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BY EMAIL and RESS

October 29, 2011
Our File No. 20110144

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

Dear Ms. Walli:

Re: EB-2011-0144 – Toronto 2012 Rates – SEC Submissions on Interrogatories

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #3 in this proceeding, this letter constitutes SEC's submissions with respect to the Applicant's responses to interrogatories on the threshold issue.

Introduction and Test

By our calculations, the Applicant received 69 interrogatories on the threshold issue, and refused to answer 34 of them on the basis that they were out of scope for that issue. With respect to SEC, the Applicant refused to answer 19 of our 23 interrogatories.

The scope of the threshold issue was first set out by the Board in its April 20, 2010 letter as follows:

> *"A distributor, including the four distributors referred to above, that seeks to have its rates rebased in advance of its next regularly scheduled cost of service proceeding must justify, in its cost of service application, why an early rebasing is required notwithstanding that the "off ramp" conditions have not been met. Specifically, the distributor must* ***clearly demonstrate why and how it cannot adequately manage its resources and financial needs*** *during the remainder of its IRM plan period."[Emphasis Added]*

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This in fact paraphrases the Board's 3rd Generation IRM Report.

This Board panel reiterated the test in EB-2010-0142, quoted in Procedural Order #1, in precisely the same words:

> *"Should THESL file a cost of service application for 2012 rates, the expectations of the Board are clear. As set out in the April 20, 2010 and March 1, 2011 letters, a distributor that seeks to have its rates rebased earlier than scheduled **must justify, in its cost of service application, why early rebasing is required and why and how the distributor cannot adequately manage its resources and financial needs** during the remainder of the 3rd generation IRM plan term."[Emphasis Added]*

The Board panel goes on to define this question as the Preliminary Issue, and sets out the procedure for considering that issue as follows:

> *"The Board has determined that it will…consider the question of whether the application filed by THESL is acceptable or whether it should be dismissed (the "Preliminary Issue"). To accomplish this, the Board will allow an initial round of interrogatories by intervenors and Board staff to seek additional information specifically related to the Preliminary Issue and THESL's evidence on the Preliminary Issue at Exhibit A1/Tab 1/Schedule 2."*

Given this foundation, we must necessarily assume that the Applicant has in its Application purported to show why they cannot adequately manage their resources and financial needs in the Test Year and beyond under IRM. This is the issue to be addressed. Questions that relate to whether they have "clearly demonstrated" that fact are relevant to the threshold issue, and must be answered in full. This includes questions related to the "resources" available to them, and questions related to their "financial needs".

Specific Questions

SEC proceeds in this matter on the assumption that if the Applicant "cannot adequately manage its resources and financial needs" because of poor management, that does not justify high rate increases year after year. Therefore, if the Applicant's plans for the Test Year reflect poor management, they are not a sufficient basis for early rebasing.

In our submission, an effective way of determining on a *prima facie* basis whether the Applicant's performance is at a reasonable standard is to compare their results to their peers. This is consistent with the Board's role as a market proxy, and is consistent with the Board's initial comparisons between distributors in the 3rd Generation IRM process and elsewhere.

It is important, however, to distinguish between *prima facie* conclusions and real conclusions. Comparative data may indicate that the Applicant has performed very poorly relative to its peers in past years, and may be useful in assessing whether the proposals for the Test Year are simply a continuation of that performance. However, there may well be other reasons why the Applicant's results are so bad.

It is generally not fair, in our view, to reach firm conclusions from comparative data without providing the Applicant with an opportunity to give an alternative explanation for those bad results.

SEC Questions 1 through 6 [Ex. R1/7/1-6], all refused, are directed at providing the Applicant with an opportunity to explain why their peers are doing so much better than they are:

1. SEC #1 provides a table showing that the Applicant is already, in 2011, charging their customers of all classes more for distribution service than any of the other nine largest urban distributors in the province. The Table provided is actually fairly gentle to the Applicant, since the Applicant's high bills are included in the average of the ten distributors listed. If the Applicant is compared just to the other nine, the Applicant is at 144% of their average. Put another way, the other nine large urban distributors can on average survive just fine billing their customers at 69% of the Applicant's levels.

2. SEC #5 deals with the same question as #1 in a different way. It compares distribution revenue per customer for 2010 between the Applicant and its nine urban peers, and shows that the Applicant is once more the worst performer. It shows that, when the Applicant is taken out of the average, its revenue level is 156% of its peers in 2010, i.e. the other nine on average make do with 64% of the revenue per customer of the Applicant. This is consistent with the bill comparison.

3. SEC #2 compares the cost of the Applicant's built system to its peers, on a per customer basis. A higher PP&E per customer likely indicates one or more of the following:

   a. higher spending for similar assets, possibly indicating lack of proper cost control, or lack of discipline in planning and prioritization of capital spending;

   b. relatively newer assets, possibly indicating a lower need for infrastructure renewal relative to the peer group;

   c. more assets per customer, perhaps as a result of a higher percentage of larger customers; or

   d. operating the utility on a more capital intensive basis than its peers, suggesting that there should be offsetting OM&A savings.

   The Applicant's built out system has a higher cost per customer than any of its peers. It is at 159% of the average of all ten, and 170% of the average of the nine peers. SEC's investigation showed that the Applicant does not have the highest percentage of larger customers (that would be Enersource), but that customer mix may be part of the explanation. It may, for example, justify the Applicant having a PP&E per customer near but somewhat lower than the PP&E per customer of Enersource, which has a similar customer mix but is a younger city with a newer system. The bulk of the differential is, however, unexplained.

4. SEC #3 supports #2. The Applicant has a higher cost system, but if its peers are spending more heavily on capital expenditures to catch up, that would suggest that the peers are low, rather than the Applicant high. The opposite is true, to a quite surprising extent. The Applicant in 2010 incurred 2.5 times the capital spending of the average of its peers. It has also already received approval for an increase in 2011, and is seeking even more increases in 2012 and beyond (the focus of the question).

5. SEC #4 also supports #2. As noted above, one possible explanation of high existing capital is an operating regime in which capital is relied on more heavily than one's peers. SEC #4 compares OM&A per customer, and shows that the Applicant is the worst in this category as well. The Applicant's peers manage with average OM&A at 62.5% of the Applicant's level. Further large increases are sought by the Applicant for 2012 and beyond, which is the focus of the question.

6. SEC #6 brings the Applicant's poor showing in questions 1 through 5 together, and asks the Applicant to explain how the Applicant is different from those peers (other than bad results). There could be a lot of reasons why the Applicant's performance compares unfavourably to its peers. For example, the Applicant may have data showing that construction costs in the City of Toronto are, say, 115% of the provincial average. Or, the Applicant could show that municipal permitting is systematically more expensive in Toronto than elsewhere, etc. In our submission, in light of the empirical data, it is important that the Applicant provide a full explanation for the unfavourable comparative results, so that the Board is in a position to assess whether that comparison negates their claim for special treatment, or is consistent with it. This is especially true in light of the Applicant's statement, in R1/1/2, page 1, "THESL does not regard its circumstances as being unique among the distributors of the province."

7. SEC #22 looks at past increases in distribution expenses of the Applicant, relative to increases for all utilities in the province. The average for 2008 through 2010 was 5.8% for all electricity distributors, including high and low growth utilities. The Applicant had average increases of 9.6% over the same period, despite being a relatively low growth utility. It is seeking above average increases for the next three years as well. It is legitimate to ask why a series of high increases in the past isn't yet enough, particularly when the Applicant suggests that its rates must go up in excess of inflation indefinitely into the future [Ex. R1/1/2, p. 7 and R1/2/8].

Key to the Applicant's position is "the 'real' cost increases that THESL is facing" [Ex. R1/2/8]. This is a theme throughout the Application, where the dire consequences of failing to fund these cost increases are discussed again and again. We see the same discussion repeated in Ex. R1/1/1 and Ex. R1/1/2.

Several SEC questions are directed at this question:

8. SEC #12, #13 and #23 are investigating whether the huge capital plan for the next several years is realistic, or just a straw man.

a. #12. Aside from the comparisons discussed earlier, which suggest that less rather than more capital spending is appropriate, we ask for confirmation that in just three years the Applicant expects to spend 86% of its current PP&E on new capital assets. We have been unable to find an example over the last six years of Yearbook data in which any distributor has incurred capital expenditures at that high level. It appears to be unprecedented.

b. #23. Related to this is the ever increasing level of planned capital spending, already disclosed in the EB-2010-0142 proceeding. In #23 we ask that the Applicant plot its current plan on the same graph as EB-2010-0142, Ex. R1/9/49, p. 2. That graph shows that each successive capital plan increases future capital spending for every future year. We believe the interrogatory response will show that the new plan has a further increase in planned spending for every year in the future.

c. #13 approaches this from a different perspective, a question directed at the allegation that the Applicant's distribution infrastructure is in bad shape.

9. SEC #18 supports #12, #13 and #23. The incentive plan has a provision that appears to incent additional capital spending. The term is not defined, so we have asked for an explanation. The explanation may show that capital spending is not being incented, or that capital spending *efficiency* is being incented, not the dollars themselves. Either would be fine. On the other hand, if the incentive plan gives management higher compensation for spending more money, we believe the Board may consider that fact relevant to whether the "real cost increases" are as real as the Applicant alleges.

10. SEC #17 deals with compensation levels, another area of alleged cost pressure. The Applicant says [Ex. B1/10/1, p. 37] that it has a recent report on the compensation of its senior executives. This report may assist the Board in determining whether the cost pressures in this area of spending are real or not.

Similar comments relating to the "real cost pressures" argument of the Applicant would apply to EP#7, EP #11, EP#14, BOMA #1, BOMA #2, AMPCO #3, and VECC #8.

Perhaps the single most surprising aspect of the Application, carried through in the responses to some interrogatories, is the notable lack of focus on productivity. The Applicant's whole analysis of CEEDs, for example, which is the centrepiece of their argument on the threshold issue, assumes that productivity improvements cannot be achieved in respect of capital spending. Responses to Staff IR #1 and #2 are also replete with statements that can only be true if, for THESL, productivity is simply not a goal they can hope to achieve.

On the other hand, 3rd Generation IRM, which the Applicant says is inappropriate, builds in an explicit Board expectation that utilities will target and achieve productivity savings.

SEC has asked a few questions dealing with productivity:

11. SEC #21 asks for a general explanation of productivity initiatives from 2008 through the end of the current proposed test period, 2014. It would appear to us that, if the Applicant is alleging that they cannot manage their financial situation within the IRM framework, it is incumbent upon them to show that their productivity initiatives – past and planned – achieve as much as is reasonably possible toward that end. When the issue is managing your resources, productivity is not irrelevant. It is the key focus.

12. SEC #14, #15 and #16 are more specific aspects of the productivity question. #14 asks about one area in which many other companies are today targeting productivity savings – online customer service. $15 and #16 are exploring whether management is under any instructions from the shareholder that affect their ability to target productivity goals. This could include restrictions, such as the dividend problem that arose with THESL in 2006, and ultimately went to court. It could also include support, for example if the City specifically promotes productivity in the Direction or other instructions.

Finally, SEC asked three questions which are solely to ensure that we – and the Board - understand the factual evidence correctly:

13. SEC #19 and #20 simply seek confirmation that certain calculations underlying the increases in operating costs are correct.

14. SEC #7 seeks to understand whether the forecasts for the Test Year are in any way influenced by a change in accounting standards, since clearly that could influence the Board's view of any alleged deficiency.

<u>Conclusion</u>

It is therefore submitted that the Board should order the Applicant to provide full answers to the questions for the reasons set forth above.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.

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Interested Parties