

REPLY SUBMISSION OF TORONTO HYDRO

1. The Applicants (“Toronto Hydro” or “THESL”) are pleased to file their reply argument in relation to the Distribution License and MAAD Applications EB-2009-0180, EB-2009-0181, EB-2009-0182 and EB-2009-0183.
2. Following the conclusion of the oral phase of the hearing and Toronto Hydro’s argument in chief on November 19, 2009, Toronto Hydro received final argument submissions from Board staff and from the following parties:
 - City of Toronto (City)
 - Electrical Contractors Association of Ontario and the Greater Toronto Electrical Contractors Association (Contractors)
 - Electricity Distributors Association (EDA)
 - Energy Probe Research Foundation (Energy Probe)
 - School Energy Coalition (Schools)
 - Vulnerable Energy Consumers Coalition (VECC)
3. Toronto Hydro’s reply argument addresses the main themes raised by Board staff and the intervenors in their argument. Toronto Hydro’s intent is not to repeat the significant amount of evidence already before the Board.
4. Neither Board staff nor intervenors pre-filed any evidence nor called any witnesses during this proceeding.

Uncontested Areas

5. From the arguments received, Toronto Hydro submits that the following facts are uncontested:
 - From the early 1900s to January 1, 1989 streetlighting was built as part of Toronto Hydro’s distribution system.¹

¹ Application, Tab 5, Affidavit of J.S. Couillard.

- The SEL System transfer occurred under a different legislative context than today wherein the former Ontario Hydro was the regulator of distribution utilities, not the Ontario Energy Board.
- This is the first time the Board has been asked explicitly to consider, from its perspective as a public policy regulator, a series of Applications involving the SEL System in Toronto.
- Functionally, the SEL System remains effectively unchanged from when it was part of the former Toronto Hydro distribution system.²
- In determining the matters before it, the correct focus is upon how the Board interprets “distribution”, “distributor” and “distribution system” as defined and applied pursuant to the OEB Act.
- The Board has jurisdiction to decide the Applications and matters before it.
- The Board’s “no harm test” is the applicable test in determining whether to approve Merger, Acquisition, Amalgamations, Divestiture (MAAD) Applications.

Intervenor support for the Applications

6. Both the City and the EDA support the relief sought by Toronto Hydro with respect to each of the Applications before the Board.

Board Staff support for the Applications

7. On the central issues before the OEB, Board staff conclusions are as follows:
 - (a) “the SEL System is in fact a central part of the distribution system that in Board staff’s view cannot be effectively separated from THESL’s distribution system” (p.5-6);
 - (b) “most components of the SEL System meets the definition of the distribution system as defined in the Act, in that they convey electricity at

² Transcript Volume 2, page 64 line 7 through page 67 line 3.

voltage of less than 50 kilovolts and include structures, equipment or other things used for that purpose” (p. 6). Toronto Hydro respectfully disagrees with Board staff’s notion that the luminaire be excluded from distribution, but this matter will be addressed below;

- (c) Mr. Sardana indicated that leaving the luminaire behind introduces one more level of inefficiency into the system. “Board staff agrees that it would be more efficient for one entity to service the SEL System” (p. 7);
- (d) Board staff agrees that there are a number of exceptions made to section 71 of the Act provided in section 71(2). Board staff submits that the Board should consider whether streetlighting services fall under one or more of the exceptions (p. 8); and
- (e) Board staff believes that the proposed transactions will not have an adverse effect relative to the status quo of the Applicants and their customers in relation to the statutory objectives in relation to electricity (p.9).

Other Intervenor Submissions

- 8. The other submissions of intervenors canvass a series of issues, some supporting Toronto Hydro in part, others offering suggestions that would result in a further carving-up of the SEL System. However, no intervenor has argued that the status quo should continue unaltered. Even intervenors who are opposed to transferring the entire streetlighting infrastructure back to THESL acknowledge that it is appropriate to return some SEL System components.
- 9. Examples of other intervenor support include:
 - Energy Probe recommends that street light conductors, connectors and handwells be transferred to THESL (p. 3);
 - Schools supports the transfer of “certain of the underground and overhead conductors and underground conduits” to THESL (p. 3);

- VECC indicated that “some of the assets to be transferred can be and are widely used to distribute electricity” (p. 5) but “at least some of the assets that THESL seeks to acquire need to be excluded from the asset transfer” (p. 3) and then refers to luminaires and poles specifically (p.3); and
- The Contractors submit that “the conductors conveying electricity to the street lights and one or more other loads are properly characterized as distribution assets, and must be transferred by THESI...”(p.3).

10. The balance of the intervenor submissions will be addressed under the following headings:

- (1) Streetlighting as Distribution
- (2) The streetlighting bulb
- (3) MAAD Applications – the Board’s “no harm” test
- (4) Streetlighting Asset Net Book Value
- (5) Rate Making Issues
- (6) Other

1. Streetlighting as Distribution

11. Toronto Hydro submits that the application of the provisions of the *Ontario Energy Board Act, 1998* (the “Act”) to the balance of the SEL System, ignoring the bulb for the purposes of this part of the argument, could not be any clearer. To “distribute” is to convey electricity at voltages of 50kV or less. The evidence before the Board is that the SEL System does exactly this. Board staff agrees – “the SEL System is in fact a central part of the distribution system that in Board’s staff’s view cannot be effectively separated from THESL’s distribution system” (p. 5).
12. In making its assessment, the Board should rightly consider the historic and ongoing usage of the SEL System as an integrated part of the distribution system in the City of Toronto. Those parties who argue that streetlighting

should not be declared part of distribution have simply ignored the vast body of evidence to this effect that is before the Board.

13. No evidence has been led in this hearing which in any way challenges the Board arriving at the same conclusion as Board staff on the facts.

A. The scenarios detailed in the evidence occur frequently

14. Toronto Hydro submits that in argument some intervenors have mischaracterized the evidence by suggesting that the scenarios discussed by the witness panel during the oral hearing were somehow “very limited” (Energy Probe at p. 18) or “should be rare” (Contractors at pp. 39(a)). Toronto Hydro respectfully disagrees and refers the Board to the November 17 transcript at page 127 lines 12-19:

MR. MONDROW: [...] And just to follow -- just to close on this line of enquiry from a -- over the last few minutes, Mr. Cook, I understood you to say that there are situations in which, because you can't connect where the bracket joins the pole, you want to connect where the bracket joins the luminaire or the fixture.

Are those -- is that a frequent situation?

MR. COOK: Yes, it is.

15. THESL does not seek ownership of the SEL System to solve problems that only occur on a limited occasion at the fringe of operations. THESL seeks Board approval for the proposed transaction because it will solve significant operational challenges that frequently occur across THESL's entire service territory.

B. The Board should avoid replacing one transient bifurcation point with another

16. The definition of a "distribution system" is clear – it includes any structures, equipment or other things used for the purpose of distributing electricity. Despite this, several intervenors have argued that, to a greater or lesser extent, the handwells, the poles, the brackets, and/or the luminaires should not be included within the distribution system. It is notable that all of the intervenors

agree that the conductors are rightfully a part of the distribution system, but somehow the poles and fixtures that are used to house and support these conductors are not.

17. In effect, these intervenors are arguing for the replacement of one unnatural bifurcation point between the SEL System and the distribution system with another. These propositions ignore the fact, which was explored in detail during the hearing, that the demarcation point is dynamic and constantly changing over time. Instead of simplifying and resolving the problems with the status quo, they instead propose changes which ignore, exacerbate or defer these problems.
18. Take the approach proposed by two of the intervenors as a case-in-point. While there is no requirement in law that more than one customer must be connected for the definition of “distribution system” to apply, this is what the Contractors (p. 19) and Schools suggest (p. 6). If the Board were to accept this approach to demarcation, it would lead to at least two results which are undesirable: first, THESL would have to dispose of any assets that it retained in 1989 where, due to the disconnection of a USL load since the original asset transfer, those assets now only serve a single streetlighting customer; and second, and more significantly, THESL would have to return to the Board from time-to-time to request further dispositions of assets as the system changes and develops over time and the problems explored in this hearing re-occur.
19. The approach proposed by Energy Probe is yet another case-in-point. Energy Probe proposes a demarcation point that excludes the poles, hardware, lighting fixtures and the service wire from the load side of the handwell (p. 10). While Energy Probe is primarily concerned with addressing the contact voltage safety issue (p. 41-42), and while Toronto Hydro learned of the unclear demarcation point problem during the contact voltage review,³ it was the lack of a clear demarcation point and not the contact voltage safety issue that triggered the proposed transaction. Energy Probe’s proposal ignores the

³ Application, Tab 6, Affidavit of Ben LaPianta at para. 9.

“regulatory gap”⁴ where the poles and service wires in question are used to service USL customers, which was illustrated in Diagram 5 of Exhibit K1.2, and instead proposes a complex and administratively burdensome “joint use” approach that will vary significantly depending on the utilization of the poles across the City, and will continue to change over time as the utilization of those assets continues to change.

C. The efficiencies proposed by Toronto Hydro are real and substantiated

20. Some intervenors suggest that the efficiencies resulting from the proposed transaction, and which are detailed in the evidence, are irrelevant.
21. Toronto Hydro respectfully disagrees. The Board cannot ignore its section 1 objectives to promote economic efficiency and cost effectiveness in the distribution of electricity. Further, to the extent the streetlighting system meets the strict definition of a “distribution system”, which THESL submits it does, then these efficiencies are directly relevant to the Board’s determination on this matter.
22. Unlike every other party to the proceeding, Toronto Hydro alone has and continues to be responsible for operating the electricity distribution system in Canada’s largest city. The intervenors speculate about what is appropriate but they are not left with the practical reality and responsibility of actually owning and operating the distribution system in the City of Toronto.
23. For example, Energy Probe proposes in argument what appears to be a simple solution that would, in its view, address the efficiency concerns raised by Toronto Hydro. This oversimplifies the situation and is simply not the case. The efficiency concerns related to trouble calls discussed at p. 14 of Energy Probe’s submission would remain, as two crews continue to be dispatched to solve what is in essence a single problem on a unified distribution system. The demarcation confusion discussed at p. 15 would remain, because (as noted above) this approach fails to address the regulatory gap and the existence of

⁴ Transcript Volume 1, page 21 line 20 through to page 21 line 24.

USL loads attached to the top of poles or where the bracket joins the luminaire.

D. Streetlighting, like electricity distribution, is a natural monopoly

24. Toronto Hydro agrees with School's submission that the analysis the Board undertakes to determine whether an activity is distribution "should be informed by the underlying purpose of the Board's regulatory power: to regulate the rates charged by monopoly providers of an essential service" (p. 3, para. 6).
25. Streetlighting, like electricity distribution, is a quintessential natural monopoly activity. It would be ludicrous to suggest that at stake in this proceeding is some threat to streetlighting service as a competitive activity. No one is going to build a competing streetlighting system in Toronto. The natural monopoly elements alone strengthen the position that it is part of the distribution system - just like the balance of the distribution system is a natural monopoly.
26. Streetlighting is also an essential service. No intervenor or Board staff, whether they support Toronto Hydro's Applications or not, has ever suggested to the Board that streetlighting is somehow a non-essential, discretionary activity.
27. Servicing that monopoly can be done by the LDC or contracted out. It appears this specific concern is the central basis for the Contractors submissions. As the Contractors acknowledge, they currently compete for this servicing work. Toronto Hydro submits that the evidence demonstrates that external contractors will continue to be used to maintain components of the unified distribution system.⁵ Further, Toronto Hydro submits that this kind of self-interest cannot influence the Board which makes decisions in the public interest, not the economic self-interest as identified by the Contractors themselves.

⁵ Application, Tab 2 at 15(b).

E. The floodgates will remain securely barred

28. Some parties suggest that by reuniting the streetlighting system with the balance of the distribution system, the Board will open the floodgates to other assets being brought in as distribution. There is no substance to this submission. As the witnesses testified, Toronto Hydro is only interested in those same assets that were historically part of its distribution system. There is an obvious and substantial distinction between streetlighting assets and those other assets, owned by unrelated third parties such as Bell telephone booths, bus shelters, etc., and that distinction is more than sufficient to allow the Board to distinguish the treatment accorded to applications to absorb these kinds of assets, however far-fetched that proposition may be.

2. The Streetlighting Bulb

29. Toronto Hydro submits that, when discussing the proper treatment of the luminaires, the Board must consider and be guided by its section 1 (1) statutory objectives:
- (1) To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
 - (2) To promote economic efficiency and cost effectiveness in the generation, transmission and distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.
 - (3) To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario, including having regard to the consumer's economic circumstances.
 - (4) To facilitate the implementation of a smart grid in Ontario.
30. The evidence before the Board is that the luminaire clearly falls within the scope of the exceptions under Section 71(2) of the *Ontario Energy Board Act, 1998*.
31. The ALAMP program detailed in the evidence is but one example of what a mesh network might resemble. The Ontario Smart Grid Forum's February

2009 report *Enabling Tomorrow's Electricity System* gives further illustration of the changing nature of the distribution grid in Ontario, as an integrated part of a two-way system that monitors and automatically optimizes the operation of interconnected elements of the power system, including end-use consumers and their thermostats, appliances and other household devices.

32. Under Section 71(2), a distributor may provide services that would assist the Government of Ontario in achieving its goals in electricity conservation, including services related to, (a) the promotion of electricity conservation and the efficient use of electricity; (b) electricity load management; or (c) the promotion of cleaner energy sources, including alternative energy sources and renewable energy sources.
33. THESL submits that the Board's traditional assumptions regarding its role as a regulator facilitating conservation through economic incentives do not apply in the unique circumstances of the streetlighting system on the facts before the Board in this hearing.
34. Unlike other electricity consumers, THESI faces no economic pressures to conserve electricity. The City is the customer for electricity consumed by the streetlights, and would directly benefit from any conservation savings or efficiency gains. In contrast, THESI owns, operates and maintains those assets and would incur only those increased expenses associated with the conservation programs or efficiency gains. This arrangement is similar to the landlord tenant "split incentives" problem. The Services Agreement between the City and THESI is on the record in this proceeding. That THESI has undertaken a pilot program demonstrates only that THESI is a good corporate citizen, it is not evidence of the Board's economic regulation at work.
35. Given this unique factual situation, we submit the best way to align interests and effectively promote conservation in the streetlighting system is to allow Toronto Hydro to assume ownership of the luminaires which makes those assets subject to Toronto Hydro's pending mandatory conservation target.
36. Toronto Hydro further submits that no harm or other adverse consequence will flow from including the luminaires within the LDC. Semantics aside, no party has pointed out any valid practical concerns or other harm of including

the bulb within the regulated distribution utility. In contrast, including the bulb is the most efficient outcome as recognized by Board staff, the EDA and the City.

37. Furthermore, it is common practice for the Board to deem certain infrastructure as distribution for regulatory and ratemaking purposes. For example, the Board routinely deems THESL's transformation equipment (which conveys electricity above 50kV) as distribution. Such equipment has always formed part of THESL's rate base and the Board determines just and reasonable rates that clearly encompass such equipment.

3. MAAD Applications – the Board's "no harm" test

38. Exhibit K2.3 included an OEB Decision involving MAAD applications filed by Greater Sudbury Hydro, PowerStream and Veridian Connections (RP-2005-0018, EB-2005-0234, EB-2005-0254, EB-20050257). In that decision "the Board has now ruled that the "no harm" test is the relevant test for purposes of applications under section 86 of the Act. The factors to be considered are those set out in section 1 of the Act".
39. When considering section 1 objectives it is clear that the Applicant's have clearly satisfied the Board's requirements. School's argues that a potential marginal rate increase to the streetlighting class should be determinative that the "no harm" test has not been satisfied. However, this reasoning should be rejected by the Board given that the City of Toronto – the principal customer facing any form of rate impact – reviewed the evidence in this proceeding and made submissions in support of the relief sought by Toronto Hydro. Further, consideration of potential or actual rate impacts in isolation are in no way determinative of whether the "no harm" test has or has not been satisfied. In applying its test the Board must consider all relevant section 1 factors. The evidence indicates that the Board's objectives will in fact be beneficially enhanced through granting the relief sought.

4. Streetlighting Asset Net Book Value

40. Schools submits that the \$60M net book value does not represent a proper valuation of the assets. Toronto Hydro submits the valuation approach

undertaken by Deloitte's should be accepted by the Board as reasonable and appropriate in the unique circumstances associated with streetlighting.

41. When the streetlighting assets were transferred from Toronto Hydro to the municipality, for the first and only time in 1989, the transfer price was \$1. This consideration obviously reflected neither net book value nor fair market value.
42. The evidence indicates that no record of streetlighting asset net book value existed at the time of the acquisition of streetlighting back from the City of Toronto. In these circumstances Toronto Hydro needed some practical and defensible solution to determine value. The Discounted Cash Flow method is an accepted approach for business valuations. For purposes of the January 1, 2006 transaction, for practical purposes the \$60M value derived by Deloitte's represented both net book value and fair market value. Mr. Couillard testified that Ernst and Young accepted the Deloitte's valuation as net book value for purposes of preparing Toronto Hydro's audited financial statements (Transcript Volume 2, p. 158, line 15-18). In these circumstances Toronto Hydro submits that its forecast net book value of \$62.5M (as at December 31, 2009) be deemed by the Board to be an appropriate net book value for regulatory and rate making purposes.
43. In the alternative, should the Board grant the relief sought, THESL would be prepared to retain another valuator to prepare a new fair market valuation for the streetlighting assets as at December 31, 2009. As Mr. Couillard testified, the City had its own fair market valuation done in connection with the 2006 transaction which yielded a significantly higher valuation than the values generated by Deloitte's and used by THESI.

5. Rate Making Issues

44. Schools has misinterpreted the evidence on rate making implications associated with the Applications. Schools state "the Applicants propose to charge a price for the streetlighting service that is not rate-regulated. This is contrary to the requirements of the OEB Act." This is not correct. The evidence indicates that the OEB has already approved rates for the streetlighting class.

45. The revenue generated from the City contract will serve as a revenue offset. As Mr. Sardana testified, if THESL receives a decision from the Board in sufficient time, it will update the 2010 EDR filing. For THESL's 2011 Cost of Service (COS) application, THESL plans to present a comprehensive cost allocation and rate making approach for the Streetlighting class based upon the transfer of the SEL System back into THESL. THESL submits that its proposal reflects a reasonable transitional approach until the time of the 2011 COS application.

6. Other Matters

- **Assumption of Liabilities**

46. In argument, Schools places particular emphasis on the distinction between the Assumed Liabilities under the 2005 and 2009 Asset Purchase Agreements. Schools recommends that the Board should somehow rewrite the transaction documents to require THESI to indemnify THESL for liabilities emanating from the condition of the assets at the time of the transfer in 2006. Toronto Hydro submits that this represents a commercially unreasonable approach which is both unnecessary and entirely ignores the allocation of risks as between the parties to two distinct commercial transactions.

47. The evidence before the Board is that the known liabilities being transferred pursuant to agreement are reasonable.⁶ All fall within the scope of Toronto Hydro's existing insurance coverage, leaving a maximum potential exposure of \$900,000 representing a worst-case scenario deductible payout. Further, as Mr. Sardana testified, these liabilities will be allocated to the specific rate classes that use those assets wherever possible.

48. The risk then revolves around unknown or unanticipated liabilities. Under THESL's proposal, any unexpected liabilities associated with streetlighting assets would be allocated directly to appropriate rate class and recovered directly from the streetlighting and USL customers that benefit from those

⁶ Transcript Volume 1, Page 93 at lines 11 through to Page 94 at line 25. Transcript Volume 2, Page 20 at line 11 through to Page 26 at line 3.

assets. In contrast, under School's proposal THESI would be left with no streetlighting assets and without the benefit of any revenue from the Services Agreement but with an unlimited obligation to indemnify THESL. We submit that the later situation is commercially unreasonable. THESI should not be made into an effective insurer for assets that ultimately benefit third parties, namely the specific USL end use customers and the City, against which THESL and not THESI is best positioned to collect.

- **The Relief Sought as an OEB Precedent**

49. Some intervenors raise the "floodgate of applications" threat if Toronto Hydro's relief is granted. This is not a valid concern or proper consideration for the Board in determining the matters before it. OEB decisions have no binding precedent status. In the event future streetlighting related applications may come before the Board, they will be determined on their own respective circumstances and merits. The matters before the Board in this hearing reflect a specific set of facts and realities that confront the Applicants.

- **Electrical Safety Authority (ESA)**

50. Some intervenors cited Ontario Regulation 161/99 and the oversight role of the Electrical Safety Authority pursuant to this Regulation. The ESA did not intervene at the hearing even though the outcome of the hearing will directly impact upon how the ESA discharges its duties in the future within the City of Toronto. Mr. LaPianta testified that his understanding is that the ESA supported Toronto Hydro's Application⁷. THESL submits that if the ESA had any concern whatsoever about the relief sought by the Applicants, it would have so indicated to the Board directly.

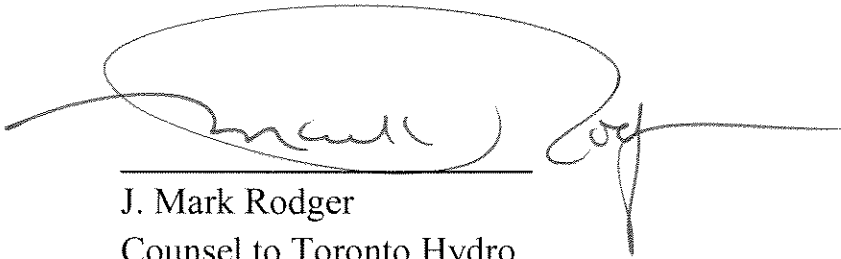
⁷ Transcript Volume 2, Page 47, lines 3 to 9.

Summary

51. In summary, the Applicants request that all areas of relief sought be granted by the Board given that:

- the entire SEL System, including the luminaire, falls within the scope of the definitions of “distributor”, “distribution” and “distribution system” contained in the OEB Act;
- in the alternative, the entire SEL System, including the luminaire, falls within the scope of the exceptions contained under section 71(2) of the OEB Act; and
- the merger transaction will not have an adverse effect relative to the status quo of the Applicants and their customers in relation to the Board’s section 1 statutory objectives in relation to electricity.

All of which is respectfully submitted.



A handwritten signature in black ink, appearing to read 'J. Mark Rodger', is written over a horizontal line. The signature is stylized and extends to the right with a long horizontal stroke.

J. Mark Rodger
Counsel to Toronto Hydro

December 3, 2009