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May 2, 2011

VIA Email and RESS

Ms. Kirsten Walli, Board Secretary
Ontario Energy Board
2300 Yonge Street,
Ste. 2701
Toronto ON M4P 1E4

Dear Ms. Walli

Re: Toronto Hydro-Electric System Limited – 2011 EDR
OEB File No. EB-2010-0142
Reply Submission

Please find attached THESL's reply submission in the above noted matter.

Yours very truly,

BORDEN LADNER GERVAIS LLP

Original signed by Mark Rodger

J. Mark Rodger

Encl.
copy to:

Colin McLorg, Toronto Hydro-Electric System Limited
Pankaj Sardana, Toronto Hydro-Electric System Limited
Glen Winn, Toronto Hydro-Electric System Limited
Intervenors of Record

EB-2010-0142

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

AND IN THE MATTER OF an Application by Toronto Hydro-Electric System Limited for an Order or Orders approving or fixing just and reasonable distribution rates and other charges to be effective May 1, 2011.

REPLY SUBMISSIONS
TORONTO HYDRO-ELECTRIC SYSTEM LIMITED

May 2, 2011

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Toronto Hydro-Electric System Limited

EB-2010-0142

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DELIVERED MAY 2, 2011

A. INTRODUCTION

1. Toronto Hydro-Electric System Limited ("THESL") is pleased to file its reply submissions in connection with its application for 2011 electricity distribution rates (the "Application").

2. THESL confirms and adopts the submissions made in its April 4, 2011 Argument-in-Chief and has limited its reply submissions to responding directly to submissions made by Board Staff on April 18, 2011 and by Association of Major Power Companies of Ontario ("AMPCO"), the Building Owners and Managers Association of the Greater Toronto Area ("BOMA"), the Consumers Council of Canada ("CCC"), the Energy Probe Research Foundation ("Energy Probe"), Pollution Probe Foundation ("Pollution Probe"), the School Energy Coalition ("SEC"), the Smart Sub-metering Working Group ("SSMWG") and the Vulnerable Energy Consumers' Coalition ("VECC"). THESL received no final submissions from any other party in this proceeding.

3. No party in this proceeding objected to any component of the Settlement Agreement, accepted by the Board at the outset of the oral phase of the hearing,

after the oral hearing and intervenor argument phase were concluded. THESL is pleased to see that the collective efforts of the utility and the intervenors to conclude a reasonable agreement during the settlement process succeeded in greatly limiting the scope of issues that the Board must now consider in this proceeding. THESL submits that the Board should adopt the Settlement Agreement as its findings on the settled and partially settled issues contained therein.

4. THESL has organized the remainder of its reply submissions in the same manner as its Argument-in-Chief, addressing the following issues which were raised by staff and intervenors in their submissions:

Interim Rates

IRM (relating to Issue 1.5);

Emerging Requirements (relating to Issues 4.1, 4.2, 9.1, 9.2 and 9.3);

Deferral and Variance Accounts (relating to Issue 6.1);

Suite Metering (relating to Issues 7.2 and 7.3); and

Cost Allocation (relating to Issues 7.1 and 7.4).

5. Capitalized terms used in these submissions are given the meaning attributed to those terms herein, and if no such meaning is given then the meaning attributed to those terms in THESL's Argument-in-Chief.

B. INTERIM RATES AND AN AUGUST 1, 2011 IMPLEMENTATION

6. None of the parties objected to THESL's proposal set out in Exhibit KH1.4 to implement the approved final rates for 2011, including the LPP rate riders, on

August 1, 2011, together with a set of fixed term rate riders to collect foregone revenue for May, June and July 2011. THESL submits that the Board should grant this request.

UNSETTLED ISSUES

1. Incentive Regulation Mechanism ("IRM")

7. THESL has reviewed and considered the submissions of Board Staff and the intervenors in respect of Issue 1.5.

8. It is worth noting at the outset that various intervenors have seized upon issue 1.5 to advance a surprising flurry of arguments and allegations, some of which are well beyond the proper scope of this issue and this proceeding.[1] THESL submits that this proceeding is not the correct forum in which to hear speculative and hypothetical arguments that do not directly relate to the Application and Issue 1.5.

9. Given that none of the parties made submissions on Issue 1.5 when the Board proposed it on the draft issues list, one might ask why the sudden interest, particularly of ratepayer groups, in this issue?

Issues List Decision and Procedural Order No. 2 at Page 4.

10. The answer is unfortunately fairly obvious. The evidence on the record is that if the Board were to impose IRM on THESL, it would amount to an effective rate freeze over the subsequent three years. As a result, ratepayer groups in particular, have seized upon this issue to try to forcefully impose a mandatory rate freeze onto THESL - notwithstanding THESL's clear and compelling evidence on the record of the urgent and ongoing need for infrastructure and workforce renewal

[1] CCC raised further jurisdictional questions in its submissions despite the fact that the Board has determined the questions are outside of the scope of the current proceeding.

and the risks that a rate freeze would pose to the long-term safety and reliability of the THESL distribution system.

11. Issue 1.5 has arisen strictly in the context of THESL's current Application for 2011 rates based on a cost-of-service methodology. This is the application that is in fact before the Board and which presently seizes the Board's attention in this proceeding. It is in this context that the Board proposed Issue 1.5 as follows:

> "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?"

12. THESL agrees with Board Staff's submissions, albeit for different reasons, that "the Board should neither determine that now is the appropriate time for THESL to commence filing rate applications under incentive regulation, nor that the present application is an appropriate base case for future IRM applications, as such a determination would, in staff's view, be premature." THESL outlines its reasons for this position and addresses various intervenor and staff concerns in the following submissions.

> **Board Staff Submission dated April 18, 2010 at page 5.**

1.1 The Board has rightly adopted a flexible approach to which methodology it uses to determine just and reasonable rates.

13. Several intervenors have seized upon Issue 1.5 to argue that it is Board policy under Third Generation Incentive Regulation Mechanism ("3GIRM") to require that all electricity distributors must operate under IRM, regardless of the

circumstances (CCC at para. 17 and 22, VECC at para 3-4, EP at para 23, SEC at para 2.6.8).[2]

14. The facts simply do not support this mischaracterization of the Board's policy to-date. The Board's June 15, 2008 report on 3GIRM does not explicitly limit the Board's discretion to determine "just and reasonable" rates to using just one mechanism: IRM.

15. Instead, THESL submits that the Board has demonstrated a fair degree of flexibility in applying several different approaches to determining just and reasonable distribution rates, including adopting:

an IRM methodology,

a single year cost-of-service methodology, and

a multi-year cost-of-service methodology.

16. For example:

On May 15, 2008, the Board approved the first application of its kind by an electricity distributor to set rates based on a multi-year cost-of-service methodology, approving THESL's application for 2008 and 2009 rates using a cost-of-service methodology (EB-2007-0680).

On April 9, 2010, the Board accepted an application by Hydro One Networks Inc. ("HONI") to set just and reasonable rates for 2010 and 2011 on the basis of a two year cost-of-service methodology (EB-2009-0096), even though

[2] Based on this flawed assumption, CCC goes on to make several accusations by suggesting that THESL has chosen to "ignore" the Board's policy in IRM by "unilaterally" choosing to file cost-of-service applications in a manner that is somehow contrary to Board policy. THESL expressly denies these surprising allegations. At no time has THESL ignored the Board's stated policy in respect of rate applications. THESL has and will continue to comply with the Board's direction in this regard.

HONI had previously made a 3GIRM mechanistic adjustment to its rates in 2009 (EB-2008-0187) using a base year that was established by HONI's 2008 rebasing application filed in accordance with the Board's 2GIRM framework (EB-2007-0681).

On April 9, 2010, the Board approved THESL's rates based on a single year cost-of-service methodology (EB-2009-0139).

On December 15, 2010, the Board determined that it would hear the cost-of-service application filed by Horizon Utilities Corporation ("Horizon") even though Horizon had previously applied under 3GIRM since 2008, was not due to apply for rebasing until 2012, and did not meet the off-ramp criteria under 3GIRM (EB-2010-0131).

On October 27, 2010 the Board found that, on the evidence, Hydro Ottawa had failed to justify the need for an early rebasing and was unable prove that it could not adequately manage its resources and financial needs during the one year remaining in the IRM plan (EB-2010-0133). The Board came to a similar decision in respect of an application put forth by Norfolk Power (EB-2010-0139). In the Hydro Ottawa Decision, the Board expressly rejected comparisons to THESL, which was never on IRM. The Board also noted explicitly in respect of 3GIRM that:

> "As with all its policies, the Board will consider alternative approaches, but these alternatives must be justified."

17. THESL submits that the Board has acted prudently and in the public interest in adopting a flexible approach to determining the appropriate methodology to use to determine just and reasonable rates: whether it be cost-of-service, multi-year cost-of-service, or IRM.

18. To do otherwise would be to risk putting the means, the particular method used by the Board to establish rates, ahead of the ultimate ends, the Board's statutory obligation to establish just and reasonable rates in a manner consistent with its objectives.

1.2 Cost of Service applications are not equivalent to rebasing applications.

19. For the reasons that follow, THESL submits that there is a fundamental distinction between a cost-of-service regulatory construct and an IRM regulatory construct, and one cannot simply equate a base-year IRM application with a traditional cost-of-service application as CCC suggests at paragraph 10 of its submissions. The Board has for many years employed two separate and distinct methods of ratemaking. These are the Incentive Regulation Mechanism, which has evolved through three phases from Performance Based Regulation at the outset to the current Third Generation Incentive Regulation Mechanism, and Cost of Service (COS) regulation, which has been used for decades by the Board in the regulation of gas distributors and more recently for electricity distributors.

20. Although these two methods of ratemaking are fundamentally different, they share one feature that is superficially similar, which in a COS framework is the test year rate application, and in an IRM framework is the rebasing application. Both of these involve comprehensive and detailed forecasts of the revenue requirement for the test year. While these can appear similar in form, they are components of fundamentally different systems of regulation. A COS application is not equivalent to or substitutable for a rebasing application, and neither is a rebasing application the same as a COS application.

1.2.1 The IRM regulatory construct

21. Two fundamental premises of the IRM regulatory construct are that:

rates become decoupled from costs during the period between rebasing years; and having been set at the initial rebasing, ratebase and revenue requirement can remain relatively stable between rebasing years, and are reasonably funded, to the detriment of neither customers nor the utility, by escalating the rates found in the initial rebasing.

22. The current IRM construct represents a series of tradeoffs that are intended, in appropriate circumstances, to produce a fair balance of protections, risks, and opportunities for the Board, utilities, and ratepayers, over the entire IRM cycle.

23. For the Board, IRM provides an efficient method to set rates for a large number of medium, small, or very small utilities. It would be impossible given current resources to use a COS approach annually for these utilities, and even if resources were available the cost per customer would be exorbitant. Nevertheless, it is not valid to infer on the basis only of a utility's small size that its revenue requirement can be held essentially constant over the period between rebasings without undue consequences for customer service, reliability, and utility earnings.

24. For ratepayers, IRM offers the prospect of rate stability in nominal dollar terms over the period between rebasings and declines in real rates due to the operation of the stretch-adjusted productivity factor. Again though, there can be no assurance that declines in real rates are sustainable or reflective of the underlying costs of the business in every case.

25. For utilities in business circumstances that permit either a stable total revenue requirement or a stable revenue requirement per customer (for those with growing load and customer bases) IRM provides an opportunity to increase short term earnings over the period between rebasings by cutting costs relative to the level implicitly allowed in rates. Because rates are no longer a function of current costs, IRM expressly allows utilities to charge more than costs in the interim period, and thereby to derive a source of earnings apart from the return on investment allowed in a COS context. It may be difficult or impossible to

determine in an individual case whether the increased earnings derive from real productivity growth or simply from unsustainable cuts to service and investment, or some combination of both. However, one thing is clear: whatever utilities can subtract from costs in the interim period is theirs to keep permanently.

26. It is also clear that in return for having rates decoupled from actual costs, and having the opportunity to retain increased earnings in the interim period through cost cutting, utilities accept the risk of having to bear unforeseen, non-extraordinary costs. This is the quid pro quo that compensates ratepayers for their risk that rates may more than cover costs.

27. THESL submits that despite superficial likenesses, an IRM rebasing application is fundamentally different than a traditional COS application because the rebasing application is necessarily just one part of a larger system of IRM regulation with which it must remain joined. Rates in the rebasing year and during the interim period cannot be separated. Prospectively, a utility launches a rebasing application with the full and proper expectation of the opportunity for increased earnings in the interim period, business circumstances permitting. Retrospectively, ratepayers demand that cost reductions accumulated through the interim period be reflected in rates at the subsequent rebasing.

28. Because of the fact that at least one whole cycle of IRM is the regulatory 'contract' in the case of IRM, the Board imposes stringent requirements on utilities that wish to 'cancel the contract' before the end of the term. This is reasonable because the increased earnings during the interim period are not able to be recaptured by ratepayers after the fact. These requirements are also clearly known to utilities which enter the IRM contract, although it cannot be inferred that all utilities which enter the contract do so willingly. In fact, they may have no practical alternative.

29. In essence then, IRM is a three-party regulatory contract between the Board, the utility, and the ratepayers (considered as one party). The rebasing application forms an integral part of that contract which necessarily unfolds over the course of several years. THESL submits that this form of regulatory contract offers the prospect of benefits for all parties in certain circumstances; however, given the underlying premises of IRM, and in particular the assumption that the utility is effectively in a steady state or a sustainable pattern of low growth in revenue requirement, THESL submits that the presumption should be that a utility needs to demonstrate its qualifications to enter the IRM contract, rather than the opposite as suggested by SEC at paragraph 2.2.6.

1.2.2 The COS regulatory construct

30. In contrast to the IRM construct, COS applications are intended to cover only the test period, usually but not necessarily one year. The utility takes the risk of non-extraordinary cost fluctuations as well as revenue fluctuations, and actual results invariably differ to some degree from the approved forecasts. However, the principal determinant of utility earnings is its allowed return on equity, and the principal determinant of rates is the approved, forecast cost of service; rates remain very closely linked to costs and the utility is not expected to systematically increase earnings by driving a greater difference between costs and revenues. Furthermore, if it does so, it will likely be penalized in a subsequent COS application.

31. It is also the case that the ‘contract’ is limited to the test year(s). The utility has no sanctioned opportunity to increase earnings through cost reductions in a subsequent interim period, and the cost savings achieved during the test period are passed through to ratepayers at the time of the next COS determination. The only lingering effects of a COS period are that absent any subsequent change, rates remain at the level set for the test year, and that all parties are entitled to repeat the process for the subsequent period.

32. The other critical distinctions between the COS and IRM constructs are that:

COS does not rely on the restrictive assumptions that business circumstances for the utility are stable, that its ratebase can remain stable or grow only slightly over the interim period, and that its overall revenue requirement can also remain essentially stable over the IRM cycle; and

COS provides a proper regulatory context to examine and determine complex, non-routine issues, which are precluded by the Board from being addressed in the mechanistic rate adjustment proceedings which apply during the interim periods in the IRM construct.

1.3 The "equality of treatment" and "uniqueness" arguments are irrelevant.

33. Board Staff and several intervenors argue that THESL should not be receiving treatment different from other distributors who are under the Board's 3GIRM framework unless such circumstances can be justified by circumstances unique to THESL.

34. It is noteworthy that while numerous other distributors are party to this proceeding, not one has argued that it is unfair for the Board to hear cost-of-service applications from THESL. It is also noteworthy that other large distribution utilities, including Hydro One, have been afforded similar treatment by the Board.

35. THESL submits that the "equality of treatment" and "uniqueness" arguments put forth by Board Staff and the intervenors are irrelevant to the Board's determination in this matter and should be disregarded.

36. The issue of whether or not IRM is appropriate for a given distributor at a given time is not dependent on whether it alone, and no other distributor, faces circumstances that make IRM inappropriate. Rather, the question should be

determined based on whether IRM produces, for that utility, an outcome that best results in just and reasonable rates that protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service while ensuring a utility continues to earn a fair return on its investment. If IRM does not produce just and reasonable rates for a utility, then it clearly does not matter whether that conclusion may also follow for other utilities.

1.4 The ICM does not address THESL's circumstances.

37. Board staff and several intervenors have argued that it is not clear why IRM mechanisms such as the incremental capital module (ICM) could not be used to deal with THESL's circumstances.

38. In its 2009 3GIRM application, Hydro One applied to the Board for an ICM adjustment, the primary purpose of which was to fund capital expenditures in excess of depreciation (CEEDs). In a Decision dated May 13, 2009, the Board expressly limited the circumstances to which the ICM is meant to apply (EB-2008-0187). Those circumstances expressly do not include CEEDs.

39. This is why THESL emphasises in considerable detail in Exhibit KH1.2, in oral testimony and in its Argument-in Chief its ongoing need for significant CEEDs. The Board's policy has limited the circumstances to which ICM can apply - a utility with significant CEEDs is ineligible to apply under the ICM and is thus left without a mechanism to fund those CEEDs under an IRM framework.

1.5 THESL should continue to have the discretion, and in-fact has the right, to file cost-of-service applications with the Board.

40. THESL submits that in light of its circumstances which have been clearly evidenced in this proceedings, it should continue to be given the discretion to file cost-of-service applications with the Board if and when needed.

41. THESL notes that although it has never filed an application under 3GIRM, the built-in incentives under 3GIRM continue to operate exactly as intended. 3GIRM provides distributors with the opportunity to increase returns to shareholders through the implementation of efficiency initiatives. THESL could elect to apply under 3GIRM to take advantage of this opportunity to increase returns.

42. By choosing not to do so, THESL is willing to forego the opportunity to earn increased returns because of very serious concerns about the deteriorating state of its distribution infrastructure, the very real risk of declining service quality, and the urgent need for continuing increases in spending to renew its infrastructure, on the one hand, and the inability of the current 3GIRM framework and the ICM to adequately accommodate a utility in this circumstance, on the other. As noted in Argument-in-Chief, THESL's under-earning in 2009 and 2010 are well documented: in 2009, THESL's actual financial ROE was 6.35% (versus an allowed ROE of 8.01%); in 2010, on a pro-forma basis, THESL's financial ROE was estimated to be 7.69% (versus an allowed ROE of 9.85%); and in 2011, on a forecast basis, THESL's financial ROE is estimated to be 7.86% (versus an allowed ROE of 9.58%).

Exhibit B1, Tab 6, Schedule 1.
Exhibit B1, Tab 7, Schedule 1.

43. This is why THESL filed its cost-of-service application in 2011 and intends to file a similar application in 2012 and beyond.

44. The circumstances in which THESL is placed lead to a very interesting dilemma. How can the Board rely on an "incentive regulation" when the party the Board intends to incentivize has already identified other material concerns related to ongoing system renewal and maintenance needs that in its view outweigh the economic incentives provided under 3GIRM?

45. One of the acknowledged risks of incentive regulation is that instead of pursuing long-term efficiency initiatives that over time would benefit ratepayers by reducing costs, utilities could choose to make short term cost reductions and sacrifice essential service quality in the pursuit of their own economic interests. Indeed, to discourage utilities from sacrificing service quality in pursuing economic incentives, utilities are required to file service quality performance measures as part of a rate application.

46. Given this risk, one would expect that the Board would be supportive of a utility that provides detailed evidence of its serious concerns with a deteriorating system and the risks to service quality, and puts those concerns ahead of its own short term economic interests to ensure the long-term integrity of the distribution system for the long-term benefit of ratepayers.

47. This risk is particularly acute given that the Board's 3GIRM remains a regulatory work in progress. As recently as March 31, 2011, Board Staff recommended in its Report that the Board should establish and codify system reliability measures and performance targets (EB-2010-0249).

48. Counter-intuitively, ratepayer groups have seized upon Issue 1.5 to argue that the Board should forcefully impose IRM on THESL. There is no doubt that imposing IRM on THESL would amount to what is in effect a 3-year rate freeze. As a result, the ratepayer groups are asking the Board to impose IRM on THESL even though the evidence is that this is simply not sustainable in the circumstances.

1.6 What is the effect of imposing IRM on THESL?

49. The Board makes a fundamental assumption as part of its IRM policy framework - that distributors are expected to be able to adequately manage their resources and financial needs during the term of their IRM plan.

50. The evidence before the Board, both in Exhibit KH1.2 and in the sworn testimony of witnesses that are the experts in the operation of their own distribution system, rebuts this assumption.

51. Under IRM, THESL would be forced to either: (i) continue to fund its infrastructure renewal at the pace necessary to ensure ongoing reliability and quality of service at the sole cost of the shareholder; or (ii) restrain its infrastructure renewal in the short term by deferring much needed infrastructure investment into the future so as to maintain its short-term economic viability.

52. The Board would be knowingly imposing a regulatory framework on THESL that: (i) forces THESL's shareholder to earn less than its legally allowed fair return on investment to fund much needed infrastructure renewal; or (ii) forces THESL to mortgage the distribution system's future integrity to artificially suppress distribution rates today.

53. Ratepayer groups may be willing to risk (ii) in hopes of achieving (i), but THESL submits that neither of these outcomes is consistent with an objective of protecting the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service while ensuring a utility continues to earn a fair return on its investment.

54. In these circumstances, when "incentive regulation" becomes "disincentive regulation", THESL submits that the Board should continue to allow utilities like THESL to continue to file cost-of-service applications. To do so would be in the long-term interests of consumers in terms of safety, adequacy, reliability and quality of electricity service and is ultimately in the public interest.

1.7 2011 is not an appropriate base year for IRM.

55. Several of the intervenors groups (CCC, BOMA, and VECC) argue that THESL's 2011 Application represents an appropriate base year for IRM applications commencing in 2012.

56. THESL submits 2011 is not an appropriate base year for IRM for two reasons. First, for the reasons detailed in argument-in-chief, IRM is simply not an appropriate framework to set just and reasonable rates in THESL's circumstances. Second, doing so would be contrary to the administrative law principles of fundamental justice and procedural fairness. Based on these common law principles of fairness in administrative proceedings, a party has a right to know the case it must meet prior to commencing a proceeding.

57. THESL submits that at no time was it notified by the Board prior to filing its Application on August 23, 2010 that its Application could or would be used as the base year to subsequently impose IRM and an effective three-year rate freeze.

58. On the contrary, given the fact that THESL has never been part of the Board's 3GIRM framework, the Board's acceptance of THESL's prior cost-of-service applications and the Board's demonstrated flexibility in accommodating other unique cost-of-service applications (such as HONI and Horizon), it was entirely reasonable for THESL to expect and rely that it could continue to file cost-of-service applications for the foreseeable future.

59. It was in this context that THESL filed its Application, which includes a capital plan and operating budget that is premised on future cost-of-service rate applications that would allow for increases in capital and operating spending in 2012 and beyond. Instead of implementing the full increase needed to achieve a 4-year infrastructure renewal plan upfront in its 2011 application, THESL instead chose to phase-in those increases slowly over time to mitigate the short-term rate

impacts on consumers. As a result, THESL filed an Application with lower capital and operating budgets than it would otherwise have if it had been notified in advance that it might have to live with a 3 year rate freeze following rebasing.

Transcript, Volume 2, Page 66, Line 17 – Page 67, Line 24.

60. The first time that THESL had any indication that its Application could remotely be considered a base year for IRM purposes occurred nearly 2 months after THESL had filed its Application, on October 15, 2010, when the Board first proposed Issue 1.5 as part of its draft issues list. By this time it was simply too late for THESL to completely redo its entire Application. To expect otherwise would have been entirely unreasonable.

61. The Board as a matter of principle strives to achieve a degree of predictability and fairness with its own regulatory processes. For these reasons, THESL submits that 2011 would not be an appropriate base year for THESL. THESL notes that Energy Probe supports THESL's position in this regard (EP at para. 18 and 27).

1.8 The evidence on the record is full, complete and has been accepted by the parties.

62. Board Staff and several intervenors have argued that because of the settlement reached in this proceeding, the Board did not have the opportunity to test THESL's capital plan or OM&A evidence in the proceeding.

63. THESL submits that while its evidence was not formally tested at the oral phase of this proceeding, it should not be faulted for participating in good faith in the settlement conference, in compliance with the Board's order in PO#3, nor should THESL be faulted in reaching a settlement on a substantial number of the issues which were left available to settle by this Board through its PO.

64. THESL has produced detailed evidence on its capital plan and OM&A budget as part of its Application, and further elaborated on this evidence in response to written interrogatories and during an oral technical conference.

65. Several intervenors have suggested in their submissions that they are unable to comment on whether THESL's evidence is sufficient to support the proposed settlement. These intervenors appear to want the benefit of the settlement proposal without being tied to the position they adopted in that proposal. Page 6 of the Board's settlement conference guidelines states clearly that:

> "It is the responsibility of the participants to ensure that the settlement proposal contains sufficient evidence to support the proposal and the quality and detail of the evidence and rationale for the settlement of issues will allow the Board to make findings on the issues."

66. As a result, all of the parties to the settlement proposal agreed that there was sufficient evidence on the record to support the proposed settlement - this is why the parties are recommending that the Board adopt the settlement as its finding on the relevant issues in this proceeding.

1.9 THESL's Application in this proceeding is a COS application.

67. THESL has since the 2008 test year filed COS applications. It has consciously foregone the benefits that it might in other circumstances have been able to realize under the IRM construct, precisely because its circumstances cannot be supported or even accommodated by that construct. As a result, THESL's cost structure, infrastructure renewal program, and revenue requirement evolution have been closely monitored by intervenors and supervised by the Board.

68. THESL has not requested, nor has the Board imposed, the IRM construct on THESL for any rate year, including the 2011 rate year. Even if the Board had the jurisdiction, it could not fairly do so now with respect to the 2011 rate year by

treating THESL's application as a rebasing application, which it is not, instead of a COS application, which it is. THESL submits that such an action taken now by the Board would be a breach of natural justice, as well as deeply unfair and unsupportable because it would deny THESL the opportunity to know the case that it must meet, and would prejudge evidence, pertaining to subsequent rate years, which THESL has yet to file. Neither the Board, nor THESL, nor intervenors have entered the IRM 'contract' with respect to THESL's revenue requirements and rates.

69. THESL's expectations that it could file a COS application, and have it treated that way by the Board, are legitimate. Several supporting reasons for this expectation, with explanation, are set out in THESL's Argument–in-Chief at paragraphs 28 through 35. Despite allegations by intervenors to the contrary, the Board's adoption of IRM for most utilities is not, and has never been, a categorical imposition of that approach on all utilities.

70. Several of the intervenors appear to trade on obscuring the difference between utilities already on IRM and the regulatory treatment that flows from that, and the regulatory approach that is taken outside of the IRM construct. They do so mainly by equating a COS application with an IRM rebasing application. THESL does not dispute that the rules of IRM would apply to it, if it had embarked on IRM. However, it has not, for good reasons, and the Board has properly accepted THESL's applications on a COS basis.

71. Furthermore, had the Board had the intention of making an express determination of the propriety of THESL applying under a COS framework for 2011, it could and should have defined under its own motion a preliminary issue as to whether it would accept a COS application for 2011 rates. That motion could then have attracted evidence and submissions from all parties and been properly disposed of in a manner that would at least have informed THESL and all parties of the

regulatory approach that the Board had determined it would take and the case that THESL would have to meet.

72. However, the Board did not take that approach. Instead, after THESL's evidence had been filed, it defined Issue 1.5. In PO#2 the Board stated explicitly "that it is appropriate to incorporate this issue to allow parties to explore the full range of approaches available to deal with the longer term issues raised by Toronto Hydro's application." The Board's definition of that issue cannot be construed as anything beyond what it is on its face, and certainly cannot be understood to indicate a prior conclusion on the Board's part that THESL either was under or that 2012 should be under an IRM framework.

73. THESL therefore submits that there is no basis to conclude that THESL's application in this proceeding is not a COS application, and much less that THESL is currently under the IRM construct and that its application must therefore be treated accordingly. THESL's current application is clearly not a rebasing, or early rebasing, application and therefore cannot properly be followed in 2012 by an IRM mechanistic, interim period adjustment.

74. For this reason the Board should also reject Staff's argument at page 5 that "in the event THESL does file a COS rebasing application for 2012 rates, the Board should, at that time, review such an application using the [early rebasing] criteria outlined above." That proposition assumes that THESL is now under the IRM contract and that any 2012 application other than for a mechanistic adjustment would constitute an early rebasing application. That assumption is clearly incorrect, and if adopted would be unfair since it would *de facto* impose IRM on THESL, contrary to THESL's filed and accepted 2011 application.

75. The Board's obligation in these circumstances is to adjudicate THESL's application as a COS application, as it was in fact filed. The Board cannot now turn THESL's COS application into a rebasing application.

1.10 IRM is not appropriate for THESL.

76. Several parties have advanced the view that IRM should and can be applied to THESL. Throughout this proceeding, THESL has been at pains to clearly explain and demonstrate why that is not true. THESL submits that the intervenor positions on this issue depend either on faulty logic, faulty 'evidence', or the seemingly wilful disregard of the proper evidence that does exist on the record.

77. In essence, THESL's evidence is that continuing investment in infrastructure renewal has been and will continue to be necessary. The historical circumstances leading to this situation are well known to the Board and are not in dispute in this proceeding. The necessary infrastructure renewal demands investment at levels well above those that can be supported through depreciation funding, and at a bare minimum must be undertaken at a pace that will prevent THESL's infrastructure deterioration from worsening. This infrastructure renewal has not been completed and cannot be completed over the next one or few years. To arrest this infrastructure renewal program now will not arrest the actual, continuing degradation of THESL's distribution system but will substantially and unjustifiably increase the risk of severely disruptive service outages as well as the incidence of localized outages.

78. The mechanics of revenue requirement and ratemaking are thoroughly understood by the Board. Significant capital expenditures exceeding depreciation (CEEDs) increase ratebase by definition. In turn, increased ratebase must be supported by corresponding capitalization, and the corresponding capitalization-related costs necessarily increase revenue requirement. These relationships exist every year, regardless of the manner of regulation. It is logically impossible to on one hand recognize that infrastructure renewal is vital and demands significant CEEDs, and on the other to maintain that revenue requirement need not increase.

79. THESL believes that all parties recognize that IRM, by construction, entails virtually zero growth in revenue requirement in the interim period between rebasings. It is therefore inescapable that if the Board were to impose IRM on THESL, it would with equal force and certainty impose a condition under which revenue requirement would support virtually zero growth in ratebase in the interim period.

80. Staff and intervenors have advanced arguments as to why, despite the considerations set out above, IRM actually does meet THESL's needs, or why THESL does not actually have those needs, or why IRM should be imposed anyway.

81. The most objectionable submission from intervenors has an example in SEC's statement at paragraph 1.2.3 that the case for THESL's capital infrastructure renewal program "has not been made out". It is objectionable because it disregards completely the extensive, detailed evidence that has been filed by THESL in its last three rate cases covering the period since 2008. This evidence specifically describes asset condition assessments conducted by THESL, numerous particular examples of failing assets such as direct buried underground cables, and the fact that a high percentage of THESL assets are beyond their expected useful lives. Most importantly, the evidence clearly indicates that the asset renewal project, necessary to bring the system to a satisfactory level of performance and reliability, cannot be accomplished in one or a few years but must instead be a long term undertaking. SEC's statement at paragraph 2.3.19 that the "catch up has already been funded" is simply a groundless assertion that follows from its disregard of the evidence.

82. SEC's use at paragraphs 2.3.20 to 2.3.33 of *ad hoc* comparisons to other utilities based on 2009 Yearbook data is equally objectionable and should be entirely rejected by the Board. First of all, the material is clearly evidentiary in nature (though not in quality); had SEC wished to introduce such 'evidence', it should

have done so in the evidentiary phase of the hearing wherein the 'evidence' could have been tested by THESL. It is improper to introduce such material at this stage of the proceeding, when the assumptions, theory, and conclusions derived cannot be adequately tested. Second, on their face the conclusions are highly tenuous and speculative and rely on undisclosed assumptions regarding the comparability of the figures used between utilities. Stated differently, the analysis is definitely not transparent or intuitively obvious. THESL strongly objects to the introduction of such material and submits that the Board should disregard it entirely.

1.11 Conclusion

83. THESL submits that the evidence on the record in this proceeding clearly shows two things: that THESL's multi-year infrastructure renewal program is necessary, and that the best existing way to manage the regulatory oversight of that program and THESL's overall revenue requirement is through a COS framework.

84. Of the existing methodologies for setting revenue requirements and rates, THESL submits that for 2011 and for the near future a cost of service methodology is the only approach that will result in just and reasonable rates.

85. COS must be chosen over IRM since IRM has been demonstrated to be inappropriate for THESL's circumstances. An IRM regime would not afford THESL the resources required to carry out the infrastructure renewal program and would prejudge evidence that THESL is yet to file concerning the specific magnitude and cost of that program in future years. The arrest of that program would introduce unacceptable and unwarranted risks of possibly severe service disruptions for THESL's customers.

86. The arguments of Staff and intervenors on this issue have not demonstrated that IRM is required by the Board or even feasible for THESL. Therefore the Board

should continue to permit THESL to file for revenue requirement and rates on a COS basis until a third and better alternative is developed.

2. EMERGING REQUIREMENTS

2.1 The EV Pilot

87. Board Staff, BOMA, CCC, EP, SEC, VECC, and PP all made submissions in support of THESL's proposed EV pilot. No party opposed the EV pilot or THESL's requested relief. THESL submits that the Board should approve the EV pilot.

88. Although the majority of parties supported the inclusion of the EV charging infrastructure in THESL's ratebase for the purposes of the pilot, some intervenors asserted that THESL should not become involved in activities in what could potentially evolve into a competitive marketplace and requested that the Board make certain findings in that regard.

89. THESL supports Board Staff's observation at page 8 of their submissions that it is premature to address these issues at this time. THESL submits that the only question before the Board in this proceeding is whether or not to approve the proposed EV pilot, and that it would be premature to decide on any more generic issues at this time. Neither the Board nor the parties have the benefit of any evidence on this generic issue in this proceeding, so no informed decision could be made at this time. In addition, the issue may raise important questions of public policy that this Board may want to examine, such as whether the Board would want to establish a stand-alone EV rate within the current distribution rate structure. THESL submits that the information and experience it gains through the EV pilot would be helpful to all parties in this regard.

2.2 Greening the Fleet

90. Board Staff, VECC, and SEC all support THESL's proposed *Greening the Fleet* program to invest moderately in the replacement of its fleet with more efficient vehicles to reduce its carbon footprint. AMPCO, SSMWG and PP made no submissions on this issue.

91. THESL's proposal to invest $2 million in capital for more efficient equipment results in incremental revenue requirement of less than 0.1% of THESL's requested base revenue requirement. This investment in 69 electric/hybrid vehicles will result in a reduction of approximately 113 tonnes CO_2e in 2012, with an additional 36,429 litres in fuel savings (approximately $35,000) in 2011.

Exhibit R1, Tab 3, Schedule 9.

92. BOMA, supported by EP, submits that THESL has not presented a formal business case to justify the purchase of efficient electric/hybrid vehicles instead of traditional fuelled vehicles and that the Board should consider whether the costs in excess of the savings should be included in revenue requirement. CCC submits that 50% of THESL's $2 million capital investment should be denied with the requirement that a more detailed business case be provided for further investments in *Greening the Fleet*.

93. THESL submits that while there is a premium associated with an investment in electric/hybrid vehicles over traditional fuelled vehicles, the premium is justified for the *Greening the Fleet* initiative to support its objective to reduce its carbon footprint. There is a very real reduction of approximately 113 tonnes CO_2e in 2012 associated with this premium. It is in fact difficult to place a value on cleaner air and reduced carbon emissions, and there is no agreed-upon dollar value for these externalities, as intervenors well know. In the result a formal business case is not possible. Despite this, THESL submits that no one would argue that traditionally fuelled vehicles should continue to dominate fleets where

an organization has the opportunity, and the means, to invest modestly in the conversion of its fleet to more fuel-efficient, environmentally-friendly vehicles.

94. THESL notes that the Province of Ontario has implemented the single largest carbon reduction initiative in North America with its plan to close all coal-fired generation facilities by 2014, and that the Province has further promoted the drive towards a low carbon economy with its *Green Energy and Green Economy Act, 2009*. Indeed, the Board's own objectives relating to the promotion of renewable generation, CDM, and the facilitation of the smart grid – while not explicitly addressing carbon neutrality – all originate from the Province's policy to reduce its carbon footprint and promote a clean energy economy in Ontario.

95. It is a well established, and THESL submits, accepted fact, that the introduction of more environmentally-friendly hybrid/electric vehicles comes at a premium. As with all new technology, premiums are reduced over time as production increases and it becomes easier to accept the environmentally-friendly choice. Early adopters pay a higher premium, making the business case more difficult, but this unavoidable fact is precisely why governments offer incentives to increase the uptake.

96. Making environmentally-friendly choices is the right thing to do and THESL submits that the Board should find that its modest $2 million capital investment is a prudent investment premium to purchase 69 hybrid/electric vehicles rather than the traditional alternative.

3. DEFERRAL AND VARIANCE ACCOUNTS

3.1 IFRS Costs

97. THESL has provided detailed evidence on the total incremental operating costs incurred to the end of 2010 (J1 T1 S2 App A updated with KH1.7) as well as the activities that have resulted in these unavoidable costs (Q1). THESL has recorded

these costs in a deferral account in accordance with the Board's requirements for IFRS costs, and no intervenor has argued that the recording of these costs was inappropriate.

98. On the day of cross-examination of THESL's witness panel on the issue, SEC introduced evidence of the IFRS transition costs of selected other LDC's (KH2.1). This new evidence showed the amounts in account 1508 related to IFRS for five other LDC's and for THESL. SEC and a number of other intervenors have used this table of 5 LDC's to argue that THESL's claim of $6.1M, covering a period of three years, is excessive. THESL takes issue with this evidence for a number of reasons.

99. First, this "evidence" introduced by SEC has not been tested. THESL acknowledges that the information comes from other public proceedings before the Board; however in this hearing, given the nature of how the information was introduced, there was no opportunity for the applicant to seek additional information related to the numbers to understand them better. As Mr. Couillard pointed out (Transcript, Volume 2, Page 34) THESL, and the Board panel in this case, have no idea what has or has not been included in the costs shown. For example, the claim for Enbridge is $3.8M. How much of Enbridge's IFRS costs are covered by its parent? Why is the claim of Waterloo North (50,000 customers) about the same as Hydro Ottawa (300,000 customers)? THESL submits that costs will vary considerably depending on a number of factors including the operational complexity, systems, and processes in use prior to conversion to IFRS. Second, the table has only 5 other LDC's. The list is hardly a comprehensive list.

100. For both of the above reasons, THESL submits that this evidence introduced by SEC provides little or no probative value to the Board.

101. Board Staff has acknowledged that information on IFRS spending by LDC's in the province is incomplete. They have suggested that for this reason, the Board should allow 50% of the requested recovery now, and leave the remainder in the deferral account for determination in a future proceeding. With respect, the Board has in this filing a complete record of what was spent by THESL, and what it was spent on (Exhibit Q). THESL has already detailed in evidence why, because of its unique position, it had to complete additional detailed studies to support the transition to IFRS. These studies were a mandatory requirement of THESL's transition to IFRS, and THESL had no choice but to incur these costs. In addition, this work led to the accounting update, which had the effect of significantly decreasing the revenue requirement impact of this Application – notably the intervenors want the benefit of the revenue requirement reduction but for some reason do not think the work and costs undertaken to achieve it were prudently incurred. Finally THESL notes that the Board itself saw value in hiring Kinectrics to complete a report on the useful lives of distribution systems and to publish that report for the sector as a whole. So it is unclear how the Board could now find, given the evidence, that THESL's costs to produce a similar report for its own system were imprudently incurred. The amounts claimed by THESL have all been audited and supported by this work. The Board has an ample record to determine, and should determine, disposition in this case.

102. A number of intervenors have suggested that costs incurred by THESL associated with gathering information on fixed assets should not be allowed. CCC argues that these costs are not directly related to IFRS. However, THESL has been clear that these cost associated with determining a detailed accounting inventory are caused by the IFRS transition (Transcript, Volume 2, Pages 34-35). The level of accounting detail that was required under previous accounting and regulatory guidelines is not sufficient for the new IFRS accounting guidelines. This was further complicated by the amalgamation that THESL went through in the late

1990's. THESL should not be "punished" for keeping records at a level of detail appropriate for accounting under the reporting regimes of the time.

103. For these reasons, THESL submits that the Board should approve the disposition of the $6.1M in IFRS transition costs as applied for.

3.2 Line Loss Variance Account

104. Pollution Probe is the prime proponent of the removal of the variance account to capture the difference in cost of power between approved and actual loss factors.

105. THESL re-iterates, and Board staff supports, that nothing has changed since the Board's Decision in EB-2007-0680 with respect to the treatment of line losses. The Board said then at Page 61 that it was not "appropriate for the Board to direct a different regulatory treatment for the Applicant than for the sector as a whole." THESL contends this remains the case.

106. The fact is that THESL's approved loss factor is among the lowest in the province (just above 3%, not the 3.9% that Pollution Probe erroneously calculates). The fact that the current variance account does not contain a material dollar amount is irrelevant to the principal of the account. In addition, Mr. Seal has pointed out that the amounts in the account are currently under review (Transcript, Volume 1, Page 171). The account serves to protect the interests of both consumers and the Company when it comes to line losses. Arbitrary removal of this account is not the way to incent continued efforts to reduce losses on the system.

4. SUITE METERING

4.1 Issues 7.2 and 7.3: Suite Metering

107. The Board defined Issues 7.2 and 7.3 as follows:

7.2 Is THESL's suite metering cost allocation study appropriate?

7.3 Are the proposed revenue to cost ratios for each class appropriate?

108. Below, THESL replies to the arguments of the SSMWG.

4.2 SSMWG Abuses the Process

109. The submissions of SSMWG do not challenge or even address the appropriateness of THESL's suite metering cost allocation study. With respect to Issue 7.2, THESL therefore submits that the Board should find that both of the studies submitted by THESL were appropriate and met the requirements of the Board.

110. It is worth noting at the outset that the study originated out of the Board's EB-2009-0139 Decision in THESL's 2010 rate proceeding, where at pages 28-29 the Board states:

> "This is not the first time that this issue has come before the Board. It was first addressed in THESL's last rate case and then in the Powerstream case one year later. In both cases the Board deferred the matter to a generic proceeding. This is now the third time that the matter has arisen in a rate case. For the reasons that follow the Board finds that THESL should undertake a cost allocation study related to its provision of suite metering services. The study shall include an analysis of the implications of creating and maintaining a separate rate class for those customers served in this manner. The Board is of the opinion that the potential for cross-subsidization is ongoing and that there may be merit in the establishment of a separate rate class for multi unit residential customers that are served directly by THESL through its suite metering provision. This should be filed as part of the next cost of service application, which THESL intends to file later this year, but in any event no later than six months from the date of this Decision."

111. The Board panel in that proceeding was expressly concerned with the potential for cross-subsidization with a view to determining whether there is any merit in establishing a separate rate class for multi-unit residential customers. THESL submits, and both VECC and CCC agree, that the evidence on the record in this

proceeding does not justify a departure from the Board's established and well accepted rate-making principles to allow for a new suite metering rate class.

112. At paragraph 22 of their submissions, SSMWG concedes that there is simply is insufficient evidence of a cross-subsidy to justify the additional complexity and costs associated with creating a new Quadlogic rate class.

113. Having found no problems with regard to THESL's cost allocation or the regulatory framework under which THESL supplies suite meters, SSMWG has resiled from its position that either a new rate class be formed on the basis of Quadlogic metering, or that THESL undertake suite metering activities from within an affiliate. Instead, it has embarked on a totally new course and has proposed an untested approach which, in THESL's respectful submissions, (i) does not directly relate to the establishment of 2011 rates or any of the specific issues in this proceeding; (ii) springs from a flawed understanding of the regulatory framework governing economic evaluations and has not been fully and carefully thought through, and (iii) cannot be more fully examined at this late stage of the hearing. For the first time in this proceeding, in its final submissions, SSMWG now proposes that THESL should be required to establish a new, separately operated and regulated business to provide metering 'upgrades'.

114. Although THESL has further submissions specifically with respect to the flaws in SSMWG proposal, THESL objects first of all on purely procedural grounds to SSMWG's abuse of the Board's process in bringing this proposal in argument. SSMWG had ample opportunity to bring evidence in this proceeding, and its proposal, improperly brought at the time of argument, is clearly based on purported facts and assertions which should have been and need to be tested. Furthermore, apart from the dubious facts upon which SSMWG relies, it also reaches conclusions which either depend on fundamental misunderstandings of the existing regulatory framework or attempt to misrepresent the consequences of the existing regulatory framework.

115. In either case, THESL submits the Board should reject the proposal of SSMWG on procedural grounds alone. This is not the appropriate forum for the relief requested by the SSMWG. Even if the Board believes that there is merit in exploring the SSMWG proposal, and THESL submits for the reasons given below that there is not, THESL submits that this should be done by way of generic proceeding. THESL would welcome the opportunity to participate in such a generic proceeding, where all of the issues relating to the novel SSMWG proposal, including the merits of the proposal, the implications of the proposal for the existing regulatory framework, and the actual competitiveness of the SSMWG market (the latter of which was questioned in evidence in this proceeding (Transcript, Volume 1, Pages 75-77)) can be more fully assessed by the parties and the Board. Finally, at a generic proceeding, the Board could also consider issues arising from the fact that the rates charged by SSMWG member companies to their customers are not currently subject to Board scrutiny, and therefore these customers constitute a group of Ontario electricity consumers with no regulatory protection with respect to whether or not they are paying just and reasonable rates.

4.3 Is There an Undue Cross-Subsidy?

116. SSMWG attempts to make much of the fact that the second cost allocation study showed that, when considering the Quadlogic-metered customers only, the revenue/cost ratio is 0.95. SSMWG conveniently ignores the fact that this revenue/cost ratio is in fact higher than that for the residential class as a whole, which is 0.86. Therefore, if there is an undue cross-subsidy problem, and THESL denies that there is, it is more of a problem outside of the Quadlogic-metered subgroup. But in fact both figures are well within the Board's accepted ranges.

117. SSMWG attempts to argue at paragraphs 13 and 14 that if anything, the Quadlogic-metered revenue/cost ratio will worsen. This argument is based on incorrect facts and ungrounded speculation. First, SSMWG argues that as the proportion of Quadlogic-metered buildings increases, the use of secondary assets

will increase. However, there is nothing to suggest that the proportion will increase. The higher use of secondary assets in the first MURB group was related to existing, small buildings such as eight-plexes on residential streets which are unlikely ever to require Quadlogic metering. As to larger retrofit buildings, there is no evidence to suggest, as SSMWG does, that these will occupy a larger proportion of Quadlogic installations than they do now; if anything, the opposite would prevail since new high-rise condominiums typically do require Quadlogic metering while not all retrofit buildings do. Whereas new buildings are required to install unit metering, not all existing MURBs will be retrofitted since there is no requirement for them to be and it is not economical in many circumstances.

118. SSMWG goes on to suggest that THESL incurs secondary wiring costs downstream of the bulk meter, and that such wiring means that the allocation of secondary asset costs should increase. Of all parties, SSMWG should know that this is false and that in-building wiring is supplied by the building owner, not THESL.

119. Finally, SSMWG dismisses as ‘speculation’ the fact that THESL has made arrangements to reduce the costs of Quadlogic meter reading by bringing that function in house. This is an outright mischaracterization of the evidence (see tr. 57, lines 4-25) and the Board should disregard it totally.

120. In summary, the evidence clearly shows that the revenue/cost ratio for Quadlogic customers is closer to unity than for residential customers overall; that this revenue/cost ratio is well within guidelines; and that there is no reason to believe that it will deteriorate but rather good reason to believe it will improve.

121. Otherwise SSMWG relies on the argument that any degree of cross-subsidy in areas where a contestable market exists is intolerable. At paragraph 16 it goes on, in a manner which truly is speculative, to state that any such cross-subsidization could result in the competitive market being ‘effectively ruined’.

122. Again however, SSMWG relies on bald assertions which are unsupported by any evidence. In fact, there is no evidence of any predatory activity on the part of THESL or of any damage to the competitive market as a result of THESL's existing offerings; instead, SSMWG implies that the mere existence of THESL in the market, offering services at rates and terms directly regulated by the Board, is itself directly injurious. THESL submits that this is simply unsupported.

123. The facts are that THESL's 'competitive position' is highly constrained, contrary to the representations of SSMWG. THESL witnesses confirmed (tr. 34, lines 6 – 36) that THESL offerings are strictly pursuant to, and in some cases required by code; that rates are strictly pursuant to THESL's Board-approved tariff; and that no distinction or discrimination exists in THESL's treatment of standard residential customers compared to MURB customers. THESL cannot offer inducements to developers for the right to obtain monopoly access to captive customers in a condominium building, and it cannot bundle its rates to effect the re-sale of electricity without a retailer licence.

124. In fact, if the Board were to accept the argument of SSMWG in this regard, which it should not, the Board would be faced with a major policy decision: either to bring all residential customers abruptly to a revenue/cost ratio of unity; or to discriminate the setting of the appropriate revenue/cost ratio as between residential customers in houses and residential customers in MURBs, all in order to meet the wishes of a narrowly self-interested group of profit-maximizing companies. THESL repeats that the costs of doing so would actually be borne by residential customers.

125. THESL customers owe no duty to the SSMWG. No harm has been demonstrated by SSMWG. Therefore the Board should not veer from the course it has set over the last several rate cases by establishing a separate rate class for Quadlogic customers (a recommendation from which even SSMWG has withdrawn), much less by discriminating the revenue/cost ratio for such a class. The Board should

instead stay the course and allow THESL to bring the revenue/cost ratio for the residential class, as a whole, closer to unity in a gradual and orderly fashion.

4.4 Is the Economic Evaluation Procedure Flawed?

126. SSMWG complains at paragraph 18 that THESL improperly, and 'without prior approval from the Board', skews its economic evaluation procedure to the disadvantage of SSMWG by not including the costs of suite meters in the calculation of any capital contribution that may be due from developers of a new MURB.

127. Again this assertion is groundless and should be dismissed. THESL's economic evaluation procedures follow from, and are completely consistent with, the Distribution System Code, which of course is the 'prior approval' in this case. The relevant principle under the DSC is that the (present values of the) incremental connection and expansion costs of a given project are compared to the revenues generated: if there is a shortfall of revenues, a capital contribution is required.

128. THESL must treat each project according to the customer and rate class to which the project will belong. If a MURB is only bulk metered by THESL, and if it contains more than 6 dwellings, it is by the terms of THESL's approved tariff a general service customer subject to general service rates. Such projects are properly credited with the revenues they are forecast to generate; THESL cannot attribute to the project greater revenues than it will receive by misapplying residential rates to a general service customer. If SSMWG wants different rates to be applied to such projects, it will have to make the case that a new rate class should be defined and applied in those cases. THESL submits that this would be unwarranted.

129. In cases where a MURB project is suite metered by THESL, each unit is a distinct residential customer of THESL and residential rates are properly applied to the calculation of the capital contribution for the project, because those are the rates that underpin the revenue that will actually be received by THESL.

130. Furthermore, despite the wishes of SSMWG, it would be totally improper of THESL to charge the developer for the cost of the suite meters because those metering costs are already included in the residential rates that will be paid by occupants. Therefore the occupants would pay twice; once in the price of the unit and again in ongoing distribution rates.

131. SSMWG attempts to trade on the fact that for condominium projects there is necessarily a transition between the initial customer (the developer, which is not an ongoing consumer) and the ultimate consumers. SSMWG asks that THESL treat the project as a commercial project only when that is advantageous for SSMWG, and as a residential project again only when that is advantageous to SSMWG. Clearly though, one project cannot be both residential and commercial. The fact that condominium developments are structured as they are with a transition between a single commercial customer and multiple residential customers is simply an issue that the SSMWG will have to deal with; neither the OEB nor THESL can or should do anything about that.

4.5 SSMWG's Proposed Solution Is Not a Solution.

132. SSMWG proposes that the business of providing Quadlogic metering should (somehow) be separated from THESL's distribution business, and that the calculation of capital contributions be modified so as to reflect only the costs and revenues pertaining to a bulk-metered, general service installation. All costs and revenues associated with the 'downstream' installation of suite meters would be undertaken by a separate Quadlogic meter business unit, which allegedly would compete on a level playing field with SSMWG members.

133. With respect, THESL submits that this solution is nonsensical and clearly has unacceptable implications that SSMWG either wishes to suppress, or of which it is simply ignorant.

134. First and foremost, and despite SSMWG's protestations that it wishes to avoid "the complexity and additional costs of developing a new residential rate subclass or developing a rate adder based upon the additional costs of installing, maintaining and reading Quadlogic meters", the SSMWG 'solution' absolutely would necessitate the development of a full new customer class and demand intricate separations of costs and revenues.

135. In the case of a new condominium building for example, the 'solution' would require THESL to calculate the capital contribution for the developer based on general service revenues that would not, in fact, ever be received by THESL, apart from a brief period prior to declaration of the building. Consequently, with essentially no revenue to offset the costs of connection and expansion, the developer would necessarily face a capital contribution virtually equal to the entire present value of the costs. Since the developer would not bear those costs except in the first instance, the ultimate result of the SSMWG proposal would be that customers would bear the entire capital cost of the new connection, through higher prices for units than would otherwise prevail. This would represent a complete and unwarranted departure from current practice.

136. Furthermore, without the development of a new rate class, THESL would instead receive from actual consumers (and not from the developer as a customer) revenues based on the existing residential rates. However, those rates would be based on assumptions and cost allocation rules underpinning service to standard residential customers, and would not reflect the fact of the excessive capital contribution already embedded in the costs of the condominium units. As a result, consumers in the condominium would be double-paying for service: once through the price of their units, and again through ongoing distribution rates.

137. If in the alternative a new rate class were to be developed based on the premises suggested by SSMWG (which is an outcome it specifically rejects), then an intricate and ongoing separation of costs would be necessary to disentangle the costs already covered by the excessive capital contribution from the balance of the costs of service. Ironically, this could easily lead to a situation in which the apparent cost of suite metering, and the associated rates, would be markedly lower than residential rates now, which in turn would of course lead to cries of protest from SSMWG.

138. THESL re-iterates its submission that this proceeding is not the appropriate forum for the relief requested by the SSMWG. It is internally inconsistent and would lead to outcomes that would be highly discriminatory and disadvantageous for MURB consumers, all for the sake of advancing the narrow commercial interests of SSMWG. Even if the Board believes that there is merit in exploring the SSMWG proposal further, with evidence adduced on this issue, THESL submits that this should be done by way of generic proceeding. Given the evidence of no cross-subsidy, it is no longer appropriate to continue to burden THESL's future rate proceedings with this issue any further.

139. The Board should therefore reject the 'solution' proposed by SSMWG.

5. COST ALLOCATION

5.1 Cost Allocation – Treatment of Transformer Allowance

140. The treatment of Transformer Allowance – credits provided to large customers who own their own transformation equipment – in the Board's Cost Allocation Model became an issue in this case.

141. Since the first implementation of the Board's Cost Allocation Model in the rate setting process (EB-2007-0680) THESL recognized a shortcoming in the Board's model with respect to Transformer Allowance. THESL made a correction for this

shortcoming – namely to ensure that only those classes who received the credit were allocated the costs of the credit – then, and has continued to do so. THESL believes this is the appropriate treatment in allocating these costs, and in fact, none of the intervenors have argued against this. Instead, the issue is the treatment of these "costs" in the revenue side of the Revenue to Cost ratios.

142. THESL agrees that the Board's current Cost Allocation Model likely does not allocate the revenue portion of the Transformer Allowance correctly for the development of the before-rate-design Revenue to Cost Ratios. THESL understands that the forthcoming refinements of the model developed as part of the EB -2010-0219 Report of the Board on Review of Electricity Distribution Cost Allocation Policy will clarify and improve this portion of the model. However, as stated on the stand and in Argument-in-Chief, THESL maintains that for developing the final rates, the "starting point" Revenue to Cost ratios do not matter; they are merely indicative. The final Revenue to Cost ratios, and hence rates, approved by the Board resulting in the recovery of the proper amount of costs from each class – including the Transformer Allowance – are what matter. And, as noted previously, no one is arguing that the cost of the Transformer Allowance credit should not be recovered from those specific classes receiving the credit.

143. VECC has argued that the application of THESL's methodology would not result in THESL recovering the overall proposed revenue requirement (VECC argument, paragraph 22 and following table). With respect, THESL maintains that it does. What VECC's table left out of the analysis was precisely the Transformer Allowance costs. VECC's table is partially reproduced below, showing that with the proposed Revenue to Cost Ratios, the full revenue requirement is in fact recovered, and further that only those classes getting the Transformer Allowance are paying for it.

Applying THESL's proposed R/C ratios to the Allocated Costs

	Col. 1 **THESL Proposed R/C Ratios**	Col. 2 **Start VECC Allocated Costs**	Col. 3 **Add Transformer Allowance Cost**	Col. 4 **Total VECC Starting Point Costs incl TOA**	Col. 5 **Allocated Rev Req incl Transformer Allowance**
Residential	92.0%	283,552,075	0	283,552,075	260,867,909
GS<50	100.0%	81,174,882	0	81,174,882	81,174,882
GS 50-999	114.6%	145,827,158	3,043,988	148,871,146	170,606,333
GS 1000-4999	111.0%	41,071,789	5,340,608	46,412,397	51,517,761
LU	104.0%	21,672,238	3,095,246	24,767,484	25,758,183
SL	77.8%	19,649,760	0	19,649,760	15,281,618
USL	86.1%	5,218,423	0	5,218,423	4,493,062
Total		**598,166,325**	**11,479,842**	**609,646,167**	**609,699,749**

Source:
Col. 1 - Exhibit L1, Tab 1, Sched 1, page 3 and Table in VECC Argument
Col. 2 - Exhibit R1, Tab 11, Sched 38, App B and Table in VECC Argument
Col. 3 - Exhibit L1, Tab 2, Sched 1, page 19
Col. 4 - Sum of Col. 2 and Col. 3
Col. 5 - Product of Col. 1 and Col. 4

Note: Difference in totals for Col. 4 and Col. 5 is due to rounding of proposed R/C ratios

144. THESL submits this is the correct treatment of Transformer Allowance costs and the application of the proposed Revenue to Cost ratios. Even in VECC's table in their argument, the allocated revenue to the classes not getting the Transformer Allowance is the same as proposed by THESL. This further demonstrates that THESL's proposed treatment is correct and consistent with proper allocation of costs.

5.2 Cost Allocation – Revenue to Cost Ratios

145. THESL has explained in its evidence its proposed gradual move towards unity for the Revenue to Cost ratios for each of the rate classes (M1 T1 S1 p4). THESL believes this is fair to all customers; both those paying less than the full costs to serve and those who have been paying more for years. VECC, in their argument, has suggested a number of reasons why this continued, measured, move toward unity is inappropriate.

146. In THESL's respectful opinion, none of these arguments is sufficient to warrant denying the small incremental change in the Revenue to Cost ratios sought by the Company to address the inequities of costs recovered by the different rate classes.

147. From a revenue recovery perspective, THESL is indifferent as between various outcomes for revenue to cost ratios since it will design the rates to collect the full approved revenue requirement and the amounts ultimately approved by the Board for each rate class. From a rate perspective, this really is an issue between intervenors.

148. However THESL believes it is being responsible to all customers in its proposal. THESL agrees with VECC that a consistent Board policy is desirable, and that this policy needs to reflect fairness to all customers. THESL's proposal accomplishes this.

D. CONCLUSIONS

149. For all of the foregoing reasons, THESL requests that the OEB approve its proposed 2011 Electricity Distribution Rates and other charges, together with the specific items of relief requested in the Application.

All of which is respectfully submitted this 2nd day of May, 2011.

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J. Mark Rodger

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John A.D. Vellone

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