Ontario Energy Board
Commission de l’énergie de l’Ontario

DECISION ON DRAFT RATE ORDER

EB-2014-0116

TORONTO HYDRO-ELECTRIC SYSTEM LIMITED

Application for electricity distribution rates effective from May 1, 2015 and for each following year effective January 1 through to December 31, 2019

BEFORE: Christine Long
Presiding Member

Ken Quesnelle
Vice Chair and Member

Cathy Spoel
Member

February 25, 2016

Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2014-0116

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

AND IN THE MATTER OF an application by Toronto Hydro-Electric System Limited for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2015 and for each following year effective January 1 through to December 31, 2019.

DECISION ON DRAFT RATE ORDER
February 25, 2016

Toronto Hydro-Electric System Limited (Toronto Hydro) filed a Custom Incentive Rate (CIR) application (the Application) with the Ontario Energy Board (the OEB) on July 31, 2014 under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998 seeking approval for changes to the rates that Toronto Hydro charges for electricity distribution, to be effective May 1, 2015 and each year until December 31, 2019. Commencing in 2016, rates will be effective January 1.

On December 29, 2015, the OEB issued its Decision and Order (the Decision) on the Application. Among other matters, the Decision established dates for Toronto Hydro to file a draft rate order (DRO) reflecting the OEB's findings in the Decision and for OEB staff and intervenors to file comments on the DRO and Toronto Hydro to file responses to any such comments.

On January 22, 2016, Toronto Hydro filed its DRO. On February 5, 2016, OEB staff and intervenors filed their comments on the DRO and on February 12, 2016, Toronto Hydro filed its reply submission.

The OEB has organized its findings on the matters raised by the DRO, the submissions by OEB staff and intervenors and the reply submission in the order in which they appear in the reply submission. The OEB has made "Findings" in response to the matters at issue in the DRO. The Findings reflect and are consistent with the findings contained in the Decision.

2.0 Capital Reductions and Application of the Stretch Factor

Incorporation of Capital Reductions into the DRO

Table 2, reproduced from the DRO below[1], shows Toronto Hydro's methodology for determining the overall level of the 10% annual capital cut required by the OEB:

Table 2 – Approved Capital Expenditure Amounts

CAPEX	2016	2017	2018	2019
APPLICATION	$518.8	$467.4	$470.1	$502.2
Stretch Factor @ 0.6%	($3.1)	($2.8)	($2.8)	($3.0)
Additional reductions	($48.8)	($43.9)	($44.2)	($47.2)
DECISION: 10% Total Reduction	$466.9	$420.6	$423.0	$451.9

Some parties questioned whether or not Toronto Hydro had implemented the cut correctly, more specifically whether Toronto Hydro should have applied the 10% reduction to capital expenditures or to the C-factor and also whether the stretch factor had been correctly applied. The OEB will make its findings on the stretch factor adjustment in the following section, while dealing in this section with whether or not the 10% reduction should be applied to capital expenditures or the C-factor.

The OEB notes in this context that its finding stated that "The OEB will not accept the capital budget as requested by Toronto Hydro. An annual reduction of 10% to the proposed capital spending is required."[2] No reference was made to this adjustment being applicable to the C-factor rather than the capital budget.

[1] P. 10
[2] Decision, p. 21

Findings

The 10% adjustment is applicable to capital expenditures, not the C-factor. This means for 2016 as an example, that the 10% reduction would be applied to the $518.8 million amount in the table above resulting in a reduction for 2016 of $51.9 million with a similar approach taken for subsequent years.

Application of the Stretch Factor to Capital

Toronto Hydro proposed in the DRO that the stretch factor adjustment to capital be applied as shown in Table 2 reproduced above. The effect of Toronto Hydro’s proposed approach is that the stretch factor adjustment reduces the 10% reduction effect from the magnitude of the adjustment the OEB intended as discussed in the above section. For 2016 as an example, the approach proposed by Toronto Hydro in the DRO reduces the 10% reduction impact from $51.9 million to $48.8 million.

In its reply submission, Toronto Hydro proposed a variation on this approach whereby the stretch factor adjustment is added to the 10% reduction rather than reducing it.[3] This has the effect of increasing the capital expenditure reduction in 2016 by $2.8 million meaning that it increases from $51.9 million to $54.7 million.

The OEB intended that the stretch factor adjustment would be applied in the normal way as are other adjustments of this kind, which is independently of the 10% capital expenditure reduction through an adjustment to the CPCI equation. The OEB’s finding on this matter in the Decision stated as follows:

> The OEB has consistently applied stretch factors to total costs in order to incent productivity in both the areas of capital expenditure and OM&A. The OEB finds no compelling reason to depart from this approach. While the Application put forward by Toronto Hydro may be a custom application, one of the key aspects of the OEB’s RRFE is the requirement to continue to make productivity improvements. As discussed later in this Decision, the OEB is concerned that the Application does not contain enough productivity incentives. Application of the stretch factor to the C factor is one way to remedy this deficiency.

The OEB notes that its finding makes specific reference in the first two lines to the stretch factor being applicable to total costs. The last line of the finding specifically

[3] Reply submission, pp. 8-9.

states that the stretch factor should be applied to the C-factor and not to capital expenditures.

Findings

The OEB is in agreement with the interpretation of its finding on this matter as outlined by OEB staff and some intervenors. Toronto Hydro is directed to apply the stretch factor directly to the capital-related revenue requirement in the 2016 to 2019 period through the CPCI equation.

Additional Information on Capital Program Reductions

The OEB notes that some parties made requests for additional information as to how Toronto Hydro was effecting the capital cuts to meet the 10% reduction contained in the Decision. OEB staff, for example, argued that Toronto Hydro should state how it defined the 10% cut and provide a breakdown of the spending by projects that were cut to achieve the 10% reduction.

In its reply submission, Toronto Hydro stated that it had complied with the 10% reduction to the requested capital expenditures for each of the five years by proportionally reducing each budgeted program by 10%, subject to two exceptions which were: (1) no reduction to Allowance for Funds used During Construction as a reduction would have a minimal impact on the revenue requirement and (2) no reduction to external plant relocations as these are pass-through costs resulting from the requirement for Toronto Hydro to move its plant to accommodate construction projects by other agencies and governmental entities.

Toronto Hydro further stated that it did not and could not have presented five years of specific capital projects to be cut as that information does not exist.[4]

Findings

The OEB will not require an itemized list of which programs were reduced and by how much. The OEB notes that this determination is in keeping with the Custom IR

[4] Reply Submission, p. 11.

approach, through which it is approving an envelope of spending which it is up to Toronto Hydro to determine how best to allocate.

3.0 Operating, Maintenance & Administration (OM&A) Adjustments

Toronto Hydro stated in its DRO that it had adjusted base OM&A of $246 million for three items specified in the Decision, which were:

(1) an additional $3.7 million in annual OM&A costs associated with the approved transfer of street lighting assets (which is fully offset by corresponding revenue offsets),

(2) an additional $1.2 million in annual OM&A costs associated with the approved CIR costs, and

(3) a reduction of $2.3 million in annual OM&A costs resulting from converting from an accrual to a cash basis of accounting OPEBs costs.

Parties raised a number of concerns with respect to these adjustments. SEC questioned the validity of Toronto Hydro's adjustments related to the approved CIR costs. OEB staff and SEC questioned the appropriateness of the additional $3.7 million in annual OM&A costs associated with the approved transfer of street lighting assets.

Findings

The Decision established a base OM&A spending level of $246 million. The OEB intended this amount as the level to which for each subsequent year of the CIR term an inflationary adder would be applied. The OEB did not introduce a "base amount" to which adjustments were made through other specific findings as submitted by Toronto Hydro. The OEB accordingly denies Toronto Hydro's request to add an additional $1.2 million in annual OM&A costs associated with the CIR application as these costs form part of the "base OM&A" amount. The OEB similarly denies the addition of $3.7 million in annual OM&A costs associated with the approved transfer of street lighting assets. The OEB accepts the $2.3 million reduction resulting from converting from an accrual to a cash basis of accounting OPEBs cost, but notes that the variance account that tracks the difference between cash and accrual OPEB accounting should match for consistency with this amount.

4.0 Depreciation Expense

Some intervenors expressed concerns about Toronto Hydro's statements regarding the impact of reducing capital additions on depreciation. The School Energy Coalition (SEC) questioned Toronto Hydro's statement that the impact of reducing capital additions in 2016 by $48.8 million is a reduction in depreciation of $500,000. Energy Probe noted that despite a lower 2015 base year CAPEX of $477.9 million, the capital-related revenue requirement amount for 2015 is only $1 million lower than the amount of $431.6 million.

Toronto Hydro stated in its reply submission that the impact of the 2015 capital budget will affect only the portion of the rate base reflecting the 2015 spend, or $267.4 million of the $531.1 million, while the remaining portion of the applied-for 2015 ISAs ($267.7 million) is a function of the prior year capital spend and as such, is not affected by the 10% reduction to the capital spending request for the CIR period.

Findings

The approach outlined by Toronto Hydro in its reply submission and summarized above is a correct interpretation of the Decision. The OEB notes that as the 10% reduction is to be applied to the total capital expenditure amount, rather than the ISA amount, it is expected that there will be impacts on depreciation expense of the 10% cut required by the OEB in the Decision in the years beyond the 2015 to 2019 rate-setting period covered by the Application.

5.0 PILs

SEC submitted that it was not mathematically possible for PILs expense to go up by $900,000 per year as a result of the 10% reduction of capital spending funding. In its reply submission, Toronto Hydro stated that its reduction of capital spending does not result in a similar reduction in PILs expense since PILs are a function of taxable income, not net income. Toronto Hydro noted that the proportional reduction of the capital program results in corresponding reductions to depreciation, interest expense and net income, while the taxable income used to determine PILs is significantly influenced by capital cost allowance, which is higher than depreciation on average for both depreciation assets and computer software.

OEB staff asked Toronto Hydro to provide an explanation as to how the forecasted net gains on the sale of properties related to its Operating Centers Consolidation Program (OCCP) would be grossed up for the PILs savings along with a quantitative example of how the gross-up would occur.

Findings

The OEB accepts Toronto Hydro's explanations as to the reasonableness of the PILs expenses. The OEB notes however that PILs will have to be recalculated to reflect the findings made in the Decision on the DRO.

The OEB supports the principle that the PILs treatment of the forecasted net gains on the sale of the OCCP properties should ensure that ratepayers receive the full capital gain after tax.

6.0 Growth Factor Adjustment

OEB staff submitted that the Decision required the growth factor to be 0.3% and did not make any reference to an adjustment of (1-SOMA). In its reply submission, Toronto Hydro noted that the Decision stipulated that the C-factor should include an element "to adjust for growth in Toronto Hydro's billing determinants in order to prevent the C factor from over-recovering capital costs." Toronto Hydro stated that by applying a growth factor to capital and not to OM&A, the Decision reflected the approach Toronto Hydro described in the reply submission.

Toronto Hydro further stated that it had accordingly in the DRO scaled the growth factor which prevented over-recovery of capital costs while allowing growing OM&A costs associated with growth to be recovered. Toronto Hydro argued that removing the scaling, as suggested by OEB staff, would apply the growth adjustment to all components of the CPCI, which would be contrary to the OEB's standard PCI which has no growth adjustment. Toronto Hydro submitted that this would also be contrary to the Decision, which specifically and exclusively applies the growth adjustment to capital.

Findings

The OEB notes that in its finding on this matter, it referred specifically to a 0.3% adjustment and made no reference to the incorporation of the scaling factor proposed by Toronto Hydro to this amount. The Decision also made no reference to specifically and exclusively applying the growth adjustment to capital as suggested by Toronto Hydro. The OEB accordingly finds that the (1-SOMA) adjustment made by Toronto Hydro should not be incorporated.

7.0 Revenue Offsets

The issue raised related to revenue offsets concerns an additional $3.7 million in annual OM&A costs associated with the approved transfer of street lighting assets and the corresponding revenue offset. The OEB has made its determination on this matter in Section 3.0 Operating, Maintenance & Administration (OM&A) Adjustments of this Decision.

8.0 Deferral and Variance Accounts

The OEB notes that parties raised several matters relating to the deferral and variance accounts including:

(1) Whether or not Toronto Hydro should be allowed to “limit” the ICM true-up variance account to strictly prudence based ICM allowances;

(2) Whether or not the Earnings Sharing Mechanism (ESM) account should be cleared annually or in some other fashion;

(3) Whether or not underspending relative to the $4 million in the externally driven capital variance account will be excluded from the capital related revenue requirement variance account, and

(4) Whether or not Toronto Hydro confirmed the assymetric nature of the capital related revenue requirement variance account.

Findings

The OEB confirms:

(1) The ICM true-up variance account is limited to strictly prudence based ICM allowances,

(2) The clearance of the ESM account will be done in accordance with normal OEB practice rather than annually as suggested by SEC

(3) The externally driven capital variance account is symmetric and all over and under spending pertaining to externally initiated plant relocates are to be captured in that account and excluded from the capital related revenue requirement variance account.

(4) The capital related revenue requirement variance account is assymetric to the benefit of ratepayers.

9.0 Standby Charges

Toronto Hydro noted in the DRO that in the application it had requested that the OEB declare the Standby Rates for the years prior to 2015 as final and the Standby Rates for the CIR period as interim until such time as the OEB concludes its process on Standby Generation. Toronto Hydro requested that as the Decision did not specifically address this issue that the OEB do so in the Final Rate Order. OEB staff and SEC questioned Toronto Hydro's request.

Findings

The OEB notes that the Decision is silent on standby rates and that consequently there is nothing on this matter to be incorporated into the Final Rate Order. For clarity, the OEB confirms that Standby Rates for the years prior to 2015 will remain interim and Standby Rates for the CIR period will also be interim,

10.0 Revenue Requirement Workforms (RRWFs)

The OEB notes that the RRWFs requested by parties were provided by Toronto Hydro in its reply submission. Consequently, there is no need for the OEB to make any findings on this matter.

11.0 Bill Impacts

The OEB notes that the additional information requested by OEB staff related to rate increase calculations was provided by Toronto Hydro in its reply submission. Consequently, there is no need for the OEB to make any findings on this matter. The OEB does however also note that revised bill impact calculations will need to be provided by Toronto Hydro as a result of the findings contained in this Decision. Toronto Hydro should file revised bill impacts in both the format of Schedule 9 of the DRO and Schedule 2 of the reply submission.

12.0 Tariff of Rates and Charges

OEB staff expressed concern that Toronto Hydro did not utilize the standard OEB terminology or format in the draft tariff sheets filed with the DRO. Toronto Hydro agreed to refile the tariff sheets to conform with the OEB format. Consequently, there is no need for the OEB to make any findings on this matter.

13.0 Draft Accounting Orders

OEB staff submitted that Toronto Hydro's OPEBs Draft Accounting Order (DAO) did not conform with what was approved by the OEB in a recent Guelph Hydro case in two areas:

(1) It does not compare forecast cash versus forecast accrual for each of the five years in the term, and

(2) Toronto Hydro proposed carrying charges which the OEB has denied in previous proceedings such as the Guelph Hydro case.

In its reply submission, Toronto Hydro stated that it had revised its DAO for the OPEBs variance account to remove carrying charges, but that no further adjustments were warranted as there are several considerations which warranted a partial departure from the Guelph Hydro decision which it then listed.

Findings

The OEB did not require Toronto Hydro to file its OPEBs DAO in conformity with the Guelph Hydro DAO and will not require that Toronto Hydro do so. The OEB will accept the adjustment related to the removal of carrying charges that was proposed inToronto Hydro's reply submission. Other than this adjustment, the OEB finds that no further adjustments to this DAO are required by Toronto Hydro with the exception of any minor changes that may be required as discussed subsequently in section 14 of this Decision.

14.0 Draft Accounting Orders (DAO)

The OEB has made its findings with respect to the DAOs in section 13 above. The OEB notes that there may be some remaining minor issues relating to formatting and wording of the DAOs that are outstanding. The OEB will require OEB staff to work with Toronto Hydro to deal with these matters and ensure that the issued DAOs are appropriately formatted and worded.

15.0 Confidential Filing

The OEB notes that the confidentiality matters raised by OEB staff in its submission were addressed by Toronto Hydro in its reply submission.

Findings

The OEB finds that Toronto Hydro has appropriately addressed the confidentiality concerns raised by OEB staff.

The OEB has reviewed the remaining information provided in support of the DRO and is satisfied that the remaining components of the DRO accurately reflect the OEB's Decision.

Toronto Hydro shall file an updated DRO including an updated Tariff of Rates and Charges and all necessary calculations and explanations reflecting the above findings. Once this material is reviewed and confirmed by the OEB, the OEB will issue a final Rate Order.

The OEB ORDERS THAT:

1. Toronto Hydro shall file an updated draft Rate Order attaching an updated Tariff of Rates and Charges reflecting the OEB's findings in this Decision on Draft Rate Order on or before **February 29, 2016**.

All filings to the OEB must quote the file number, EB-2014-0116, be made in searchable/ unrestricted PDF format electronically through the OEB's web portal at https://www.pes.ontarioenergyboard.ca/eservice/. Two paper copies must also be filed at the OEB's address provided below. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at http://www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Martin Davies at Martin.Davies@ontarioenergyboard.ca and OEB Counsel, Maureen Helt at Maureen.Helt@ontarioenergyboard.ca.

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DATED at Toronto, February 25, 2016

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary