

**IN THE MATTER OF** the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15, (Schedule B) to the *Energy Competition Act, 1998*, S.O. 1998, c.15;

**AND IN THE MATTER OF** an Application by Toronto Hydro-Electric System Limited for an Order or Orders approving or fixing just and reasonable distribution rates and other charges to be effective May 1, 2011.

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**ARGUMENT-IN-CHIEF  
TORONTO HYDRO-ELECTRIC SYSTEM LIMITED**

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April 4, 2011

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**EB-2010-0142**

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**DELIVERED APRIL 4, 2011**

**A. INTRODUCTION**

1. On August 23, 2010 Toronto Hydro-Electric System Limited (“THESL”) submitted an application to the Ontario Energy Board (the “Board”) pursuant to Section 78 of the *Ontario Energy Board Act, 1998*, as amended, (the “Act”) for approval of its proposed electricity distribution rates and other charges for the rate year commencing May 1, 2011 (the “Application”).
2. On October 18, 2010 the Board issued Procedural Order No. 1. This procedural order allowed for submissions on the draft issues list. The issues list was finalized and approved by the Board in its November 11, 2010 Issues List Decision and Procedural Order No. 2 (the “Issues List”). Procedural Order No. 1 also provided for the delivery of and responses to written interrogatories from Board staff and intervenors. Through this process THESL received over 400 interrogatories and responded with more than 1,600 pages of additional evidence in support of the Application.
3. On December 13, 2010 the Board issued Procedural Order No. 3 which provided for the delivery of and responses to written interrogatories in respect of the cost

allocation study for suite metering services, the filing of additional evidence, a transcribed technical conference to be held on January 24, 2011, and a settlement conference commencing January 25, 2011.

4. THESL responded to these additional interrogatories on January 7, 2011, a technical conference was held on January 24, 2011, and on January 25, 2011 the settlement process commenced. On January 26, 2011, THESL filed a letter with the Board requesting an adjournment to the settlement discussions until THESL could file an update to its application to reflect material, late-breaking mandatory accounting changes (the “Accounting Update”). The Board approved the adjournment in its Procedural Order No. 8 dated January 27, 2011. THESL filed the Accounting Update on February 9, 2011 and responded to additional written interrogatories on February 23, 2011. The settlement conference reconvened on February 28, 2011 pursuant to the Board’s Procedural Order No. 9 dated February 1, 2011.
5. THESL and eight intervenors participated in the settlement conference which concluded with the filing of a settlement proposal with the Board on March 25, 2011 (updated on March 28, 2011 to include the rate impact tables reflecting the Board’s updated cost of capital parameters) (the “Settlement Agreement”). Pursuant to the Settlement Agreement the parties reached complete settlement of 23 issues from the Issues List and partial settlement of another 6 issues from the Issues List – significantly reducing the scope of issues that the Board would have to address in the oral hearing. During the first day of the oral hearing in this proceeding, on March 29, 2011, the Board accepted the Settlement Agreement as filed. THESL submits that the Board should adopt the Settlement Agreement as its findings on the settled and partially settled issues contained therein.

6. The parties to the Settlement Agreement were able to settle the vast majority of issues; however a few issues remained contested for the oral phase of the hearing. In general, the unsettled issues related to the following five topics (including a reference to the relevant issues from the Issues List):
  - (a) IRM (relating to Issue 1.5);
  - (b) Emerging Requirements (relating to Issues 4.1, 4.2, 9.1, 9.2 and 9.3);
  - (c) Deferral and Variance Accounts (relating to Issue 6.1);
  - (d) Suite Metering (relating to Issues 7.2 and 7.3); and
  - (e) Cost Allocation (relating to Issues 7.1 and 7.4).
  
7. THESL files these submissions as its argument-in-chief in this matter.

## **B. ITERIM RATES AND AN AUGUST 1, 2011 IMPLEMENTATION**

8. On March 25, 2011 THESL filed a letter with the Board formally requesting an order of the Board making THESL's existing distribution rates interim, effective May 1, 2011. This letter was marked as Exhibit KH1.4. The Board granted this request during the first day of the oral hearing and indicated that it would accept submissions on the appropriate implementation date.

### **Exhibit KH1.4.**

**EB-2010-0142 Transcript Volume 1 dated March 29, 2011 at Page 15, Lines 6-9.**

9. Instead of a May 1, 2011 implementation date THESL proposes to implement the approved final rates for 2011, including the LPP rate riders, on August 1, 2011, together with a set of fixed term rate riders to collect foregone revenue for May, June and July 2011. THESL submits that this is the first viable implementation

date given the practical impossibility of implementing rates on May 1, 2011 (reply submissions are not due until May 2, 2011) and THESL's subsequent billing system conversion (which was scheduled to occur after a May 1<sup>st</sup> implementation). THESL is particularly concerned with the practical difficulties and associated risk of billing errors associated with attempting to implement new rates in the middle of a major billing system conversion, as was described by Mr. McLorg during Panel 3.

**EB-2010-0142 Transcript Volume 2 dated March 30, 2011 at Pages 72-73.**

## **UNSETTLED ISSUES**

### **1. IRM**

10. The Board defined Issue 1.5 in Procedural Order No. 2 as follows:

“When would it be appropriate for Toronto Hydro to commence filing rate applications under incentive regulation? Is this application an appropriate base case for a future IRM application? If not, why not?”

11. In Procedural Order No. 2, the Board described its rationale for including Issue 1.5 in this proceeding. On page 4 of the Procedural Order that the Board states “it is appropriate to incorporate this issue to allow parties to explore the full range of approaches available to deal with the longer term issues raised by Toronto Hydro’s application.” By way of a letter dated March 1, 2011, the Board notified distributors of its expectations concerning the filing of cost of service (“COS”) rate applications for rebasing within the context of incentive regulation (“IRM”). Although THESL has never filed an application under the existing Third Generation Incentive Regulation Mechanism (“3GIRM”) regime, on March 25, 2011 THESL filed a letter with the Board indicating its intention to file a cost of service application for 2012 distribution rates. This letter was marked as evidence

as Exhibit KH1.2. THESL continues to rely on the evidence set out in this exhibit and the supporting testimony of THESL's Panel 3 regarding this matter.

12. With respect to the first question, THESL submits that for the period until THESL's ratebase stabilizes (i.e., when annual capital expenditures level off and are matched by depreciation), it would not be appropriate for THESL to file rate applications under the existing 3GIRM.
13. Most directly, this is because 3GIRM effectively freezes THESL's revenue requirement during the period between rebasing applications. A static revenue requirement between rebasing years would not be compatible with or compensatory of a significantly increasing ratebase, nor with the goal of providing the greatest practical degree of 'rate smoothing'. THESL submits that it has demonstrated in its past three cost of service rate filings that substantial year-over-year increases in ratebase are and will continue to be a necessity and that it cannot carry out vital infrastructure renewal if capital expenditures are limited to the current level of depreciation.
14. Ratebase, and not yearly capital expenditure, is the driver of the capitalization-related expenses included in revenue requirement. The level of ratebase is principally determined (apart from other minor adjustments) by the balance between capital expenditures, which increase ratebase, and depreciation, which decreases ratebase. So long as capital expenditures exceed depreciation, ratebase must grow. Conversely, when depreciation exceeds capital expenditures, ratebase will decrease.
15. Capitalization-related revenue requirement in any given year is determined by average ratebase, and does not specifically or directly support capital expenditures *per se* undertaken in that year. It is not correct to conclude that rates set on the basis of an approved level of capital expenditures in a given year can continue to be compensatory in the subsequent year if those capital expenditures exceed

depreciation, since if they do, ratebase will have grown and so, therefore, will have revenue requirement.

16. For example, it is not the case that if THESL had approved capital expenditures of \$350 million in year one, that the same year one capitalization-related revenue requirement would necessarily continue to support that \$350 million level of capital expenditures in year two. That would only be true if ratebase did not change between the two years.
17. Similarly, it is not true that if THESL proposed capital expenditures of \$375 million in year two, the 'shortfall' in revenue requirement would be \$25 million. The shortfall in capitalization-related revenue requirement between the two years is instead determined by the difference between average ratebase in the two years, which is in turn directly dependent on the amount by which capital expenditures exceed depreciation.
18. The only capital expenditures that can be supported in the subsequent year under a condition of a frozen revenue requirement are those that are just equal to depreciation. In that case, apart from the effects of the half-year rule, ratebase would be static and would be supported by a frozen revenue requirement.
19. In fact, presuming that planned capital expenditures are fully completed, the operation of the half-year rule makes it the case that actual ratebase in the subsequent year is greater than in the base year, by half of the amount by which those capital expenditures exceed depreciation in the base year. As a result, a predictable deficiency in revenue requirement will occur, and the magnitude of that deficiency, under a frozen revenue requirement, will increase directly with the level of capital expenditures exceeding depreciation (CEEDs) in the base year. As set out in Exhibit KH1.2, that deficiency in THESL's case would be approximately \$13 million, given the 2011 level of CEEDs.

20. Consequently, when the level of CEEDs is significant, it is not even the case that a frozen revenue requirement in the subsequent year supports the ratebase that then actually exists. THESL submits that this outcome is confiscatory and directly contradicts other express findings of the Board, namely those concerning the weighted average cost of capital and THESL's 2011 approved capital spending. The Board has determined authorized returns to capital (i.e., returns to equity and debt) as well as capital expenditures and depreciation. Given 2011 opening ratebase, the latter two of these determine 2011 year end ratebase, which becomes 2012 opening ratebase. Even supposing that 2012 ratebase remains static (i.e., capital expenditures equal depreciation), the effect of not recognizing the increase in 2012 ratebase is to deny the authorized returns to that incremental ratebase, which is contrary to the Board's other findings noted above.
21. Therefore, with respect to the second question (Is this application an appropriate base case for a future IRM application?), THESL submits that it is not, due first of all to the marked inadequacy of a frozen revenue requirement in circumstances where significant CEEDs are required, and second because the operation of 3GIRM in years between rebasing does not compensate for the approved ratebase that will actually exist at the end of the rebasing year.
22. In essence, the second question takes as a premise the proposition that 3GIRM is appropriate for THESL. Since THESL strongly disputes that premise, it cannot agree that its application for 2011 revenue requirement and rates could then serve as the basis for a ratemaking system that is itself inappropriate for THESL.
23. In response to a question posed by the Board, THESL witnesses clarified on the record that the inadequacy of revenue requirement would occur not in 2011, but rather in subsequent years if 2011 were to be construed as a rebasing year. THESL filed its 2011 application expressly as a non-IRM cost of service application and not as a rebasing application. Furthermore, THESL was able to

settle a large number of issues with the intervenors on this basis, significantly narrowing the scope of issues remaining for the Board to determine in this matter.

**EB-2010-0142 Transcript Volume 2 dated March 30, 2011 at Pages 64, Line 13 to Page 67, Line 23.**

24. THESL has over the past several years undertaken very strenuous efforts to present cost of service cases to the Board precisely because of its view that it would be irresponsible to neglect the urgent needs for infrastructure and workforce renewal that exist on its system. As a result THESL has consciously foregone the opportunities for greater earnings that by design are offered under an IRM framework. THESL's under-earning in 2009 and 2010 are documented in its Application. In 2009, THESL's actual financial ROE was 6.35% (versus an allowed ROE of 8.01%), and in 2010, on a pro-forma basis, THESL's financial ROE was estimated to be 7.69% (versus an allowed ROE of 9.85%).

**Exhibit B1, Tab 6, Schedule 1.**

**Exhibit B1, Tab 7, Schedule 1.**

25. THESL submits that 3GIRM represents a different regulatory framework among all parties, one which THESL has not entered due to its obligations around system renewal. There would be a breach of natural justice and procedural fairness were the Board now to fundamentally change the nature of the relief sought by THESL in its 2011 application, and thereby change the underlying regulatory framework. While THESL expressly denies that a 3GIRM rebasing application would be appropriate in its circumstances, had it known that its application would be treated as one it would have brought a significantly different application, and furthermore would have made significantly different business and operating plans in contemplation of that outcome.
26. For example, THESL would be forced to budget significantly more for reactive maintenance. THESL would also potentially incur program wind-down costs in

order to arrest or substantially slow its infrastructure renewal program. In addition, in order to deal with the half-year rule problem, THESL would have proposed rates to support the full year end rate base for 2011, offset in that year by establishment of a one-year negative rate rider to compensate rate payers for the revenue requirement difference between 2011 average ratebase and 2011 year-end ratebase. Upon expiry of the negative rate rider at the end of the 2011 rate year, the base distribution rates then in effect for 2012 would at least support the actual opening rate base for 2012.

**EB-2010-0142 Transcript Volume 2 dated March 30, 2011 at Pages 64, Line 13 to Page 67, Line 23.**

27. Were the Board now to treat THESL's actual 2011 application as an application for rebasing, it would deny THESL the right to know the case that it must meet and respond accordingly.
28. THESL had and continues to have a legitimate expectation that its 2011 application would be heard as a stand-alone cost of service application, precisely because it has not had its rates set on an IRM basis for the past three years, has not been within the IRM framework, and could therefore not be 'rebased' as though it were in that framework.
29. The Board itself explicitly reinforced THESL's expectations regarding its 2011 application by giving THESL direction in its EB-2009-0139 Decision (on 2010 rates), wherein it stated at page 29:

“For the reasons that follow the Board finds that THESL should undertake a cost allocation study related to its provision of suite metering services. The study shall include an analysis of the implications of creating and maintaining a separate rate class for those customers served in this manner. The Board is of the opinion that the potential for cross-

subsidization is ongoing and that there may be merit in the establishment of a separate rate class for multi unit residential customers that are served directly by THESL through its suite metering provision. This should be filed as part of the next cost of service application, which THESL intends to file later this year, but in any event no later than six months from the date of this Decision. (emphasis added)

30. At pages 34 and 35 of the same Decision, the Board stated:

“The Board’s concern regarding the lack of a robust plan related to DG arose in the context of a rate application. The Board’s direction to THESL was to file the product of its direction in this rate setting proceeding. The Board remains of the view that a cost of service proceeding is the most appropriate forum to review the analysis requested.

...

THESL shall continue its analysis of the incorporation of DG into its Central and Downtown areas. In that regard it shall file a plan concurrent with its filing according to its distribution system planning requirements.”

31. In the second passage, the Board goes beyond the 2011 rate year and directs that THESL should file its DG study concurrent with its distribution system planning filing, due in THESL’s next case, and expressly states that a cost of service proceeding is the ‘most appropriate forum’ for its review. The Board would defeat its own direction were it to find that THESL should file on an IRM basis for 2012 rates.

32. Furthermore the Board provided the following direction to utilities in its July 9, 2010 Chapter 3 Filing Requirements for Transmission and Distribution

Applications, at Section 5.0 Specific Exclusions from IRM Applications (emphasis added):

The IRM application process is intended to streamline the processing of a large volume of rate adjustment applications, and is therefore mechanistic in nature. For this reason, the Board has determined that the IRM process is not the appropriate venue by which a distributor should seek relief on issues which are substantially unique to an individual distributor or more complicated and potentially contentious. The following are examples of specific exclusions from the IRM rate application process:

- (a) Smart Meter Cost Recovery Rate Rider;
  - (b) Rate Harmonization, other than that pursuant to a prior Board decision;
  - (c) Loss Factor Changes;
  - (d) Loss Carry Forward Adjustments to PILs/taxes; and
  - (e) Loss of Customer Load.
33. Due to its size, centrality, system characteristics and policy-forward orientation, THESL regularly seeks relief “on issues which are substantially unique to an individual distributor or more complicated and potentially contentious”, often at the express direction of the Board. For example, the potential addition of a separately defined sub-class for Quadlogic-metered customers is an issue that is complicated and contentious and in fact was instigated by a party other than the Board or THESL.
34. Another example illustrating THESL’s unique situation for 2012 is the Board’s February 11, 2010 Decision to approve the transfer of certain assets that are

properly characterized as distribution assets to THESL, which due to historical circumstances unique to the City of Toronto were considered part of the streetlighting system (EB-2009-0180/0181/0182/0183). In response to a Board request, THESL has since filed additional evidence supporting the transfer of distribution assets. The Board is now reviewing the details of this additional evidence. Once the transfer receives final approval of the Board, THESL will need to address issues of cost allocation, rate design, and rate impacts arising from the asset transfer. THESL intends to address these issues formally in its next (2012) rates case, where these issues can be addressed comprehensively and in context of an overall cost of service application.

35. THESL submits that it is unreasonable to expect that such issues will predictably vanish for three years every fourth year, and agrees with the Board that it is equally unreasonable to deal with those issues within the context of a 'mechanistic' process. Typically these issues have direct revenue requirement and rate implications for Toronto customers, beyond the generic import they have as precedents for the industry.
  
36. Fundamentally the Board must satisfy itself on the question of whether the electricity distribution system in Toronto requires substantial, continuing reinvestment in order to bring it to an acceptable operating condition and minimize the risk of severely disruptive service outages. THESL submits squarely that it does, and that this has been demonstrated and accepted by the Board and stakeholders in THESL's previous cost of service rate cases. There is no basis in evidence to support the conclusion that the work required is so minimal that it can be supported through depreciation funding alone. While the precise level and pace of reinvestment is a matter for the Board to determine finally in each application, there is a clear need for year-over-year expenditures substantially in excess of depreciation.

37. If the Board accepts this as flowing from the need to “protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service”, it must accept that substantial capital expenditures and associated costs arise and must be funded in this effort. It would be a pragmatic contradiction for the Board to accept that the investment must take place to protect the quality of service, and at the same time effectively deny to THESL the revenue requirement resources absolutely required for that purpose.
38. Ultimately it is the Board’s judgement that must be exercised to determine the appropriate balance between the pace of system renewal and the risks that that renewal mitigates, and the rate impacts of the associated investment. While THESL is strongly of the view that the pace of renewal must be vigorous and must at least prevent the existing situation from worsening, THESL will manage the resources afforded to it by the Board in the best manner it can. What THESL submits is not open to the Board, acting responsibly, is the imposition of a regulatory regime that does not provide resources corresponding to the Board’s assessment of the pace of investment that must be undertaken. THESL submits that the evidence clearly shows that the pace of investment must substantially exceed depreciation, in 2011 and in coming years, and that freezing THESL’s revenue requirement for 2012 by imposing 3GIRM would effectively be a finding that significant infrastructure renewal is not required, contrary to evidence that the Board has already accepted.

## **2. EMERGING REQUIREMENTS**

39. In Procedural Order No. 4 issued January 12, 2011, the Board determined that the following three proposed expenditures included by THESL as part of its capital budget will not be eligible for settlement: (i) the energy storage project included under emerging requirements; (ii) the electric vehicle charging infrastructure program included under smart grid as part of emerging requirements; and (iii) the fleet & equipment services expenditures under the general plant category, due to

the inclusion of vehicle purchases related to the green initiative (collectively, the “Emerging Requirements”). These expenditures relate to Issues 4.1, 4.2, 9.1, 9.2 and 9.3 and were excluded from the Board approved Settlement Agreement.

40. On March 25, 2011, THESL wrote to advise the Board and the parties that it withdraws the energy storage proposal from the requested relief in the Application (although it continues to be THESL’s intention to include the energy storage project as part of its 2012 cost of service rate application). As a result, during the oral phase of this proceeding the parties focused on: (i) the electric vehicle charging infrastructure pilot project (the “EV Pilot”) and (ii) the greening the fleet initiative (“Greening the Fleet”).

**Exhibit KH1.3.**

**2.1 *The EV Pilot***

41. In response to several auto manufacturers’ intention to start selling plug-in electric vehicles (“EVs”) to consumers in the City of Toronto in 2011 and the Provincial Government’s target that one in 20 vehicles in Ontario be electric by 2020, THESL has proposed a \$600,000 EV Pilot the purpose of which is to gather data to better understand the impact of an entirely new class of load, EVs, on the THESL distribution system.

**Exhibit G1, Tab 1, Schedule 1.**

42. The EV Pilot involves THESL studying the EV charging infrastructure needs in the City of Toronto, focussing primarily on assessing the upstream distribution system upgrades required to accommodate EVs in the City of Toronto by installing and monitoring roughly 30-40 EV charging stations across the City.

43. An EV charging station consists of EV charging units, metering equipment, communications equipment and an EV management system. The charging station is distinct from the electrical load, which are the different EVs that can be connected to the charging station. Charging stations can be located at the homes of individuals for private use by that consumer; at business premises for use by the private fleet of that business; or on third party private property for public use by electric vehicle owners typically in consideration of a charging fee. Charging stations can be installed behind existing meters, making them invisible to the distribution utility, or they can be installed as separately metered connection points, allowing the utility to monitor, measure, and better forecast the effect of EV loads on the THESL distribution system.
44. The EV Pilot is expected to produce a number of tangible benefits for THESL. First, it will provide THESL with an understanding of the real-time impacts of EVs on its distribution grid, including loading and power quality. Second, it will enable THESL to help develop safety, operating and control procedures and practices related to EV charging infrastructure connected to the THESL grid. Third, it will allow THESL to understand the design, specifications, standards, metering, communications, security, privacy, billing and data requirements surrounding vehicle charging.
45. The release of plug-in EVs in the City of Toronto in 2011 is a commercial reality. Widespread adoption of EVs has the potential to materially affect the demand profile on the THESL distribution grid. Current estimates suggest that a typical residential household's demand could double as a result of the purchase of an EV. However, the specific technologies used and user charging behavior (when an owner decides to charge their vehicles) will play a role as well. The purpose of the EV Pilot is to gather important information to facilitate a better understanding of the impact of EVs on the THESL distribution system.

## 2.2 *Greening the Fleet*

46. THESL's equipment asset budget for 2011, excluding the \$2 million allocated for THESL's "Greening the Fleet" initiative, has been settled as part of the Board approved Settlement Agreement. In support of THESL's environmental strategy to be carbon neutral by 2020, THESL has adopted purchasing and operating initiatives intended to reduce carbon emissions, including the continued introduction of "greener" technology to the THESL fleet. THESL has forecast a modest increase in equipment assets of approximately \$2 million for 2011 to support the "Greening the Fleet" fleet replacement program. THESL submits that this initiative is reasonable and appropriate in light of its corporate objective to be carbon neutral by 2020.

### **3. DEFERRAL AND VARIANCE ACCOUNTS**

47. The Board defined Issue 6.1 as

Is the proposal for the amounts, disposition and continuance of Toronto Hydro's existing Deferral and Variance Accounts appropriate?

48. No settlement was reached on this issue.
49. In the original Application, THESL requested that the Board approve the disposition of deferral and variance account balances summarized in Exhibit J1, Tab 1, Schedule 2 together with the consequential rate riders and their proposed effective periods. The clearance, if approved, amounted to a \$3.7M debit to customers before carrying costs. THESL proposed to clear the regulatory assets by means of a rate rider credit over a 12-month period from May 1, 2011 to April 30, 2012. Table 2 of Exhibit J1, Tab 1, Schedule 2, summarizes this proposal and is shown below (with a typographical error in the last column for IFRS Costs corrected as per a re-filing dated November 8, 2010).

Table 2: Summary of Proposed Disposition (\$ millions)

	<b>Principal Balance as at December 31, 2009</b>	<b>Carrying Charges for Jan 1, 2010 to April 30, 2011</b>	<b>Balance for Clearance as at April 30, 2011 Including Carrying Charges</b>
RSVA <sub>WMS</sub> (1580)	(7.4)	(0.1)	(7.5)
RSVA <sub>Network</sub> (1584)	3.1	0.1	3.2
RSVA <sub>Connection</sub> (1586)	(3.3)	(0.0)	(3.3)
Low Voltage Variance (1550)	0.2	0.0	0.2
Pils and Tax Variance (1592)	(3.3)	0.0	(3.4)
IFRS Costs (1508)	7.1	0.1	7.2 *
Late Payment Charges (1508)	7.8	0.0	7.8 *
2008 RARA variances	(0.5)	(0.3)	(0.8)
<b>Total Amount Requested for Disposition</b>	<b>3.7</b>	<b>(0.3)</b>	<b>3.3</b>

\* These amounts were subject to the further changes during the hearing, which changes are discussed in greater detail below.

50. Since the time of the original Application, and over the course of the hearing, various developments arose which have an effect on THESL's proposed disposition of these accounts. These developments are summarized below.

**3.1 Late Payment Charges (1508)**

51. On February 22, 2011 the Board issued a Decision and Order in EB-2010-0295 (the "LPP Decision") requiring THESL to recover from all of its ratepayers its share of the approved recovery amount, specified as \$7,525,588.82, over a 24-month period starting May 1, 2011. On February 25, 2011, THESL filed a letter with the Board updating its original forecast to reflect the amount and method of recovery specified in the LPP Decision. Consistent with the Board's approval of THESL's request for interim rates and THESL's request for an August 1, 2011

rate implementation date, THESL seeks to clear this account over a 21 month recovery period commencing August 1, 2011.

**Exhibit J1, Tab 2, Schedule 9.**

**3.2 IFRS Costs (1508)**

52. In the Application, THESL forecast approximately \$7.1 million to be cleared reflecting incremental OPEX associated with preparing for the transition to International Financial Reporting Standards (“IFRS”) accounting. The amounts forecast relate to expenditures until the end of December 2010. Any IFRS costs incurred after this date are included as part of THESL’s 2011 OM&A budget envelope, which was settled by the parties as part of the Board approved Settlement Agreement.

53. At the time of the Application, the transition to IFRS was to occur in January 2011. However, in September 2010, subsequent to the filing of the Application, the Accounting Standards Board issued its decision stating that qualifying entities with rate-regulated activities would be permitted to defer the adoption of IFRS for one year, up to January 1, 2012. As Mr. Couillard described in his testimony, THESL chose to defer the adoption of IFRS, and as a result was able to reduce the amount it is now seeking to clear from its IFRS Costs account to \$6.1 million. The reduction was mainly due to THESL’s ability to use internal resources to do the required work in 2011 instead of having to rely on external consultants to meet the earlier deadline.

**Exhibit KH1.7.**

**EB-2010-0142 Transcript Volume 2 dated March 30, 2011 at Page 24, Lines 10-22.**

54. THESL submits that these costs were necessary and prudently incurred in light of the mandatory transition to IFRS. THESL has provided detailed evidence on the

activities it undertook to prepare for IFRS at Exhibit Q1, Tab 1, Schedule 1 and in the Accounting Update that THESL filed at Exhibit Q1, Tab 2.

55. The Accounting Update, which resulted in a \$23.7 million dollar reduction in 2011 Base Distribution Revenue Requirement (which together with the LEAP increase of \$0.6 million resulted in a net \$23.1 million reduction), was only possible as a direct result of the work THESL completed in preparation for IFRS. This includes a number extraordinary expenses that were unique to Toronto Hydro in light of the new obligations IFRS imposed, such as the de-recognition of assets, componentization of assets, the development of a supportable depreciation methodology, and direct attribution of labour costs to capital projects. For example the review of useful lives of distribution system assets and the resulting report filed at Exhibit Q2, Tab 2, Schedule 7-2 and the THESL and Pinchin Environmental review of useful lives of building facilities were requirements created by IFRS. Although THESL will not convert to IFRS until 2012, all the work related to fixed assets provided better information on some of THESL's accounting estimates and will be implemented in 2011 under Canadian GAAP. Accordingly THESL was able to reduce customer rates in the short term with the use of information such as the revised depreciation rates. THESL submits the costs it incurred in connection with the mandatory transition to IFRS were prudently incurred and amounted to a material reduction in 2011 Base Distribution Revenue Requirement, which reduction was accepted by the parties in the Board approved Settlement Agreement.

### **3.3 *Line Loss Variance Account (1588)***

56. Over the course of the proceeding it became apparent that one area of dispute concerned the question of whether the Board should continue its practice of maintaining a variance account for differences between deemed and actual losses. THESL notes that the Board has previously dealt with the issue of the line loss

variances in the Board's EB-2007-0680 Decision for THESL's 2008-9 rate years.

The Board found at page 61 that:

“In the Board's view it would not be appropriate for the Board to direct a different regulatory treatment for the Applicant than for the sector as a whole by eliminating the provision for a true-up. Moreover, while there is always room for improvement in this area, the Applicant's line losses do not appear to be excessive. The Board does not accept Pollution Probe's proposal and accepts the Company's provision for line losses at 3.1%.”

57. THESL submits that there has been no fundamental change in circumstances that would warrant a departure from the Board's existing practice regarding line losses.

### **3.4 Summary**

58. As a result of the various adjustments noted above, the total amount that THESL is now seeking to clear in two separate rate riders, which includes LPP and amounts to a total \$2.4 million charge to customers before carrying costs. Carrying costs will be calculated on accounts where authorized to time of disposition using the Board approved carrying cost rates. Consistent with the Board's approval of THESL's request for interim rates and THESL's request for an August 1, 2011 rate implementation date, THESL seeks to clear all of the accounts over a 9-month recovery period commencing August 1, 2011 except the Late Payment Charges account which THESL seeks to recover over a 21-month period commencing August 1, 2011. The methodology to calculate the rate riders is in accordance with OEB EDDVAR guidelines.
59. THESL seeks the continuation of all deferral and variance accounts, except that THESL seeks Board approval to write off the nominal balance of \$6,947 in

Accounts 1565 and 1566 – CDM Expenditures and Recoveries, and to close these accounts. This amount is the final difference between approved CDM third tranche amounts collected in rates and spent on CDM programs.

**Exhibit J1, Tab 1, Schedule 2.**

#### **4. SUITE METERING**

60. In Procedural Order No. 3, the Board determined that Issues 7.2 and 7.3 related to THESL's suite metering were not eligible for settlement. The Board defined these Issues as follows:

“7.2 Is Toronto Hydro's suite metering cost allocation appropriate?”

7.3 Is it appropriate for Toronto Hydro to establish a separate rate class for multi-unit residential customers that are served directly by Toronto Hydro through its suite metering provision?”

61. On December 1, 2010, THESL filed its cost allocation study for suite metering services (the “Original Study”) pursuant to the requirements of the Board's EB-2009-0139 Decision with Reasons.

**Exhibit L1, Tab 3, Schedule 1.**

62. Although Issue 1.1 was settled as part of the Board approved settlement, THESL adopts and reiterates its submissions, made during the January 19, 2011 oral hearing on a motion by SSMWG, that the Original Study responds appropriately with the EB-2009-0139 Decision.

**Transcript of a Motion brought by SSMWG in EB-2010-0142 held January 19, 2011 at Pages 51-56.**

63. On January 21, 2011, in its Decision on a Motion filed by the Smart Sub-metering Working Group (“SSMWG”), the Board directed THESL pursuant to its authority under Subsection 21(1) of the *Ontario Energy Board Act, 1998* to produce additional evidence in the form of a new cost allocation study for suite metering service and dividing the residential customer class into three sub-categories of: (i) approximately 9,000 suite metering customers, (ii) approximately 110,000 remaining customers in the Original Study’s suite metered sub class and (iii) all of the other residential customers (the “Further Study”). The Board specified in its Decision that the Further Study should use the Board’s approved methodologies.
64. On February 18, 2011, in compliance with the Board’s direction THESL filed the Further Study with the Board.
65. With respect to Issue 7.2, although THESL does not maintain or propose a distinct ‘suite metering cost allocation’, it submits that it has properly and fully met the Board’s requirements to produce studies documenting the results that would arise under the defined scenarios were THESL to maintain such an allocation.
66. Those results show that irrespective of the precise definition of the ‘suite metering sub-class’, that sub-class has a higher Revenue/Cost ratio than the residential class as a whole, and in the case where the sub-class comprises all members of the ‘suite metered multi-unit residential building’ group, that the Revenue/Cost ratio significantly exceeds unity.
67. Therefore, THESL submits that a claim cannot be made that the residential suite metering sub-class is being subsidized by the residential class as a whole.
68. With respect to Issue 7.3, THESL submits that insufficient grounds exist to justify creating a separate sub-class of suite metered customers, especially when that sub-class is narrowly defined on the basis of a transient technology. The evidence

indicates that the Quadlogic sub-class Revenue/Cost ratio is well within Board guidelines and is in fact closer to unity than the residential class overall.

69. Since the customers that actually pay the distribution rates in that class are residential customers by the Board's own definition and under THESL's approved tariff, the Board would have to satisfy itself that there are strong grounds to discriminate the applicable Revenue/Cost ratio for that sub-group of customers relative to residential customers as a whole. Those customers, as all residential customers, have no opportunity to choose the metering technology that will be installed in their building.
70. In essence, this is a question around the allocation of a revenue requirement previously determined by the Board. As such, it is THESL's customers who are more directly affected by the Board's decision than THESL itself, since the Board's decision has the potential to affect rates of the residential class as a whole if not other classes as well. THESL's customers have no duty to accommodate the competitive wishes of a group of narrowly self-interested, profit maximizing corporations. Those corporations have willingly entered an existing marketplace and evidently are sufficiently enticed to remain in that market, being under no compulsion to do so.
71. In contrast, through the provisions of the Distribution System Code at section 5.1.9, the Board requires distributors to be suppliers of last resort to master consumers who wish to, or must, install unit meters.
72. Therefore, especially since MURB customers specifically, and residential customers generally, will be the parties to bear the cost of any decision to establish a new sub-class, rather than THESL itself, THESL urges the Board to move cautiously if at all in this area and to apprise itself fully of the rate and cost consequences on all rates classes of doing so. There is at the present time no clear basis to justify discrimination of the Revenue/Cost ratios as between two or more

sub-classes of the residential class. Therefore THESL submits that no change should be made at this time.

## **5. COST ALLOCATION**

73. In Procedural Order No. 2 the Board articulated Issues 7.1 and 7.4 as follows:

“7.1 Is Toronto Hydro’s cost allocation appropriate?

...

7.4 Are the proposed revenue to cost ratios for each class appropriate?”

74. In the Board approved Settlement Agreement in respect of Issue 7.1, the parties were able to settle the cost allocation proposed by THESL with one exception: the Intervenor did not agree with the methodology used by THESL to account for the transformer allowance. The parties agreed that the transformer allowance methodology should be determined after an oral hearing on that issue.

75. In the Board approved Settlement Agreement in respect of Issue 7.4, the parties were unable to reach an agreement on THESL’s proposed revenue to cost ratios for each class.

### **5.1 *Treatment of Transformer Allowance***

76. THESL has used the Board’s cost allocation model, adjusted for a shortcoming in the way transformer allowance costs were allocated in the model, to allocate the revenue requirement and form the basis of determining rates for each of the classes.

77. THESL has indicated in its evidence that the costs of the transformer allowance are directly allocated in the Cost Allocation model only to those classes which

directly receive the transformer allowance credit – namely the GS 50-999 kW, 1000-4999 kW, and Large User classes. None of these transformer allowance costs are allocated to any of the other classes.

78. On the revenue side of the cost allocation model, the distribution revenue line is calculated by THESL using the 2010 approved rates (which include costs associated with the transformer allowance amount only for the three classes indicated above), applied to the 2011 forecast billing units, and then increasing each class' estimated revenue by the same percentage such that total revenue (after revenue offsets) equals the revenue requirement.
79. As was explained by Mr. Seal, the resulting revenue to cost ratios (derived by dividing the revenues and costs as determined above) form the “starting point” revenue to cost ratios in the Application. That is, they are the revenue to cost ratios that each class would exhibit assuming the current rate structure applied against the Test year forecasted and allocated costs.

**EB-2010-0142 Transcript Volume 1 dated March 29, 2011 at Page 154-155.**

80. THESL submits that even if the parties disagree with the method used to derive these “starting point” revenue to cost ratios, the costs that THESL proposes to collect from each class – or the Revenue Responsibility – is completely independent of this starting point.
81. So, for example, at Exhibit L1 Tab 2, Schedule 1, Page 22, on the line titled “Revenue Requirement (includes NI)”, the total revenue requirement, along with the costs allocated to each class, based on the Cost Allocation Model, is shown. The Residential class has been allocated \$283.6M of the revenue requirement, or costs. No costs for the Transformer Ownership Allowance have been allocated to this class.

82. THESL made a policy decision in preparing this Application that for the Residential class, the Revenue Responsibility of this class should be 92% of the costs (for a revenue to cost ratio of 0.92). Therefore, in designing the rates for this class, THESL has calculated those rates which will allow it to achieve the 92% revenue to cost ratio. As a result of this policy decision, the revenue proposed to be collected from this class is entirely independent of the “starting point” revenue to cost ratio as determined using the Boards Cost Allocation model noted above. Because of this, THESL submits that any concerns with the “starting point” revenue to cost ratio are at most academic in that they do not in any way alter THESL’s proposed cost allocation.

## **5.2 *Movement Towards Unity***

83. THESL has indicated in the evidence that while the current (2010) revenue to cost ratios are within the Board’s guidelines as established in EB-2007-0667, THESL believes that a continued, incremental move toward full cost recovery for all classes is appropriate.

**Exhibit M1, Tab 1, Schedule 1, Page 4.**

**Exhibit R1, Tab 11, Schedule 38.**

84. THESL submits that its proposed revenue to cost ratios are appropriate, for an incremental move to unity for all classes – that being one of fairness for all classes and recognition of the potential shortcomings of the cost allocation model and data. (R1 T11 S38 part g, and Tr1 p158 lines 5-27)

## **D. CONCLUSIONS**

85. For all of the foregoing reasons, THESL requests that the OEB approve its proposed 2011 Electricity Distribution Rates and other charges, together with the specific items of relief requested in the Application.

All of which is respectfully submitted this 4<sup>th</sup> day of April, 2011.

*Original signed by J. Mark Rodger*

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J. Mark Rodger

*Original signed by John A.D. Vellone*

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John A.D. Vellone

Counsel to Toronto Hydro-Electric System Limited

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