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BY EMAIL and RESS

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Ontario Energy Board
2300 Yonge Street
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2011-0178 – Kingston 2012 Rates

We represent the School Energy Coalition. Pursuant to the Notice of Hearing in this matter, these are SEC's submissions with respect to the Application. SEC's submissions are limited to consideration of the claim for an Incremental Capital Module.

ICM Qualification

The Board's criteria for approval of an Incremental Capital Module are set out in the 3rd Generation IRM report dated July 14, 2008 (the "IRM Report"), and the Supplemental Report dealing with the capital module dated September 17, 2008 (the "Supplemental Report"). Those reports require that an ICM, to be approved, must satisfy a number of criteria.

In general, SEC agrees that the incremental capital in this Application meets the monetary threshold, and that both need and prudence for each of the projects has been established in the evidence. While the Applicant refused to provide full justification for the projects through the filing of their business cases [SEC #3], the information in the Application leads us to believe that these projects are probably needed. Were it not for the position we are taking on the other criterion, below, we might view the support provided as insufficient, but on our view of the facts this is not a critical element.

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However, this Application proceeds on the assumption that the only test of whether needed and prudent incremental capital qualifies is whether the utility's spending exceeds the threshold. That is not the case. The Board has made clear that projects that are part of the normal capital spending requirements of the utility do not qualify for ICM treatment. On this criterion, it is submitted that all but one of the proposed incremental projects do not qualify.

The starting point on this issue is the careful description, in the Supplemental Report (at pages 30 and 31), of the Board's intended scope of the ICM:

"The Board notes that there are clearly differences in perception as to the purpose of the incremental capital module. Ratepayer groups perceive the capital module as a mechanism aimed solely at addressing extraordinary or special CAPEX needs by distributors. The distributors, on the other hand, perceive the module as a special feature of the 3rd Generation IR architecture which would enable them to adjust rates on an on-going, as-needed basis to accommodate increases in rate base.

In the Board's view, the distributors' view is not aligned with the comprehensive price cap form of IR which has been espoused by the Board in its July 14, 2008 Report. The distributors' concept better fits a "targeted OM&A" or "hybrid" form of IR. This alternative IR form was discussed extensively in earlier consultations but was not adopted by the Board. The intent is not to have an IR regime under which distributors would habitually have their CAPEX reviewed to determine whether their rates are adequate to support the required funding. Rather, the capital module is intended to be reserved for unusual circumstances that are not captured as a Z-factor and where the distributor has no other options for meeting its capital requirements within the context of its financial capacities underpinned by existing rates."

This establishes a criterion of "unusual circumstances". Spending that utilities normally do on a year by year basis is not covered by the ICM. It is not intended to cover the situation in which the utility simply has a high budget in a given year. It is intended to cover situations – the transformer station is the example most often used – that are simply not part of the ordinary course of business.

This quote from the Supplemental Report was expressly adopted by the Board in EB-2008-0187, the first ICM application to come before the Board. The Board panel in that case went on to explain it further, saying [page 8 and 9]:

"In its adoption of the incremental capital module as part of the third generation incentive rate mechanism the Board was providing the regulatory flexibility that is required to accommodate unanticipated events that may occur over an extended IRM term. The rapid policy evolution that is currently being experienced in the electricity distribution sector, such as the requirements under the Green Energy Act (Bill 150) may drive capital spending on an array of initiatives that would not typically be considered in a distributor's traditional planning exercise. This evolving policy environment is an example of the envisioned drivers that justified the provision of the regulatory flexibility that the incremental capital module is intended to create.



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It should be noted however, that in this application the proposed capital spending was not linked to any anticipated new legislative directives or requirements, in particular those associated with the tabled Green Energy Act; as Hydro One noted, that would be the subject of another application.

In considering Hydro One's application in this case it is apparent that Hydro One has conflated the calculation of the threshold and the eligibility criteria. While the relationship between depreciation expense and capital spending establishes the base materiality threshold, the relationship itself is not the determinative factor in assessing the appropriateness of the use of the incremental capital module. Hydro One has substantially predicated its application on the gap between its depreciation expense and its capital spending plan. In fact what the Board requires in considering an application under the incremental capital module is a demonstration that the distributor is facing extraordinary and unanticipated capital spending requirements; i.e. something other than the normal course of business."

In our submission, the Board has stated clearly the need for projects under ICM to be unusual and outside of the ordinary course of business, and distinguishes between capital spending plans that merely exceed the threshold, and ICM-type capital spending plans.

The Proposed Projects

Four projects are proposed for the ICM. Each can, and in our submission, must, be assessed against the requirement of "unusual circumstances".

The ***King Street 44 kV Underground Cable Rebuild (M454)*** is the replacement of direct-buried PILC cable with modern cable enclosed in concrete ducts. This is intended to address a problem that has existed since at least the 1990s, in which this cable has a history of failures and other problems. M454 is the longest section of the M4 line, which is the only line the Applicant has with PILC cable [SEC #5]. Another section, M455, has been "identified...for future work" [SEC #5].

What is clear about this project is that it is part of a normal, step-by-step program under which the utility will upgrade its system. There is no external factor that makes it necessary to do it in 2012. Indeed, the Applicant admits that the reason for the 2012 scheduling is that they plan to do a rebuild of MS#1 in 2013, and that would be facilitated by scheduling M454 for 2012 [SEC #5].

We also note that the risk of delaying this project is described by the Applicant [Staff #5(e)] as essentially a continuation of the risks that have existed for some years – low voltage complaints, power quality issues, and potential failure of sensitive equipment. None of this is new.

It would appear to us, therefore, that the only unusual thing about it is that it is a big project. We therefore went back and reviewed the Applicant's capital budget for the last few years (as filed in EB-2010-0136), and note that projects of over a million dollars are a regular part of the Applicant's annual capital spending. 2011 had the MS#11 and MS#3 breakers, for example,



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and 2010 had the Princess Street Rebuild, all in excess of a million dollars. Therefore, this is not comparable to a utility needing to build a \$10-\$20 million transformer station once every ten or twenty years.

All of this demonstrates, in our submission, that this project does not have unusual circumstances sufficient to qualify for ICM treatment.

The **MS#5 Circuit Breakers Retrofit** is replacing circuit breakers and related equipment in a municipal substation. It is one of a series of similar projects done by the Applicant, which admits that “circuit breaker projects often form part of Kingston Hydro capital activity” [SEC #7]. For example, the 2011 capital plan included similar projects for MS#3 and MS#11, both larger than this one.

Asked why this project was unusual, the Applicant could only say [Staff #5(c)] that the equipment is unreliable, and in 2010 they found out that there will be no more replacement parts available.

In our submission, this is a normal course of business project and does not qualify for ICM treatment.

The **TV #11 Rebuild** is the replacement of an old transformer and related equipment and conversion to a manhole [SEC #9(e)]. Kingston Hydro says it is “unusual in that the circuit configuration in the vault does not allow for the provision of alternate power supply to large business customers” [Staff #5(c)]. This circuit configuration, of course, is not new, and the problem has existed for many years. Asked to report on problems with the existing assets, the Applicant reported a fire in 2002 and secondary breaker failures in 2006 [Staff #5(d)]. Nothing recent.

The other rationale given is the “window of opportunity” resulting from the City requiring other work to be done in 2013. The thesis is that road closures in 2013 will divert traffic to this area, meaning that the work cannot be done in 2013. Therefore, they have scheduled it for 2012. It could just as easily have been scheduled for 2014 or 2015.

We note that work of this type is a common annual inclusion in the Kingston capital plan, including the TV#12 project in 2010.

We also note that the Roney Report [Ex.6,App.A, p. 7], and external review of the condition of certain of the utility’s assets, recommended shoring work for TV#11 in 2009, but only part of it was done in 2009, and the rest has still not been done. It would appear to us that, if this project was urgent, the time to do it was 2009, since that is the time that the structural issues were identified. Since that time, the Applicant has had an intervening cost of service application in which this was not mentioned, and only brings it forward as urgent three years later as part of an ICM application.

It is therefore submitted that this project does not qualify for ICM treatment.



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The **TV#6 Rebuild** is a more unusual situation. In December 2010 the Applicant received a structural assessment that recommended some work on this and other transformer vaults [Ex. 6, App. A. p 5]. While the report did not consider it urgent, the Applicant moved this project to the top of its priority list because structural and electrical work both needed to be done, and in 2012 there was a particular opportunity to do this work at a lower cost.

The lower cost appears to arise because of City of Kingston roadwork in this location in 2012. It is not clear to us whether this work on Princess Street is part of the Downtown Action Plan [see EB-2010-0136, Ex. 2/4/7, p. 47], but it does appear to be the case here that there is an opportunity to solve a number of existing problems with this vault, and save money doing it.

In our view, this is the only one of the projects that may be sufficiently unusual that it qualifies for the ICM. The Board has not to date approved an ICM for a project that, while clearly normal course of business [see SEC #10(c)], is being carried out in an IRM year primarily because of a particular window of opportunity such as this one. Approving this project therefore might be an expansion of the ICM concept, but a small one that focuses on the overall benefit of the timing chosen.

Further ICM Applications

We note that the Applicant in this case has refused to tell the Board or parties whether it plans to file further ICM applications in future years [SEC #11]. This flies in the face of the Supplementary Report, App. B, p. VI, which clearly requires the Applicant to provide this information to the Board.

Given that the 2011 capital spending was \$6 million, the plan for 2012 is \$6 million, and there are many references to projects in 2013 (including some approved for 2011 and delayed), it would appear to us clear that this is the first of a series of planned ICM applications from this utility. If so, in our submission the Board should make it clear to the Applicant that such a course of action is not consistent with the Board's policy.

General Comments on ICM

SEC notes that this ICM is being presented in the context of an ongoing controversy within the electricity distribution sector about whether 3rd Generation IRM provides sufficient funds for utilities' increasing capital needs.

For example, the EDA, of which the Applicant's CEO is the current Chair, has given a report to the Board urging special capital funding for LDCs. Toronto Hydro, in EB-2011-0144, has sought substantial rate increases over several years, largely on the basis of their claimed need for increased capital funding. The Chair of the Board has convened a series of meetings with stakeholders in which this will be one of the key questions, and has provided a straw man to those stakeholders which assumes a need for increased capital spending.

Against that backdrop, SEC has two comments relative to the current Application:



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1. It is not clear to SEC that there is a need for a higher level of capital spending by electricity distributors in Ontario. In a report released this week, the Conference Board of Canada has estimated that the total capital spending requirements (excluding GEA related spending such as smart grid) for Ontario electricity distributors over the next twenty years will be about \$20.6 billion. According to the Board's yearbook data for 2010, the last year currently available, Ontario LDCs had \$1.8 billion of capital additions in that year, which translates to \$36 billion over twenty years. Most of those LDCs were on IRM in 2010. On the face of it, at least, the current system is already providing sufficient funding for LDCs across the province to make the capital investments that they need.
2. The Kingston case is not being decided on any new rules that may come out of the current processes of the Board. This case is being decided under the ICM currently in place, one that has already been both explained and subsequently interpreted by the Board. It has been used by utilities such as Guelph and Oakville to support good projects, and has been successful in achieving the Board's results. Any substantial change to the current ICM now, as a result of this case, or the context surrounding it, would in our view be both inappropriate, and unfair to all of those LDCs who followed the Board's guidance and believed what the Board said in the IRM Report, the Supplemental Report, and the EB-2008-0187 Decision.

Conclusion

It is therefore submitted that the Board should deny ICM treatment for the M454, MS#15, and TV11 projects, because none of them have the necessary unusual circumstances to warrant use of the ICM, but the Board should allow ICM recovery for the TV6 project.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.

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cc: Wayne McNally, SEC (email)
Interested Parties