2025 Victoria Avenue
Regina, SK
Canada S4P 0S1
Phone: 1 (888) 757-6937

November 2017

Saskatchewan Rate Review Panel
P.O. Box 1301
Saskatoon, Saskatchewan
S7K 3N1

RE: Saskatchewan Industrial Energy Consumers Association (SIECA) Submission to the Saskatchewan Rate Review Panel (SRRP), October 30, 2017

SaskPower appreciates the submission from the Saskatchewan Industrial Energy Consumers Association (SIECA) regarding our 2018 Rate Application. We are grateful to address the recommendations presented.

<u>SIECA recommendations to the SRRP</u>

1. *Deny SaskPower's request for a rate increase.*

The proposed rate increase is required for SaskPower to earn its long-term return on equity (ROE) target in 2018-19. Our company has not achieved its ROE target since 2011, instead consistently requesting rate increases that fell short of the ROE target in order to reduce the impact on customers. As a result, since that time SaskPower's debt ratio has climbed to 75.7%, which is outside our shareholder-approved target range of 60 to 75%.

Demand for electricity in Saskatchewan continues to grow, with SaskPower's record peak demand being broken annually. The costs to serve new load and to replace or refurbish major sections of existing aging infrastructure in order to maintain a reasonable level of reliability far exceed the cost of inflation.

As a Crown, SaskPower has a duty to serve the entire province. Our company must accommodate growth in demand and new connections to the province's electricity system regardless of the impact on profitability. New generation options and grid infrastructure are substantially more expensive than the assets they are replacing. As a result, the impact of capital investment has a significant impact on SaskPower's expenses. Overall, our company does not consider that our capital program can be materially reduced without imperilling the long-term physical health of Saskatchewan's electricity system.

2. *Require SaskPower to provide evidence of its true weighted average cost of capital in all future rate applications.*

If directed by the SRRP, in future rate applications SaskPower will provide the weighted average cost of capital. Please refer to SaskPower's clarification concerning SIECA's discussion of return on rate base percentage later in this response.

3. *Require SaskPower to calculate any proposed ROR in the commonly accepted format supported by sufficient evidence in all future rate applications.*

SaskPower asserts that it calculates return on rate base in an accepted format that is supported by sufficient evidence. Please refer to SaskPower's clarification concerning SIECA's discussion of return on rate base percentage later in this response.

4. *Require SaskPower to provide an account level comparison of its latest actual 12 month OM&A expenses with those in its proposed cost of service and provide evidence supporting any difference between the two in all future rate applications*

In future rate applications, SaskPower will provide OM&A expense information as directed by the SRRP.

5. *Require SaskPower to provide third a third party depreciation study with its next rate application.*

SaskPower has deferred past external depreciation studies as part of our company's restraint efforts. During the last external study, the consultant's recommendations resulted in a $1.3 million decrease in SaskPower's depreciation expense. SaskPower completes an internal study annually.

6. *Require SaskPower to develop a confidentiality agreement to facilitate its ability to provide confidential data in response to interrogatories.*

Of the 275 total interrogatories received by SaskPower, only 12 — or 4% — of responses contained confidential information. Of those, the majority contained sensitive information concerning customers or third-party contracts. However, all responses containing confidential information were submitted to the Saskatchewan Rate Review Panel for its review.

<u>SaskPower clarification of material contained in SIECA submission: SaskPower's Return on Rate Base Percentage (Page 3)</u>

SIECA asserts that SaskPower develops its proposed 7.15% return on rate base (RORB) in order to achieve an 8.5% return of equity (ROE), when in fact, the opposite is true. SaskPower calculates the revenue required to achieve an ROE of 8.5% as outlined in <u>Schedule D: 2017-SaskPower Rate Change Proposal Terms of Reference</u> (Section E(ii)) and the RORB from SaskPower's cost of service is derived from this revenue and the financial inputs from its approved Business Plan.

The 2018 Fiscal RORB is calculated as follows:

$$\begin{aligned}\textbf{RORB} &= \textbf{(Revenue Requirement – Expenses) / Rate Base}\\ &= \textbf{(2,539.4 – 1,867.0) / 9,399.1}\\ &= \textbf{7.15\%}\end{aligned}$$

Source: 2018 Fiscal Test Embedded Cost of Service Study

SIECA claims that SaskPower's true cost of equity embedded in SaskPower's proposed rates are well out of line with the cost of equity approved for electric utilities in the United States. They attempt to illustrate this in the table they provided below, which summarizes the calculations:

Calculated True ROE at SaskPower's Stated Return on Rate Base (SIECA)

		Amount	Capital Structure		Cost of Capital		Component Weighted Cost of Capital
Debt	$	6,994	75.16%	*	4.87%	=	3.66%
Equity	$	2,312	24.84%	*	14.05%	=	3.49%
	$	9,306	100.00%		Return on Rate Base	=	7.15%

SaskPower replicated SIECA's table using the actual information contained in the 2018 Fiscal Test Cost of Service Study. The results are provided in the table below:

Calculated True ROE at SaskPower's Stated Return on Rate Base (SaskPower)

		Amount	Capital Structure		Cost of Capital		Component Weighted Cost of Capital
Debt	$	6,994	75.16%	*	5.71%	=	4.30%
Equity	$	2,312	24.84%	*	11.51%	=	2.86%
	$	9,306	100.00%		Return on Rate Base	=	7.15%

Inputs:

		RORB
Rate Base	$9,399,060,000	
Revenue Requirement	$2,539,425,000	
Expenses	$1,867,012,996	
Operating Income Before Finance Charges	$672,412,004	7.15%
Less: Finance Charges	$403,700,000	4.30%
Projected Return	$268,712,004	2.86%

At first glance, it would appear that SaskPower's true cost of equity is overstated (11.51%). However, the 2018 fiscal rate application, if approved, has an effective date of March 1, 2018. SaskPower will be recovering only 1/12th or 0.42% of the proposed 5.0% system average increase in the last month of the fiscal year (ending March 31, 2018). Cost of Service studies are conducted on an annualized basis and therefore must include the full 12 months of projected revenue to properly reflect the 5.0% system average increase, even though SaskPower will not fully recover it, thereby overstating the actual RORB SaskPower will achieve in 2018 fiscal. Once the table is updated with the projected revenue under the March 1, 2018 effective date, the results are as follows:

Calculated True ROE at SaskPower's Stated Return on Rate Base (SaskPower - March 1, 2018)

		Amount	Capital Structure		Cost of Capital		Component Weighted Cost of Capital
Debt	$	6,994	75.16%	*	5.71%	=	4.30%
Equity	$	2,312	24.84%	*	6.77%	=	1.68%
	$	9,306	100.00%		Return on Rate Base	=	5.98%

Inputs:

Rate Base	$9,399,060,000	
Revenue Requirement	$2,428,700,000	
Expenses	$1,867,012,996	RORB
Operating Income Before Finance Charges	$561,687,004	5.98%
Finance Charges	$403,700,000	4.30%
Projected Return	$157,987,004	1.68%

Note: Revenue requirement from section 6.1.1, page 28, Rate Application

Based on this updated information, SaskPower's RORB decreases to 5.98% and is more in line with SIECA's estimated value of 5.77% (SIECA submission - Table 2, page 4) but, contrary to SIECA's assertion, does not negate SaskPower's need for a rate increase.

Under the revised table, SaskPower is actually falling short of its equity return target for the fiscal year by only recovering 6.77% on equity based on the March 1, 2018 effective date. SaskPower would need an additional increase of approximately $40.5M to meet its ROE target of 8.5%. However, a more appropriate test is to examine whether SaskPower's proposed 2018 fiscal 5.0% system average increase will garner the appropriate ROE during the next fiscal year (2019), when a full year of revenue can be included and no additional increase is applied:

Calculated True ROE at SaskPower's Stated Return on Rate Base (SaskPower - 2019 Fiscal)

		Amount	Capital Structure		Cost of Capital		Component Weighted Cost of Capital
Debt	$	7,674	74.58%	*	5.72%	=	4.27%
Equity	$	2,615	25.42%	*	8.54%	=	2.17%
	$	10,290	100.00%		Return on Rate Base	=	6.44%

Inputs:

Rate Base	$9,745,475,245	
Revenue Requirement	$2,566,600,000	
Expenses	$1,939,345,000	RORB
Operating Income Before Finance Charges	$627,255,000	6.44%
Finance Charges	$415,800,000	4.27%
Projected Return	$211,455,000	2.17%

Note: 2019 fiscal revenue requirement is from section 6.1.1, page 28, Rate Application

As shown in the table above, once the 2019 fiscal revenue is adjusted to include the 5.0% system average from 2018 fiscal, SaskPower is projecting to meet its targeted ROE of 8.5%, which is approximately 1.1% lower than the average of 9.6% provided by SIECA in Exhibit 3 of its submission.

SaskPower clarification of material contained in SIECA submission:
Cost Allocation and Rate Design (Page 6)

SaskPower has identified that SIECA has been making inconsistent arguments with regard to use of the Equivalent Peaker Method (EPM) to classify generation costs. During the 2017 Cost of Service Review conducted with the assistance of Elenchus Research Associates, SIECA objected to Elenchus' recommendation that SaskPower replace the EPM with the Average & Excess (AED) methodology:

"SIECA urges SaskPower to reject Elenchus' recommendation to deploy the Average and Excess (A&E) classification/allocation methodology. Elenchus has not demonstrated that the current Equivalent Peaker (EP) methodology is inappropriate or unsustainable…." (SIECA - June 29, 2017)

However, in SIECA's final submission to the SRRP regarding the 2018 Rate Application, SIECA has revised its position:

"SIECA has previously voiced its opposition to the …use of an opaque Equivalent Peaker generation fixed cost classification methodology unsupported by evidence." (SIECA – October 30, 2017)

SaskPower agrees with SIECA's revised position with regard to the use of the EPM and will replace it with the AED methodology as per Elenchus' recommendation from the 2017 Cost of Service Review. This change will occur during the next scheduled rate application.

SIECA's continued opposition to SaskPower's use of the 2CP methodology to allocate demand related costs seems unusual. During the 2017 Cost of Service review, SaskPower illustrated that the use of the 2CP allocator actually benefits the Power customer class compared to the 1CP method. This is confirmed in the table below:

2015 Base Embedded Cost of Service Study ($ Millions)					
	Revenue	Allocated		Revenue to Revenue	
Customer Class		Revenue Requirement		Requirement Ratio	
	(Actuals)	1 CP	2 CP	1 CP	2 CP
Power - Published Rates	$ 464.5	$ 446.1	$ 440.6	1.04	1.05

Source: Review of Cost Allocation and Rate Design Methodologies, Elenchus Research Associates, Appendix D, Page 26

The table above shows that the 2CP methodology results in an allocated Revenue Requirement for Power Class customers being approximately $5.5 million less than the results calculated using 1CP. Similarly, the Revenue to Revenue Requirement Ratios calculated using 2CP yields 1.05 for the Power Class versus 1.04 calculated using 1CP, indicating that the class would likely experience lower increases than they would under the 1CP methodology.

During the 2017 Cost of Service Review, Elenchus Research Associates recommended that SaskPower continue to use the 2CP Methodology and SaskPower agrees with that recommendation.

It is important for all parties to understand that a COS study is not an exercise in analyzing hypothetical scenarios to select a methodology that benefits (or disadvantages) certain customer classes the most; but rather is designed to select a methodology that best fits the utility's circumstances and operating conditions and manage the outcomes accordingly.

Any subsequent impacts on the R/RR ratios that may come from a change in methodologies are then managed through rate applications when rebalancing the customer rate classes. If the impact on the R/RR ratios is significant for one or more of the customer rate classes, the impact may be staged over a number of rate applications in order to not cause undue hardship or rate shock to the class or classes.

Conclusion

SaskPower appreciates the submission of SIECA. Our company values the participation of all stakeholders in the rate review process, and welcomes continuing dialogue as we strive to provide our customers with reliable, sustainable and cost-effective power.