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***via RESS e-filing – original to follow by courier***

Ms. Kirsten Walli, Board Secretary  
Ontario Energy Board  
2300 Yonge St, 27<sup>th</sup> Floor  
P.O. Box 2319  
Toronto, ON M4P 1E4

Dear Ms. Walli:

**RE: Toronto Hydro-Electric System Limited's  
Application for Approval of Contact Voltage Remediation Costs  
OEB File EB-2010-0193  
Filing of Supplementary Evidence**

THESL has received the Board's Procedural Order #4 in which the Board granted THESL's request to file supplementary evidence in this proceeding. In accordance with that Order, THESL encloses its supplementary evidence.

Yours truly,

*[Original signed by]*

Colin McLorg

Manager, Regulatory Policy and Relations  
[regulatoryaffairs@torontohydro.com](mailto:regulatoryaffairs@torontohydro.com)

cc: Intervenor of Record for EB-2010-0193, by email only

## Reconciliation of Contact Voltage Costs

### Introduction

THESL requested and obtained the Board's permission to submit this supplementary evidence because THESL is concerned that the existing record may not have provided a transparent explanation of the derivation of THESL's actual 2009 controllable expenses, or the differences of presentation between THESL's audited 2009 financial statements and what the Board requires for the determination of the allowed contact voltage cost recovery.

In addition THESL corrects, by way of this supplementary evidence, an error in the identification of charitable donation and special event costs which are non-eligible for inclusion in controllable expenses. As a result controllable expenses are reduced by \$0.46 million and the amount requested for contact voltage cost recovery is correspondingly reduced from \$9.05 million to \$8.586 million. THESL regrets this error and any misunderstanding it may have caused.

The allowance/disallowance mechanism established by the Board in the EB-2009-0243 Decision is novel in that it makes the allowable recovery of contact voltage costs a function of the level of THESL's controllable expenses, of which certain 'residual' contact voltage costs are a part. ('Residual' contact voltage costs are those actual contact voltage costs in excess of the \$9.44 million amount conditionally approved for recovery.) Nevertheless the tables forming Appendix A to this supplementary evidence and this accompanying narrative demonstrate that actual 2009 controllable expenses can be accurately and independently derived from THESL's audited 2009 financial results, and that while the allowable contact voltage recovery amount depends on the level of controllable expenses, there is no circularity in the calculation. No circularity exists because the level of actual controllable expenses is strictly independent of the allowable contact voltage recovery amount.

An appearance of circularity may have been created due to the fact, explained below, that when controllable expenses are within a certain range, the sum of controllable expenses and any amount disallowed for recovery under the mechanism established by the Board will be identically equal to the threshold amount of controllable expenses set by the Board i.e., 2009 allowed controllable expenses. This result is a direct outcome of the Board's allowance/disallowance mechanism.

Some confusion may also have been created due to differing recognition and presentation requirements as between THESL's financial reporting and what could be termed 'regulatory accounting' as it applies to the allowance/disallowance mechanism in this case. Specifically, accounting standards required THESL to recognize, as a regulatory asset, its estimate of the amount that would ultimately be recoverable as extraordinary contact voltage cost. THESL did this and the

recognition is explicit in THESL's 2009 audited statements. As a corollary, any remaining non-capital expenditures, including any disallowed amount, must be categorized as part of operating expenditures i.e., a current period expense in 2009. However, this does not in any way defeat the operation of the Board's allowance/disallowance mechanism or introduce circularity since any disallowed amount is already included in total expenditures for 2009. The recognition of a portion of those expenditures as a regulatory asset is simply an accounting procedure and does not in any way affect the actual 2009 controllable expenses or the operation of the Board's allowance/disallowance mechanism.

## Description and Explanation of Table 1.

Table 1 sets out the derivation of THESL's actual controllable expenses for 2009, the breakdowns of contact voltage costs, and the composition of 2009 actual operating expenses.

### DERIVATION OF 2009 ACTUAL CONTROLLABLE EXPENSES

Line 1: Actual operating expenses inclusive of residual contact voltages costs, but excluding that portion of total contact voltage costs that was estimated by management at the time of financial statement preparation to be recoverable through the Contact Voltage proceeding. That estimated amount was deferred and recorded on the balance sheet in a regulatory asset account. Source: Audited 2009 financial statements.

Line 2: The estimated recoverable amount of contact voltage expenses deferred and recorded as a regulatory asset as at December 31, 2009. The deferral *per se* of this amount has no impact either on the level of total actual expenses or the amount ultimately to be determined by the Board to be recoverable, but was required for financial statement purposes to provide the best estimate of THESL's financial position at that time. Source: Audited 2009 financial statements.

Line 3: Total audited operating expenditures, re-categorized for the purpose of this proceeding.

Line 4: Actual operating expenses falling in categories that are ineligible for inclusion in revenue requirement and controllable expenses. These expenses consisted of non-Winter Warmth charitable donations and special event costs.

The figure of \$724,000 represents a correction to the evidence originally filed by THESL and is the actual expense in this group of accounts, rather than \$0.3 million as originally filed. THESL mistakenly used a budget rather than an actual figure. THESL regrets this error and any consequential misunderstanding it caused.

Line 5: Total actual contact voltage expenditures in 2009, a portion of which were conditionally approved for recovery, and the balance of which represent actual operating expenses in expense categories which are eligible for inclusion in controllable expenses.

Line 6: Actual operating expenses net of categorically ineligible amounts and total contact voltage expenses.

Line 7: Residual contact voltage expenses defined as total actual non-capital contact voltage expenses minus the full conditionally approved (i.e., maximum potential) recoverable amount.

Residual contact voltage expenses were actual expenses incurred in account categories eligible for inclusion in controllable expenses and revenue requirement, but excluded by the Board from recoverable contact voltage expenses. For example, these costs included follow-on scanning costs. However, their exclusion from recoverable contact voltage costs does not preclude these costs from inclusion in controllable expenses.

Line 8: 2009 Actual controllable expenses categorically comparable to the threshold spending amount set by the Board in the EB-2009-0243 Decision.

In computing the amount of actual controllable expenses, THESL took the position that no part of the conditionally approved amount of \$9,440,000 could be included in 2009 controllable expenditures for purposes of comparison to the threshold controllable expense level of \$195,200,000. Stated differently, THESL interpreted the EB-2009-0243 Decision to require comparison to actual controllable expenses exclusive of the amounts which might eventually be recovered. Therefore, although expenses of \$9,440,000 were actually incurred and may not be totally recovered, that amount was excluded from the calculation of 2009 actual controllable expenses.

#### DERIVATION OF DISALLOWED CONTACT VOLTAGE EXPENSE

Line 9: 2009 Actual controllable expenses

Line 10: The Threshold Controllable Expenses amount, established in the EB-2009-0243 Decision, equal to the 2009 allowed amount in the same category. That Decision stated that any shortfall of actual Controllable Expenses relative to the 2009 allowed amount would be deducted from the conditionally approved contact voltage recoverable amount. Please also refer to pages 2-3 of THESL's original recovery application dated May 14 2010.

Line 11: The disallowed amount, calculated as described above (Actual Controllable Expenses minus Threshold Controllable Expenses)

#### CONTACT VOLTAGE COST BREAKDOWN

Line 12: Conditionally recoverable contact voltage costs.

Line 13: Disallowable portion of contact voltage costs.

Line 14: Actual recoverable contact voltage expenses, equal to the amount conditionally approved less the disallowable amount.

Lines 15 through 18 and 19 through 23: Total contact voltage expenses decomposed into various categories, illustrating the differences between conditionally allowed and actually allowable and disallowable amounts.

Lines 24 through 31: A reconstruction of total 2009 operating expenses, proceeding from 2009 actual controllable expenses excluding contact voltage and adding expense items in a stepwise manner to ultimately reconcile to total 2009 audited operating expenses.

Line 28 demonstrates that as long as any disallowed amount is in the range of \$0 to \$9,440,000, the sum of controllable expenses plus disallowed expenses will be identically equal to \$195,200,000. This result follows from the definition of the conditionally allowed amount in the EB-2009-0243 Decision, which, in the form of an equation, states that

$$D = CE_t - CE_a \text{ (for } 0 \leq D \leq \$9.44 \text{ million)}$$

where D stands for the disallowed amount,  $CE_t$  stands for the threshold level of controllable expenses, and  $CE_a$  stands for actual controllable expenses. (D can neither be less than zero nor greater than \$9.44 million). As a result

$$CE_a + D = CE_t$$

or

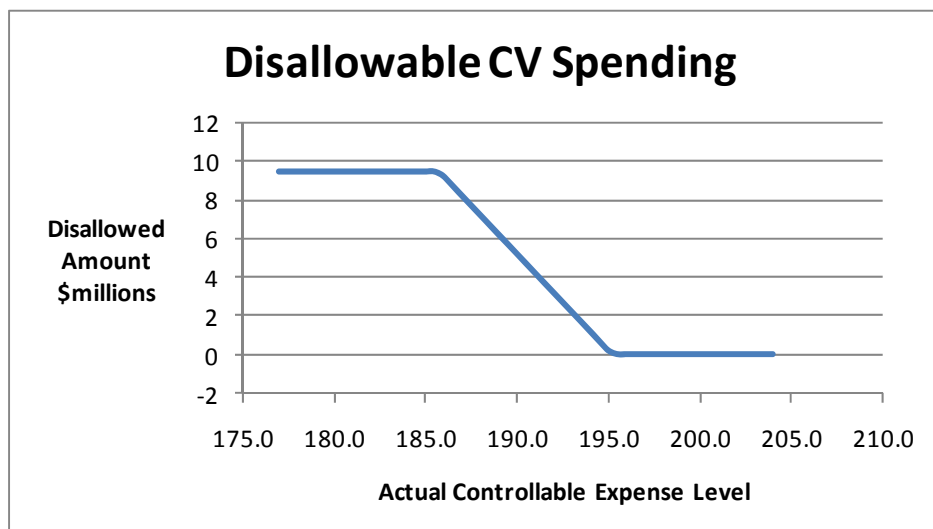
$$CE_a + D = \$195,200,000$$

If actual 2009 controllable expenses exceeded the threshold amount the disallowed amount would be zero (that is, the entire \$9,440,000 would be eligible for recovery), and the sum of controllable plus disallowed expenses would simply be equal to controllable expenses. If actual 2009 controllable expenses were less than  $(\$195,200,000 - \$9,440,000 =)$  \$185,760,000 then the disallowed amount would be \$9,440,000, and the sum of controllable plus disallowed expenses would be less than \$195,200,000. Within the stated range, however, the actual allowable and actual disallowable amounts are complements that add identically to \$9,440,000, and it follows that the sum of controllable expenses plus disallowable expenses will be identically equal to \$195,200,000. This result is further illustrated in Table 2 in which various hypothetical levels of spending, along with their consequences for the allowable and disallowable amounts, are depicted.

## Description and Explanation of Table 2.

Table 2 essentially replicates Table 1 with the addition of 3 columns depicting different hypothetical levels of operating expense, so as to illustrate the operation of the allowance/disallowance mechanism. Column 1 shows the 2009 actuals, with Columns 2, 3, and 4 respectively showing lower than actual spending, spending with a shortfall greater than \$9.44 million, and spending higher than the threshold.

Readers will observe at Line 11 that the disallowable amount grows in Columns 2 and 3 and is maximized in Column 3 as the spending shortfall increases and surpasses the \$9.44 million level. Conversely Column 4 with a higher spending level (exceeding the threshold) shows a disallowable amount of \$0. The allowable amount, which is the complement of the disallowed amount, is shown at line 20. However, the disallowable amount is not a continuous mathematical function since at any controllable expense level less than \$185,760,000, it is \$9,440,000; it then decreases linearly until it reaches zero, when controllable expenses are at or above the threshold level. This is depicted in the Chart below.



Lines 24 through 29 show how the various quantities of interest move as spending varies. In particular, Line 28 shows that within the described range of spending, any two arbitrarily different levels of spending produce the same sum of controllable and disallowed expenses.

## Conclusion

As a ratemaking mechanism the allowance/disallowance algorithm is unusual and THESL is not aware of any precedent which might have aided all parties in readily understanding its detailed implications. THESL is concerned that a misunderstanding could naturally have arisen from the existing record were parties to have concluded that THESL's calculations were such as to automatically reach a spending level of \$195,200,000 and thereby defeat the purpose of the mechanism.

THESL has not attempted to defeat the purpose of the mechanism but acknowledges that clarity may have been lacking in this area. THESL offers this supplementary explanation for the purpose of dispelling any obscurity which may exist around this issue.

## RECONCILIATION OF CONTACT VOLTAGE EXPENSES

**TABLE 1**

### **Derivation of 2009 Actual Controllable Expenditures**

Line	Item	Col. 1
1.	Operating Expenses	195,460
2.	Contact Voltage Regulatory Asset	9,050
3.	Total Operating Expenses	204,510
4.	Less Categorically Ineligible Expenses	-724
5.	Less Total Contact Voltage Expenses	-15,139
6.	Controllable Expenses Excluding Contact Voltage	188,647
7.	Add Residual Contact Voltage Expenses	5,699
8.	<b>2009 Actual Controllable Expenses</b>	194,346

### **Derivation of Disallowed Contact Voltage Expense**

9.	Actual Controllable Expenses	194,346
10.	Less Controllable Expenses Threshold	-195,200
11.	<b>Disallowed Portion of Conditionally Recoverable Expenses</b>	-854

### **Contact Voltage Cost Breakdown**

12.	Conditionally Recoverable Contact Voltage Costs	9,440
13.	Less Disallowed Portion	-854
14.	<b>Actual Recoverable Contact Voltage Costs</b>	8,586
15.	Total Contact Voltage Expenses	15,139
16.	Conditionally Recoverable Expenses	9,440
17.	Residual Contact Voltage Expenses	5,699
18.	<b>Total</b>	15,139
19.	Total Contact Voltage Expenses	15,139
20.	Actual Recoverable Contact Voltage Costs	8,586
21.	Disallowed Portion	854
22.	Residual Contact Voltage Expense	5,699
23.	<b>Total</b>	15,139

### **Composition of 2009 Actual Operating Expenses**

24.	Controllable Expenses Excluding Contact Voltage	188,647
25.	Residual Contact Voltage Expense	5,699
26.	2009 Actual Controllable Expenses	194,346
27.	Disallowed Contact Voltage Expenditures	854
28.	2009 Actual Controllable Expenses + Disallowed	195,200
29.	Actual Recoverable Contact Voltage Costs	8,586
30.	Categorically Ineligible Expenses	724
31.	Total Operating Expenses	204,510



**COMPARISON OF SPENDING SCENARIOS**

**TABLE 2**

Line	Item	Col. 1	Col. 2	Col. 3	Col. 4
		ACTUAL	LOWER SPENDING	LOWEST SPENDING	HIGHER SPENDING
1.	Operating Expenses	195,460	190,000	185,000	200,000
2.	Contact Voltage Regulatory Asset	9,050	9,050	9,050	9,050
3.	Total Operating Expenses	204,510	199,050	194,050	209,050
4.	Less Categorically Ineligible Expenses	-724	-724	-724	-724
5.	Less Total Contact Voltage Expenses	-15,139	-15,139	-15,139	-15,139
6.	Controllable Expenses Excluding Contact Voltage	188,647	183,187	178,187	193,187
7.	Add Residual Contact Voltage Expenses	5,699	5,699	5,699	5,699
8.	<b>2009 Actual Controllable Expenses</b>	194,346	188,886	183,886	198,886

**Derivation of Disallowed Contact Voltage Expense**

9.	Actual Controllable Expenses	194,346	188,886	183,886	198,886
10.	Less Controllable Expenses Threshold	-195,200	-195,200	-195,200	-195,200
11.	<b>Disallowed Portion of Conditionally Recoverable Expenses</b>	-854	-6,314	-9,440	0

**Contact Voltage Cost Breakdown**

12.	Conditionally Recoverable Contact Voltage Costs	9,440	9,440	9,440	9,440
13.	Less Disallowed Portion	-854	-6,314	-9,440	0
14.	<b>Actual Recoverable Contact Voltage Costs</b>	8,586	3,126	-	9,440
15.	Total Contact Voltage Expenses	15,139	15,139	15,139	15,139
16.	Conditionally Recoverable Expenses	9,440	9,440	9,440	9,440
17.	Residual Contact Voltage Expenses	5,699	5,699	5,699	5,699
18.	<b>Total</b>	15,139	15,139	15,139	15,139
19.	Total Contact Voltage Expenses	15,139	15,139	15,139	15,139
20.	Actual Recoverable Contact Voltage Costs	8,586	3,126	0	9,440
21.	Disallowed Portion	854	6,314	9,440	0
22.	Residual Contact Voltage Expense	5,699	5,699	5,699	5,699
23.	<b>Total</b>	15,139	15,139	15,139	15,139

**Composition of 2009 Actual Operating Expenses**

24.	Controllable Expenses Excluding Contact Voltage	188,647	183,187	178,187	193,187
25.	Residual Contact Voltage Expense	5,699	5,699	5,699	5,699
26.	2009 Actual Controllable Expenses	194,346	188,886	183,886	198,886
27.	Disallowed Contact Voltage Expenditures	854	6314	9440	0
28.	<b>2009 Actual Controllable Expenses + Disallowed</b>	195,200	195,200	193,326	198,886
29.	Actual Recoverable Contact Voltage Costs	8,586	3,126	0	9,440
30.	Categorically Ineligible Expenses	724	724	724	724
31.	<b>Total Operating Expenses</b>	204,510	199,050	194,050	209,050