EB-2010-0142

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B, as amended;

AND IN THE MATTER OF an Application by Toronto Hydro-Electric System Limited pursuant to the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for the distribution of electricity commencing May 1, 2011.

FINAL ARGUMENT
ON BEHALF OF THE
SCHOOL ENERGY COALITION

April 18, 2011

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TABLE OF CONTENTS

1 GENERAL COMMENTS

1.1 *Introduction*

1.1.1 On August 23, 2010 Toronto Hydro-Electric System Limited filed an Application for new distribution rates, effective May 1, 2011. The process included extensive interrogatories, a technical conference, an ADR, and an oral hearing. Most of the major issues were settled, but a few issues were considered in the hearing, and remain to be decided by the Board.

1.1.2 This is the Final Argument of the School Energy Coalition on the issues not settled by the parties.

1.1.3 The ratepayer groups who intervened in this proceeding have worked together throughout the hearing to avoid duplication, including exchanging drafts or partial drafts of their final arguments. We have been greatly assisted in preparing this Final Argument by that co-operation amongst parties. Where we are in agreement with the submissions of other parties, we have not repeated their arguments here, but have adopted their reasoning where applicable.

1.1.4 For the Board's convenience, we have organized our submissions into the five topics set forth in the Argument in Chief from the Applicant.

1.2 *Summary of Submissions*

1.2.1 This Final Argument contains an analysis of some of the issues arising in this proceeding. The following are the main recommendations resulting from that analysis.

1.2.2 ***IRM.*** SEC believes that this Board panel cannot make a binding determination as to the rate-setting mechanism to be used for Toronto Hydro in 2012. However, we do comment on the substantive issues raised by the Applicant.

1.2.3 The body of our submissions details the reasons why continued high rate increases under further cost of service applications are not, in our view, justified. With respect to the primary rationale for continued high rate increases, the "need" for more and more capital spending, in our view that case has not been made out. Further, we demonstrate with empirical data that not only has the Applicant already been given approval for at least a billion dollars of extra capital spending over the period 2006-2011, but both their existing capital infrastructure and their approved increases in capital spending far exceed those of their peers.

1.2.4 Our final recommendations on IRM are that in our view the Board should:

(a) Confirm that no binding determination can be made by this Board panel as to whether the Applicant's 2012 rates will be set on an IRM or COS basis.

(b) Confirm that the 3rd Generation IRM regime applies to Toronto Hydro, subject to the exceptions set out in the Board's letters of April 20, 2010 and March 1, 2011, and the procedure for considering those exceptions set out therein.

(c) Clarify that nothing in this Board panel's decision should be interpreted as implying that this Board expects or prefers in any way that the Applicant should apply in 2012 on a cost of service basis.

1.2.5 ***"Emerging Requirements".*** We support spending on the EV pilot and Greening the Fleet, subject to some specific comments on the implications of the application.

1.2.6 ***Deferral and Variance Accounts.*** SEC believes that the Board should allow clearance of $1,366,004 from the IFRS Transition Costs account. In addition, we propose that the Board allow a further amount of approximately $1.7 million to remain in the account until the Board has more examples of the IFRS transition costs of other utilities.

1.2.7 With respect to the balance of just over $3 million, we submit that as it is admittedly the result of poor past record-keeping, it should be borne by the shareholder and not the ratepayers.

1.2.8 ***Cost Allocation.*** SEC supports the submissions of VECC on the transformer allowance, and believes that the revenue to cost ratios should not be moved closer to unity unless that same principle is applied in other cases. To date, the Board has been reluctant to do so.

1.2.9 ***Implementation Date.*** We support the Applicant's proposal.

2 IRM

2.1 *The Issue*

2.1.1 The Applicant seeks a statement of some sort from this Board panel that either a) they are not obligated to use IRM as their 2012 rate-setting method, or b) they have provided sufficient justification in this proceeding for a cost of service application in 2012.

2.1.2 At the end of this section of our Final Argument, SEC sets out a recommendation for a response by the Board to Issue 1.5, including our submission – which apparently is agreed by the Applicant – that this Board panel is not seized with an application for 2012 rates, and therefore lacks jurisdiction to decide in any binding way the method of rate-setting for 2012.

2.1.3 However, in the expectation that the Board panel may wish to comment on some of the substance of the COS vs. IRM issue, SEC seeks, in the analysis below, to consider some of the key points that arise.

2.2 *Background Facts*

2.2.1 The Board has established an incentive regulation mechanism applicable to electricity distributors. Nothing in the Board's IRM report or rules suggests that the Applicant in this case is exempt from the 3rd Generation IRM regime.

2.2.2 However, in the EB-2007-0680, Toronto Hydro applied for rates on the basis of a three year cost of service, a method of multi-year rate-setting that had been rejected by the Board in the 3rd Generation IRM Report [EB-2007-0673]. Notwithstanding this disjunct, the Board panel in the EB-2007-0680 case approved rates based on two years of cost of service.

2.2.3 In the Argument in Chief, the Applicant takes the position that it "has not been within the IRM framework" [para. 28], and essentially implies that the Board has allowed it to be an exception to the 3rd Generation IRM regime.

2.2.4 For the Board's assistance, we have annexed to this Final Argument as Appendix A the full text of the Board's decision in EB-2007-0680 relating to the method of setting rates. We note in particular the following:

(a) The Board did not allow the three year cost of service requested. It allowed instead two years.

(b) The Board specified that it expected rates for the years after 2009 (the second

year) to be set based on IRM. Thus, it was clearly not contemplating that Toronto Hydro would be exempt from IRM; quite the opposite.

(c) The Board allowed a substantial increase in capital spending, reflecting a need for additional capital renewal.

(d) The reason for allowing a two year cost of service, rather than requiring IRM for the second year, was that at the time of the decision the Incremental Capital Module had not been finalized. It is clear from the decision that if the ICM had been in place, the Board would have looked at even the two year cost of service differently.

2.2.5 Toronto Hydro's next application was a cost of service application in EB-2009-0139. In that proceeding, the Board was not asked by any party to consider the issue of whether cost of service or IRM was appropriate, and it did not initiate such an inquiry on its own motion. In the end, almost all issues were settled, and the rate-making methodology did not come up.

2.2.6 In a letter to all distributors dated April 20, 2010, the Board provided a list of distributors who were expected to file cost of service applications for 2011. The Applicant is included on that list. There does not appear to be any analysis in that letter of whether Toronto Hydro in fact qualified to file on a cost of service basis. The same letter sets out criteria for utilities not on the list who wish to have cost of service applications considered.

2.2.7 On March 1, 2011, the Board issued a letter identifying those who are scheduled to file cost of service applications for 2012 rates. The Applicant is not on that list. The letter reiterates the criteria to be applied if utilities not on the list wish to file on a cost of service basis.

2.2.8 We know of no other statement by the Board determining directly or indirectly whether the Applicant is allowed to file on a cost of service basis in any given year.

2.3 ***Capital Plan***

2.3.1 The primary rationale given by Toronto Hydro for continued cost of service applications is that they claim to have a need incur several billion dollars of additional capital spending over the period 2008 through about 2015. Indeed, the Applicant admits that "the Board must satisfy itself" [AIC para 36] of the need for increasing capital spending in order to conclude that continuing cost of service applications are appropriate.

2.3.2 In support, they have filed asset condition information in EB-2009-0139 and the current proceeding. They have also filed their business plans for the past couple of

years, with forecast capital spending. The business plans have been filed on a confidential basis.

2.3.3 In our view, this question of rapidly spiraling capital needs has several components, which we will deal with in turn.

2.3.4 ***Existing Capital Infrastructure.*** The Applicant has been saying since the EB-2007-0680 proceeding that it is underinvested in its distribution infrastructure. Indeed, in the decision in that proceeding the Board criticized the utility for its failure to maintain sufficient levels of investment in capital assets.

2.3.5 It does not appear to us that anyone has attempted to test this proposition of underinvestment. To do so, SEC went to the 2009 Electricity Distributors Handbook from the Board, which sets out balance sheet, income statement, and other information from all distributors for the calendar year 2009.

2.3.6 One of the metrics that SEC uses to assess capital spending of distributors is PP&E per customer, which is simply the net Property, Plant and Equipment of the utility divided by its number of customers. It is a rough method of comparing the relative capital intensity of LDCs.

2.3.7 Attached as Appendix B to this Final Argument is the list of the top ten (by size of PP&E, excluding Hydro One) distributors in 2009, and their PP&E per customer.

2.3.8 What is clear from the comparison is that, when compared on this basis, at least in 2009 Toronto Hydro had significantly more capital invested per customer than any of its peers, in some cases more than twice as much. Where Toronto Hydro had $2,803 of PP&E per customer in 2009, two relatively comparable utilities (large urban systems with low growth and older infrastructure), Ottawa and Horizon, had PP&E per customer of $1,732 (62% of Toronto Hydro) and $1,374 (49% of Toronto Hydro) respectively.

2.3.9 SEC does not suggest that this metric is determinative of anything. There are many reasons why these disparities could be occurring. However, one would normally expect that a utility with a major problem of underinvestment would, relative to its peers, have lower capital per customer than at least some of them. When that is not the case – and particularly where a utility's capital in the ground is not only higher than all of its peers, but substantially higher than most – the question is fairly put why that would be the case in the face of claims of capital need.

2.3.10 We have looked for other comparisons that would demonstrate that, on some empirical basis, Toronto Hydro has a serious problem of underinvestment. Nothing that we have looked at shows anything of the sort. In fact, everything we have seen indicates that they should be better off than their peers, and thus have a less pressing need for capital

investment now.

2.3.11 Thus, Toronto Hydro is left leading its bottom-up evidence – asset condition assessment – claiming a substantial need for additional investment, in the fact of empirical evidence pointing in the opposite direction. Since the ACA and related evidence of the "need to spend" are based on professional judgment, which can vary from one engineer to another, the Board is faced with the "hard" evidence pointing one way, and the "soft" evidence pointing the other.

2.3.12 In our submission, the asset condition information and related capital plans currently before the Board are insufficient to overcome the obvious questions raised by the comparative data.

2.3.13 ***Spending "Bulge" – Absolute Amount.*** The second issue is not about whether the Applicant was underinvested in the past, but whether the Board has already provided sufficient capital "catch-up", and whether any further bulge in the capital budgets is still necessary.

2.3.14 The Applicant has been telling the Board and its ratepayers since 2006 or so that it was expecting to embark on a substantial capital renewal program to replace aging infrastructure. This history led to the following exchange in the oral hearing in this proceeding:

> *"MR. SHEPHERD: Do you recall the EB-2005-0421 -- sorry, Mr. Seal.*
> *[Laughter]*
> *MR. SHEPHERD: Do you recall that?*
> *MR. SARDANA: I don't, no, but --*
> *MR. SHEPHERD: That is your 2006 rate case.*
> *MR. SARDANA: Yes, I do remember parts of it, sure.*
> *MR. SHEPHERD: You recall that at that time the statement was made by Toronto Hydro that you were going to have to spend an extra billion dollars to catch up on capital renewal? Do you remember -- it shocked everybody. A billion dollars.*
> *MR. SARDANA: Subject to check, sure.*
> *MR. SHEPHERD: But the reason I ask that is because since -- prior to 2006 you were spending less than $100 million a year on capital; right?*
> *MR. McLORG: Under a rate freeze.*
> *MR. SHEPHERD: Well, but for many years prior to that you weren't under a rate freeze. It was still under a $100 million a year; right?*
> *MR. McLORG: We were under an IRM -- the first-generation PBR, and that effectively was tantamount to a rate freeze for utilities. They had minor increases in revenue requirement, but nothing on the order that would support significant capital expenditures exceeding depreciation.*
> *MR. SHEPHERD: Well, here's why I ask the question, because from 2006 to*

> *2010 your actuals, plus the budget you've been given for this year already in the settlement, by my calculation totals $1.6 billion. And your previous spending would have been under $600 million.*
>
> *So my question is, haven't you already got your billion dollars? Why do you need more? You asked for a billion. You got it.*
>
> *[Witness panel confers]*
>
> *MR. McLORG: We don't have the 0421 record before us, Mr. Shepherd. But it seems to us that the billion dollars that was referred to was specifically money that was envisioned for sustaining capital; that is, the rejuvenation of our system. That is not the total capital that we spend.*
>
> *MR. SHEPHERD: All right. I will put the quote in argument.*

2.3.15 Sadly, we can't put that quote into argument. Significant portions of the transcript and other documents in that proceeding are redacted due to confidentiality, and while it is clear that people remember the number, as we do, we can only assume (without having access any more to the unredacted documents) that the number arose during an in camera session. To the best of our knowledge, that number, now on the public record in this proceeding, was never itself confidential (we have heard it a number of times outside of the hearing room in non-confidential settings), but it appears to be no longer possible to recreate the precise reference.

2.3.16 That having been said, nothing much turns on whether the Applicant said it needed an extra billion dollars in 2006. It has subsequently done new forecasts, and claims that the number is far more than that.

2.3.17 But what the Board does know is that the Applicant was spending less than $100 million per year on capital prior to 2006. Since that time, it has been given approval to spend substantially more than that. By our calculation, the total approved capital spending for 2006 through 2011 is at least $1.6 billion. This is at least $1 billion more than the previous spending levels.

2.3.18 The Applicant can argue why that was spent, and how, and why the former spending was so low. However, none of that changes the fact that this Board has authorized incremental capital spending, over and above the existing levels of capital spending, of at least a billion dollars. Or, put another way, the Applicant had PP&E in 2005 of $1.5 billion. Since that time, it has been authorized to incur $1.6 billion in additional capital spending.

2.3.19 It is submitted that, assuming there was a need to catch up from past underspending, as identified in the EB-2005-0421 and EB-2007-0680 decisions, <u>that need to catch up has already been funded</u>. In our submission the case has not been made for continued high levels of spending over and above that extra billion dollars in catch up funding.

2.3.20 ***Spending "Bulge" – Comparison to Other LDCs.*** Not only has the Applicant already

spent or received approval to spend a huge amount of money on capital renewal, but the Applicant's catch-up spending far exceeds that of its peers.

2.3.21 To do a proper comparison, SEC went back to the Yearbooks, and compared 2005 PP&E, and PP&E per customer, to 2009 figures for the ten largest LDCs (excluding Hydro One). What we found was surprising.

2.3.22 In the period 2005 to 2009, four years, Toronto Hydro increased its net PP&E (i.e. after accounting for depreciation replenishment, which is additional) by $479 per customer, a total of more than $359 million. This is a 20.6% increase in PP&E per customer.

2.3.23 No other large utility had an increase in PP&E, or PP&E per customer, that was anywhere close to that level. For example, the next highest was Hydro Ottawa, which added $104 million of net PP&E, which works out to $267 per customer. This is despite the fact that in 2005 Hydro Ottawa's PP&E per customer was substantially below that of Toronto Hydro ($1,465 vs. $2,324). The other obvious comparable, Horizon, added only $40 million in net PP&E in that period, about $149 per customer.

2.3.24 If this four year period stood in isolation, that would be problem enough. But Toronto Hydro has received approval for large capital spending increases in 2010 and 2011. As a result, we calculate that net PP&E will increase by a further $500 million over those two years, meaning that its PP&E per customer will exceed $3,500.

2.3.25 The Board has already seen a request for increases of capital spending by Horizon for 2011, on which a decision is pending. It is clear, though, that even if Horizon receives approval for its entire requested budget, it's PP&E will still be around 40% of Toronto Hydro's. That is, the gap between them is already getting bigger, just based on the current Test Year.

2.3.26 Hydro Ottawa will certainly ask for a substantial increase in net PP&E when they file their 2012 cost of service application. We know that because their 2011 application was initially filed on a cost of service basis (EB-2010-0133), and in that application they requested a net increase in PP&E of $22 million [Ex. B1/1, p. 1 in that application]. Even had they received approval for all of that requested capital budget, their PP&E per customer would still be well under $2,000.

2.3.27 All of this leads us to believe that, based on comparative information, Toronto Hydro is massively outspending its peers on capital projects. If anything, this comparison suggests that the agreement by intervenors and the Board to allow substantial capital increases over the 2008-2011 period may have been more than they need.

2.3.28 Against this backdrop, Toronto Hydro claims that they need to continue to increase their capital spending, year after year, indefinitely into the future.

2.3.29 The other way to look at this is to face the central argument of the Applicant head on. They argue that if capital spending exceeds depreciation, the IRM regime is unfair and "confiscatory".

2.3.30 The problem with this argument is that the other Ontario LDCs appear to be able to handle the IRM regime very well, and still spend in excess of depreciation on new capital assets. A simple calculation of the capital spending disclosed in the 2009 Yearbook shows that gross PP&E increased by an average of 123% of depreciation relative to 2008. That is, the increase in PP&E, which is the capital spending for the year, was 123% of the depreciation taken during the year. Interestingly, Toronto Hydro, which was under cost of service in 2009, and allegedly under huge pressure to spend on capital, spent only 121% of depreciation.

2.3.31 In 2009, 41 LDCs had higher ratios of capital spending to depreciation than Toronto Hydro. The Applicant can argue, as it does [Tr. 2:42], that some of them are growth utilities whose capital spending produces additional revenues. Others clearly are not, and a casual review of the Yearbook information demonstrates that many utilities on IRM, despite relatively low customer growth, still manage to spend on capital renewal without complaining about it.

2.3.32 This is consistent, it is submitted, with the Board's decision on the ICM, in which there is essentially a 130% threshold before capital spending qualifies for recognition as incremental. We note in passing that, in the EB-2007-0673 proceeding that formed the basis of 3rd Generation IRM, the Applicant through the CLD made submissions on how to handle capital spending during IRM. That submission was that the threshold should be 125%.

2.3.33 In our submission, the Applicant has not demonstrated that their situation is sufficiently different from the situations faced by their peers, that the Applicant's much higher proposed future spending levels are justified.

2.3.34 ***Impact of Past Decisions and Settlements.*** The Applicant asserts that the decisions and settlements in their past and current rate cases show that "substantial, continuing reinvestment" in infrastructure "has been demonstrated and accepted by the Board and stakeholders in THESL's previous cost of service rate cases" [AIC, p. 12].

2.3.35 With respect, neither the decisions nor the settlements show anything of the sort.

2.3.36 With respect to decisions, the Board has in the 2008 decision provided for an increase in capital spending, but at the same time reinforced the Board's view that THESL must file on an IRM basis starting in 2010.

2.3.37 Notwithstanding this, the Applicant filed cost of service for 2010 and 2011, and

negotiated with intervenors additional increases in capital spending in those two years. There is no admission in either of those two settlement agreements that Toronto Hydro has a long-term need to spend a lot of money on capital. Both agreements are, by their terms, applicable only to those specific years.

2.3.38 As noted in our subsequent analysis [para. 2.5.11 et seq.], the settlements do not support any theory that the aggressive THESL capital plan has been approved or accepted. They are more consistent with the explanation that the Board and parties have already allowed any necessary bulge in capital spending, rather than the theory that future high levels of capital spending have been accepted.

2.4 *Authorized in 2010 Decision*

2.4.1 In addition to the argument of implied approval of the capital plan, discussed above, in AIC para 29-31 Toronto Hydro seeks to convince the Board that the Decision of the Board in EB-2009-0139 authorizes the Applicant to seek cost of service rates in 2012.

2.4.2 It should, of course, be noted that almost all of the issues in the 2010 case were settled. Only a few were left, and in some of them the Board clearly contemplated that the Applicant would carry through on its intention to file for cost of service in 2011. While we might disagree with whether this was sufficient basis for this current application, that has already happened, and is no longer an issue.

2.4.3 However, it is also clear that nothing in the EB-2009-0139 decision contemplates a cost of service application for 2012. Thus, while Toronto Hydro claims [AIC para. 31] that if the Board requires IRM for 2012, it would "defeat its own direction", the Board has in fact given no such direction. The one example given by the Applicant, the DG study, is "due in the [2012] rate case" [AIC para 30] only because that's when the Applicant has scheduled it. It would be a funny world indeed if, as the Applicant seems to imply in para. 32-34 of its AIC, it is free to schedule special studies and issues annually, and then use that scheduling as justification for filing on a cost of service basis.

2.5 *Nature of a Base Year Application*

2.5.1 Toronto Hydro takes the curious position that it would have filed a different application if the assumption had been that it was the base year for an IRM period. There are at least three points that need to be made in response to this surprising allegation.

2.5.2 ***Basis for the Assumption.*** The Applicant complains that it has the "right to know the case it must meet" [AIC para. 27], and that it had a "legitimate expectation" [AIC, para. 28] that it could continue to file on a cost of service basis, essentially indefinitely.

2.5.3 The problem with this argument is that the Board's policy on IRM is pretty clear, and at no time has any Board panel or the Board generally said that Toronto Hydro is exempt from that policy. In fact, in the EB-2007-0680 proceeding, the Board expressly determined that Toronto Hydro should go on IRM starting in 2010. In fact, the Applicant ignored that directive and filed on a cost of service basis anyway. The only reason that failure to follow the Board's decision was accepted is that the case settled. Had it not, their right to have a cost of service increase would certainly have been challenged.

2.5.4 The one fact that favours their "we thought we were exempt" assumption is that Toronto Hydro was on the Board's published list for 2011 cost of service applications, and the current application was not challenged on a threshold issue.

2.5.5 From Toronto Hydro's point of view, this is a difficult fact on which to hang their whole case. Not only is it clear that the 2010 decision presumed a 2011 cost of service application. Not only is it the case that the Board's administrative act of setting out a list for 2011 was not subject to input from both sides, as would be required if it were a rate-making decision. As well, at the very most "getting on the list" for 2011 only supports cost of service for 2011, not any other year. At no time has the Board said that Toronto Hydro has free rein to apply for cost of service in any other year, and the only time the Board has commented on that, in EB-2007-0680, it said the opposite.

2.5.6 In this respect, Toronto Hydro appears to be like the young boy who sneaks into the ballpark to watch the games for free. He's been doing it for a while. One time he got caught, but was let off with a warning not to do it again. Another time the guard saw him, but winked and did nothing. On the basis of this history, he has concluded that he now has a right to watch ballgames for free as often as he wants. With respect, that is simply an incorrect conclusion, even for a young boy.

2.5.7 ***Nature of the Application.*** Toronto Hydro argues that it would have filed a "significantly different application" [AIC, para. 25], with "more reactive maintenance" [AIC, para. 26], it would have incurred program wind-down costs [AIC, para. 26], and it would have proposed, contrary to Board policy, "full year-end rate base" as the basis for revenue requirement [AIC, para. 26], had it known that it was facing the spectre IRM in its future.

2.5.8 The obvious answer to this is that nothing in the Board's policies or filing guidelines suggests that a base year application is any different from a normal cost of service application. In fact, the whole premise of the 3rd Generation IRM regime is that once the legitimate costs of running the utility for a year are determined in a normal cost of service proceeding, a formula based on historical data and econometric modeling produces a fair annual adjustment in rates. While the Board often does make some minor adjustments for one-time costs in the base year, those usually reduce the

revenue requirement, so the Applicant here would not be disadvantaged if that step were missed.

2.5.9 But the better answer to this argument lies in the Applicant's own evidence and argument. In response to a question from Ms. Hare, Mr. McLorg said the following [Tr.2:67]:

> *"MS. HARE: What's the difference if it is a rebasing year or just a one-year? MR. MCLORG: Well, the difference is that the consequence of it being considered a rebasing application, to be followed in subsequent years by the application of the price cap adjustment, is that in the following years the revenue requirement couldn't grow in the way that we feel we have documented with our long-term capital plan and our explanation of the need to spend in excess of depreciation in capital expenditures. So our concern doesn't revolve around this year. Our concern revolves around what would happen next year and in subsequent years." [emphasis added]*

2.5.10 The Applicant couldn't be clearer, and this is reiterated in para. 23 of the AIC, where they say "the inadequacy of revenue requirement would occur not in 2011". Given the forward test year method used for cost of service, this is a complete answer to the "different application" argument. As long as the revenue requirement is enough, which the Applicant expressly admits it is for 2011 whether or not this is a base year, the Applicant can spend it on what it feels is appropriate at the time.

2.5.11 ***Settlement.*** Toronto Hydro implies [AIC para. 23 and elsewhere] that it settled most issues in this proceeding on the assumption that they would have an opportunity for further large increases in spending in 2012 through a cost of service application. Thus, on this theory, even if the application is not different, the settlement was.

2.5.12 This is most surprising, because on the facts before the Board the assumptions of the parties in entering into the settlement must logically have been the opposite, and that is certainly true of SEC.

2.5.13 It is in fact true that, during the settlement conference, the Board issued a letter identifying the LDCs who were scheduled for cost of service in 2012. Toronto Hydro was not on that list. Any reasonable person looking at that letter can only conclude that Toronto Hydro would likely be subject to IRM in 2012. At the very least, it would be complete folly to negotiate on the basis that the Board's March 1st letter was of no importance.

2.5.14 SEC is a perfect example. While it is obviously not appropriate in argument to give evidence as to motives for settlement, it is a reasonable objective conclusion from the known facts that SEC, which has long resisted Toronto Hydro's incessant claims that it needs to spend more money, would not lightly agree to a further increase in capital

spending. The most likely explanation for that agreement is "This is the last we'll see of these capex increases for a while". $400 million in capex could be justified as a reasonable "last gasp" to complete a catchup plan. Given SEC's stated positions, it obviously could not be justified in the context of even higher spending next year and the year after.

2.6 ***Third Generation IRM Regime***

2.6.1 The essence of the Applicant's position, in this proceeding as in the EB-2007-0680 proceeding and the EB-2009-0139 proceeding, is that they don't like the 3rd Generation IRM Regime, so they should be allowed to "opt out" and select a different rate-setting model that gives them higher rates.

2.6.2 In this respect, we note that in EB-2007-0680, the Applicant's rationale for a three year cost of service, as opposed to IRM, was to reduce their regulatory activities and instead focus on operational matters [See Appendix A, page 1]. Contrary to that supposed rationale, they have now pursued three cost of service applications in the four year period that otherwise would have had one under IRM.

2.6.3 Throughout the Argument in Chief, the Applicant makes arguments that are essentially opposition to the 3rd Generation IRM regime. Examples include paragraphs 15 – 19, 21, and 38.

2.6.4 In the EB-2007-0673 proceeding, the Board considered extensive submissions from stakeholders, both written and oral, established and then listened to a working group that had a majority of LDC representatives, hired experts to study not only the issues themselves, but how other jurisdictions have handled them, and informed itself through detailed econometric analysis. This was a very thorough process, in which the Applicant participated fully.

2.6.5 But the Board has made its decision on this. It balanced the interests of all parties, coming to a fair result. Proposals made by SEC and other ratepayer groups were rejected. Proposals made by LDCs including the Applicant were rejected. The Board formulated a system that considered all of the input and then delivered a fair and balanced rate-setting mechanism.

2.6.6 The Applicant doesn't agree with the system (it is "irresponsible" – para. 38; "confiscatory" – para. 20; etc.], but the decision on the design of that system has already been made. The Applicant complains that the system doesn't deal with certain problems, but they forget that these problems were already considered, and the Board has reached its conclusions.

2.6.7 A good case in point is the claim that the 3rd Generation IRM regime does not reflect compensate for the approved rate base in the IRM years [AIC para. 15-21]. In this

respect, the Applicant appears to have forgotten the empirical basis for the formula. This was not plucked out of the air. The formula is based on past data, which includes the impact of capital spending and thus increasing rate base over time.

2.6.8 In our submission, it is time for the Board to tell Toronto Hydro that they do not have a discretion to choose the rate-setting method that they prefer. The Board's method of setting rates is not controlled by the Applicant. Rather, the Board, as regulator, establishes rates, and establishes the method of setting them as well. The Board has established a 3rd Generation IRM regime, and it applies to the Applicant. The exceptions are clearly identified, and at the appropriate time the Applicant can make its case that those exceptions apply to it.

2.7 ***The Appropriate Forum to Decide on IRM Exceptions***

2.7.1 It appears to be common ground amongst the parties that the Board does not have jurisdiction in this proceeding to make a binding determination with respect to the method of setting 2012 rates. That binding determination can only be made by the Board panel seized with a 2012 rate application.

2.7.2 We would add to this that the Board has already established a method of determining whether a utility scheduled for IRM should instead have their rates determined on a cost of service basis. It is not ad hoc. Individual Board panels do not have to reinvent the wheel.

2.7.3 What the Board has said, instead, is that exceptions to the IRM schedule will be decided on a consistent and principled basis, pursuant to guidelines that have been established by the Board and published so that all know the Board's expectations.

2.7.4 Thus, when the Applicant says that "THESL has not entered" [AIC, para. 25] the IRM system, they completely miss the point. THESL is part of that system, because all LDCs are part of that system. The onus is on Toronto Hydro, within a well known and understood framework, to make their case that they qualify for an exception. That opportunity takes place when they file their 2012 rate application, not in their 2011 rate application.

2.8 ***SEC Recommendation***

2.8.1 Based on the above analysis, SEC recommends that the Board respond to Issue 1.5 as follows:

(a) Confirm that no binding determination can be made by this Board panel as to whether the Applicant's 2012 rates will be set on an IRM or COS basis.

(b) Confirm that the 3rd Generation IRM regime applies to Toronto Hydro, subject

to the exceptions set out in the Board's letters of April 20, 2010 and March 1, 2011, and the procedure for considering those exceptions set out therein.

(c) Clarify that nothing in this Board panel's decision should be interpreted as implying that this Board expects or prefers in any way that the Applicant should apply in 2012 on a cost of service basis.

2.8.2 In our view, on the last point the Board panel in this proceeding is able to go further, for the guidance of the Applicant, and say that based on the evidence before it, there is no indication that Toronto Hydro is likely to qualify for cost of service treatment in 2012. It is fair to say that a full evidentiary record is not before this Board panel, so a determination of qualification for cost of service cannot be made (even if this panel were seized with the 2012 threshold issue0, but at the same time it is reasonable for this Board panel to say that nothing you've seen so far suggests that they would qualify.

3 "EMERGING REQUIREMENTS"

3.1 *The Unsettled Issues*

3.1.1 Since Toronto Hydro first created the new category they call "Emerging Requirements", SEC has been concerned that the creation of this new category does not appear to have any basis in logic. It seems, rather, to be a catchall for many projects that would have been done if there were no such category, but are sufficiently "special" that they can be grouped under a new category as if they are something new.

3.1.2 The settlement of most of the capital budget meant that the question of whether there is such a new category, and what it means, does not come before the Board in this proceeding. However, SEC believes it is important to make clear that, notwithstanding that the two examples below are quite unusual projects, we do not in general believe that the creation of this new category for many projects can be taken to imply that any of those projects are either "emerging" or "requirements". In fact, many of them are projects that would have otherwise been in the existing categories, and by creating the new category the Applicant has made it difficult to compare the spending in the other categories on a year over year basis.

3.1.3 Subject to that general comment, there are two capital projects that were not considered in the settlement conference.

3.2 *EV Charging Infrastructure*

3.2.1 The Applicant proposes to spend a relatively small amount on a pilot project to test EV recharging options. The likelihood that we will see a dramatic increase in plug-in vehicles in the near future makes this a sensible pilot, and we believe it should be approved.

3.2.2 We do have two comments.

3.2.3 First, there was some discussion in the hearing to the effect that perhaps recharging stations are a natural part of the distribution system, and therefore perhaps part of the distributor's monopoly. In our submission, the Board should make very clear in its decision that approving a pilot project in no way makes a statement about the proper role of a distributor in the ownership or operation of EV recharging infrastructure. This would seem to us to be a naturally competitive area, and in our submission there is no evidentiary basis in this proceeding to conclude that it should be part of the monopoly distribution business.

3.2.4 Second, Staff in their Final Argument have proposed that the Board require sharing of the EV Pilot information with other distributors. We agree completely with their

submissions in this regard.

3.3 ***Greening the Fleet***

3.3.1 Consistent with our positions in other proceedings, SEC believes that forward-thinking utilities should take leadership roles and be good corporate citizens. Of course, utilities have to be careful not to spend unreasonable amounts to achieve those goals, but with that caveat we believe that these are important roles for large companies to play.

3.3.2 In this case, we believe the incremental capital cost of approximately $2 million to purchase hybrid and electric vehicles is a reasonable expenditure to show environmental leadership and good corporate citizenship. The fact that it may also have long-term benefits in demonstrating the value of electric transportation (and thus balancing daytime peak load with nighttime charging load) is simply an added benefit.

4 DEFERRAL AND VARIANCE ACCOUNTS

4.1 *IFRS Transition Costs*

4.1.1 ***The Evidence.*** The Applicant seeks to clear the Deferral Account for IFRS Transition Costs in the amount (after an initial estimate of $7.2 million) of $6.1 million [Ex. KH1.7]. However, that is not the full total.

4.1.2 In the oral hearing, witnesses for the Applicant first alleged that there was only a further $3.1 million of IFRS costs in the 2011 Test Year [Tr. 2:29]. Pressed on this point, Mr. Couillard admitted that in fact there is $3.1 million in the budget of one department [Tr. 2:39], and an additional $0.6 million in the controller's department [Tr. 2:32]. Further, Mr. Couillard admitted after cross-examination that an amount he estimated at $1 million in the Test Period is not ongoing costs, but rather additional one-time costs associated with the transition [Tr. 2:30].

4.1.3 It is common ground that the amount for the IFRS transition costs is very high for Toronto Hydro. In fact, Mr. Couillard recounted that the Audit Committee of his board, comprised by law of a majority of independent directors, monthly pressed him on the costs, asking "Why is it so expensive?" [Tr. 2:36]. His only overall defence to this was that his auditors (who, of course, were being paid a substantial amount of this money) supported management's view that this was a reasonable cost [Tr. 2:36].

4.1.4 SEC also filed Exhibit KH2.1, which at page 7 had a comparison of IFRS transition costs reported for a few utilities, including Horizon, Ottawa, and Enbridge. The Applicant's costs were more than ten times any of them, except Enbridge. In the latter case, a larger utility with geographically diverse and complex assets, the Toronto Hydro amount is almost double the Enbridge amount.

4.1.5 In further cross-examination, Mr. Couillard advised the Board of the "major reason" [Tr. 2:34] for the high costs. Toronto Hydro, he said, did not have the same asset records as other utilities. While admitting that "most utilities have these records" [Tr. 2:35], he estimated that "probably half" [Tr. 2:37] of the Toronto Hydro IFRS transition costs are the result of having to reconstruct these records that other utilities have already.

4.1.6 ***Analysis***. In our submission, the cost to reconstruct records that a properly run utility meeting the standards that other utilities meet would already have, should not be recoverable from ratepayers. This would appear to be solely the result of imprudent management, and therefore the responsibility of the shareholder rather than the ratepayers.

4.1.7 Assuming that Mr. Couillard's estimate of a half was intended to refer only to the

amount being sought for clearance, this would bring the amount in the account down to about $3 million.

4.1.8 In our submission, the first step, therefore, is to remove half of the account, disposing of it to account of the shareholder.

4.1.9 With respect to the remaining amount, it is submitted that without evidence as to its reasonableness, the Board should turn to comparable utilities to benchmark the spending. The two most comparable amounts are Horizon and Ottawa, since both are large urban utilities with low growth and older distribution systems. Horizon's IFRS transition costs are $511,250, and Ottawa's are $560,752.

4.1.10 There is no reason to think that IFRS transition costs get substantially bigger as a utility gets bigger. Indeed, while Ottawa is about 1.7 times the size of Horizon (by revenues), its IFRS transition costs are only about 10% higher. This stands to reason. The vast majority of these costs will be similar, independent of how many zeros there are in the numbers.

4.1.11 However, Mr. Couillard points out in his evidence that Toronto Hydro is a reporting issuer, and this increases some of its costs. While this should not apply to all of them, it would certainly justify some amount in excess of the Ottawa and Horizon benchmarks.

4.1.12 The simplest way to do this is to gross up the Horizon and Ottawa amounts, on a linear basis, to reflect the larger size of Toronto Hydro. This would certainly be the maximum, as it would not recognize any economies of scale.

4.1.13 Toronto Hydro is 5.43 times the size of Horizon (by distribution revenues) and 3.30 times the size of Ottawa. Applying those ratios to the Horizon and Ottawa costs, the results are $3,044,883 and $1,687,125 respectively.

4.1.14 In our submission a reasonable approach is to average these two comparables, resulting in a gross IFRS transition cost amount for Toronto Hydro of $2,366,004, which would be more than four times the costs for either of the other two large urban distributors.

4.1.15 But that is not the comparable number. Mr. Couillard admits that there is another $1 million embedded in the 2011 agreed OM&A. Therefore, to make an apples to apples comparison, one would have to deduct that from the amount calculated above, leaving a net amount to be claimed through the deferral account of $1,366,004. That is the amount for which, in our view, the Board should order clearance to ratepayers.

4.1.16 In effect, our proposal is that the Applicant recover $2,366,004. $1 million of that is recovered in rates in 2011 through the inclusion in the agreed OM&A budget. The

balance is recovered through clearance of the deferral account.

4.1.17 We also note, that if the Applicant ends up on IRM as it should, the $1 million one-time cost is built into rates for a further three years, which is a windfall to the utility. However, as that issue is settled, there is nothing that can be done about it.

4.1.18 We have in addition had an opportunity to review the Final Argument of Board Staff. In their submissions, Staff propose that part of the balance in the account be recovered now, and the rest remain in the account. Their rationale is that as additional distributors file their IFRS transition costs, the Board will get an increasingly clear picture of what constitutes reasonable spending levels. Armed with that additional information, the Board could make a determination in a future proceeding as to whether any of the amount remaining the account should be recoverable from ratepayers.

4.1.19 This solution has much to commend it, and we support that structure. Our numbers would be different, though. We have noted that half the account should be cleared to the shareholder. Of the remaining $3 million, we propose that the amount we have calculated above - $1,366,004 - be cleared as part of this application. The remaining amount, about $1.7 million, would be the subject of a future application by Toronto Hydro when the Board has better information on IFRS transition cost levels of various Ontario distributors.

4.2 ***Line Loss Variance Account***

4.2.1 We have never understood why distributors are not responsible to forecast and manage their own line losses. On the other hand, we have not been actively involved in this issue, so we have no submissions to augment those of Pollution Probe.

5 SUITE METERING

5.1.1 It has been the consistent position of SEC that participation by regulated utilities in competitive markets is generally to be avoided. If it cannot be avoided, it should be supervised very tightly by the regulator. The potential for abuse – even unintentional abuse – is constant and has many forms. And, where a utility makes a marketplace less competitive by its participation, all customers are hurt by that result. Therefore, in our view the Board must review cost allocation, business practices, and other areas in which competition could be undermined, with a forensic eye.

5.1.2 Subject to our restatement of that general principle, SEC has no submissions on the suite metering issues that have been presented in this proceeding.

6 COST ALLOCATION

6.1 *The Unsettled Issues*

6.1.1 In the area of cost allocation, there are two aspects that are unsettled: the correct treatment of the transformer allowance; and the proposal to move revenue to cost ratios closer to unity for classes already within the range.

6.2 *Transformer Allowance*

6.2.1 We have had an opportunity to review the submissions of VECC on this issue, and in general we agree with their reasoning and conclusion.

6.2.2 We note that since the transformer allowance cost allocation issue was identified as a problem in 2008, there have been two legitimate approaches to solving it, the one proposed, then and now, by VECC, and the one currently being proposed by the Applicant. There is nothing wrong with the proposal of the Applicant, except one thing. The Board has already chosen the solution to this problem, and it is set out in the Filing Requirements. That solution is the methodology proposed by VECC.

6.2.3 In our submission, this is one of those regulatory methodologies that benefits from a single, well-understood standard that has been approved by the Board. There is no reason why the Board should allow utilities to choose a methodology, just as there is no reason to invite each utility to choose how they present their PILs information, or their FTE information. Not everything should be standardized, of course. But this particular issue seems to us to be exactly the sort of thing that benefits from everyone understanding the standard, approved approach to the issue.

6.3 ***Revenue to Cost Ratios***

6.3.1 SEC has always believed that the goal of each LDC should be to get all revenue to cost ratios to 100% of allocated costs. Since most schools are in the GS>50 class, and that class is the one that most often recovers more than 100% of allocated costs, over the entire province it would be beneficial for schools to speed up the move to unity.

6.3.2 But, we fought that battle, and we lost. In 2008 and thereafter, in numerous cases, SEC argued that there should be movement toward unity. In general, the Board concluded in those cases that the cost allocation data is insufficiently rigorous to warrant a full move to unity. At this point, said the Board in those cases, the goal should be to get everyone within the ranges established by the Board. As the data becomes better, classes can then be moved closer to unity.

6.3.3 The Applicant's data is no better than the data they had in 2008. Therefore, in our view further movement towards unity is, on the Board's normal practice, premature.

6.3.4 SEC would still like to see further movement towards unity. On average, rates for schools would go down.

6.3.5 However, what we would not like to see – and what we believe the Board should avoid – is a situation in which the move to unity is left to the discretion of individual utilities. It is not up to the utilities, in our view, to decide what rates for each class are "just and reasonable". They can provide valuable input to the Board, but in the end the fair division of revenue responsibility between classes should be decided by the Board based on ratemaking principles and goals that are applied consistently by the Board to all distributors.

6.3.6 The Applicant says that they have made a "policy decision" [AIC, para. 82] that residential should be at 92%. This is, in our submission, not a "policy" matter that should be within a utility's discretion. No benefit is gained by giving this discretion, and granting the discretion creates a scope for exercise in ways not consistent with good ratemaking. A utility should not, for example, be free to decide that GS<50 customers should pay a little less in order to stimulate the local economy. It should not, for example, be free to decide that residential customers should get a break on rates in a municipal election year. While no-one is suggesting that the Applicant is doing either of these things, the fact is that ratemaking "policies" should be established by the Board, based on a set of common principles, and the utilities should simply implement those policies.

7 OTHER MATTERS

7.1 *Implementation Date*

7.1.1 The Applicant has proposed an August 1st implementation date of rates effective May 1, 2011. This likely disadvantages schools, who have low billing determinants in July, and therefore would bear a higher effective cost for July if it is charged based on billing determinants for the rest of the year.

7.1.2 However, in our submission the potential problems associated with implementing a new billing system at the same time as new rates outweighs this issue. We therefore agree that the Board should accept the Applicant's implementation date proposal.

7.2 *Costs*

7.2.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

All of which is respectfully submitted.

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Jay Shepherd
Counsel for the School Energy Coalition