical, with a 50/50 sharing of any achieved ROE exceeding the allowed ROE on a regulated basis by 100 basis points for each test year. The mid-year rate base would be used to calculate the ROE for each year. Any excess earnings to be refunded to customers would be adjusted for tax impacts in the year, and accumulated in a deferral account (DVA). Hydro One proposed that any refund would be disposed of at the time of its next rebasing application.

SEC supported Hydro One's proposed ESM, noting that "it is generally consistent with other ESMs that have been approved by the Board."[86] In its submission, OEB staff did not oppose the proposed ESM, but made two submissions with respect to the calculation of carrying charges on the balances of the proposed DVA and disposition of any balance at Hydro One's next rebasing application. OEB staff noted that Hydro One had concurred with the proposals in responses to interrogatories.[87]

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[85] Exhibit A/3/2/p. 9/section 2.1.
[86] SEC, *op. cit*., p. 19.
[87] OEB staff, *op. cit*. p. 40. The interrogatories referenced were Exhibit I/15/CME-7 part h) and Exhibit I/15/Staff-64.

BOMA and CCC submitted that the ESM should have no deadband, and that any refunds should be returned to ratepayers as part of the annual rate adjustment (similar to what the OEB approved for Enbridge Gas Distribution),[88] and not wait until the end of the plan term.[89] VECC also submitted that the 100 basis point deadband should be eliminated.[90] CME submitted that the proposed 100 basis point deadband was equivalent to about $40M in revenue requirement, and was too high. It submitted that the ESM deadband should be the same as the Z-factor materiality threshold, and that the ESM DVA should be cleared annually.[91]

Hydro One replied that the 100 basis point deadband provides greater incentive for a utility to increase its productivity. Hydro One also noted that the OEB found shortcomings for Enbridge Gas' Custom IR, such as lack of total cost benchmarking and independent budget assessment and that these shortcomings are not present in its application.[92] Hydro One noted the support of OEB staff, QMA and SEC for its proposed ESM.

Findings

The OEB approves an asymmetrical earnings sharing mechanism (ESM) that will share regulated earnings on a 50:50 basis between Hydro One and its customers for all earnings in excess of 100 basis points from the OEB-approved return on equity. The OEB finds that this will provide the appropriate protection for customers if Hydro One has excess earnings. The Custom IR framework is intended to incent Hydro One to achieve productivity improvements, and any incentives can be diminished if an ESM is too restrictive.

As proposed by Hydro One, the ESM will be on an actual basis (earnings not normalized for weather). Using actual earnings is a simpler approach to assessing the earnings that will be shared, and any amounts shared with customers will be based on the actual regulated earnings of Hydro One each year.

The OEB is establishing a deferral account for Hydro One to record any amount to be shared during the term. Interest will accrue annually on any balance in the account using the OEB's prescribed interest rates for deferral and variance accounts. This account will be reviewed for 2018 and 2019 earnings with the annual update application

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[88] EB-2012-0459, Decision and Order, p. 15.
[89] BOMA, *op. cit.*, p. 39, and CCC, *op. cit.*, pp. 8-9.
[90] VECC, *op. cit.*, p. 13.
[91] CME, *op. cit.*, pp. 18-20.
[92] Hydro One Reply Argument, *op. cit.,* p. 41.

for 2021 rates, to determine whether any amount should be refunded to customers. The account balance will also be reviewed for disposition with Hydro One's next rebasing application. As noted by OEB staff, a final review will be required once financial results for 2022 are finalized.

3.2.8 Z-factor and Off-Ramps (Issue 16)

Issue 16. Are the proposed Z-factors and Off-Ramps appropriate?

Z-factor

Hydro One proposed a Z-factor to deal with unforeseen costs based on the criteria set out in the OEB's policies. The OEB's policy requires that a Z-factor claim be for a non-routine event outside of the control of management and clearly outside of the base upon which rates are derived. Hydro One initially proposed using a materiality threshold of $1.0 million,[93] consistent with the *Filing Requirements for Electricity Distribution Applications - Cost of Service* (Cost of Service Filing Requirements).

OEB staff did not oppose Hydro One's proposed Z-factor treatment and the proposed $1 million materiality threshold, but suggested that an option available to the OEB would be to "right-size" the materiality threshold; an option contemplated in the Rate Handbook for Custom IR plans.[94] OEB staff suggested a materiality threshold of $3.0 million, as Hydro One transmission has a threshold of $3 million based on its revenue requirement of about $1.5 billion,[95] similar to the proposed revenue requirement of about $1.45 billion for Hydro One distribution in this application.

BOMA proposed a $3.0 million materiality threshold for the Z-factor.[96] CCC submitted that the Z-factor threshold should be $4.0 million, and the Z-factor should be symmetrical – Hydro One should also be required to apply to refund to customers Z-factor savings, in revenue requirement terms, exceeding the $4.0 million threshold.[97] VECC proposed that the materiality threshold should be $3.75 million (0.25% of

[93] Exhibit I/16/CCC-18. See also Exhibit I/16/CME-10.
[94] Rate Handbook, *op. cit.*, p. 27.
[95] EB-2017-0260, Decision, Hydro One Networks 2018 Transmission Revenue Requirement, December 20, 2017, p. 5..
[96] BOMA, *op. cit.*, p. 39.
[97] CCC, *op. cit.*, p. 10.