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Toronto Hydro-Electric Systems Limited
2012, 2013 & 2014 Electricity Rate Application
Submissions of AMPCO on the Preliminary Issue

1. Toronto Hydro-Electric System Limited (THESL) filed a Cost of Service (COS) application August 26, 2011 to apply to the Ontario Energy Board (the "Board") to increase its delivery charges annually on May 1, 2012, May 1, 2013 and May 1, 2014.

BACKGROUND

2. In 2006, the Board established a multi-year rate setting plan for electricity distributors. Electricity distributors are to have their rates set on a cost of service basis only once over a period of several years, with rates being set using an incentive regulation mechanism (IRM) in the intervening years.[1]

3. The Board has determined that the plan term for the 3rd generation IR will be fixed at three years (i.e. rebasing plus three years). The rates of the distributor are not expected to be subject to rebasing before the end of the plan term other than through an eligible off-ramp.[2] An off-ramp is based on a pre-defined set of conditions under which the IR plan would be terminated or modified because its normal end-of-term date, usually because of extreme events that cannot be effectively addressed, or that should not be addressed, through Z-factor treatment or some other IR mechanism such as earnings sharing.[3]

4. THESL has historically, for the most part predominantly filed COS applications. In 2006, THESL filed a forward test year COS Application. For 2007, THESL filed on an Incentive Rate Making (IRM) basis. For 2008 to 2010, THESL filed on a three-year forward test period basis, and was granted a two-year forward test period. For 2009, THESL filed a formulaic update application as part of the approved multi-year test period. For each of 2010 and 2011 THESL filed forward test year COS applications.[4] Thus, the last year and only year THESL filed an IRM application was 2007.

5. In its April 20, 2010 letter regarding Early Rebasing Applications, the Board provided a list of distributors scheduled for rebasing in 2011. THESL was included on the list. In the Board's letter dated March 1, 2011 regarding Electricity Distributors Scheduled to Apply for Rebasing for 2012 Rates, the Board identified a list of distributors that are expected to file a cost of service application

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[1] April 20, 2010 Board Letter Re: Early Rebasing, Page 1
[2] Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008, Page 7
[3] Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008, Page 37
[4] Exhibit R1, Tab 3, Schedule 3

regarding 2012 rates. THESL was not included on the list.

6. As set out in the Board's 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.

7. The April 20, 2010 letter also indicated "The Board's rate-setting policies are such that distributors are expected to be able to adequately manage their resources and financial needs during the term of their IRM plan."

8. In response to the Board's expectations as set out in the above letters, THESL filed "The Manner of Regulation for THESL" (Exhibit A1, Tab 1, Schedule 2) in the current application to explain the reasons for filing a cost of service application for electricity distribution for the 2012, 2013 and 2014 rate years. THESL acknowledges that the onus is on THESL to make its case and demonstrate that rates for 2012 should be set on a basis other than by the application of the IRM mechanistic adjustment; i.e., COS.[5]

9. In Procedural Order No. 1 in this proceeding dated October 4, 2011, the Board referenced its Partial Decision & Order from THESL's Cost of Service Application for 2011 electricity rates (EB-2010-0142): "While the Board accepts that there have been deviations from the Board's multi-year rate setting plan, including the acceptance of THESL's non-conforming applications in the past, the Board considers the April 20, 2010 letter to be a clear and explicit statement of the Board's expectations of distributors on a going forward basis. Given this clear and direct communication to THESL and other distributors regarding the Board's expectations, the Board does not accept THESL's view that it is reasonable for it to have approached its 2011 application with an expectation that it would also be making a cost of service application in 2012. The Board is not persuaded by THESL's submissions that the Board's stated rate setting policies did not apply to it. "[6] The Board made no determination as to what THESL is required to file in its subsequent rate application and left it to THESL to determine the manner in which it chooses to apply for any adjustments to its rates for 2012. The acceptability of the application will be determined by the Board at that time. [7]

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[5] Exhibit A1, Tab 1, Schedule 2, Page 4
[6] EB-2010-0142 Partial Decision & Order, Page 10
[7] EB-2010-0142 Partial Decision & Order, Page 10

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<u>THE PRELIMINARY ISSUE</u>

10. In the context of its EB-2010-0142 Decision and the Board's April 20, 2010 and March 1, 2011 letters, the Board determined as indicated in Procedural Order No. 1, that it will consider as a "Preliminary Issue" the question of whether the application filed by THESL is acceptable or whether it should be dismissed.

11. THESL's position is that the Board should decide that THESL's application is acceptable and to proceed on to an oral hearing to consider this COS application in establishing distribution rates for Toronto Hydro for the years 2012, 2013 and 2014.[8]

12. In its Argument-In-Chief, THESL submits that in deciding the Preliminary Issue, the Board is making a preliminary assessment on whether Toronto Hydro has provided sufficient evidence within a band of reasonableness to permit the Board to conclude that a COS hearing should be held because IRM does not appear to permit THESL to manage adequately its resources and financial needs.[9]

13. THESL believes that different distributors across the province face varied circumstances in terms of condition of plant, the need for capital expenditures and load and customer growth, and that these different circumstances produce different outcomes when the IRM framework is applied.[10]

14. THESL's evidence indicates that as part of its last three rate cases, THESL has demonstrated the need for capital spending substantially exceeding depreciation. THESL submits that increased expenditures and investments are required to address a pressing need to invest substantially in its aging, and in many cases failing distribution infrastructure. The investment is needed both to restore acceptable levels of service in areas experiencing poor reliability, and to replace end of life equipment where the risk of failure is high.[11] In addition, THESL submits there is an ongoing need for workforce renewal to support the proposed capital plan and replenish an aging workforce. [12] THESL's circumstances also include a stagnant load growth. [13]

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[8] THESL Argument-In-Chief, Page 3
[9] THESL Argument-In-Chief, Page 7
[10] Exhibit A1, Tab 1, Schedule 2, Page 21
[11] Exhibit A1, Tab 1, Schedule 2, Page 30
[12] Transcript Volume 2, November 11, 2011, Page 90
[13] Exhibit A1, Tab 1, Schedule 2, Page 22

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15. During cross examination by AMPCO's counsel, THESL indicates that the IRM model doesn't work for THESL. "It might work for others, but for us it doesn't work."[14] THESL takes the position on this preliminary issue first, that there are circumstances faced by utilities that give rise to structural cost pressures that cannot be accommodated under IRM; secondly, that IRM would create a structural deficit and allowed revenue requirement that would be severely problematic for those utilities and their customers; and thirdly, that THESL is in exactly those circumstances.[15]

16. In the current application, THESL proposes the following increases in revenue requirement, capital, OM&A and FTEs for the 2012, 2013 and 2014 test years.

	2010 Actual	**Approved 2011 EDR**	**2011 Bridge**	**2012 Test**	**2013 Test**	**2014 Test**
Revenue Requirement[16]	512.6	522.1	520.6	571.4	639.5	712.8
Capital[17]	381.1	378.8	429.1	590.0	615.0	640.0
OM&A [18]		238.0	242.1	262.3	289.7	298.7
Union & Non-Union FTEs[19]	1,657[20]		1,843 (1700 employees today provided by THESL witness in Transcript Volume 2, Page 18)	1,925	1,980	2,204
Growth in FTEs[21]				147	55	44
Proposed ROE[22]		9.58%	9.58%	9.58%	9.58%	9.58%

[14] Transcript Volume 2, November 11, 2011, Page 98
[15] THESL Argument-In-Chief, Page 8
[16] Exhibit J1, Tab 1, Schedule 1, Table 1, page 1
[17] Exhibit D1, Tab 8, Schedule 1, Table 1, Page 5
[18] Exhibit A1, Tab 1, Schedule 2, Table 2, Page 25
[19] Exhibit A1, Tab 1, Schedule 2, Table 3, Page 26
[20] Exhibit R1, Tab 4, Schedule 3
[21] Exhibit A1, Tab 1, Schedule 2, Table 3, Page 26
[22] Exhibit A1, Tab 1, Schedule 2, Table 5, Page 28

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17. Under its distribution licence, THESL has an obligation to ensure the adequacy, reliability and quality of electricity service. In support of the expenditures and investments in the current application, THESL indicates that it must undertake certain expenditures to meet its duties as a distributor, and these expenditures entail a revenue requirement greater than that produced under the IRM framework.[23]

18. THESL undertook an exercise to compare the effects and consequences of an IRM framework on revenue requirement, CAPEX, OM&A, test year deficiency resulting from unrecognized rate base and equity returns, based on the proposed expenditures and investments in the current application. [24] THESL concludes that IRM will predictably result in a number of material adverse consequences and unacceptable outcomes including the potential inability to earn a reasonable return under IRM which is contrary to the fair return standard.

19. THESL is asking the Board to accept the results of their analysis and their position that the level of proposed expenditures and investments are necessary and prudently undertaken.

20. AMPCO notes that in the last two COS applications, THESL's capital budget has been agreed to as part of a settlement process between THESL and intervenors and has not been tested as part of a hearing before the Board.

21. During cross examination by Board Staff and AMPCO's counsel, THESL witnesses explained the impact of reaching a settlement with intervenors on a capital budget that was less than the amount pre-filed in the application as a ramping up that was amenable or agreeable to the parties that THESL could live with[25] and it was a reasonable pace to move from the $100 million to the $600 million.[26]

AMPCO POSITION

22. AMPCO submits that the issue of a reasonable pace of capital investments and a responsible ratemaking pace underpins the preliminary issue now before the Board to determine whether or not THESL is able manage its resources and financial needs during an IRM period. AMPCO cannot at this stage of the process accept THESL's level of proposed expenditures or the consequences it

[23] Exhibit A1, Tab 1, Schedule 2, Page 1
[24] Exhibit A1, Tab 1, Schedule 2, Pages 21-28
[25] Transcript Volume 2, November 11, 2011, Page 98
[26] Transcript Volume 2, November 11, 2011, Page 11

describes if regulated under IRM. In order to make a determination on a reasonable pace of investment, evidence on THESL's capital and workforce renewal programs needs to be heard.

23. AMPCO agrees with THESL that there is nothing in the legislation or the Board's own policy that fetters the Board's discretion in a particular case to determine rates on a COS basis. [27] AMPCO also agrees with THESL's position that the utility needs options to choose the best regulatory construct on their circumstances for their customers.[28] The Board should set rates on a case by case basis on the specific circumstances of the applicant and the evidence in each particular proceeding.

24. AMPCO members represent a cross section of Ontario's major industries: forestry, chemical, mining and minerals, steel, petroleum products, cement, automotive and manufacturing and business consumers in general. Like THESL, these industries manage long-lived capital-intensive assets, and make decisions based on long term investment horizons.

25. THESL's proposed capital budget and workforce renewal plan has not been tested nor thoroughly reviewed. Because of that AMPCO is unable to accept that the proposed spending and investments are necessary and prudently incurred. As such it does not appear as if it is possible to determine whether THESL has adequately managed its resources and financial needs. Accordingly, AMPCO submits that THESL has not met the threshold test that the Board established in its April 20, 2010 and March 1, 2011 letters. It is submitted, however, that this threshold test has been arbitrarily established by the Board and not meeting it should not deny THESL the opportunity to make a COS Application during which all of THESL's proposals would be subject to the normal review applied by Board staff, interveners and the panel.

26. AMPCO acknowledges that THESL has filed five volumes of evidence in this proceeding. THESL submits that taken in its totality, the evidence is intended to show the Board exactly what the system needs and requirements are and the utility's prudent plans to manage those needs and requirements.[29] This evidence has not yet been adequately tested to determine if the expenditures are necessary and prudent or overstated. THESL provided very limited information on its efforts to achieve gains in productivity in the discussion of the preliminary issue.

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[27] A1, Tab 1, Schedule 2, Page 12
[28] Transcript Volume 2, November 11, 2011, Page 31
[29] THESL Argument-In-Chief, Page 6

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27. AMPCO submits that the Board's proper assessment of THESL's proposed expenditures and investment requirements (the testing of their evidence) cannot be done without a full hearing of that evidence. The revenue requirement should be determined based on the Board's review of these expenditures and any offsetting productivity improvements in a COS application.

28. AMPCO submits that the Board's determination of the Preliminary Issue should be to accept the application filed by THESL, and

29. AMPCO further submits that if the Board accepts THESL's COS application, the capital and workforce renewal plans should be exempt from any settlement process.