

EB-2007-0680

**TORONTO HYDRO-ELECTRIC SYSTEM LIMITED
PROPOSED SETTLEMENT AGREEMENT**

November 27, 2007

EB-2007-0680: PROPOSED SETTLEMENT AGREEMENT

This Settlement Agreement (“Agreement”) is for the consideration of the Ontario Energy Board (“the Board”) in its determination, under Docket No. EB-2007-0680, of rates for 2008, 2009, and 2010 for Toronto Hydro-Electric System Limited (“THESL”).

By Procedural Order No.1 dated September 21, 2007, the Board scheduled a Settlement Conference to commence November 20, 2007. The Settlement Conference was convened, in accordance with Procedural Order No. 1, with Mr. George Dominy as facilitator. The Settlement Conference proceeded until November 22, 2007.

No comprehensive settlement was reached. However, in some instances the parties reached complete settlement on a specific issue, or agreed that an issue could be narrowed. This Agreement identifies the issues on the Board’s list for which multi-party settlement or agreement on narrowing of the issue has been reached.

No agreement was reached on the threshold issue identified by the Board concerning the length of the test period (i.e., whether Board Orders should be issued for 2008, 2009, and 2010 or for fewer rate years). The proposed narrowings or settlements of specific issues set out below are intended to be neutral on the threshold issue and without prejudice to any party’s position on, or the eventual determination of, that issue.

The Issues List as determined by the Board’s decision dated October 15, 2007 is attached as Appendix A to the Agreement. The parties agree that this Agreement and the Appendix form part of the record in the proceeding.

Each of the issues identified below falls within one of the following three categories:

1. An issue for which there is no settlement;
2. An issue for which there is a proposed narrowing of scope, agreed to by THESL and other parties, but for which one or more parties may disagree or take no position; and,
3. An issue for which complete settlement was reached.

For the purposes of this Agreement, the term “no position” may apply to parties who were involved in negotiations on an issue but who ultimately took no position on that issue, as well as parties who were not involved in negotiations on that issue at all.

The parties agree that all positions, information, documents, negotiations and discussion of any kind whatsoever which took place or were exchanged during the Settlement Conference are strictly confidential and without prejudice, and inadmissible unless relevant to the resolution of any ambiguity that subsequently arises with respect to the interpretation of any provision of this Agreement.

The role adopted by Board Staff in Settlement Conferences is set out on page 5 of the Board’s Settlement Conference Guidelines. Although Board Staff is not a party to this Agreement, “Board Staff who participate in the settlement conference are bound by the same confidentiality standards that apply to parties to the proceeding”, as noted in the Guidelines.

The evidence supporting the settlement for, or agreement on narrowing of scope for each issue where this was achieved is set out in that section of the Agreement.

The following parties participated in the Settlement Conference:

Toronto Hydro Electric System Limited (“THESL”)
Consumers Council of Canada (“Consumers Council”)
Energy Probe Research Foundation (“Energy Probe”)
Pollution Probe Foundation (“Pollution Probe”)
School Energy Coalition (“Schools”)
Vulnerable Energy Consumers Coalition (“VECC”)

STATEMENT OF PROPOSED SETTLEMENT BY ISSUE

The complete Issues List, as approved by the Board on Oct 15, 2007, is set out below, along with any scope-narrowing proposal agreed upon by any of the intervening parties and THESL. Details of the proposed scope-narrowing, along with references to the corresponding evidence are provided under each defined issue.

1 Operating Costs

1.1 Is the proposed level of Operation, Maintenance, Administration and General Expenses acceptable?

No Settlement

1.2 Has the applicant addressed the Board's concerns related to distribution expenses paid to affiliates with a response that provides reasonable costs?

No Settlement

1.3 Are the procurement policy and the costs that flow from it appropriate?

Narrowing of the issue:

Parties accept the evidence with respect to THESL's procurement policy *per se*. However, specific costs for items procured using the procurement policy remain unsettled.

The following parties agree with this narrowing of the issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References:

Exhibit C2, Tab 3, Schedule 1

Exhibit C2, Tab 3, Schedule 1, Appendix A

Exhibit R1, Tab 1, Schedule 1.25

1.4 Are the proposed levels of depreciation and amortization expense acceptable?

Narrowing of the issue:

Parties accept the depreciation and amortization rates and calculation methodology proposed by THESL, with the exception of the treatment of stranded meter costs. The

specific levels of proposed depreciation and amortization costs, inasmuch as they are determined by changes in the value of ratebase, remain unsettled.

The following parties agree with this narrowing of the issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References:

Exhibit D1, Tab 6, Schedule 3

Exhibit D1, Tab 6, Schedule 4

Exhibit D1, Tab 13, Schedule 1

Exhibit D1, Tab 14, Schedule 1

Exhibit R1, Tab 1, Schedule 4.13

Exhibit R1, Tab 1, Schedule 4.13, Appendix A

2 Operating Revenue

2.1 Are the proposed revenue offsets reasonable for rate determination?

No Settlement

3 Taxes

3.1 Is the PILs provision reasonable?

Complete Settlement

Parties accept THESL's tax calculation methodology, subject to adjustments to the level of the PILs allowance to reflect the Board's Decision, and to incorporation of the effects of known changes to GST and federal tax rates through the continuing use of variance accounts. See also Issue 10.1

The following parties agree with the settlement of this issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References:

Exhibit H1, Tab 1, Schedule 1

Exhibit R1, Tab 1, Schedule 5.1

Exhibit R1, Tab 1, Schedule 10.7

3.2 Are the proposed levels for Capital Taxes and Property Taxes appropriate?

Narrowing of the issue:

THESL's methodology and tax calculations are accepted by the parties. The specific levels of tax remain unsettled because they are a function of ratebase levels.

The following parties agree with this narrowing of the issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References:
Exhibit H1, Tab 1, Schedule 1

4 Rate Base

4.1 Are the proposed capital plan and level of capital expenditures acceptable?

No Settlement

4.2 Is the proposed working capital appropriate?

Narrowing of the issue:

Parties accept the results of THESL's lead-lag study (i.e., the Navigant Study) and working capital calculation methodology. There is no settlement on the specific level of the working capital allowance because of its dependence on other unsettled items.

The following parties agree with this narrowing of the issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References: Exhibit D1
Exhibit D1, Tab 15, Schedule 1
Exhibit D1, Tab 15, Schedule 2
Exhibit D1, Tab 15, Schedule 3
Exhibit D1, Tab 15, Schedule 4
Exhibit D1, Tab 16, Schedule 1

4.3 Will the proposed capital expenditures permit a significant expansion of distributed generation in downtown Toronto by 2011?

No Settlement

5 Cost of Capital and Rate of Return

5.1 Is the applicant's proposal for adjusting the return appropriate?

Complete Settlement

Preamble

THESL's Cost of Capital evidence proposes that Allowed Return on Equity be determined prior to the test year or, if applicable, the test years, using the Board's methodology as detailed in the Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, issued December 20th, 2006. THESL will update the test year Revenue Requirement to reflect the updated ROE. THESL has not proposed that its cost of debt be updated during the three test years, but instead proposed that the cost of debt be set for all years based on the evidence and forecasts provided in Exhibit E1.

Settlement

Parties agree that the Allowed Return on Equity will be updated prior to the beginning of the 2008 test year, and, if necessary, the 2009 and 2010 rate years, using the Board's ROE methodology.

Additionally, the forecast cost of short term debt and new long-term debt in a given test year will be updated using the Board's methodology for the deemed long term and short term debt rates to determine the corresponding rates applicable in that test year.

Parties also agree that in the event this proceeding results in a rate order for 2009, the actual amount of, and interest rate applicable to, any debt issued in 2008 will be reflected in the determination of revenue requirement for the 2009 test year. If applicable, an

adjustment will be made in 2010, so that the 2010 revenue requirement will be updated to reflect those parameters for debt actually issued during 2008 and 2009.

THESL will file, prior to the beginning of each rate year, its projections for cost of capital and the associated change in revenue requirement for the forthcoming test year, once the forecast ROE and debt costs are determined in accordance with the Board's methodology. THESL will provide intervenors of record in this proceeding a copy of its filing in order to allow intervenors to submit any comments to the Board within 5 working days.

Rationale

By proposing to use the Board's methodology for determining the long term and short term debt rates, adjusting the cost of debt is nearly as mechanistic as adjusting the Return on Equity. Parties agree that the method described above adequately protects both ratepayers and the company from exogenous changes in interest rates and debt timing issues over the three-year test period. This mechanism mimics the adjustment that would be made under single year cost of service applications, in that the embedded (i.e., actual) cost of issued debt is reflected in rates for all years subsequent to the test year.

The following parties agree with the settlement of this issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References:

Exhibit E1
Exhibit R1, Tab 1, Schedule 5.1
Exhibit R1, Tab 6, Schedules 4
Exhibit R1, Tab 6, Schedules 16

5.2 Is the applicant's forecast of debt reasonable?

Complete Settlement in conjunction with Issue 5.1

6 Load Forecast

6.1 Is the applicant's load forecast acceptable?

No Settlement

7 Cost Allocation and Rate Design

7.1 Did the applicant apply the Board's cost allocation methodology correctly?

Complete Settlement

Parties agree that THESL has correctly applied the Board's cost allocation methodology.

The following parties agree with the settlement of this issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties take no position on this issue: Pollution Probe

Evidence References:

Exhibit L1

Exhibit R1, Tab 1, Schedule 7.2

Exhibit R1, Tab 1, Schedule 7.8

Exhibit R1, Tab 1, Schedule 7.10

Exhibit R1, Tab 1, Schedule 7.11

Exhibit R1, Tab 6, Schedule 28

7.2 Are the proposed revenue to cost ratios reasonable?

No Settlement

7.3 Are the Fixed Monthly Charges reasonable?

No Settlement

7.4 Are the loss adjustment factors reasonable?

No Settlement

8 CDM

8.1 Is it appropriate to provide funding for the third tranche residential load control programme as proposed by the applicant, given that the applicant is also seeking funding from the OPA for a residential load control program?

No Settlement

8.2 Is it appropriate to provide incremental funding for governance of all existing CDM programmes as proposed by the applicant?

No Settlement

9 Smart Meters

9.1 Are the proposed costs for smart meters appropriate?

No Settlement

9.2 Is the proposed method of recovery of smart meter costs sought in the application appropriate?

No Settlement

10 Deferral and Variance Accounts

10.1 Is the proposal for the continuation of existing variance and deferral accounts appropriate?

Narrowing of the issue:

The parties accept THESL's proposal for the continuation of existing variance and deferral accounts, as set out below, with the exceptions of THESL's proposals to continue variance account treatment for distribution losses, and to discontinue the use of the smart meter deferral account.

RSVA - Wholesale Market Service Charge	1580
RSVA - One-Time Wholesale Market Service	1582
RSVA - Retail Transmission Network Charge	1584
RSVA - Retail Transmission Connection Charge	1586
Retail Cost Variance Account - Retail	1518
Retail Cost Variance Account - STR	1548
Hydro One LV Variance Account	1550
Conservation and Demand Management Expenditures and Recoveries	1565
CDM Contra	1566
Deferred Payments in Lieu of Taxes	1562
Deferred PILs Contra Account	1563
PILs & Taxes Variance	1592
Recovery of Regulatory Asset Balances	1590

The following parties agree with this narrowing of the issue: Consumers Council, Energy Probe, Schools, VECC, and THESL.

The following parties do not agree with this narrowing of the issue: Pollution Probe. Pollution Probe objects to the continuation of variance account treatment for distribution losses, and otherwise takes no position with respect to other variance and deferral accounts.

Evidence References:

Exhibit J1, Tab 1, Schedule 2
Exhibit J1, Tab 2, Schedule 8
Exhibit J1, Tab 2, Schedule 9
Exhibit R1, Tab 1, Schedule 10.3
Exhibit R1, Tab 1, Schedule 10.3 Appendix C
Exhibit R1, Tab 1, Schedule 10.6

10.2 Is the proposal for the establishment of any new variance accounts appropriate?

No Settlement

10.3 Is the proposal for the amounts and disposition of Toronto Hydro's existing deferral and variance accounts appropriate?

No Settlement

10.4 Should there be a variance account for capital expenditures within the test period?

No Settlement

11 Rate Implementation

11.1 Is the proposal for 2009 and 2010 rates justified?

No Settlement

11.2 Is the proposal for rate implementation appropriate?

No Settlement

APPENDIX

Appendix A: Board Approved Issues List (Oct 15, 2007)

Appendix A
EB-2007-0680
Toronto Hydro-Electric System
Issues List

1 Operating Costs

- 1.1 Is the proposed level of Operation, Maintenance, Administration and General Expenses acceptable?
- 1.2 Has the applicant addressed the Board's concerns related to distribution expenses paid to affiliates with a response that provides reasonable costs?
- 1.3 Are the procurement policy and the costs that flow from it appropriate?
- 1.4 Are the proposed levels of depreciation and amortization expense acceptable?

2 Operating Revenue

- 2.1 Are the proposed revenue offsets reasonable for rate determination?

3 Taxes

- 3.1 Is the PILs provision reasonable?
- 3.2 Are the proposed levels for Capital Taxes and Property Taxes appropriate?

4 Rate Base

- 4.1 Are the proposed capital plan and level of capital expenditures acceptable?
- 4.2 Is the proposed working capital appropriate?
- 4.3 Will the proposed capital expenditures permit a significant expansion of distributed generation in downtown Toronto by 2011?

Appendix A
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Issues List

5 Cost of Capital and Rate of Return

- 5.1 Is the applicant's proposal for adjusting the return appropriate?
- 5.2 Is the applicant's forecast of debt reasonable?

6 Load Forecast

- 6.1 Is the applicant's load forecast acceptable?

7 Cost Allocation and Rate Design

- 7.1 Did the applicant apply the Board's cost allocation methodology correctly?
- 7.2 Are the proposed revenue to cost ratios reasonable?
- 7.3 Are the Fixed Monthly Charges reasonable?
- 7.4 Are the loss adjustment factors reasonable?

8 CDM

- 8.1 Is it appropriate to provide funding for the third tranche residential load control programme as proposed by the applicant, given that the applicant is also seeking funding from the OPA for a residential load control program?
- 8.2 Is it appropriate to provide incremental funding for governance of all existing CDM programmes as proposed by the applicant?

9 Smart Meters

- 9.1 Are the proposed costs for smart meters appropriate?
- 9.2 Is the proposed method of recovery of smart meter costs sought in the application appropriate?

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Issues List

10 Deferral and Variance Accounts

- 10.1 Is the proposal for the continuation of existing variance and deferral accounts appropriate?
- 10.2 Is the proposal for the establishment of any new variance accounts appropriate?
- 10.3 Is the proposal for the amounts and disposition of Toronto Hydro's existing deferral and variance accounts appropriate?
- 10.4 Should there be a variance account for capital expenditures within the test period?

11 Rate Implementation

- 11.1 Is the proposal for 2009 and 2010 rates justified?
- 11.2 Is the proposal for rate implementation appropriate?