Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2009-0180
EB-2009-0181
EB-2009-0182
EB-2009-0183

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

AND IN THE MATTER OF an application pursuant to section 60 of the *Ontario Energy Board Act, 1998* by 1798594 Ontario Inc. seeking an electricity distribution licence;

AND IN THE MATTER OF an application pursuant to section 86(1)(a) of the *Ontario Energy Board Act, 1998* by Toronto Hydro Energy Services Inc. seeking an order granting leave to sell streetlighting assets as an entirety or substantially as an entirety to 1798594 Ontario Inc.;

AND IN THE MATTER OF an application pursuant to section 86(1)(b) of the *Ontario Energy Board Act, 1998* by Toronto Hydro Energy Services Inc. seeking an order granting leave to sell streetlighting assets necessary in serving the public to 1798594 Ontario Inc.;

AND IN THE MATTER OF an application pursuant to section 86(1)(c) by Toronto Hydro-Electric System Limited and 1798594 Ontario Inc. seeking leave to amalgamate;

AND IN THE MATTER OF a request pursuant to section 77(5) of the *Ontario Energy Board Act, 1998* by 1798594 Ontario Inc. seeking the cancellation of the distribution licence applied for in a separate application under section 60 of the *Ontario Energy Board Act, 1998;*

AND IN THE MATTER OF an application pursuant to section 18(2) of the *Ontario Energy Board Act,* 1998 by 1798594 Ontario Inc. and Toronto Hydro-Electric System Limited for an order assigning Toronto Hydro-Electric System Limited's electricity distribution licence to a proposed amalgamated entity consisting of 1798594 Ontario Inc. and Toronto Hydro-Electric System Limited.

BEFORE: Gordon Kaiser
Vice Chair and Presiding Member

Cynthia Chaplin
Member

Ken Quesnelle
Member

DECISION AND ORDER

INTRODUCTION

On June 15, 2009, Toronto Hydro Corporation's subsidiaries, 1798594 Ontario Inc. ("NewCo"), Toronto Hydro Energy Services Inc. ("THESI") and Toronto Hydro-Electric System Limited ("THESL") collectively referred to as the "Applicants" filed applications with the Ontario Energy Board (the "Board") under sections 60(1), 86(1)(a)(b)(c) and 77(5) of *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 (Schedule B) (the "Act"). The applications were later amended to include a request for an order under section 18(2) of the Act and to withdraw the request which had been made under section 77(5) of the Act. The Board assigned the applications file numbers EB-2009-0180, EB-2009-0181, EB-2009-0182 and EB-2009-0183. Given that the applications were interconnected, the Board chose to consider these applications together through a consolidated hearing, pursuant to its power under section 21(5) of the Act.

The Board's Notice of Applications and Hearing was issued on July 21, 2009 and was published and served by the Applicants as directed by the Board. The following parties were granted intervenor status in the proceeding: the City of Toronto, the Electricity Distributors Association ("EDA"), the Electrical Contractors Association of Ontario ("ECAO") and Greater Toronto Electrical Contractors Association ("GTECA"), Energy Probe Research Foundation ("Energy Probe"), Hydro Ottawa Limited, Powerstream Inc., Save the Toronto Bluffs, the School Energy Coalition ("SEC"), Veridian Connections Inc. and the Vulnerable Energy Consumers Coalition ("VECC"). The City of Toronto, ECAO/GTECA, Energy Probe, SEC and VECC also applied for cost eligibility. The City of Toronto's request was denied. The others were approved.

Procedural Order No. 1 was issued on August 26, 2009, and made provision for interrogatories ("IRs") and responses to IRs, filing of intervenor evidence, IRs on intervenor evidence and response to those IRs. No intervenors filed evidence.

By way of a letter dated October 21, 2009, the Board requested additional information from the Applicants. The Applicants' response to the Board's letter was filed on November 6, 2009.

The oral hearing was held on November 17 and 19, 2009. Final submissions were received from Board Staff and intervenors on November 27 and 29, 2009. The Applicants filed their reply submissions on December 3, 2009.

The full record of this proceeding is available for review at the Board's offices.

THE APPLICATIONS

The Applicants filed five separate but related applications. The applications collectively seek a declaration by the Board that streetlighting assets in the City of Toronto (the "SEL System"), currently owned by THESI, are deemed to be a distribution system and, ultimately, to make the SEL System part of a new amalgamated distribution company consisting of THESL and NewCo ("NewTHESL").

To facilitate this, NewCo has applied for a distribution licence under section 60(1) of the Act to own and operate the SEL System. In the same application, NewCo seeks a declaration by the Board that the SEL System is deemed to be a distribution system. THESI currently owns and, pursuant to a service agreement with the City of Toronto, operates and maintains the SEL System. THESI has applied to the Board for leave to sell its SEL System to NewCo under sections 86(1)(a) and (b) of the Act for $66.066 million, which the Applicants state represents the net book value of the assets. If all Board approvals sought are granted, THESI intends to transfer the SEL System and the related service agreement to NewCo. Furthermore, NewCo and THESL applied under section 86(1)(c) of the Act for an order granting leave to amalgamate.

Subject to an order of the Board granting NewCo and THESL leave to amalgamate, in their original applications, NewCo and THESL requested the cancellation of THESL's existing electricity distribution licence under section 77(5) of the Act and requested that the Board issue a new electricity distribution licence to NewTHESL under section 60(1) of the Act. However, the applications were amended to withdraw the request made under section 77(5) of the Act and to include a request for an order assigning THESL's existing electricity distribution licence to the amalgamated entity, NewTHESL, under section 18(2) of the Act.

The effect of the proposed licensing, asset transfer and merger transactions is to create an electricity distribution company for the City of Toronto, which includes the streetlighting system.

The Applicants indicated that customers, other than streetlighting and unmetered scattered load ("USL") customers, will not be affected by the proposed transactions. All costs and offsetting revenues will be directly allocated to the specific streetlighting and USL customers served by those assets. The Applicants further stated that incorporating the SEL System within a single distribution utility will result in enhanced safety and increased efficiencies and reliability.

The Applicants argue that the entire SEL System, including the luminaire, falls within the scope of the definition of "distributor", "distribution" and "distribution system" contained in the Act. Accordingly, they argue that the applications should be granted in full. In the alternative, the Applicants argue that the entire SEL System, including the luminaire, falls within the scope of the exceptions contained under 71(2) of the Act. Finally, the Applicants argue that the applications should be approved because the merger transactions will not have an adverse effect on customers having regard to the Board's statutory objectives under section 1 of the Act with respect to electricity.

The intervenors all agreed that at least some parts of the SEL System should be transferred to the distribution utility, although none agreed that the entire system should be transferred. None of the intervenors agreed that parts of the SEL System fall within the scope of the exceptions contained in section 71(2) of the Act. The intervenors were also of the view that the valuation provided by the Applicants was inappropriate for ratemaking purposes and some were concerned that the transactions may result in the potential for harm to one or more class of ratepayers.

For the reasons which follow, the Board approves the transfer of some but not all of the SEL System assets. The excluded assets are defined in the decision.

THE ISSUES

The following issues were raised in the proceeding and are addressed in this decision:

1. Do the streetlighting assets qualify as distribution assets under the definitions of "distribute" and "distribution system" in the Act?
2. If the streetlight assets do not qualify as distribution assets, can they be included in the distribution business under the exceptions allowed for in section 71(2) of the Act?
3. Does the proposed transaction meet the "no harm" test?

Do the streetlighting assets qualify as distribution assets under the definitions of "distribute" and "distribution system" in the Act?

The Applicants argued that the entire SEL System, including the luminaire, bracket, conductor and pole, falls within the scope of the definitions of "distribute" and "distribution system" contained in the Act because the components of the entire SEL System either convey electricity at a voltage level below 50kV or, in the case of the structures and fixtures, are used to distribute electricity.

Board staff submitted that most components of the SEL System meet the definitions "distribute" and "distribution system" because the components convey electricity at a voltage of less than 50kV and include structures, equipment or other things used for that purpose. Board staff further submitted that not all components of the SEL System meet the definitions because at a certain point the System acts like a load and consumes electricity. It is Board staff's position that distribution stops at the luminaire.

ECAO/GTECA submitted that a defining characteristic of a distribution system is the provision of service to more than one customer. It submitted that the luminaires and the brackets that attach them to the poles are loads and cannot be owned and operated by the licensed distributor and further that the poles are not distribution assets, and cannot be owned and operated by the licensed distributor. SEC supported this position.

The Applicants responded that under this framework 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. The Applicants also claimed that 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.

Energy Probe submitted that the demarcation point of ownership could be established as the connection to the supply conductor. In Energy Probe's view, this would result in THESL having control of both the handwells and the connections inside the handwells, which would facilitate the prevention of a recurrence of the public safety concerns that arose with contact voltage problems.

The Applicants responded that Energy Probe's proposal ignores the situations where poles and service wires are used to service USL customers. The Applicants argued that Energy Probe has focused on the contact voltage issue in its proposal while it was the lack of a clear demarcation point and not the safety issue that triggered the proposed transaction.

In summary, the Applicants claimed that the various ownership demarcation points submitted by the parties would result in the replacement of one unnatural bifurcation point between the SEL System and the distribution system with another and that therefore the proposals should be rejected.

Board Findings

The terms “distribute” and “distribution system” are defined in the Act as follows:

> “distribute”, with respect to electricity, means to convey electricity at voltages of 50 kilovolts or less
>
> “distribution system” means a system for distributing electricity, and includes any structures, equipment or other things used for that purpose

The definition of “distribute” has two important components: first “to convey electricity” and second transmitting “at voltages of 50 kilovolts or less.” The Applicants ask the Board to interpret the definition in such a way that it could include anything that operates at a voltage level under 50kV. This approach overlooks an important component of the definition – the concept of “conveyance”. The two components must be considered together in determining whether an asset meets the definition of distribution.

It is clear that THESL does not claim to have responsibility or authority for the electrical equipment operated below 50kV that is on the load side of well established ownership demarcation points such as meter bases for underground services or service attachment points for overhead services. The application of “below 50kV” as the single defining criterion would not exclude customer owned equipment in these scenarios.

There is little dispute that an essential feature of a distribution asset is that the asset must be used to convey electricity. In other words, the asset must be used to carry electricity to a load or a customer. It is also clear that the concept of distribution implies “multiple recipients”. These basic concepts are clear from the overall legislative scheme governing distribution systems and distributors including the licensing, rate setting and system codes that apply to distributors.

The Applicants reject ECAO/GTAECA’s application of this concept of multiple users because it is not rigid and would require continuous updating as customers come and go on any particular circuit. The Board agrees with the Applicants that a criterion that depended on use at any particular point in time would result in a cumbersome and likely inoperable scheme by which to separate distribution system assets and non-distribution system assets. However, a criterion based on the functionality or the *intended* use,

addresses this concern because the classification would remain constant irrespective of the use at any particular time. For example, a distribution circuit that has been legitimately put in place to service multiple customers remains a distribution facility even if only one customer is attached at a particular time.

The Board would also note that a distributor is not *required* to own all of the structures, equipment and other things which are utilized for distribution. THESL uses a variety of structures in its operations which it does not own, and these structures are not considered distribution assets. For example, building attachments and other utility structures, such as telecom poles, are routinely used to facilitate electricity distribution.

The Board finds that the definition of "distribute" and "distribution system" cannot and should not be interpreted so as to include assets which are clearly end-use loads. Further, the Board finds that the definition of "distribute" and "distribution system" can and should be interpreted so as to include the conductors, structures, equipment and other things that are intended for the use of multiple customers (at less than 50kV). Similarly, the Board finds that the definition of "distribute" and "distribution system" cannot and should not be interpreted so as to include the conductor, structures, equipment and other things which are dedicated to streetlighting itself. The demarcation point between the distribution system and the SEL System will be governed accordingly.

As a result of this finding, the Board has determined that the luminaire is not a distribution asset under the definition. It is clearly an end-use load.

The question remains whether various other assets of the SEL System, including conductors, poles, and streetlight brackets and the conductor on those brackets, are appropriately considered distribution assets or whether they are dedicated to the purpose of streetlighting. In order to make this determination the Board must consider the purpose, functionality or intended use of the assets.

Conductors

The Board concludes that if the distribution circuits are overhead lines, then all conductors (and associated equipment), excluding the conductor along the streetlight bracket, can appropriately be considered distribution system assets. In this situation, streetlights, residential customers, general service customers, and USL customers can all be served from these distribution circuits, in various connection configurations. The

Board finds that in this situation the functionality or intended use of the conductor is distribution related.

Similarly, if the distribution circuits are underground in a mixed use urban setting, then the underground conductor and the above ground conductor (and associated equipment), excluding the conductor along the streetlight bracket, can appropriately be considered distribution system assets. The urban landscape, with its signage, traffic lights, phone booths, etc., is such that the functionality or intended use of the conductors is for multiple connections to multiple users.

If, however, the distribution circuits are underground in a residential setting, then the Board concludes that the underground conductors are appropriately considered distribution assets but the conductor on the poles and brackets can not be considered distribution assets. In this situation, the conductors are used almost exclusively for streetlighting as the existence of other users is extremely limited. In this situation it cannot be said that the functionality or intended use of the conductors on the poles includes other customers.

Poles

The Board concludes that if the distribution circuits are overhead lines, then the poles can appropriately be considered distribution system assets. In this situation, streetlights, residential customers, general service customers, and USL customers can all be served from these poles, in various connection configurations. The Board finds that in this situation the functionality or intended use or primary purpose of the pole is distribution related.

Similarly, if the distribution circuits are underground in a mixed use urban setting, then the poles can appropriately be considered distribution system assets. The urban landscape, with its signage, traffic lights, phone booths, etc., is such that the functionality or intended use of the poles is part of a distribution system serving multiple connections to multiple users.

If, however, the distribution circuits are underground in a residential setting, poles in the Board's view are not distribution assets. In this situation, the poles are used almost exclusively for streetlighting as the existence of other users is extremely limited. Accordingly, it cannot be said that the functionality or intended use of the poles includes other customers.

Streetlight Brackets and Conductor on Streetlight Brackets

The Board concludes that streetlight brackets and the conductor on streetlight brackets cannot be appropriately considered part of the distribution system assets. Given the Board's decision on the classification of the luminaire, a demarcation point that resulted in having the brackets classified as distribution assets could be problematic as these are typically of a common unit design. In addition, the primary purpose of the bracket and the associated conductor is related to the streetlight, not to convey electricity to other users.

The Board acknowledges that there is one scenario presented in evidence in which the conductor on the bracket has been used in conjunction with serving another distribution customer. However, the evidence is that this happens when there has been a malfunction in the underground circuit and there is no other suitable connection for an isolated load point until such time as the malfunction is remedied. The Board finds that this represents a specialized means of providing continuity of service pending a resolution of the underground problem, although the resolution may in fact take some considerable time. In this instance, although the bracket and conductor are being used for distribution purposes, this is not the primary purpose, nor the intended functionality of the assets. The Board concludes that suitable arrangements can be made between the distributor and the streetlighting entity to facilitate these temporary arrangements.

Expressway Lighting

The Board is unable, on the evidence before it, to determine the proper classification for the expressway lighting. The Board's decision in this case is conditional on the Applicants providing a proper asset valuation for all streetlighting assets including specific valuations for the categories of the assets the Board finds not to be distribution assets. The Board requests an asset valuation for expressway lighting and in addition requests evidence as to whether this category of asset should be included in the distribution assets or not.

If the streetlight assets do not qualify as distribution assets, can they be included in the distribution business under the exceptions allowed for in section 71(2) of the Act?

Section 71(1) of the Act restricts distributors from carrying on activities other than distribution:

> 71(1) Subject to subsection 70(9) and subsection (2) of this section, a transmitter or distributor shall not, except through one or more affiliates, carry on any business activity other than transmitting or distributing electricity.

As indicated in section 71(1), there are exceptions to this general prohibition, which are identified in section 71(2):

> 71(2) Subject to section 80 and such rules as may be prescribed by the regulations, a transmitter or distributor may provide services in accordance with section 29.1 of the *Electricity Act, 1998* 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.

The Applicants argued that if the Board found that the luminaires do not fall within the definitions of distribution and distribution system, then the luminaires should be deemed to be distribution assets because they fall within the exceptions contained under section 71(2) of the Act. The Applicants pointed particularly to the potential for enhanced energy efficiency, through demand response, and potential smart grid applications for streetlighting.

VECC submitted that the proper scope of section 71(2) does not include a utility taking on the role of customer to its own distribution services by acquiring the "load" assets of its customers and subsequently operating that load in a managed, conservation and efficiency based manner, possibly with the use of cleaner energy.

ECAO/GTECA argued that pursuing the Applicants' reasoning to its logical conclusion, THESL would be entitled to seek to own any electrical device capable of more efficient operation. It submitted that simply because a fixture or appliance can be operated more efficiently does not mean that ownership and operation of such an appliance is a proper or permitted business activity for Ontario's electricity distributors. SEC submitted that the proper interpretation of the exception is that assets whose purpose is to promote the

efficiency of other assets, either in the distribution system or load attached to the system could be distribution assets even if they are not used to convey electricity.

In reply, the Applicants submitted that the Board must consider and be guided by its section 1(1) objectives when determining the proper treatment of the luminaires. They reiterated their claim that the luminaire clearly falls within the scope of the exceptions under 71(2) of the Act, and pointed to the evidence on the ALAMP program as an example of an associated smart grid technology.

The Applicants also asserted that the special circumstances of this case, namely that the streetlight assets are owned by THESI rather than the City of Toronto, warrants special consideration. The Applicants asserted that THESI has no incentive to invest in more efficient streetlighting and therefore THESL with its conservation mandate is the preferred owner.

Board Findings

The Board does not accept the Applicants' argument that the exceptions include the ownership of load facilities such as the luminaires. Similarly, the Board finds that the exceptions do not include the streetlight brackets, conductor on the brackets, or poles and conductor on poles in residential settings with underground distribution circuits.

The legislation makes provision for a distributor to "provide services" to promote electricity conservation and the efficient use of energy, load management or cleaner energy sources. The Board does not consider it reasonable to interpret the words "provide services" to include the concept of ownership of what would otherwise be customer equipment. The Board agrees with SEC that assets whose purpose is to promote the efficiency of other assets, either in the distribution system or load attached to the system, could be part of the distribution system, even if they are not used to convey electricity, through inclusion under the exception.

Streetlighting service in and of itself is not a service which promotes conservation or efficiency. Similarly, the luminaire, the streetlight brackets, conductor on the brackets, and poles and conductor on poles in residential settings with underground distribution circuits do not represent a service to promote conservation or efficiency.

The Board concludes that the remaining streetlighting assets do not qualify as exceptions under section 71(2).

This approach is fully consistent with the Board's statutory objectives related to protecting the interests of consumers, promoting economic efficiency, promoting conservation and demand management and facilitating a smart grid. The interests of consumers are protected and economic efficiency is promoted where there is an appropriate separation of distribution and non-distribution assets and businesses. The Board cannot consider the expansion of the distribution system beyond that prescribed by legislation in the promotion of economic efficiency. This would be contrary to the underlying basis of the legislation which is to regulate distribution and to separate distribution from other activities. Similarly, the distributor's role with respect to conservation and demand management is appropriately limited to the provision of services in those areas, and not the ownership of load and load-related assets. Likewise, it is not necessary for the distributor to own load or load-related assets in order to develop a smart grid.

Finally, the Board does not accept the Applicants' argument that special consideration is warranted in this case because the streetlight assets are owned by THESI rather than the City of Toronto. The implication is that there is a diminished incentive to enhanced energy efficiency. As the City pointed out in its argument, it is responsible for determining the appropriate mechanism for delivery of municipal services including streetlighting and for the appropriate level of municipal spending. The City has determined it is appropriate to enter into a long term contract for streetlighting services. Irrespective of the contractual arrangements, the City remains the customer of a service to supply lighting. As the customer, the City has the incentive to acquire the service on the most cost effective basis possible, the same as any other customer. It is also notable that the program for more efficient streetlights referred to in the evidence ("ALAMP") is a program being run by THESI.

Does the proposed transaction meet the "no harm" test?

The Applicants argue that the proposed transaction meets the "no harm" test in that there will be only a marginal increase in rates which in all likelihood will be offset by cost savings resulting from the transaction. The Applicants also argued that the transaction assists the Board in meeting its section 1 objectives by eliminating ambiguity, increasing efficiency and increasing safety. The Applicants also claim that this transaction is the only practical means by which the Board can achieve its objective to facilitate the development of a smart grid with respect to streetlighting assets.

The intervenors on the other hand, argued that the proposal does not meet the "no harm" test given the adverse rate impacts for streetlighting and USL classes as well as potential impacts on other classes. They are also concerned about the lack of a proper asset valuation which may prevent the Board from correctly establishing the rate base and rates in the future.

The "no harm" test as used in the joint MAAD[1] case is a relatively narrow test. The principle in that case as the Board outlined recently in the Dawn Gateway[2] case is that the Board will focus on the transaction before it and not some other hypothetical transaction that the citizens may be arguing would provide a better deal than the one the municipality had chosen to pursue. As the Board said in Dawn Gateway, "the Board does not see any reason to depart from the no harm test, but notes that in any particular case, the determination by the Board of whether there is harm requires a comparison of the effect of the proposed transaction to the status quo." The Board stated at paragraph 55 of that decision:

> Keeping these factors in mind, the Board has considered the following questions:
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> - Would there be benefits as a result of the asset sale?
> - Would there be harm to the integrity, reliability, and operational flexibility of Union's system?
> - Would there be harm to potential future distribution customers seeking connection to Union?
> - Would there be harm to Ontario's gas market as a result of the sale?
> - Would there be harm to landowners?
> - Would there be harm to ratepayers as a result of the asset sale?

In the circumstances of this case, the application of the "no harm" test requires the Board not to look only at rate impact but to consider other objectives which include eliminating ambiguity, reducing regulatory costs and increasing efficiency and safety. In

[1] Ontario Energy Board, *Application by Greater Sudbury Hydro Inc. to acquire all outstanding shares in West Nippissing Energy Services Ltd., Application by PowerStream Inc. and Aurora Hydro Connections Ltd. to acquire all outstanding shares in Aurora Hydro Connections Ltd., Application by Veridian Connections Inc. and Gravenhurst Hydro Electric Inc. to acquire all outstanding shares in and subsequently amalgamate with Gravenhurst Hydro Electric Inc.,* EB-2005-0234, EB-2005-0254, EB-2005-0257, August 31, 2005 ("Joint MAADs").

[2] Ontario Energy Board, *Application by Union Gas Limited pursuant to section 43(1) of the Act, for an Order or Orders granting leave to sell 11.7 kilometers of natural gas pipeline running between the St. Clair Valve Site and Bickford Compressor Site in the Township of St. Clair, all in the Province of Ontario,* EB-2008-0411, November 27, 2009 ("Dawn Gateway").

reaching the decision to approve this transacting the Board has considered all of these factors.

Rate Impacts for Streetlighting and USL

The Applicants indicated that the only customers to be affected by the proposed transactions would be the Streetlighting and USL customers. For these classes there will be an estimated additional revenue requirement of $350,000 which in the Applicants' view would not be a significant rate impact.

Board staff noted that if the Board grants the applications, the rate impact on the Streetlighting and USL customers will depend on which assets are determined to be distribution assets and the value allowed for inclusion in ratebase. Board staff concluded 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 Board's statutory objectives in relation to electricity.

SEC submitted that the Streetlighting and USL classes will be paying higher rates as a result of this transaction which SEC maintained was contrary to the "no harm" test. VECC also submitted that because the Streetlighting and USL classes face an increase in their net revenue requirement of approximately $350,000 these customers are harmed by the proposal. In VECC's view the solution would be to disallow recovery of the additional $350,000.

The Applicants responded that the transactions meet the "no harm" test requirements and noted that the principal customer facing a rate increase is the City of Toronto which supports the applications. In addition, the Applicants submit that in applying the "no harm" test, the Board must consider all relevant factors in section 1 of the Act, and not rate impacts alone.

Potential Impacts on other Classes

The Applicants intend to transfer the *2006 Street and Expressway Lighting Agreement* between the City of Toronto and Toronto Hydro Street Lighting Inc. to THESL and use the revenues generated from the agreement to offset costs. The Applicants submit that all costs and offsetting revenues will be directly allocated to the specific Streetlighting and USL customers served by those assets.

SEC submitted that if the streetlighting assets are deemed to be distribution assets, then THESL cannot as a matter of law charge for the streetlighting service except in accordance with an order from the Board. Any charge in respect of the asset would have to be a distribution charge. It could not be revenue offset, as suggested by the Applicants. In SEC's view, the Act requires that rates for distribution services be charged on a regulated basis, so if these assets are distribution assets, the service provided through them must be at regulated rates. SEC submitted that the Board would have to find that the proposed charges in respect of the streetlighting services are just and reasonable but that no information has been provided to justify the proposed rates that are currently set forth in the various streetlighting agreements.

SEC also submitted that if the costs to service the streetlighting assets increase in the future due, for example, to aging infrastructure, increased liability claims, or other factors, those costs will be passed on to the Streetlighting customers, whereas under the current arrangement theses costs would be THESI's responsibility. The risk of those cost increases, in SEC's view, are therefore being transferred from THESI to THESL's distribution customers without compensation.

VECC submitted that THESL should provide more detailed information regarding the regulatory treatment of the transferred assets and related capital and OM&A expenses, to ensure that that no costs related to those assets are being "left" to the other classes, and that the Streetlighting and USL classes are attracting the appropriate level of the fully allocated costs of THESL's general expenses. VECC submitted that the Board should make explicit the cost allocation principles to be applied by THESL to any transferred assets to ensure that no harm, either now or in the future, is caused to ratepayers as a result of the transfer of the assets. VECC submitted that the Board should order that all costs and expenses related to streetlighting assets be directly allocated to the Streetlighting and USL classes.

The Applicants responded that the Board has already approved rates for the Streetlighting and USL classes and the revenue generated from the contract with the City will serve as revenue offset. Furthermore, the Applicants submitted that 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 application, THESL plans to present a comprehensive cost allocation and rate making approach for Streetlighting and USL classes based on the transfer of the SEL System into the distribution system. THESL

submitted that its proposal reflects a reasonable transitional approach until the time of the 2011 cost of service application.

SEC also submitted that the liabilities to be assumed by THESL are more extensive than those assumed by THESI. SEC pointed out that while in the initial transaction the purchaser, Toronto Hydro, assumed only a specific list of liabilities, in the current transaction THESL's potential liability is unlimited; it is essentially taking over all known and unknown liabilities associated with the streetlighting assets. SEC submitted that the assumed liabilities raise an important point about the risks to THESL ratepayers emanating from this transaction and submitted that recent experience related to contact voltage incidents and ensuing litigation demonstrates that the liabilities associated with these assets could be significant. SEC submitted that there is no guarantee that the associated costs will be allocated only to streetlighting and USL customers. For example, in the event that THESL's liability insurance rates increase in the future as result of the increased liability of the streetlight assets, it would be difficult to allocate that increase to a single rate class. SEC concluded that if the transfer is accepted, the asset purchase agreement should be required to be amended to provide that THESI indemnify THESL for liabilities emanating from the condition of the assets at the time of the transfer.

The Applicants responded that the liabilities being transferred are reasonable and fall within the scope of Toronto Hydro's existing insurance coverage and will be allocated wherever possible to the specific rate classes that use those assets. The Applicants further stated that unexpected liabilities associated with streetlighting assets would be allocated directly to the streetlighting and USL customers.

Asset Valuation

The intervenors were generally of the view that the valuation methodology used to calculate the proposed amount of $66 million to be added to rate base was inappropriate. While the Applicants agreed that the Deloitte valuation was not intended to assess the value of the streetlight assets, which would be the normal process in establishing the value to be included in rate base, they argued that an asset valuation would produce a level even higher.

SEC argued that the Deloitte valuation, while appropriate for a business valuation, was not appropriate for regulatory purposes because it is derived from a revenue-based fair market value not the physical value of the assets. VECC submitted that THESL should

either provide appropriate evidence that the actual net book value would be higher than the Deloitte evaluation, or, if the actual net book value is lower than the value proposed, establish that lower value.

In reply, the Applicants stated that the valuation approach undertaken by Deloitte should be accepted by the Board as reasonable and appropriate in the unique circumstances associated with streetlighting. Alternatively, the Applicants submitted THESL would be prepared to retain another valuator to prepare a new fair market valuation for the streetlighting assets as at December 31, 2009.

Board Findings

The Board does not agree that a rate increase automatically results in a proposed transaction failing the "no harm" test. There are a number of specific public interest factors to consider within an overall assessment of the no harm test, all of which flow from the Board's statutory objectives. These factors include:

- Appropriate ownership of distribution assets.
- Enhanced clarity and efficiency from a clear and enduring demarcation between regulated distribution assets and unregulated customer load assets.
- Rate impacts for current and future customers.

In addressing these specific factors, the Board believes it is appropriate to review the historical background to this transaction.

The evidence in this proceeding regarding the historic management of the streetlight assets and transfers deals specifically with the former Toronto Hydro and the former City of Toronto. This combination is only one of the six former utility/municipality pairings that now form THESL and the City of Toronto. The Board accepts the evidence of Mr. Couillard that there is no reason to think that the other former utilities did anything different than Toronto Hydro. In paragraph 9 of his affidavit that was filed with the applications, Mr. Couillard states:

> While I focused my review on Toronto Hydro, it is my understanding and I do verily believe that street lighting was developed as part of an integrated distribution infrastructure at other predecessor utilities of THESL, namely, Scarborough PUC, East York Hydro, North York Hydro, Etobicoke Hydro and York Hydro.

In 1985 Ontario Hydro, in its role as the regulator of municipally owned electric utilities, issued a new service guide provision regarding streetlight assets.

> In the case of streetlighting, which is utilization equipment, municipal utilities should be encouraged to transfer ownership to the municipal corporations on a prescribed basis. The rationale for this approach is that decisions on new lighting and replacements (including types of supports and fixtures) rests with Council. Also, by minimizing expenditures on street lighting, the municipal utility can apply more of its capital resources to extensions and improvements to the distribution system. [3]

In response to this service guide update and related amendments to the accounting manual issued by Ontario Hydro, Toronto Hydro sold its street lighting infrastructure to the City of Toronto, effective January 1, 1989, for the nominal sum of $1. The evidence contains the notes to the Toronto Hydro 1989 financial statements and these notes detail the accounting adjustments that were made to reflect the sale of the streetlighting assets to the City. Under these accounting adjustments all system costs associated with street lighting were removed from the balance sheet of Toronto Hydro.

There is no indication that any analysis was performed at that time to determine the actual functionality of the assets included in the accounts being removed. The total amounts in the accounts were removed.

It is the Board's view that had Toronto Hydro only transferred the assets that were the subject of Ontario Hydro's noted concern, that being the actual utilization equipment and any supports and fixtures that were exclusive to that purpose, thus retaining the assets that also had the functionality of serving other loads, the operational complications cited in evidence would have been substantially avoided. The Board recognizes that this is hindsight and that the decisions made by Toronto Hydro at that time only resulted in complications 10 years later as a result of the commercialization of the sector and the coming into force of section 71 of the Act. It would be unreasonable to expect that Toronto Hydro should have anticipated these eventualities.
In the Board's view, the appropriate steps to be taken now to eliminate the unnecessary operational complications that exist is a repatriation of distribution assets, not a repatriation of all streetlight assets. This is not only necessary to reduce the operational complications as described by the Applicants but also required to ensure that

[3] Tab 5, Exhibit L: Excerpt of Ontario Hydro Municipal Service Guide- Regulation of Municipal Utilities, Section 3.2 at page 4 dated May 1, 1985

distribution assets are properly within the ownership of the licensed distributor. This aspect is an important component of the Board's assessment of the "no harm" test.

The Board also finds that safety is a relevant concern. The Electrical Safety Authority has responsibility for public safety related to electrical infrastructure and equipment in Ontario. Distribution systems that are owned and operated by licensed distributors are governed by regulation 22/04 under what has been described as an objective based approach to regulation. Customer owned equipment is governed by the Ontario Electricity Safety Code under what has been described as a prescriptive approach to regulation. The Applicants claim that one of the benefits of having the SEL System transferred to THESL would be the avoidance of the confusion that arises from having the SEL System governed by two separate safety regimes.

Given the Board's findings on what are appropriately distribution assets, an ownership demarcation point will remain and therefore the two respective safety oversight programs will continue. To the extent that the conductors and associated equipment that have been serving multiple customers are the source of the confusion, the Board concludes that the classification of these assets as distribution assets and the transfer of these assets to THESL will alleviate the problem.

With respect to the asset valuation, the Board notes that the Deloitte methodology is not one that is typically employed for regulatory purposes. As SEC noted, the Deloitte valuation is a revenue-based fair market valuation; it is not a physical valuation of the assets. The Board will require an asset valuation to be prepared for the physical assets and will determine at that point, and on the basis of the revised transaction, the appropriate amount for inclusion in rate base.

With respect to rate impacts for current customers, the Board notes that the City of Toronto represents the customer most directly impacted and it supports the transaction. The Board concludes that the rate impacts that have been estimated are not unreasonable. However, these impacts have been estimated on the basis of the proposed transactions, and both the assets to be transferred and the proper net book value for those assets have yet to be determined. The Board will revisit this aspect of the proceeding if the Applicants choose to revise the transactions and file additional evidence. If the impacts are potentially unreasonable then actions to mitigate those impacts will be considered.

With respect to potential future impacts, the Board would note that it controls the setting of rates and an appropriate cost allocation process can ensure that costs are not shifted from the Streetlighting class to other classes. With respect to the liability issue specifically, the evidence is clear that the liabilities are well within the insured limits for the distributor, and again, if particular circumstances were to arise which resulted in significant costs associated with the streetlighting assets, the Board could ensure that the costs would be allocated appropriately. The Board also accepts the evidence of the Applicants that there is the potential for cost savings through greater efficiencies in the overall operations of the system and these efficiencies would have the effect of reducing costs and rates.

The Board concludes that the transfer of distribution assets (as specified in this Decision) from THESI to NewCo meets the "no harm" test because:

- There will be appropriate ownership of distribution assets.
- There will be enhanced clarity and efficiency from a clear and enduring demarcation between regulated distribution assets and unregulated customer load assets.
- Any rate impacts on the Streetlighting or USL class are expected to be small and can be mitigated if appropriate.
- Longer term rate impacts are not expected to be significant because of the potential for greater efficiencies and the ongoing attention given to proper cost allocation.

CONCLUSION

In conclusion, the Board approves the transfer of the distribution assets which have been specifically identified in this decision. The Board is not approving the transfer of any other assets. This approval is conditional on the Applicants filing additional evidence setting out the revised transactions and including an asset valuation within 90 days. The asset valuation must include:

- an asset valuation for the total SEL System;
- an asset valuation for those categories of assets which the Board has determined are distribution assets; and
- an asset valuation for those categories of assets which the Board has determined are not distribution assets.

As indicated earlier, the Board has not reached a decision on a proper classification of expressway lighting. The Board asks the Applicants in their additional evidence to provide an asset valuation for this category of assets and to provide further evidence as to whether these assets should be distribution or not distribution.

Intervenors will have the opportunity to submit interrogatories on the additional evidence and the Board will make provision for further submissions. The Board will issue a procedural order setting out these details after the Applicants have provided the further evidence.

In the event the Board accepts the asset valuations that are subsequently provided by the Applicants, the Board will issue an electricity distribution licence to NewCo, grant NewCo and THESL leave to amalgamate and upon amalgamation, cancel NewCo's electricity distribution licence and assign THESL's existing electricity distribution licence to NewTHESL under section 18(2) of the Act.

COST AWARDS

The Board has determined that costs will be assessed against Toronto Hydro-Electric System Limited. The Board has also determined that it is appropriate to deal with the cost claims in two phases. Intervenors eligible to claim costs may make their claims now for costs incurred up until and including the date of this Decision and Order. Any costs relating to the continuation of this proceeding will be dealt with at a later time.

IT IS ORDERED THAT:

1. Intervenors eligible for cost awards shall file with the Board and forward to THESL their respective cost claims within 21 calendar days from the date of this Decision and Order.
2. THESL may file with the Board and forward to the applicable intervenor(s) any objections to the claimed costs within 35 calendar days from the date of this Decision and Order.
3. Intervenors whose cost claims have been objected to may file with the Board and forward to THESL a response to any objection for cost claims within 42 calendar days of the date of this Decision and Order.
4. THESL shall pay the Board's costs of, and incidental to, this proceeding immediately upon receipt of the Board's invoice.

All filings to the Board must quote file numbers EB-2009-0180, EB-2009-0181, EB-2009-0182 and EB-2009-0183, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format filed through the Board's web portal at www.errr.oeb.gov.on.ca. Filings must clearly state the sender's name, postal address and telephone number and, if available, a fax number and e-mail address. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found on the "e-Filing Services" webpage of the Board's website at www.oeb.gov.on.ca. If the web portal is not available you may email your document to BoardSec@oeb.gov.on.ca.

DATED at Toronto, February 11, 2010

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary