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BY E-MAIL

October 1, 2010

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St. 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Board Staff Submission
Toronto Hydro-Electric System Limited
Application for Recovery of Approved Contact Voltage Remediation Costs
Board File Number EB-2010-0193**

Please find the attached Board staff submission in the above proceeding. Please forward the following to Toronto Hydro-Electric System Limited and all other parties to this proceeding.

Sincerely,

Original Signed By

Martin Davies
Project Advisor, Applications & Regulatory Audit

Attachment



ONTARIO ENERGY BOARD

STAFF SUBMISSION

**APPLICATION FOR RECOVERY OF AMOUNTS
RELATED TO CONTACT VOLTAGE EMERGENCY
REMEDICATION COSTS IN 2011 RATES**

Toronto Hydro-Electric System Limited

EB-2010-0193

October 1, 2010

INTRODUCTION

On May 14, 2010 Toronto Hydro-Electric System Limited (“THESL” or the “Applicant”) filed an application (the “Application”) with the Ontario Energy Board (the “Board”) requesting the Board’s approval of rate riders to recover approved costs incurred by THESL for the emergency correction of contact voltage conditions on its system, effective May 1, 2011. The costs had been approved in the Board’s EB-2009-0243 Decision (the “Decision”), which found that any relief provided in the Decision would be conditional on THESL’s actual spending in controllable OM&A expenditures for the 2009 year (ending December 31, 2009). THESL was authorized to record in a deferral account an amount of \$9.44 million for review once the 2009 audited financial results were known and upon application by THESL to clear the balance in the sub-account.

The Vulnerable Energy Consumers’ Coalition (“VECC”), the School Energy Coalition (“SEC”), the Energy Probe Research Foundation (“Energy Probe”) and the Canadian Union of Public Employees, Local One (“CUPE One”), were intervenors in the EB-2009-0243 proceeding and were deemed by the Board to be intervenors in the present proceeding.

This submission reflects observations and concerns which arise from Board staff’s review of the pre-filed evidence and interrogatory responses made by THESL and is intended to assist the Board in evaluating THESL’s application and in setting just and reasonable rates.

THE APPLICATION

THESL has applied to recover an amount of \$8.586 million, to be adjusted for interest as found appropriate by the Board, for approved contact voltage remediation costs effective May 1, 2011.

Board staff’s comments are focused on five areas related to this application: (1) the proposed recovery amount, (2) the allocation of the spending shortfall to the customer classes, (3) the approach to and timing of the recovery of allocated costs from the customer classes, (4) the approach to interest carrying charges, and (5) the appropriate implementation date.

APPROPRIATE RECOVERY AMOUNT

Background

The Board found in the Decision that THESL's recovery of up to \$9.44 million of contact voltage remediation costs would be conditional on THESL's actual controllable OM&A expenditures for the 2009 year. The \$9.44 million had arisen from its determination that the total of \$14.35 million of contact voltage related recovery requested by THESL should be reduced by \$4.91 million, resulting in the approved amount of \$9.44 million.

In making this finding, the Board expressed the concern that if in fact there was underspending in the 2009 total controllable OM&A, it would confer a double benefit to the shareholder.¹

The Board therefore found that in the event THESL's actual controllable OM&A expenditures were below the level reflected in THESL's 2009 approved base rates, the amount of the relief eligible for recovery found would be reduced by the amount of the under spending.

The Decision provided details as to how the appropriate amount of relief should be determined. Based on the information filed in the proceeding from THESL's 2010 rates application, the total OM&A level used to derive 2009 rates was \$350.0 million. Excluding amortization expenses of \$154.4 million, the total controllable expenses used to derive 2009 rates were \$195.6 million. On this basis, the Board determined that any under spending in OM&A controllable expenses below \$195.6 million would be deducted from the conditional relief found in its Decision. THESL's audited 2009 statements were to be the basis of determining the level of under spending, if any.²

In a letter to the Board dated December 17, 2009, THESL stated that the amount of \$195.6 referenced in the Decision included \$0.4 million of expenditures on donations and special events, which was not included as a part of 2009 rates and should therefore be excluded, meaning that an appropriate reference level of approved controllable 2009 OM&A would be \$195.2 million.³

¹ EB-2009-0243 Decision, Toronto Hydro-Electric System Limited, December 11, 2009, p. 9

² Ibid

³ Exhibit J, Tab 1, Schedule 1

Discussion and Submission

Staff accepts the validity of the \$0.4 million adjustment to 2009 approved controllable OM&A as outlined in THESL's December 17, 2009 letter.

Staff submits that a key issue confronting the Panel in its consideration of THESL's application is that the Decision does not state whether or not the 2009 actual controllable OM&A expenses to be compared to the approved amount used to determine 2009 rates would be inclusive or exclusive of contact voltage remediation costs, and if exclusive, whether the costs to be excluded would be only those approved for recovery in the Decision, or all costs that are related to the contact voltage emergency, whether they were approved for recovery by the Board or not.

Accordingly, it is staff's view that there are three potential approaches open to the Board to determine an appropriate level of recovery of contact voltage remediation costs by THESL. These are defining actual 2009 controllable OM&A as (i) including all contact voltage costs, (ii) excluding only contact voltage costs approved for recovery in the Decision and (iii) excluding all contact voltage costs.

THESL's application is based on the assumption that the second approach, involving only the exclusion of Board approved contact voltage costs is appropriate. The following discussion reviews each of the three approaches.

(i) Definition of controllable OM&A as including contact voltage costs

The adoption of this approach would mean that THESL would be allowed recovery of the maximum \$9.44 million allowed in the Decision, rather than the \$8.586 million that THESL is requesting.

This is because in its application, as updated in its Supplementary Evidence, THESL states that the total controllable OM&A amount arising from its 2009 audited financial statements including contact voltage costs is \$204.51 million.⁴

The derivation of the \$204.51 million amount is explained by THESL in a table included in its response to a Board staff interrogatory.⁵ Staff has reorganized this table to

⁴ THESL, Recovery of Amounts Related to Contact Voltage, Supplementary Evidence – Appendix A

⁵ Exh J/Tab 1/Sch 3 and Supplementary Evidence Appendix A

separate out contact voltage costs from the remaining controllable OM&A items as shown below and updated it for the correction contained in THESL's supplementary evidence:

	2009 Actual (\$ millions)
Operations	49
Maintenance	46.5
Billing and Collections	35.1
Community Relations	5.5
Administrative and General	47.5
Other Distribution Expenses	11.8
Less: Donations & Special Events	-0.3
Add: rounding	0.1
Controllable OM&A (w/o CV costs)	195.2
Actual Recoverable Contact Voltage Costs	8.6
Categorically Ineligible Expenses	0.7
TOTAL CONTROLLABLE OM&A	204.51

Therefore, if the Board was to determine that the appropriate definition of controllable OM&A to be compared to the benchmark amount of \$195.2 million was the total controllable 2009 OM&A including contact voltage costs, this amount at \$204.51 million substantially exceeds \$195.2 million and THESL would be entitled to recover the full \$9.44 million maximum awarded in the Decision.

The Board may wish to consider whether or not in this context the inclusion of the contact voltage costs in the 2009 actual controllable OM&A amount provides a comparable base to the adjusted 2009 comparator referenced in the Decision since no specific contact voltage remediation costs were incorporated at the time 2009 rates were set.

- (ii) *Definition of controllable OM&A as excluding only contact voltage costs approved for recovery in the Decision*

This is the approach proposed by THESL and results in the referenced recovery amount of \$8.586 million. The derivation of the allowable recovery amount is outlined in the table below:

\$ millions	THESL Approach
(1) 2009 Controllable Expenses	204.51
(2) Contact Voltage Costs	9.44
(3) Categorically Ineligible Expenses	0.724
(4) Net Expenses (1) - (2) - (3)	194.346
(5) Approved 2009 Expenditure Level	195.2
(6) Under Expenditure (4) - (5)	-0.854
(7) Maximum Recoverable Expenditures	9.44
(8) Allowable Recovery (6) + (7)	8.586

Staff notes that THESL's approach is based upon the assumption that it is necessary to deduct contact voltage related costs from the actual 2009 controllable OM&A to achieve a valid comparator. Staff submits that once this principle is established, the next question that arises is whether it is appropriate to deduct only Board approved costs, or whether all contact voltage costs, whether approved by the Board for recovery in the Decision or not, should be excluded.

Staff submits that a resolution of this matter may require consideration of the reasons outlined in the Decision for the \$4.91 million of disallowed costs. This is further discussed in the following section which reviews the third potential approach.

(iii) Definition of controllable OM&A as excluding all contact voltage costs

The implication of the Board adopting this approach would be to significantly reduce THESL's claimed level of recovery. Staff notes that if all of the contact voltage costs identified by THESL were excluded from the 2009 controllable OM&A level, it would reduce THESL's claimed level of recovery from \$8.586 million to \$2.89 million, as is shown in the table below. This table is based on the deduction of the updated total amount of 2009 contact voltage costs provided by THESL in response to a Board staff interrogatory in this proceeding as updated in THESL's supplementary evidence.⁶

⁶ Exh J/ Tab 1/Sch 4 and Supplementary Evidence – Appendix A

\$ millions	THESL Approach	Alternate Approach
(1) 2009 Controllable Expenses	204.51	204.51
(2) Contact Voltage Costs	9.44	15.14
(3) Categorically Ineligible Expenses	0.724	0.724
(4) Net Expenses (1) - (2) - (3)	194.346	188.646
(5) Approved 2009 Expenditure Level	195.2	195.2
(6) Under Expenditure (4) - (5)	-0.854	-6.554
(7) Maximum Recoverable Expenditures	9.44	9.44
(8) Allowable Recovery (6) + (7)	8.586	2.886

Staff submits that the appropriate criteria for assessing whether or not contact voltage costs are eligible for Z-factor recovery would not necessarily be the same as those used for assessing whether or not such costs should be deducted to determine an appropriate comparative level of achieved 2009 controllable OM&A expenses as required by the Decision.

In this context, staff submits that the Board may wish to consider whether the key criterion to be used should be whether or not the disallowed costs were caused by the contact voltage emergency and would not have been incurred in its absence, rather than whether or not they were found eligible for Z-factor recovery. Staff notes in this context that the 2009 approved controllable OM&A levels were set on the basis that no specific contact voltage costs would be incurred. The key question which arises from this is if such a deduction is not made, whether or not an over-recovery of these costs by THESL will occur.

If the Board accepts this approach, it is then first necessary for the disallowances made in the Decision to be reviewed to determine if any were made because the costs in question were found to be not caused by the contact voltage emergency. It would follow from this approach that any such costs would not be included in the deduction.

The Decision disallowed \$4.91 million of THESL's original contact voltage cost recovery claim, consisting of two components: (1) \$2.41 million of ongoing scanning costs, and (2) \$2.5 million related to overtime maintenance costs and other factors.

The disallowance of the \$2.41 million of ongoing scanning costs was stated in the Decision as being for the reason that once the emergency event was dealt with, the

costs for ongoing scanning of the system could not be characterized as emergency related.⁷ However, these costs would clearly not have been incurred in the absence of the contact voltage emergency and, as such, would appear to be necessary to be included in the deduction which is made in the calculation of a comparable controllable OM&A base to that on which 2009 rates were derived.

The other deduction made in the Decision was \$2.5 million related to two factors. These were that: (1) THESL would not have incurred overtime maintenance costs had the necessary maintenance been undertaken as part of its ongoing maintenance program, and (2) some of the remediation work undertaken during the emergency would have otherwise arisen as forced outages of secondary circuits, as THESL would have responded to those events as normal trouble calls and the costs would have been reflected in its 2009 revenue requirement for OM&A.⁸

Staff notes that the second component of this disallowance related to the remediation work was made because the costs in question were found to be not incremental as a result of the contact voltage emergency, but would have been incurred in its absence as they were already reflected in the 2009 revenue requirement. This would not have been the case with the overtime costs. As such, staff submits that the Board needs to consider whether or not only the costs related to the remediation work should be excluded from the contact voltage costs deducted to determine the appropriate actual 2009 controllable OM&A base. The remainder, specifically the overtime maintenance costs, appear to be costs that arose as a result of the emergency and on this basis, would be included in the deduction when using this approach.

Since the Decision did not provide a breakdown of these two disallowances, the next question that needs to be resolved is how much of the total \$2.5 million disallowance relates to the non-incremental costs.

Staff notes that the Decision did make reference where the non-incremental costs were concerned to Energy Probe's suggestion that the \$1 million materiality threshold serve as a deductible.⁹ If this amount was added back to the \$2.89 million referenced above, this would increase THESL's allowable recovery under this methodology to \$3.89 million. Given the element of approximation involved in these types of calculations, staff

⁷ EB-2009-0243 Decision, p. 11

⁸ EB-2009-0243 Decision, p.11

⁹ EB-2009-0243 Decision, p.10

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submits that if the Board was to adopt this approach, a reasonable recovery level would be \$5 million, rather than the \$8.59 million proposed by THESL.

In conclusion, staff submits that the Board first needs to determine whether any contact voltage costs need to be deducted from the actual 2009 controllable OM&A level in assessing an appropriate recovery level for THESL in this matter. Staff notes that the original Decision stated that the conditional finding, "...is not intended to reopen the testing of the 2009 revenue requirement nor the prudence of the actual 2009 OM&A spending." The Board may wish to consider whether this statement supports the first approach outlined in this submission.

If not, then staff submits that the Board needs to determine the amount of contact voltage costs to be deducted from the actual 2009 OM&A spending and whether such an amount would be reduced by all the Board denied costs as proposed by THESL, or only contact voltage costs claimed by THESL and found by the Board to be unrelated to the emergency, as outlined in the third approach discussed in this submission. In making this determination, the Board needs to consider whether or not the approach which it adopts would allow THESL to effectively recover costs that were incurred after its 2009 rates had been set, other than those that were approved in the Decision on the basis that they were emergency-related.

THESL was asked in a Board staff supplementary interrogatory why it did not adopt the approach of excluding all contact voltage costs including the residual contact voltage expenses, rather than only the non-residual costs, in determining the 2009 Actual Controllable Expenses for purposes of comparing to the amount underpinning THESL's 2009 rates. THESL's response stated in part that:

...had the Board intended to disallow residual contact voltage expenses from inclusion in the calculation of controllable expenses, it certainly would have done so in its Decision. Nowhere in the Decision is there any express statement or implication that residual contact voltage expenses, all of which were incurred in account categories eligible for inclusion in revenue requirement, would not be recognized as operating expenses eligible to be included in the calculation of controllable expenses.¹⁰

Staff would note in this context that the Decision also provides no specific direction (aside from the general comment noted above) as to whether approved contact voltage

¹⁰ Exh J2/Tab 1/Sch 2a, pp.2-3

costs, which have been deducted by THESL, should be excluded or included in calculating the appropriate level of controllable expenses.

SPENDING SHORTFALL ALLOCATION

Background

The Decision did not comment on the issue of the allocation of any spending shortfall between cost categories. THESL proposes to allocate the spending shortfall proportionally between the two categories of costs for which recovery was approved in the original application, which were scanning and remediation costs.

Discussion and Submission

Board staff has no concerns with THESL's proposal.

APPROPRIATENESS OF COST RECOVERY FROM CUSTOMER CLASSES

Background

The Decision stated that the Board would not make a finding for the balance of contact voltage costs regarding the appropriate recovery period, or method of recovery in that Decision, and that these matters would be dealt with when THESL brought forward an application for disposition of any of these balances.

THESL is requesting recovery through fixed-term monthly rate riders with costs allocated to Streetlighting and USL classes recovered over a period of 3 years and costs for all other classes recovered over a single rate year. Recovery is requested to commence May 1, 2011.

THESL's evidence demonstrated that the impacts of its proposed recovery are highest for the Streetlighting and USL classes, ranging between 1.2% and 6.5%, which is why THESL is proposing the three year recovery periods for these classes. Impacts for all other classes are between zero and 1.4%.

Discussion and Submission

Staff has no concerns with THESL's approach. However, staff notes that if the recovery amount claimed by THESL was to be reduced by the Board, the impacts for the most affected customer classes would also be reduced. Depending on the outcome of this Decision, the Board may wish to allow THESL the option of maintaining a mitigation plan for the affected classes or align the recovery period with the remaining classes as part of THESL's draft Rate Order.

INTEREST CARRYING CHARGE APPROACH***Background***

The Decision had determined that until the disposition matter had been brought forward by THESL, there would be no interest on the \$9.44 million amount. It did not elaborate further on this matter.

In the present application, THESL requests carrying charges to be calculated, using the Board's prescribed interest rates and methodology, from a date to be determined by the Board until the date of requested rate implementation on May 1, 2011.

Discussion and Submission

Board staff has no concerns with THESL's proposal and submits that the Board may wish to consider whether or not an appropriate date from which carrying charges should be assessed would be from December 11, 2009, which was the date of the Decision.

RATE IMPLEMENTATION DATE***Background***

THESL has proposed an implementation date of May 1, 2011 for any additional revenues awarded to it by the Board arising from the contact voltage emergency. In response to a Board staff interrogatory,¹¹ THESL stated that the reason it had chosen this date was to minimize the number of rate changes for its customers by coinciding with the anticipated implementation of rates for 2011. THESL also noted that the

¹¹ Exh J/Tab 1/Sch 6

suggested implementation date in this application is also consistent with that proposed in THESL's 2007 CDM application (EB-2008-0401), in which the Board's September 22, 2009 Decision approved rate implementation to begin the following year on May 1, 2010.

THESL further suggested that if the proposed May 1, 2011 implementation date is not acceptable to the Board, the alternative of November 1, 2010 would be more reasonable than an isolated rate change coming at an unexpected time for consumers.

Discussion and Submission

Staff has no concerns with THESL's proposal regarding the implementation date and accepts the reasons outlined in THESL's response to the Board staff interrogatory for the choice of such an implementation date.

- All of which is respectfully submitted –