Colin McLorg
14 Carlton St.
Toronto, Ontario
M5B 1K5

Telephone: 416-542-2513
Facsimile: 416-542-3031
regulatoryaffairs@torontohydro.com

toronto hydro
electric system

2010 October 7

via RESS e-filing – original to follow by courier

Ms. Kirsten Walli, Board Secretary
Ontario Energy Board
2300 Yonge St, 27th 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
Reply Submissions

THESL has received the Board's Procedural Order #4 in this proceeding. In accordance with that Order, THESL encloses its Reply Submissions.

Yours truly,

[Original signed by]

Colin McLorg

Manager, Regulatory Policy and Relations
regulatoryaffairs@torontohydro.com

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

Toronto Hydro-Electric System Limited

EB-2010-0193: Recovery of Contact Voltage Costs

Reply Submissions

Introduction

These are the reply submissions of Toronto Hydro-Electric System Limited (THESL) with respect to the recovery amount determination phase (EB-2010-0193) of the Contact Voltage proceeding. The Board's Decision in the original contact voltage cost recovery application (EB-2009-0243) (the 'Decision') established the maximum amount approved for conditional recovery, as well as the express conditions for the determination of the actual amount to be recovered, and the requirement for THESL to apply for that recovery. The present proceeding is essentially a matter of implementing that Decision.

These reply submissions address the case that THESL is required by the Decision to meet, the calculation of controllable expenses pursuant to the Decision, and matters of rate implementation.

The Case that THESL Must Meet

In its December 2009 Decision the Board conditionally approved THESL's recovery of a substantially reduced amount relative to its then-current forecast of contact voltage expenditures. The forecast and applied-for amount was $14.35 million, and actual expenditures were $15.14 million; the Board conditionally approved an amount of $9.44 million for recovery. The Board also expressly stipulated the condition that was to be met by THESL, and applied by the Board, in subsequently determining the actually recoverable portion of the conditionally approved amount.

The condition that was to be, and has been, met by THESL was given by the Board at page 9 of the Decision:

> "The Panel therefore finds that it would be reasonable in the circumstances for any relief provided in this Decision to be conditional on THESL's actual spending in controllable OM&A expenditures for the 2009 year (ending December 31, 2009). In the event that THESL's actual controllable OM&A expenditures are below the level reflected in THESL's 2009 approved base rates, the amount of the relief eligible for recovery found below shall be reduced by the amount of the underspending. To emphasize, this finding is not intended to reopen the testing of the 2009 revenue requirement nor the prudence of the actual 2009 OM&A spending.
>
> 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 amortizations expenses of $154.4 million, the total controllable expenses used to derive 2009 rates was $195.6 million. Any underspending in OM&A controllable expenses below $195.6 million shall be deducted from the conditional relief found in this Decision. THESL's audited 2009 statements shall be the basis of determining the level of underspending, if any."

By way of letter subsequent to the Decision and in the EB-2010-0193 application, THESL submitted that the concept of the Decision referred to the approved 2009 controllable expenses, and that the authoritative source of that figure was the Board's decision in the 2009 rates case, EB-2009-0069. In that decision, approved 2009 controllable expenses were set at $195.2 million, as distinct from $195.6 million. In Board Staff's submissions in this proceeding, Staff states at page 3 that it accepts the validity of that adjustment, and THESL continues to rely on the figure of $195.2 million as the reference level of 2009 controllable expenses for the purposes of this proceeding.

There is no dispute about what condition applies to the determination of the actually recoverable contact voltage amount; the Decision is perfectly clear that actual 2009 controllable expenses are to be compared to the reference level of $195.2 million and that any shortfall of actual controllable expenses relative to the reference level is to be deducted from the conditionally approved amount of $9.44 million. THESL accepts the Board's Decision in this regard and submits that that condition must govern the determination of the actually recoverable amount. Furthermore, THESL submits that this is the only governing condition and that the imposition of further conditions, implicitly or explicitly, after the fact of the Decision would constitute an improper and unjustified alteration of the Decision.

The Calculation of Controllable Expenses

In practical terms the questions now before the Board are simply: what expenditures are to be included in the calculation of 2009 actual controllable expenses; what evidence is required to establish those expenditures as actual 2009 expenses; and has that evidentiary burden been met?

First with respect to what expenditures are to be included in the calculation of 2009 controllable expenditures, Board Staff have isolated three possible approaches:

- To include all operating expenditures categorically eligible for inclusion in revenue requirement[1], including all contact voltage expenditures (Board Staff alternative (i));
- To include all operating expenditures categorically eligible for inclusion in revenue requirement, but only those contact voltage expenditures in excess of the maximum conditionally approved amount (i.e., only 'residual contact voltage expenditures') (Board Staff alternative (ii)); and
- To include all operating expenditures categorically eligible for inclusion in revenue requirement, but excluding all contact voltage expenditures (Board Staff alternative (iii))

The intrinsic logic of the Decision rules out alternative (i), since it would permit a situation in which the <u>sum</u> of 'non-contact voltage' operating expenditures and contact voltage expenditures could equal $195.2 million, and in which THESL would apparently be eligible to recover not only the

[1] I.e., excluding expenditures such as non-heating charitable donations, which are operating expenditures for financial statement purposes but which are excluded categorically from controllable expenses.

(normal, at risk) amount of $195.2 million already reflected in rates, but also a further amount of $9.44 million representing contact voltage expenditures. THESL submits that the logic of the Decision was clearly that THESL would be required to make controllable expenditures of $195.2 million or more apart from costs that would be recoverable as extraordinary contact voltage costs in order to be able to recover the full conditionally approved amount; and that any shortfall in those expenditures relative to the reference amount would be deducted from the allowable contact voltage recovery amount.

It is also implicit in the Decision that THESL would not be entitled to recover any amount in excess of $195.2 million through the contact voltage mechanism; THESL would remain at risk for any overspending. This illustrates the asymmetric nature of the contact voltage mechanism. Any shortfall in spending is deducted from the recoverable contact voltage amount while THESL would continue to absorb any excess spending. The contact voltage mechanism thus acted to alter the usual risk configuration in favour of ratepayers and in no way creates any opportunity for THESL to 'over-recover' any of its actual 2009 costs.

The Decision also rules out alternative (iii) since the Decision neither explicitly states nor implicitly requires that contact voltage expenditures not eligible for recovery as extraordinary contact voltage costs (i.e., the residual contact voltage costs) are anything other than controllable expenses in the usual sense. Had the Board any intention of excluding residual contact voltage expenditures from the category of controllable expenses it would have specified that. The Board was clearly conscious of the fact that it had excluded those (forecast) expenditures from recovery as contact voltage costs, and in fact it established a unique ratemaking mechanism under which controllable expense was a key determinant of an amount which was to be established after actual controllable expenditures were known. The Board could not have failed to be aware that contact voltage expenditures in excess of the maximum allowable amount would exist, and yet it nowhere stated or implied that those expenditures would not be eligible for inclusion in controllable expenses for purposes of the test that it established.

Furthermore the Decision clearly contemplated that THESL would undertake expenditures related to contact voltage that would be part of normal operations and be subject to 'budgetary re-alignments'. For ease of reference, THESL repeats here its response to Board Staff Interrogatory #2 on THESL's supplementary evidence, which explains this point:

> "b) The recognition of the residual contact voltage expenses as controllable expenses does not result in their being recovered as extraordinary contact voltage expenses, since the Board expressly excluded them from that category. As a result the residual contact voltage expenses become part of 'normal' operating expenses for which the shareholder is at risk. In its Decision, the Board recognized this explicitly at page 11 where it stated:
> "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. For these reasons, the Panel reduces the requested relief by a deemed amount of $2.5 million.**

The Panel further reduces the requested relief by $2.41 million in ongoing scanning costs as suggested by Energy Probe and SEC for the reason that once the emergency event was dealt with, the costs for ongoing scanning of the system cannot be characterized as emergency related. Once the emergency was resolved and THESL made a decision to change its operating parameters of the secondary system to an inspect and maintain model, **these costs were part of normal budgetary pressures that are subject to budgetary re-alignments**. [emphasis added]"

In this case the proposal by THESL is exactly in accordance with the Board's Decision. To the extent that there is any shortfall in controllable spending below the allowed 2009 amount, that shortfall is deducted from the conditionally recoverable contact voltage amount. Had THESL overspent controllable expenses, it would not be entitled to, nor would it obtain, any recovery from ratepayers."

At paragraphs 14 and 15 of its submissions, Energy Probe supports the view that the residual contact voltage costs are eligible for inclusion in controllable expenses.

At pages 5 through 9, Board Staff discusses its Alternatives (ii) and (iii). Specifically, at page 6 Board Staff notes:

> "In this context, staff submits that the Board may wish to consider whether the key criterion to be used [in determining which contact voltage costs should be included in controllable expenses] 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."

THESL has explained above why contact voltage costs up to the maximum conditionally allowable amount should not be included in the calculation of actual 2009 controllable expenses for purposes of comparison to the reference amount, and understands, based on their respective submissions, that there is no opposition to the exclusion of those costs on the part of Board Staff and intervenors. Therefore the question put by Board Staff reduces to one concerning only the residual contact voltage costs.

THESL submits that this question [i.e., whether the residual contact voltage costs were 'caused' by the contact voltage condition] is not within the scope of this proceeding, which deals only with implementation of the Decision, because the answer to that question is not a determinant of whether any part of THESL's actual 2009 operating expenses constituted controllable expenses.

The Decision itself, as noted above, placed no restrictions or tests on residual contact voltage costs with respect to their eligibility as controllable expenses, and certainly did not stipulate that they would have to be 'caused' by the contact voltage condition. They were, but that fact is irrelevant. For the Board to give regard to this question would be to constructively and improperly alter the Decision, since to do so would be to impose a further condition, absent in the Decision, that residual contact voltage costs must be 'caused' by the contact voltage condition in order to qualify as controllable expenses.

The further observation that "the 2009 approved controllable OM&A levels were set on the basis that no specific contact voltage costs would be incurred" is also not within the scope of this proceeding. The Decision expressly stated, also as noted above, "To emphasize, **this finding is not intended to reopen the testing of the 2009 revenue requirement nor the prudence of the actual 2009 OM&A spending**." (emphasis added). The Board is aware that there are always differences between forecast expenditures proposed and approved on one hand, and actual expenditures made in response to changing conditions on the other. The fact that the contact voltage costs altogether were unforeseen at the time of 2009 revenue requirement approval has no bearing on whether residual contact voltage costs actually incurred should be considered controllable expenses, and that test is of course not applied to any other components of 2009 controllable expenses.

Therefore there is no basis in the Decision or otherwise for the proposition that actual residual contact voltage expenses are not to be included in actual controllable expenses. The fact that THESL re-prioritized certain operating expenditures, apart from those potentially recoverable through the contact voltage mechanism, to deal with the contact voltage issues on its system does not disqualify those expenditures from inclusion in the calculation of 2009 controllable expenses.

The only questions that the Board must consider in this regard are whether the residual contact voltage expenditures fell in categories of expense eligible for inclusion in revenue requirement, which they did, and whether there is proper evidence as to their existence and accuracy, which there is.

The remaining possibility is Board Staff's Alternative (ii), which corresponds to THESL's proposal. That proposal is fair and proper, since it conforms to the express condition and intrinsic logic of the Decision, precludes any improper cost recovery on the part of THESL, and recognizes that categorically eligible, actual expenditures outside the contact voltage cost recovery envelope were incurred by THESL and properly constitute controllable expenses for purposes of comparison to the reference amount.

Substantiation of Controllable Expenses

The School Energy Coalition (Schools) attempts in its submissions to improperly re-write the Decision by asserting that THESL has not met evidentiary requirements that do not in fact exist in the Decision, expressly or by implication. In contrast, Board Staff expressed no concerns in its submission as to whether THESL has properly substantiated the reported level of actual controllable expenses for 2009.

The Decision was explicit and clear in defining the basis for substantiating the actual 2009 controllable expenses. As noted above, the Decision states at page 9:

> "Any underspending in OM&A controllable expenses below $195.6 million [now $195.2 million] shall be deducted from the conditional relief found in this Decision. **THESL's audited 2009 statements shall be the basis of determining the level of underspending, if any.**" (emphasis added)

In its Application, supplementary evidence, and interrogatory responses THESL has clearly demonstrated the derivation and composition of its actual 2009 controllable expenses, on the basis of its unqualified, audited 2009 financial statements. Those financial statements were directed by the Board to be the basis of deriving the 2009 actual controllable expenses, and cost elements which form part of actual 2009 operating expenditures but which are not eligible for inclusion in controllable expenses have been properly and accurately removed in that calculation. Those financial statements were also substantially reflected in the consolidated audited financial statements of Toronto Hydro Corporation, which were submitted to the Ontario Securities Commission in compliance with its legislation and regulations and were reported to external markets. No party has suggested, nor is there any evidence whatsoever, that those financial statements were flawed.

Schools, however, has improperly attempted (at paragraph 34) to assert the existence of a further test of the validity of 2009 actual controllable expenses, which is that they not exceed the 'normal' level of controllable expenses. The Board should disregard this assertion because it is groundless for the reasons set out below.

First, there is no basis in the Decision for such a test, and it is not in the power of Schools to alter the Decision.

Second, there is no conceptual basis much less an actual definition for a 'normal' level of controllable expenses, either annually or at any sub-annual interval. THESL's response to School's interrogatory #3 on THESL's supplementary evidence explained this clearly and is reproduced here for ease of reference:

> "THESL rejects the premise of this question, which is that an 'average monthly' OM&A figure is a proper benchmark for any comparison. THESL's monthly OM&A expenditures are a result of a complex set of interacting factors which may change during the course of any year and between years. As is demonstrated in the quarterly data provided in the response to SEC interrogatory #4, there is no consistent pattern to monthly or quarterly expenditures and no conclusions can be validly drawn as to the accuracy or prudence of those expenditures as reported simply by comparing the time-patterns of those expenditures. THESL's recognition of expenses is guided by established and generally accepted accounting principles and is not driven by any considerations of monthly or other time-based averages.
>
> In addition, while THESL had provided the requested 2009 OM&A monthly data in Exhibit J, Tab 1, Schedule 3, Appendix A, it strongly cautioned that for a variety of reasons this data was of very limited value for general analysis.
>
> ...
>
> Monthly trends in spending are irrelevant to the test specified in the Board's original Decision."

More generally Schools asserts throughout its submissions that THESL has failed to meet the evidentiary requirements necessary to support its recovery cost application. THESL reminds the Board that the evidentiary requirements referred to in School's submissions are not the Board's requirements as stated in the Decision but rather are those of Schools. Schools provides no basis or explanation for its characterization at paragraph 7 of certain unspecified information as 'critical', unless the information becomes critical because Schools has asked for it. Exactly the opposite of the allegations by Schools is true: THESL has fully and transparently met the evidentiary requirements set out in the Decision.

Therefore, the recommendation by Schools at paragraph 34 that the Board now abandon the content of the Decision and reduce the actually recoverable contact voltage amount by $8 million, on the basis of a non-existent test referring to an undefined and unjustified standard of spending, is utterly without merit, unfair, and should be entirely disregarded by the Board. No other party advocated the position taken by Schools.

Conclusion

The matter before the Board in this proceeding concerns only the implementation of the Decision. The substantive determination of the maximum allowable amount for contact voltage cost recovery has already been decided and the express condition governing the determination of the actual allowable amount has been established. To meet that condition and its evidentiary burden in this case, THESL has provided in evidence a clear and comprehensive statement of its actual 2009 controllable expenses, entirely in accordance with the express requirements of the Decision. Moreover, that evidence has demonstrated that the mechanism specified by the Board has worked exactly as it was intended to and that there will not be any excess recovery of costs by THESL. THESL accepts the mechanism specified in the Decision and has not at any time attempted to defeat or circumvent its intended operation.

THESL submits on the basis of the evidence in this proceeding that it has met all the requirements of the Decision, and that the Board should now find that the amount of $8.586 million documented in THESL's supplementary evidence, plus carrying charges, is properly recoverable by THESL as contact voltage cost in accordance with the Decision.

THESL further submits that the Board should approve THESL's proposals, which attracted no opposition in the arguments of Board Staff and intervenors, concerning:

i. the methodology for allocating the awarded contact voltage costs to the various rate classes; and
ii. the recovery periods over which the rate riders by class would be in effect.

With respect to the issue of the timing of rate implementation, THESL observes that there would be a benefit to consumers to discharge this matter at an earlier time rather than a later time in order to minimize carrying costs. Furthermore, there is generally a benefit to all parties for there to be a timely conclusion to proceedings before the Board and implementation of the outcomes of those proceedings. Therefore THESL requests that the Board render its decision in this matter at a time that would permit rate implementation for November 1, 2010, if possible. THESL undertakes to produce as soon as reasonably possible after the release of the decision a draft rate order for review by the Board and intervenors, documenting the development of the rate riders necessary to recover the awarded amounts in accordance with the decision.

If a November 1, 2010 implementation is not possible, THESL respectfully requests that the Board issue its Decision at its early convenience and authorize implementation of corresponding rates at the time of the next general distribution rate change, which THESL currently foresees as May 1, 2011.

All of which is respectfully submitted this 7th day of October, 2010,

Toronto Hydro-Electric System Limited