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BY EMAIL and RESS

February 5, 2016
Our File No. 20140116

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2014-0116 – Toronto 2016-2020 Rates – SEC DRO Comments

We are counsel for the School Energy Coalition. This letter provides SEC's comments with respect to the Draft Rate Order filed by Toronto Hydro on January 22, 2016.

SEC has had an opportunity to review the DRO comments filed by OEB Staff earlier today, and as a result has been able to edit these comments and reduce their length. Where possible, we have simply referred to the OEB Staff comments when we agree with them.

The DRO is deficient in a number of material areas. It is not enough that the Applicant correct those deficiencies by way of reply. SEC believes that, prior to providing reply submissions, the Applicant should re-file its DRO to be in compliance with the Decision, and then, after comments from parties and OEB Staff at that time, Toronto Hydro should provide reply submissions.

We note that Toronto Hydro assumes that the Decision allows them to spend 94.4% of what they requested ($3.596 billion over five years, summarized on page 13 of the DRO, compared to $3.809 billion, as proposed in the Application). SEC does not believe that the Board intended to allow a 94.4% recovery of the requested amount, and the comments below indicate some of the reasons for this disjunct. This is the reason, in our view, why the Board's estimate of 5% distribution rate increase (per year) on page 2 of the Decision, is so different from the DRO, which implies increases of 7-8% per year for five years. Clearly there is a mismatch between what the Board intended, and what the Applicant has proposed in the DRO.

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10% Capital Reduction

The Board provided in the Decision that capital additions in each year will be reduced by 10%.

SEC agrees with the submissions of OEB Staff that:

- A detailed capital budget for each year, incorporating the 10% reduction, is required.
- The reduction should be implemented before applying the stretch factor of 0.6%.
- The assumptions of the Applicant as to the point in time of the reductions should be made clear.

We also note below that both the impact on depreciation expense, and the impact on PILs, are counter-intuitive, and the Applicant should show how those impacts are calculated.

SEC submits that the Applicant should file a complete capital budget, not just for 2015 (actual, up to but not exceeding plan) and 2016 (forecast), but for all five years (since the C-factor is based on forecast capital budgets), incorporating the results of the Decision. The capital evidence should show the prioritization by the Applicant, and the results of the 10% reduction on cost of capital, depreciation, and PILs (plus anything else, such as AFUDC, that may be impacted). The reduction should also ensure, through the C-factor, that the half-year rule does not unduly reduce the impact of the capital additions reduction in each subsequent year. To the extent, if any, that the Applicant proposes to reduce expenditures that have a tax shield more than other expenditures, it should provide a justification for so doing. In the event that it is not able to provide such a justification, its PILs impacts should mirror the impacts on other aspects of the revenue requirement. "Tax optimization" (i.e. maximizing rate revenues) is not, in our submission, an appropriate part of the DRO process.

In preparing this detailed impact analysis, the Applicant should not reduce Renewable Enabling Investments as part of this 10% reduction. Since those investments are already protected by a variance account, they should be excluded from the 10% reduction. A 10% reduction in REI is not a real reduction, and cannot be what the Board intended.

C-Factor

There are two problems with how the C-Factor has been implemented, separate from the revised capital additions budget.

First, SEC agrees with OEB Staff that the stretch factor should be applied before the 10% reduction, as noted above. This substantially reduces the capital spending funded in rates. If the Applicant's interpretation is accepted, on the other hand, the capital spending is essentially unaffected by the stretch factor.

Second, the Applicant has not applied the 10% reduction to the C-factor, but instead to the capital budget. A reduction of the C-factor would reduce the revenue requirement from capital additions, rather than the capital additions themselves.

In our submission, the Applicant should show the Board, through detailed calculations, the difference between applying the 10% reduction to the capital budget, and applying it to the annual revenue requirement (cost of capital, depreciation, and PILs) from cumulative capital additions. It is not clear to SEC that the two calculations will product identical results. If the differences are (as we suspect) material, the Board should know that before issuing its final rate order.

OM&A

The Decision is clear that the Base OM&A is $246 million [page 2 of the Decision]. The Applicant's proposal to increase this to $248.9 million by various adjustments is not consistent with the Decision, and should be disallowed. Correcting this would result in OM&A over the five years, based on the current forecasts, being about $15 million less than the Applicant proposes.

The Applicant notes three adjustments. In the first, Streetlighting, the Applicant was quick to take the benefit of the change, but declined to implement the identical offsetting entry. In the second, regulatory costs, the Applicant claims that the Board authorized an extra $6.0 million for application costs. We are unable to find that incremental budget in the Decision. In the third, the Applicant proposes that the OM&A be reduced by $1.2 million, subject to recording the difference in a variance account so that there is no effective reduction.

In our submission, the Board was clear that the 2015 OM&A is $246.0 million, and that amount will increase by the formula, i.e. Inflation less stretch factor. We see no reason that there would be any adjustments to those annual amounts.

Revenue Offsets

Whether or not the Streetlighting costs are an extra adjustment to OM&A, they are included in OM&A. Therefore, the revenue offsets for each year should include $3.7 million for Streetlighting. The failure of Toronto Hydro to include that adjustment in the DRO is unacceptable, and in our submission the Board should make that clear.

Depreciation Expense

The Applicant suggests that the impact of reducing capital additions in 2016 by $48.8 million (which is itself too low, as noted above), is to reduce depreciation by $500,000. This is, in our submission, not a reasonable result.

According to the 2014 Distributors' Yearbook, Toronto Hydro had a weighted average depreciation rate of 2.62%, and in fact in the Application the total depreciation on new assets, relative to cost, was more than 3% (excluding the impact of the half year rule). An effective depreciation savings of 1% is therefore not really possible, and something 50-100% higher is likely more correct.

SEC has proposed that the Applicant provide a detailed calculation of the impacts of the 10% reduction for each year, which should explain why this problem is arising.

PILs

The Applicant suggests [page 6 of the DRO] that, as a result of the Board ordering a 10% reduction of capital spending, the PILs expense will go up by $900,000 per year. This is not mathematically possible.

SEC has proposed, above, that details of changes to the annual budget and related revenue requirement be provided, and in our view the answer to this conundrum will be revealed in that disclosure. SEC expects that the Applicant has elected to reduce expenditures with the highest tax shields, thus increasing the effective tax cost of capital spending. Of course, the Applicant is not bound by the detailed budget, since it is not provided, so it can spend with a higher average tax shield, and pocket the difference. This should not be allowed.

Standby Rates

Toronto Hydro proposes that, because the Decision did not approve their request to make interim standby rates final, the Board should make them final in the rate order. SEC agrees with OEB Staff on this.

In our view, this is relatively simple. The Applicant asked for an order. The Board did not give that order. If they still want that order, they should file a Motion for Review to vary the Decision.

Revenue Requirement Work Forms

The Board ordered the Applicant to file RRWF's for each year, along with the DRO. Toronto Hydro simply declined to follow the Board's order. This should not be considered acceptable, on a number of levels.

First, this is an order of the regulator. File this document. It is not unreasonable to file it with caveats. It is not unreasonable to say filing it is impossible, although that is clearly not correct, since a number of other LDCs have been able to do so.

What is unreasonable is to just say no. SEC believes that the first step is to file what the Board ordered filed. If there is then a debate about the usefulness of that, of that, those submissions should follow compliance.

Second, the Applicant filed five years of tariff sheets. The underlying information is the same, in this situation, so the filing of the RRWF for each year is easily doable. To say complying with the Board's order is inappropriate is clearly inconsistent with filing tariff sheets.

Third, the Board estimated annual distribution rate impacts of the Decision at 5%, and the DRO implies annual rate increases of 7-8%. This is a situation in which it is important for the Board to see what is happening, and refusing to provide what was ordered is simply the wrong answer.

For this reason, SEC disagrees with OEB Staff, who said that they thought filing the RRWF annually would be acceptable. In our view, it is not. The Board is seeing rate proposals that are

inconsistent with what it thought it was deciding. A full reconciliation, over all five years, is necessary now.

We note that the Decision may in fact have had the effect of ordering a 7% annual increase, rather than 5%. The detailed calculations will show if that is so. If that is so, so be it, but at the very least the Board should know that now, not after the fact some years from now.

Fourth, the rates for each year are in any case made up of a growth factor, an OM&A figure driven by an escalator, and an adjusted annual capital budget. Yes, there are variables at play, but the basic calculation is a simple one. It is not difficult to prepare a Revenue Requirement Work Form for each year.

SEC believes that the Applicant declined to file this information because then they would have to answer to the public for five years of high annual percentage increases in both rates and budgets. While we understand that Toronto Hydro suffers under more media scrutiny than most LDCs, that is not reason to refuse to provide standard information that is useful to the Board.

This refusal is not acceptable. Do the calculations, and file the numbers. If the resulting rate increases are publicly embarrassing, the Applicant has no-one to blame but themselves.

Draft Accounting Orders Generally

OEB Staff has proposed that there are some aspects of the Draft Accounting Orders in respect of which they will deal with the Applicant privately. While it was likely not OEB Staff's intention to propose secrecy, that is the effect. In our submission, this is not an acceptable practice.

It is, in SEC's view, normal and proper practice before submissions to discuss areas of confusion, or routine errors, by telephone or email with the Applicant. Not just OEB Staff, but any party, can do that. The reason it is acceptable is that the result of those discussions is either a) a correction on the record, or b) a statement in OEB Staff's or the party's submission that they talked to the Applicant, raised issue X, and got it resolved in a particular manner. There is nothing hidden.

In this case, OEB Staff is proposing that, after all parties have had their opportunity to comment on the DRO, OEB Staff and the Applicant will sit in a back room and work out other aspects of the DAOs. This is not, in our submission, a transparent and open process. The Board should not allow it.

Earnings Sharing

Toronto Hydro proposes that it will clear the earnings sharing account sporadically, i.e. when they determine that the balance is big enough.

In our submission, the ESM account should be cleared annually, as part of the Applicant's annual filing, as is the normal case with other ESM mechanisms. That way, the ratepayers are not relying solely on the Applicant's determination of when it is appropriate to clear the account. It is reviewed by the Board each year. The Board still has the option to determine that the

balance is too small to clear, and should be rolled over, but the Board makes that decision. The Board is not allowing the utility to decide whether the balance is too small to clear.

ICM True-Up Account

The Applicant seeks to limit this account to "prudence-based ICM disallowances". This is not appropriate. The true-up of the ICM requires not just a prudence review of each project, but also assessment by the Board as to whether the projects and programs are in compliance with the approved ICM. Any disallowance by the Board as a result of the true-up proceeding, for whatever reason, should be captured by this account.

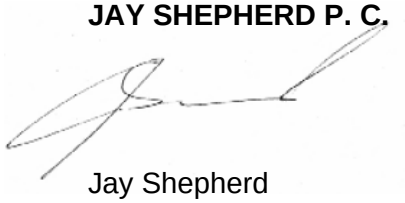
It is indeed possible that the only disallowances will relate to prudence, but it is, in our view, inappropriate for this Board panel to purport to limit the discretion of the subsequent true-up panel with respect to disallowances. If the only disallowances relate to prudence, that panel will so determine, and the variance account will operate as the Applicant proposes. If the subsequent panel disallows any ICM expense for any other reason (unacceptable changes in the nature of a project, errors in calculation of the spending, improper capitalization of operating costs, or any other reason), the account would capture that disallowance as well.

Conclusion

SEC submits that the Applicant should be ordered to file additional information, and to make the corrections noted herein and in the OEB Staff submissions, and then re-file their DRO. All parties should at that time have the opportunity to make submissions on the corrected DRO.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



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cc: Wayne McNally, SEC (email)
Interested Parties