

IN THE MATTER OF applications pursuant to Sections 60(1), 86(1)(a), 86(1)(b), 86(1)(c) and 18(2) of the *Ontario Energy Board Act, 1998* by Toronto Hydro-Electric System Limited (“THESL”), Toronto Hydro Energy Services Inc. (“THESI”), and 1798594 Ontario Inc. (“NewCo”) (collectively, the “Applicants”) seeking a declaration by the Board that street and expressway lighting assets in the City of Toronto are deemed to be a distribution system and orders to facilitate the transfer of the street and expressway lighting assets to a newly amalgamated distribution company consisting of THESL and NewCo;

AND IN THE MATTER OF additional evidence filed by the Applicants pursuant to a Decision and Order of the Ontario Energy Board (the “Board”) dated February 11, 2010.

**ARGUMENT-IN-CHIEF
OF TORONTO HYDRO-ELECTRIC SYSTEM LIMITED,
TORONTO HYDRO ENERGY SERVICES INC., AND
1798594 ONTARIO INC.**

June 3, 2011

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DELIVERED JUNE 3, 2011

A. INTRODUCTION

1. On June 15, 2009, Toronto Hydro-Electric System Limited (“THESL”), Toronto Hydro Energy Services Inc. (“THESI”), and 1798594 Ontario Inc. (“NewCo”) (collectively, the “Applicants”) filed applications (the “Initial Applications”) with the Ontario Energy Board (the “Board”) seeking a declaration by the Board that the street and expressway lighting assets in the City of Toronto (the “SEL System”) are deemed to be a distribution system and seeking orders to facilitate the transfer of the street and expressway lighting assets to a newly amalgamated distribution company consisting of THESL and NewCo (“NewTHESL”).
2. On February 11, 2010, the Board issued its Decision and Order (the “Decision”) approving the transfer of a subset of the streetlighting system assets which met the Board’s definition of distribution assets, but such approval was conditional on the

Applicants filing additional evidence within 90 days of the Decision providing an asset valuation and setting out the revised transaction details.

3. On March 4, 2010, THESL requested, and was granted by the Board, an extension to the time allowed for the filing of the additional evidence to January 31, 2011. In response to the Decision, the Applicants undertook two comprehensive but inter-related studies. The first is an exhaustive enumeration of all streetlighting assets on public property within the City of Toronto which was conducted in order to develop an inventory of those assets and to create a database including, for each of the identified assets, further characteristics necessary for the purpose of classifying those assets as transferable or non-transferable according to the terms of the Decision (the “Inventory Study”). The Inventory Study findings were then used as an input to a second study (the “Valuation Study”) conducted to establish a valuation for the assets, in all the categories required by the Decision, by means of the Depreciated Replacement Cost (“DRC”) methodology.
4. On January 31, 2011, the Applicants filed with the Board the additional evidence required from the Decision (the “Additional Evidence”). The Additional Evidence comprised of a description of the studies and processes for enumerating and categorizing the streetlighting system assets; an asset valuation for the total streetlighting system; an asset valuation for those categories of assets which the Board has determined are distribution assets; an asset valuation for those categories of assets which the Board has determined are not distribution assets; and a statement of the revised transaction amounts for which approval is sought hereby.

B. RELIEF REQUESTED

5. The Applicants continue to rely generally on the substance of and relief sought through the Initial Applications, as modified herein to give effect to the Decision. Specifically, the Applicants seek:

- (a) a finding by the Board that the assets described herein as distribution assets in accordance with the Decision are eligible for transfer to NewTHESL by the substantially the same means and structure of transactions (but with revised amounts) as set out in the Initial Applications and as conditionally approved in the Decision;
 - (b) a finding by the Board that \$29.418 million represents an appropriate amount to attribute to ratebase as a result of the transfer; and
 - (c) a finding by the Board that the ratebase, revenue requirement, and rate consequences of the transfer will be determined in the context of THESL's next cost of service application for 2012 rates.
6. THESL does not seek recovery through rates of the costs of the studies required by the Decision.

C. PROCEDURAL MATTERS

7. On February 18, 2011, the Board issued Procedural Order No. 4 allowing for the filing of written interrogatories on the Additional Evidence and on March 23, 2011, THESL filed its responses to the written interrogatories received from Board staff, School Energy Coalition ("SEC"), and the Electrical Contractors Association of Ontario and the Greater Toronto Electrical Contractors Association ("ECAO-GTECA").
8. On April 6, 2011, the Board issued Procedural Order No. 5. While the Board accepted THESL's evidence that it does not have the depreciated replacement cost ("DRC") information on its distribution assets, the Board viewed the production of such information as warranted and so ordered the Applicants to file additional evidence in response to Board Staff interrogatory 4.1 on or before April 27, 2011.

9. On April 13, 2011, in response to Procedural Order No. 5, THESL filed a letter with the Board stating that it could not provide a DRC analysis of its distribution assets in the time provided. On April 21, 2011, the Board issued Procedural Order No. 6 requiring THESL to provide an update on its efforts on or before May 10, 2011.
10. On May 6, 2011, THESL filed a letter with the Board stating that despite best efforts, THESL was unable to provide the information requested by the Board because the data required to perform the analysis required by the Board is not available and that the costs and timeframe required to collect the required data would be substantial. THESL noted that its effort to collect similar data on its streetlighting system last year cost over \$1 million and took approximately 8 months to complete. On May 24, 2011, the Board issued Procedural Order No. 7 finding that, in consideration of THESL's letter, it will not require that any further evidence be filed and providing for written submissions in this matter.

D. THE DECISION AND THE ADDITIONAL EVIDENCE

1. The Inventory Study and the Categorization of Assets

11. To appropriately implement the Decision, the Applicants conducted an exhaustive Inventory Study of the SEL assets across the City of Toronto. The study was completed by a specially trained team of surveyors that were equipped with customized handheld devices and software to gather the necessary information. The data was then validated using field visits, input logic checks, GIS map inspection and field audits.
12. The Board in its Decision approved the transfer of the distribution assets specifically identified in the Decision and did not approve the transfer of any other assets (Decision at pg. 20). The Applicants submit that they have appropriately identified and categorized the SEL assets in accordance with the terms of the Decision. Specifically:

- (a) The Applicants categorized as streetlighting assets: all luminaires, brackets, conductors on or within brackets, streetlighting-only poles in residential (non-mixed use) areas served by an underground system together with conductors within those poles, and streetlight relays (Additional Evidence at pg. 7).
 - (b) The Applicants categorized as distribution assets: streetlighting poles in overhead supply or mixed use areas, together with any associated pole foundations, conductors used to supply streetlights exclusive of conductor running up non-distribution streetlight poles and along or within brackets, and handwells containing connections to streetlighting circuits (Additional Evidence at pgs. 11-12).
 - (c) The Applicants categorized as distribution assets: all eligible streetlight assets in mixed use areas (such as poles, but excluding luminaires and brackets) on Collector and Arterial Roads defined in the Toronto Road Classification System on the basis that these assets objectively meet the Board's "intended use" test because Collector and Arterial Roads have existing and future bus shelters, traffic signals and pedestrian crossings which presently do or will require connection to the distribution system (Additional Evidence at pgs. 12-13).
13. In its Decision, the Board also indicated that it was unable, on the evidence before it, to determine the proper classification for the expressway lighting. The Applicants' submit that they wish to withdraw their request that these assets be transferred on the basis that they do not fall within the criteria established by the Board in the Decision for distribution assets (Additional Evidence at pg. 11).
14. The results of the Inventory Study and the categorization of the SEL assets are shown in Table 2 at page 14 of the Additional Evidence.

2. The Asset Valuation

15. In its Decision, the Board ruled that its approval was conditional on the Applicants filing additional evidence setting out the revised transactions and including an asset valuation. The asset valuation was to include: (i) an asset valuation for the total SEL System; (ii) an asset valuation for those categories of assets which the Board has determined are distribution assets; and (iii) an asset valuation for those categories of assets which the Board has determined are not distribution assets.
16. Since a conventional historic-cost valuation of the assets in question was not and could not be made available, THESL commissioned a physical valuation study to be conducted by a well respected third party valuator - ValuQuest - which, after surveying the alternative valuation approaches available, conducted a valuation of the SEL assets using the Depreciated Replacement Cost methodology. The Asset Valuation is included at Appendix B of the Additional Evidence.
17. The Applicants submit that the DRC methodology yields a result that meets the Board's requirement for an asset valuation. It is cost-based and is not dependent on an assumed revenue stream derived from the assets to determine their value. Furthermore it closely approximates the value represented by the assets in their current, partially depreciated condition and is not simply a replacement cost analysis.
18. THESL submits that the Board should accept the Asset Valuation together with the Inventory Study as sufficient to meet the additional evidence requirements in the Decision.

3. The Appropriate Value to Attribute to Ratebase

19. While it is generally accepted that the Board does not have the authority to approve or change the actual consideration paid in an asset transfer transaction, the Board has the authority to set the appropriate ratebase for the transferred assets. In this regard, the

Board has consistently relied upon a cost standard over a value standard as the appropriate methodology to ascribe asset value to ratebase. In the past, when a utility has paid more than the net book value for particular assets, the Board has disallowed the premium paid over the net book value from inclusion in ratebase.

20. The ValuQuest Report found a total DRC value of the SEL assets of \$99.141 million. Of this, the DRC value attributable to the SEL assets that have been categorized as distribution assets is approximately \$45.976 million.
21. THESL acknowledges that the DRC methodology is not a perfect proxy for continuous historical cost information that normally underlies recognized asset values for the purpose of rate setting. A significant conceptual difference between these two approaches is that the DRC method adopts (as it must) the current replacement cost as the basis for the calculation, whereas historical cost accounting naturally reflects a lower nominal historical acquisition cost since that is built up over time as equipment is acquired, and partially reflects lower nominal acquisition costs prevailing several decades ago without the effect of intervening inflation. Offsetting this effect is the fact that the DRC methodology assigns a value for accumulated depreciation that is based on the current replacement cost of the subject assets multiplied by the fraction of their total expected lives which has already accumulated. Therefore, the nominal amount of accumulated depreciation under the DRC is correspondingly greater than the accumulated depreciation which would prevail under the historic cost approach.
22. In the absence of perfect historic information, THESL submits that the DRC results show that a 'physical', cost-based valuation of the assets in fact exceeds the current carrying value of the assets on the books of the Applicants. In the Additional Evidence, THESL explained that the aggregate SEL asset net book value at 2010 year end is \$63.453 million (unaudited), approximately \$35.688 million less than the DRC value of \$99.141 million. However, both accounting and regulatory practice preclude a 'write-up' of the assets. From an accounting perspective, an existing owner cannot write-up the value of assets on its books despite the fact that the market or realizable value of those assets

might exceed the book value. From a regulatory perspective, similar reasoning applies: ratebase is not calculated based on the fair market value of the assets in question. As a result, given the outcome of the DRC valuation, the question of whether that should underpin the ratebase value of the transferred assets is moot since that would not be acceptable under either accounting or regulatory guidelines.

23. In the converse, had the DRC valuation arrived at a result lower than the current carrying value, the Applicant would be obliged to write-down the value of the assets and the reduced value would represent the ceiling value that could be recognized in ratebase.
24. In summary, the ratebase value of the transferred assets is constrained to be the lower of the current carrying value (which, apart from the relatively minor effects of intervening depreciation and asset acquisition represents the price actually paid for the assets by the Applicant) and the realizable value.
25. THESL submits that in the absence of perfect historic information, and given that the DRC valuation has found that the fair market value of the assets substantially exceeds their current carrying value, the current net book value represents a fair value of those assets for inclusion in ratebase.
26. Despite the fact that the assets cannot be written up to the fair market value, the ValuQuest Report together with the Applicants' classification of the assets into the streetlighting and distribution categories can be used to determine the proportions of the total current NBV represented by the transferrable assets along with the streetlighting assets. By applying the percentage of total SEL assets eligible for transfer (46.362%) to the 2010 year end net book value of the total SEL assets (\$63.453 million), \$29.418 million is proposed for inclusion in ratebase in consideration of the transfer of distribution assets. This is \$16.558 million less than the valuation of the transferred assets using the DRC methodology, a reduction in ratebase which THESL submits is fair to all parties. THESL submits that the Board should accept THESL's proposal for inclusion of \$29.418 million in ratebase for the transferred distribution assets.

4. The “No Harm” Test

27. In its Decision at Page 20, the Board concluded that the transfer of distribution assets (as specified in the Decision) from THESI to NewCo meets the “no harm” test because: (i) there will be appropriate ownership of distribution assets; (ii) there will be enhanced clarity and efficiency from a clear and enduring demarcation between regulated distribution assets and unregulated customer load assets; (iii) any rate impacts on the Streetlighting or USL class are expected to be small and can be mitigated if appropriate; and (iv) longer term rate impacts are not expected to be significant because of the potential for greater efficiencies and the ongoing attention given to proper cost allocation. THESL submits that nothing has changed since the original Decision was made, and that all of these factors continue to support a finding that the proposed transfer meets the “no harm” test.

E. CONCLUSIONS

28. For all of the foregoing reasons, the Applicants request that the Board accept the Additional Evidence as provided by THESL and grant the orders and approvals as requested in the Initial Application, with the necessary modifications arising from the Additional Evidence, together with the other relief as requested herein.

All of which is respectfully submitted this 3rd day of June, 2011.

*Original signed by John A.D. Vellone for J.
Mark Rodger*

J. Mark Rodger

Original signed by John A.D. Vellone

John A.D. Vellone

Counsel to the Applicants.