EB-2010-0142

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

AND IN THE MATTER OF an application by Toronto Hydro-Electric System Limited for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2011.

BUILDING OWNERS AND MANAGERS ASSOCIATION OF THE GREATER TORONTO AREA
("BOMA")

FINAL ARGUMENT

April 17, 2011

A - INTRODUCTION

This is the Argument of the Building Owners and Managers Association of the Greater Toronto Area ("BOMA") on the unsettled issues related to the setting of 2011 rates for Toronto Hydro-Electric System Limited ("THESL") effective May 1, 2011.

B – SETTLEMENT AGREEMENT

On March 25, 2011 the Settlement Agreement reached by the parties was filed with the Board. The Settlement Agreement resulted in the complete settlement of 23 issues from the Issues List and a partial settlement of 6 additional issues. A total of 5 topics were not settled.

The issues not settled fall into five general categories, as listed below, with some related to a number of issues from the Issues List. These topics are:

1. Incentive Regulation (Issue 1.5)
2. Emerging Requirements (Issues 4.1, 4.2, 9.1, 9.2 and 9.3)
3. Deferral and Variance Accounts (Issue 6.1)
4. Suite Metering (Issues 7.2 and 7.3), and
5. Cost Allocation (Issues 7.1 and 7.4).

BOMA's submissions on each of these five topics is provided below

C - INCENTIVE REGULATION

The specific issue related to this topic is **Issue 1.5 - When would it be appropriate for Toronto Hydro to commence filing rate applications under incentive regulation? Is this application an appropriate base case for a future IRM application? If not, why not?**

BOMA submits that the current cost of service application should be used to set base rates followed by IRM applications for rates for 2012 through 2014. Base rates should be set based on a cost of service application. The 2011 Application is a cost of service application. There was no justification provided by THESL to wait for another cost of service application for 2012 and use that as the base year for setting rates.

In BOMA's view, THESL has not provided any credible evidence as to why IRM as prescribed by the Board will not work for them. Specifically, no evidence was provided as to the impact on the return on equity for 2012 or future years. There is no evidence to indicate that THESL would reasonably be expected to be outside of the 300 basis point range that would trigger a review under the IRM mechanism. If THESL does trigger this mechanism during the IRM term, a regulatory review would initiated.

BOMA believes that the Board should direct THESL to file for 2012 rates based on the IRM mechanism so that the ratepayers are accorded the opportunity to benefit from efficiencies gained by the utility as it learns to operate under an IRM mechanism. THESL would be required to appropriately prioritize its operating and capital expenditures and strive for efficiency gains.

Despite its assertions to the contrary, BOMA submits that it is no different than many other utilities across the province that are facing an aging workforce, infrastructure replacement and limited load growth. To treat THESL differently is not fair to other distributors or to THESL's ratepayers.

BOMA further notes that in the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008, the Board noted that *"By and large, capital replacement, distributor diversity and similar issues are likely to be more manageable with shorter plan terms*". The Board determined that term of the IRM plan would be set at three years (rebasing year plus three years). BOMA submits that this term is short enough that it should apply to distributors that have significant capital replacement programs.

D - EMERGING REQUIREMENTS

The Board determined that three expenditures proposed by THESL as part of its capital budget would not be eligible for settlement (Procedural Order No. 4 dated January 12, 2011). These three proposed expenditures included the energy storage project included under emerging requirements, the electric vehicle charging infrastructure program included under smart grid as part of emerging requirements, and the fleet & equipment services expenditures under the general plant category due to the inclusion of vehicle purchases related to the green initiative. THESL withdrew its request related to the energy storage project on March 25, 2011. The remaining two projects relate to Issues 4.1, 4.2, 9.1, 9.2 and 9.3

i) Electric Vehicles Pilot Program

THESL has proposed a $600,000 electric vehicle charging infrastructure pilot program. This pilot is in anticipation of several auto makers selling plug-in electric vehicles to consumers in Toronto in 2011. The purpose of the pilot is to gather data to better understand the impact of an entirely new class of load on the THESL distribution system.

BOMA accepts the need for the pilot program and submits that the Board should allow this expenditure. These expenditures include the costs for 30 to 40 charging stations that will be distributed throughout the city (Tr. Vol. 1, page 90).

BOMA is concerned that THESL is purchasing the charging stations but understands that as part of the pilot program this may be necessary. However, BOMA submits that the Board should indicate to THESL that ownership of the charging stations and their inclusion in rate base is only allowable for the pilot program. BOMA does not believe that THESL should become involved in a competitive market that is likely to evolve if and when electric vehicles increase in number. THESL indicated that it had not decided whether or not it intended to be involved on a long term basis in this competitive industry (Tr. Vol. 1, pp. 105-108).

ii) Greening the Fleet

THESL has included a $2.012 million premium in its proposed 2011 capital expenditure budget related to its corporate objective to be carbon neutral by 2020 (Exhibit R1, Tab 1, Schedule 72).

THESL did not do a business case on the additional costs associated with the premium (Exhibit R1, Tab 11, Schedule 26 & Tr. Vol. 1, pp. 103-104).

The additional costs associated with the premium of more than $2 million expected to be paid for these vehicles is related to the additional depreciation expense and the additional return on capital that will be incurred in the 2011 test year. Vehicles are depreciated over a relatively short period of 5 to 8 years resulting in depreciation rates of 12.5% to 20%. The return on capital is approximately 7% (after tax). Applying these figures to the $2 million premium and assuming the half-year rule for the addition to rate base, a conservative estimate would be an increase in the revenue requirement of about $200,000 ($2 million x 1/2 x 20%). THESL has indicated that the savings in the test year associated with reductions in fuel consumption and changes in fuel type is approximately $35,000 (Exhibit R1, Tab 3, Schedule 9). This leaves cost in excess of the savings of $165,000.

BOMA submits that the Board should consider whether the costs in excess of the savings associated the premium paid for greening the fleet should be included in the revenue requirement for the 2011 test year. THESL did not undertake a business case to provide any justification of why it would be appropriate for ratepayers to fund this additional cost. THESL was clear that the greening the fleet initiative was driven by its shareholder.

E - DEFERRAL AND VARIANCE ACCOUNTS

The specific issue associated with this topic is **6.1 - Is the proposal for the amounts, disposition and continuance of Toronto Hydro's existing Deferral and Variance Accounts appropriate?**

BOMA has limited its submissions on deferral and variance accounts to the line loss variance account and to IFRS costs.

i) Line Loss Variance Account (1588)

The issues associated with the line loss variance account is whether or not the Board should continue its practice of maintaining a variance account for differences between deemed and actual losses.

The Board last dealt with this issue in EB-2007-0680. At that time the Board indicated that it would not be appropriate to have a different regulatory treatment for THESL than for other distributors. BOMA submits that this is still the case today. It is submitted that the Board should not depart from its existing practice with respect to line losses for THESL in this proceeding.

However, BOMA sees merit in a sector wide review of the line loss variance account and whether or not distributors should be protected from differences between forecast and actual losses.

ii) IFRS Costs (1508)

THESL filed an update to Exhibit S2, Tab 1, Schedule 15, Appendix A that reflected IFRS related costs through 2010 (Exhibit KH 1.7). The updated costs that THESL is seeking to recover from ratepayers is $6,104,115, inclusive of carrying charges.

Mr. Couillard indicated that one of the major reasons why the THESL costs were so significant is that the company had no fixed-asset ledger that would provide the information required for IFRS purposes (Tr. Vol. 2, pp. 34-36). Mr. Couillard further indicated that the cost of getting this information probably amounted to one-half of the $6.1 million included in the variance account (Tr. Vol. 1, page 37). It was also indicated that other utilities *"spent a fair amount of money in the past to put those records together"* (Tr. Vol. 2, page 38).

BOMA submits that the Board should consider whether the approximate $3.0 million in costs associated with bringing its records up to date should be recovered through the

IFRS account or whether this cost should be to the account of the shareholder to reflect that this information should have been collected in the past, as done by other utilities.

F - SUITE METERING

The specific issues identified as part of this topic are **Issue 7.2 - Is Toronto Hydro's suite metering cost allocation appropriate?** and **Issue 7.3 - Is it appropriate for Toronto Hydro to establish a separate rate class for multi-unit residential customers that are served directly by Toronto Hydro through its suite metering provision?**

BOMA notes that page 3 of the BDR report titled Cost of Service Study for Individually Metered Suites in Multi-Unit Residential Buildings dated November 29, 2010 and filed as Exhibit L1, Tab 3, Schedule 1, it is stated that "*It does not appear that separation of the residential class would have a significant impact on the allocation of costs to other customer classes*". Based on this evidence, BOMA does not take any position on the appropriateness of the cost allocation associated with suite metering. Nor does BOMA take any position on the appropriateness of the need to establish a separate rate class for multi-unit residential customers that are served directly by Toronto Hydro through its suite metering provision.

G - COST ALLOCATION

There are two specific issues identified as part of this topic: **7.1 - Is Toronto Hydro's cost allocation appropriate?** and **7.4 - Are the proposed revenue to cost ratios for each class appropriate?** BOMA provides submissions on both of these issues below.

i) Issue 7.1 - Is Toronto Hydro's cost allocation appropriate?

BOMA submits that THESL's cost allocation is not appropriate because of the way it treats the revenues needed to offset the transformer allowance costs. BOMA submits that the correct cost allocation methodology is the one reflected in the response to Exhibit R1, Tab 11, Schedule 38, Appendix B Corrected January 13, 2011. This is a response to a VECC interrogatory that asked for the removal of the transformer ownership allowance

("TOA") as a cost and the removal of the revenues associated with this cost from the distribution revenues used for each customer class.

The impact of the removal of the TOA can be seen by comparing the response provided to the VECC interrogatory in Exhibit R1, Tab 11, Schedule 38, Appendix B Corrected with the response a Board Staff interrogatory found at Exhibit R1, Tab 1, Schedule 96. The latter response reflects the THESL methodology.

The difference in the methodologies presented can be seen in the "Direct Allocation" line of sheet O1. Under the THESL methodology the costs associated with the TOA are shown under the GS > 50, GS 1000-4999 and Large Use rate classes. These costs are not reflected in the response to the VECC interrogatory.

At the same time, the additional revenue needed to cover these costs are shown in the THESL methodology as coming from all rate classes. Mr. Seal confirmed that this is how the revenue side of the cost allocation model works (Tr. Vol. 2, page 13). For example, the incremental revenue shown for the Residential rate class is more than $4.7 million. The increment revenue for the Large Use class associated with the TOA is about $0.5 million despite a direct allocation of approximately $3.1 million to this class (Tr. Vol. 2, pp. 12-13),

The impact of this inclusion is to change the revenue to cost ratio. This occurs because there is no TOA cost allocated to the residential class, but the revenues generated by this class in the THESL methodology increase. The following table shows the difference by rate class in the revenue to cost ratios of including and excluding the TOA.

	Residential	GS<50	GS 50-1000	GS 1000-4999	Large Use	Street Light	USL
TOA Included THESL	89.07	99.01	120.45	115.03	105.45	69.57	80.98
TOA Excluded VECC	87.41	97.18	120.62	127.49	118.18	68.23	79.46
Difference	(1.66)	(1.83)	0.17	12.46	12.73	(1.34)	(1.52)

As the above table illustrates, including the TOA in the revenue to cost ratio calculation pulls down the ratios for those three classes for which the TOA is direct allocation and artificially inflates the ratios for the rate classes that are not allocated any TOA costs. For example, the residential class sees its revenue to cost ratio increase from 87.41% to 89.07%. This increase is due to the additional $4.7 million attributable to it as noted above, despite the fact that the residential class does not pay for any of the TOA.

Similarly, by including the TOA, the revenue to cost ratios are artificially lowered for those classes that have a TOA. This is especially noticeable for the GS 1000-4999 and Large Use rate classes as shown in the table above. The actual revenue to cost ratios are significantly higher when the TOA is removed than shown under the THESL methodology. In particular, the Large Use ratio, excluding the TOA, is 118.18%, which reflects the removal of about $0.5 million in revenue and $3.1 million in TOA costs. This ratio is above the Board's approved range for this rate class while it is well within the range under the THESL methodology.

As shown in the response to Undertaking JH1.3, a change in the TOA rate has an impact on the revenue to cost ratios of all rate classes. BOMA submits that this is not logical. Mr. Seal appeared to agree that this result did not make sense (Tr. Vol. 2, pp. 14-15).

As an example, why should the residential ratio change because the TOA rate changes? Residential customers to not get allocated any of these costs and they do not pay for any of these costs, so their revenue to cost ratio should be independent of the TOA. This is precisely what happens under the VECC approach since the TOA costs and revenues are not included in the calculation. Any change in the TOA rate has no impact on the revenue to cost ratios. This is the logical outcome that one would expect.

ii) Issue 7.4 - Are the proposed revenue to cost ratios for each class appropriate?

BOMA supports the revenue to cost ratios as proposed by THESL (Table 1 of Exhibit L1, Tab 1, Schedule 1). THESL has indicated that the revenue to cost ratios are within the Board's guidelines as established in EB-2007-0667. However, as noted above, this would not be case if the VECC methodology is adopted. In any case, THESL has indicated that the starting point of the revenue to cost ratios does not impact on its plan to adjust the ratios (Tr. Vol. 2, pp. 17-18). BOMA agrees with and supports this assessment, with the exception noted below.

The difference in the starting revenue to cost ratios is the result of how the revenues are calculated for each rate class. Other than the removal of the TOA costs, there is no impact on the costs. As Mr. Seal indicated, THESL is setting the revenue to cost ratio for the residential class to 92% of the costs and these costs are not different under the two methodologies discussed above.

BOMA does note, however, that since the costs for GS 50-999, Intermediate and Large Use classes have been lowered under the VECC methodology that removes the costs associated with the TOA, applying the same revenue to cost ratios should result in differing rates. BOMA has assumed that if the Board endorses the VECC methodology, THESL will compute the adjustments necessary to the revenue to cost ratios for the three classes noted above to make them equivalent to their proposal.

THESL has made a policy decision to increase the residential revenue to cost ratio from the 2010 Board Approved level of 90.0% to 92.0% (Exhibit L1, Tab 1, Schedule 1). The ratio for the Streetlighting and USL classes are also proposed to be increased, bringing these classes closer to unity as well. The additional revenue generated from the increase in these ratios is then used to reduce the ratios for those classes that are over contributing (Exhibit M1, Tab 1, Schedule 1, pages 4-5), bringing the ratio for the GS 50-999 class down from the 2010 Board Approved figure of 115.5% to 114.6%. The corresponding figures for the Intermediate class is a reduction from 119.8% to 111.0% and the Large Use class is projected to decline from 108.1% to 104.0%. It is these last three rate classes where the ratios being moved to may have to be altered to reflect the removal of the TOA costs if the Board determines that methodology is the proper starting point.

This policy decision of THESL is a continuation of the gradual movement toward unity for all rate classes that THESL started in 2008. The following table shows the Board Approved revenue to cost ratios for 2008, 2009 and 2010, along with the proposed 2011 ratios. The 2008 and 2009 figures are taken from Table 1 of Exhibit L1, Tab 1, Schedule 1 in EB-2009-0139. The 2010 and 2011 figures are taken from the corresponding schedule in the current application.

Rate Class	2008 Board Approved	2009 Board Approved	2010 Board Approved	2011 Proposed
Residential	85.0	86.2	90.0	92.0
GS < 50	97.6	100.5	100.0	100.0
GS 50-999	129.1	125.3	115.5	114.6
Intermediate	135.7	130.2	119.8	111.0
Large Use	110.3	108.6	108.1	104.0
Streetlighting	40.0	51.4	70.0	77.7
USL	62.0	70.8	80.0	86.1

The Board policy on the appropriate revenue to cost ratios has evolved over the last several years. The Report of the Board on the Application of Cost Allocation for Electricity Distributors (EB-2007-0667) ("Board Report") set the benchmark ranges for each rate class.

The Board Report indicated in Section 2.3.4 that a distributor should endeavour to move their revenue to cost ratios closer to one if this is supported by improved cost allocations.

In a number of cost of service application Decisions for 2008 rates (EB-2007-0901 - Espanola Regional Hydro Distribution Corporation, EB-2007-0931 - PUC Distribution Inc., EB-2007-0742 - Guelph Hydro Electric System Inc.), the Board concluded:

> *"As the Board has noted in the Cost Allocation Report, cost causality is a fundamental principle in setting rates. However, observed limitations in data affect the ability or desirability of moving immediately to a revenue to cost framework around 100%.* ***The Board's target ranges are a compromise until such time as <u>data is refined</u> and <u>experience is gained</u>****."* (emphasis added)

When asked what THESL had done to improve their cost allocations, Mr. Seal indicated that THESL has continually updated the input data that goes into the model and has used their latest information on their load profiles for the interval customer classes (Tr. Vol. 2, pp. 16-17). THESL also indicated in part (g) of the response provided in Exhibit R1, Tab 11, Schedule 38 that it is comfortable enough with the model results to continue to move the revenue to cost ratios for all classes incrementally closer to full recovery. BOMA submits that this supports the continued movement in 2011 toward unity and is consistent with Board policy.

In those Decisions noted above, the Board accepted the general principle that where the proposed ratio for a given class was above the Board's target range there should be a move of 50% toward the top of the range from what was reported in the Information Filing and where the ratios in the Informational Filing were below the Board's ranges there should be a move by 50% toward the bottom of the Board's target ranges.

The Board was even more specific in the EB-2007-0693 Decision and Order dated August 11, 2008 for Wellington North Power Inc. where it stated:

> *"The Board has adopted a practice in virtually all of the rebasing applications for 2008 rates where utilities have been obliged to move revenue-to-cost ratios to points within the ranges depicted above, wherever practicable, and closer to the range in circumstances where achieving the range would result in what is considered to be an unreasonable rate impact.*
>
> *An important element in the Board's report on cost allocation was its express reservation about the quality of the data underpinning cost allocation work to date. The report frankly indicated that the Board did not consider all of the data underpinning the report to be so reliable as to justify the application of the report's findings directly into rate cases. For this reason, among others, the Board established the ranges depicted above and mandated the migration of revenue to cost ratios currently outside the ranges to points within the ranges, but not to unity. In short, the ranges reflect a margin of confidence with the data underpinning the report. No point within any of the ranges should be considered to be any more reliable than any other point within the range. Accordingly, there is no particular significance to the unity point in any of the ranges.*
>
> *As is noted above, with the exception of the street lighting and sentinel lighting classes, all of the Applicant's proposed revenue to cost ratios fall*

> *within the range as provided in the Board's report on cost allocation.* ***The Board will not approve any further movement within the ranges as requested by a number of the intervenors in this proceeding, and by the Applicant itself with respect to the Residential class.****"* (emphasis added)

A review of the EB-2008-0237 Decision and Order dated March 25, 2009 for Niagara-on-the-Lake Hydro Inc. ("NOTL") is informative and is relative to the current proposal by THESL. Based on the proper starting point that correctly reflected the transformer ownership allowance, the GS > 50 class had a revenue to cost ratio above 100%, but within the Board approved range for this rate class.

The School Energy Coalition ("SEC") submitted that the level of cross-subsidization by the GS > 50 kW class was unacceptable and that NOTL should be required to reduce the revenue to cost ratio for this class to 100% over the next two years.

In its Decision, the Board deviated from the policy reflected in previous decisions, as follows:

> *"The Board concurs with SEC regarding the level of cross-subsidization by the GS>50 KW customer class.* ***While previous Board decisions have not approved any further movement for customer classes already within target ranges, there is no other mechanism to mitigate the cross-subsidization by the GS>50 kW customer class.*** *The Board finds that* ***it is within the utility's discretion to move towards revenue to cost ratio of unity as long as the impact can be borne by affected rate classes****. Accordingly, the Board finds that NOTL's proposal to set rates that move the revenue to cost ratio for residential and GS<50 kW customer classes half of the way towards 100% and to move USL to 100% is appropriate. The additional revenue shall be allocated to reduce the revenue to cost ratio for the GS>50 kW customer class."* (emphasis added)

The Board found that it was within the utility's discretion to move toward revenue to cost ratios of unity as long as the impact could be borne by the affected rate classes. In this application, the affected rate class is the residential class where the ratio is proposed to be moved from 90.0% to 92.0%, as well as the streetlighting and USL classes.

Exhibit KH 1.1 includes Appendix C to the Settlement Proposal and shows the bill impacts on the various rate classes of the agreed to revenue requirement flowing from the

Settlement Proposal, along with the THESL proposal related to the movement of the revenue to cost ratios. As shown on page 1 of Appendix C, the total bill impact for the streetlighting class is 9.9%, just below the 10% level that would require rate mitigation. The increase for the USL class is 2.8%. The total bill impact for the residential class is only 1.0%.

BOMA submits that the increases in the rate classes that see their revenue to cost ratios moving up towards 100.0% are all impacts that can be borne by these classes. As a result, it is submitted that the Board should approve the continuation of the gradual movement to unity for the revenue to cost ratios as proposed by THESL because the impacts can be borne by the affected rate classes.

H - COSTS

BOMA requests that it be awarded 100% of its reasonably incurred costs. BOMA was an all-issues participant in this process, including the review of evidence, preparation of interrogatories and participation in the settlement conference and in the oral hearing.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

April 17, 2010

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