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BY RESS and EMAIL

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Our File No. 20090180

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2009-0180/1/2/3 – Toronto Streetlighting – SEC Submissions

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #8 in this proceeding, these are SEC's submissions with respect to the valuation of the streetlighting assets.

Introduction

1) In June 2009 the Applicant and two of its affiliates sought approval of a series of related transactions designed to transfer to the regulated utility certain assets that had previously been used as unregulated street and expressway lighting assets. In a Decision dated February 11, 2010, the Board approved the transfer of only part of the streetlighting assets, subject to the filing of additional evidence that, among other things, would go to the specification/allocation, and valuation, of those assets. That additional evidence was eventually filed almost a full year later, on January 31, 2011.

2) In this subsequent phase of the proceeding, the Applicant is now seeking approval from the Board for its designation of the assets to be transferred and the value of those assets for rate base purposes. The Applicant also seeks an order deferring consideration of all rate base, revenue requirement and ratemaking implications with respect to those assets until their 2012 rate application, which they propose will be a cost of service application.

3) These are the submissions of the School Energy Coalition in this phase of the proceeding. In summary, SEC's positions are as follows:

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a) The onus was on the Applicant throughout. The Applicant has failed to provide suitable responses to a number of interrogatories, and the evidence presented lacks sufficient information for the Board to make determinations with respect to value and selection of qualifying assets. Therefore, the Board should not grant the approvals requested at the valuation proposed. SEC proposes instead an alternative approach.

b) The proposed methodology for dividing assets between those that can be transferred, and those that cannot, is fatally flawed, in that arterial and collector roads cannot reasonably be used as a proxy for compliance with the Board's conditions in the February Decision. SEC proposes a different asset allocation, which can be implemented based largely on the existing evidence.

c) The request to have ratemaking and other implications deferred to the 2012 cost of service proceeding presupposes that the Applicant will be allowed by the Board to have rates for 2012 set on a cost of service basis. This has not yet been determined by the Board, the Applicant is not scheduled for cost of service in 2012, and many parties oppose granting them an exception. Therefore, if the Board makes a determination with respect to the assets and their value, it is submitted that the Board should defer the rate base, revenue requirement, and ratemaking issues until the Applicant's next cost of service proceeding, and should make clear that the Board is not suggesting or implying the need for cost of service in 2012.

Failure to Provide Information

4) The entire purpose of this second phase of the proceeding was to allow the Applicant to file additional evidence with respect to what specific assets would qualify as distribution assets under the terms of the February Decision, and their value. On the surface, it appeared that it would be largely mechanistic, since the Board had already set out the principles to be followed. The Applicant took almost a year to prepare that evidence, but still failed to file a complete record. Further, when through interrogatories or Board orders the Board and the parties sought to obtain additional evidence, so that there would be a complete record, the Applicant has fairly consistently declined to provide that additional information.

5) The most obvious example of this is the Applicant's refusal to provide the information ordered in PO #5. As the Board pointed out in PO#5, the Applicant did not file information on the actual depreciated cost of the assets in question, or information on the depreciated cost of comparable assets so that an estimate could be made, but instead proposed to rely on a valuation approach that is essentially identical to the approach the Board rejected in the February Decision.

6) The Applicant's response, in their letter of April 13th, was that they could produce the data, but that they did not know how long it would take, and would have to file it with many caveats. The Board's response, in PO#6, was to accept that there might be caveats, and ask for a date when the information would be available. The Applicant's further response, on May 6th, was that the cost would be very high, and the work would take several months. No proposal was made by the Applicant for alternate information to deal with the underlying question.

7) If this were the only example of the Applicant's limited provision of information, it could perhaps be viewed as an anomaly, or as the unfortunate result of the specific circumstances. The Board has withdrawn its order to produce this information, and must simply assess the Application on the information at hand.

8) Unfortunately, this is one of a number of examples. There are at least the following additional examples (out of a total of fourteen interrogatories):

a) SEC IR #2. SEC asked the percentage of arterial and collector roads by length that have bus routes, a key fact if the Applicant's asset allocation methodology is to be assessed. The Applicant advised that 90% of arterial and 39% of collector roads, by number, have bus routes, but did not have any information on this fact by length, which would of course be the key criterion if streetlighting poles are being allocated.

b) SEC IR #3. It appeared to SEC that NBV was consistently assumed to be 64% of FMV. We asked if that was true, and to provide the justification for the assumption. The answer does not answer the question of whether the assumption was made, and the "explanation" does not appear to respond to the question.

c) SEC IR #5. The Applicant was asked to confirm that the minimum NBV of every asset was assumed to be 6.4% of replacement cost. The Applicant advised that they didn't understand the question, but made no attempt to contact SEC to have it clarified. They then proceeded to refer to the relevant valuation information, but did not explain, justify, or even confirm the conclusion that is plain from their tables of value.

d) SEC IR#7. SEC used the filed evidence to derive NBV allocated to distribution for concrete poles. This is a figure that the Applicant would have to know in order to complete the transaction and do the resulting accounting entries. However, the Applicant declined to say if the figures quoted agreed with their figures, apparently because SEC did not show how its figures were calculated. Since SEC did not ask the Applicant to review our calculations, but only to advise whether the resulting number is right, the answer is non-responsive and unhelpful. This is especially problematic since the number for which confirmation was being requested is clearly one the Applicant would have to know. Even at this stage of the proceeding, the Board still does not know the NBV of the concrete poles that the Applicant is seeking to add to rate base, despite the fact that it is likely to be around half of the total valuation.

e) ECAO #1 and #2. ECAO sought to determine the relative numbers of poles on arterial and collector roads that have distribution attachments. The Applicant responded that it had done a count, which resulted in 8,178 poles on arterial streets, and 1,704 poles on collector streets, having distribution attachments. No analysis was provided, whether by way of ratio of poles on those streets, comparison of results to claimed numbers, types of poles and costs, etc. Only the minimum amount of information was given, and most of the components of the ECAO questions were simply unanswered.

f) ECAO #3. ECAO asked what analysis the Applicant had done supporting its arterial/collector methodology. The answer is non-responsive to the question.

g) Staff #1. Staff followed up on specific comments in the February Decision by asking about rate impacts. The response essentially says that the Applicant doesn't yet have that information, and then speaks only in generalities.

h) Staff #3. Staff asked what process the Applicant proposed to consider the rate implications in 2012. The Applicant responded with a reference to its intent to "defer for disposition in its 2012 rate case" costs in 2011 and the first four months of 2012. However, the Application does not seek approval for a deferral account.

9) In addition, we note that not only did the Applicant fail to provide the information requested in Staff #4 (the subject of P) #5), but they also failed to make any attempt to deal with the underlying premise of the question, i.e. that depreciated replacement cost generally is higher than historical acquisition cost.

10) SEC has used its best efforts to assess the valuation information, even assuming that the assets allocated to distribution are correct (which seems questionable – see below), but we are unable to find any basis on which to agree with the Applicant's proposal. Whether it is correct or not is, in our view, impossible to determine based on the evidence filed. On that evidence it is in fact more likely to be wrong than right.

11) At the root of our concern is the fact that the Applicant has made no attempt to determine – directly or by proxy – the historic cost and resulting book value of the assets in question. While the Applicant says [AIC p. 6] that the DRC methodology used is "cost-based", that is in fact a bit of an equivocation. A "cost-based" valuation would be based on the cost of those actual assets, not the fictional cost of some other assets that would hypothetically be used to replace those assets. There does not appear to be any credible argument offered or available that the replacement cost of old assets, no matter how adjusted, can be used as a proxy for the historic cost of those assets.

12) Further, it appears to us that the Applicant has made insufficient efforts to actually find out the real historical cost of those assets, based on when they were first purchased. This is one of those things where the common sense response is "someone must know this".

13) This uncertainty is what prompted SEC to ask questions like SEC #3 and SEC #5. If the Applicant is, as it appears, using shortcuts to calculate the relationship between book value and fair market value, and is specifying that every asset has a minimum value relative to replacement cost, no matter how old or decrepit it may be, this is a concern. The Applicant's failure to provide the Board and parties with an informative response to those questions, and others, exacerbates the problem.

14) On the face of it, estimating the value of the affected assets seems like an eminently tractable problem. Can it be done with precision? Probably not, but certainly one would expect the Applicant to be able to offer a book value valuation, within say a 10% or 15% error band, that can form the basis for the Board's decision. In this case, it is submitted that the Board cannot have any confidence that the affected assets have a book value of $30 million, or $15 million, or $5 million.

15) It is therefore SEC's submission that the Applicant has not come close to discharging its onus to support a transfer value.

16) This leaves the Board, it is submitted, with three alternatives:

    a) Reject the Application for lack of evidence.

    b) Decline to make a determination, but adjourn sine die, with leave to the Applicant to bring it forward once more once it has appropriate evidence.

    c) Allow the Application for transfer of assets, but at a value of $1.

17) While either (a) or (b) above is probably a reasonable answer, SEC does not believe that either should be implemented. Rejecting the Application would be justified, but would on the surface be inconsistent with the February Decision, and therefore not optimal. Adjourning sine die appears to provide complete procedural fairness, but continues a proceeding indefinitely into the future that has already probably had more procedural attention than should have been necessary.

18) SEC therefore proposes that the Board approve the transfer of assets (subject to the determination of the appropriate assets) at a value of $1. At least initially, this seems like a pretty tough decision, but in our submission it is an appropriate balancing of interests and evidence. This is particularly true

since the primary value to the Toronto Hydro companies of making the assets regulated assets is the ability to include the operating costs associated with these assets in rates, and to include new qualifying assets in rate base. The actual value of depreciating, and earning a return, on what is likely not more than $5 - $10 million of assets is not very material for a utility the size of the Applicant.

19) In this regard, we note that 79% of the poles are concrete poles [App. F of Valuation], and 39% of those concrete poles are more than 50 years old [App. G of Valuation]. These are are ascribed values in the evidence, but clearly can have no remaining book value given that the Applicant depreciates no poles on a period longer than 40 years [EB-2010-0142, Ex. B1/Tab 6, Sched. 1, App. A, page 10, where "distribution lines" are listed as depreciated at 2.5% to 4.0%, which is 40 to 25 years]. In fact, 51.2% of concrete poles in App. G of the Valuation are at least 40 years old, so should be fully depreciated already.

Arterial and Collector Roads Test

20) The Applicant proposes to allocate assets based on whether they are on arterial, collector, or local roads, using the City of Toronto's Road Classification system.

21) Asked about how this tracks to distribution system use of these streetlighting assets, the Applicant was not able to provide any useful answers, as set out earlier. In particular, the Board does not know what percentage of streetlighting assets on each of the classes of roads is currently used for distribution purposes.

22) What we do know is the following:

    a) The Applicant has identified 12,607 poles (5,633 + 4,355 + 2,609) as having distribution attachments [ECAO IR #1.3], but has proposed that 40,274 poles [Prefiled Evidence, page 18] be treated as distribution assets. This is the bulk of the transferred assets.

    b) The main reason for selecting arterial and collector roads as indicative of streetlighting assets with distribution uses is the presence of bus routes, but 10% of arterial roads, and 61% of collector roads, do not have bus routes [SEC IR #2].

23) We have also reviewed the City of Toronto Road Classification map from their website, which could provide the Board with insight into the nature of that classification system. What we found, just looking at the geographic area around the Board, is as follows:

    a) Eglinton, Yonge, Mt. Pleasant, Avenue Road, Oriole Parkway, and Davisville are classified as Arterial Roads.

    b) Collector Roads includes Duplex and parts of Chaplin (the remainder being Arterial), but also includes Broadway, Roselawn, Edith, Berwick, Manor Rd. E., Soudan, Erskine, Broadway, Redpath, Blythwood, Glengrove, Merton, and parts of Castlefield, Briar Hill, Craighurst, and Montgomery. Many of these are quite minor roads, and some of them quite obviously "residential" as opposed to "mixed use" in character.

24) The Applicant has reached the conclusion that 74.4% of the poles, and 54.9% of the streetlighting assets by DRC based value, should be allocated to distribution. The primary basis for this allocation is the assumption that all streetlighting assets on arterial and collector roads should be considered distribution assets, and those on other roads should not.

25) In our submission, the Applicant has not filed sufficient data to support the reasonableness of this assumption, and the data they have filed, summarized in para. 22 above, is inconsistent with the assumption being true. Further, when the assumption is tested by actually looking at which roads are classified in which category, applying common sense to even the brief sample we have given above demonstrates that there is no apparent correlation between the city classification system and distribution use of assets.

26) The Applicant does have evidence as to which poles are used for distribution purposes. In our submission, the poles that should be allocated to distribution and therefore transferred (at $1) are those 12,607 listed in ECAO IR#1.3, and the non-pole assets should be allocated in a similar manner. The Applicant should be required to come in with detailed information on this revised allocation at the time of their next cost of service application (see below).

Implications for IRM

27) The Board will be aware that the Applicant proposes to file for 2012 rates on a cost of service basis. The Board will also be aware that the Applicant is not on the Board's list of LDCs that are scheduled to file on a cost of service basis for 2012, and that as a result the question of whether the Applicant should be allowed to seek cost of service rates for 2012 is a live and highly contentious issue in their EB-2010-0142 2011 Rates case. A decision in that proceeding is pending, and this issue is one of those not yet resolved.

28) The Board may also be aware that, among the Applicant's submissions in that case seeking to justify another year of cost of service increases, the Applicant claimed that previous Board decisions required future actions that can only take place in a cost of service context, and therefore a 2012 COS proceeding was required.

29) SEC is concerned that, if the Board decided, as the Applicant has requested, that the rate base, revenue requirement, and ratemaking implications of the Board's decision in this proceeding should be considered in their "2012 cost of service application", the Applicant will then seize on that as a reason to be allowed another year asking for high rate increases through cost of service.

30) SEC therefore requests that, if the Board decides to allow the transfer of some or all of the proposed assets, at whatever value it ultimately determines, the Board not approve the allocation of the rate base, revenue requirement and ratemaking implications to a 2012 cost of service proceeding. Rather, in our submission the Board should stipulate that the Applicant should have those matters considered "in its next cost of service rates application", and that the Applicant not be permitted to claim rate base, revenue requirement, or rate impacts of this transaction until that time.

31) In this regard, we note that the Board's original decision in this matter was in February of 2010. In our submission, the Applicant had ample opportunity to have this matter resolved prior to its 2011 rate case, which is still going on, but failed to do so. If the result is that it now has to wait until 2015 or 2016 before having these assets included in rates, that would be entirely the result of the Applicant's own actions, and consistent with the purpose of the IRM system. In any case, given the true value of the assets, the impacts are likely to be small.

32) It is therefore submitted that the Applicant's request to refer these aspects to their 2012 proceeding should not be approved. We would also ask that the Board be explicit in saying that any followup review by the Board of the results of the Board's decision should not be considered to be a reason to change the normal schedule for the Applicant's cost of service reviews.

Other Issues

33) The School Energy Coalition submits that it has acted responsibly and efficiently in its participation in this proceeding, with a view to assisting the Board as much as possible, and therefore asks that the Board order payment by the Applicant of SEC's reasonably incurred costs of that participation.

34) SEC also thanks the Board for allowing SEC to file these submissions late. We apologize once more for failing to ensure that we received documents in this matter on a timely basis.

All of which is respectfully submitted.

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Yours very truly,
JAY SHEPHERD P. C.

Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested parties (email)