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