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via RESS – signed original to follow by courier

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street, 27th floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Toronto Hydro-Electric System Limited ("Toronto Hydro")
Custom Incentive Rate-setting Application for 2015-2019 Electricity Distribution Rates and Charges (the "Application") – Evidence Conference Follow-Up Response
OEB File No. EB-2014-0116

Toronto Hydro writes to the Ontario Energy Board ("OEB") in respect of the above-noted matter.

On November 17, 2014, the OEB held an Evidence Conference where Toronto Hydro made a presentation regarding its approach to the Application, focussing specifically on the custom aspects of Application. Pursuant to Toronto Hydro's commitment at the Evidence Conference, this letter provides an excerpt Toronto Hydro's response to Member Quesnelle's question, which appears on pages 12 to 14 of the Evidence Conference transcript. The response was filed on the record on November 28, 2014, as part of Toronto Hydro's response to Undertaking J1.7.

Response to Member Quesnelle's Question

Member Quesnelle asked Toronto Hydro to comment on the relationship between the financial treatment of assets (i.e., Financial Useful Life) and the optimal replacement strategy embodied in the steady state concept (i.e., Economic End-of-Life). What follows in this response demonstrates that the financial assumptions that are made for financial reporting purposes have a dynamic relationship to good engineering, system care and economic decision-making.

The distribution system is in steady state when the backlog of assets operating beyond end-of-life and hence the aggregate operating (or lifecycle) cost is effectively minimized. Toronto Hydro uses a variety

of measures to inform its judgment regarding the optimal replacement strategy, which balances system needs with value for ratepayers. (These concepts are explained in Exhibit 2B, Section D.)

As indicated in the evidence, the most compelling approach from an economic perspective is to immediately replace the backlog of assets operating beyond end-of-life so that the cost of ownership would be balanced sooner. However, Toronto Hydro has adopted a paced approach for the CIR application. The utility's capital needs currently exceed depreciation. Capital expenditures are expected to converge towards deprecation over time if the investments reflected in the application are made as and when required.

While capital costs and depreciation are expected to converge, this not the same as saying that the Financial Useful Life of assets (i.e., depreciation periods) will converge with their Economic End-of-Life values (i.e., optimal replacement time). These two measures are fundamentally different. The financial lives are based on the range of expected service lives of asset classes as derived from the 2009 "Useful Life of Assets" study.[1] In contrast, the economic lives are determined on an individual basis for each asset based on its particular age and condition (if information is available) and its risk cost.[2]

For these reasons, Economic End-of-Life could not be used to calculate the Financial Useful Life and associated depreciation expense under MIFRS. The economic lives of individual assets within an asset class can vary substantially (for an example see Undertaking J1.15) and can change based on changes in system configuration. Thus, economic lives do not offer a consistent and stable metric for recovery of capital cost.

Please do not hesitate to contact me if you have any questions.

Yours truly,

[original signed by]

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cc: Charles Keizer and Crawford Smith
Ken Quesnelle, OEB Member
Intervenors of Record for EB-2014-0116

[1] Prepared by Kinectrics for Toronto Hydro and filed in EB-2010-0142 (Exhibit Q1, Tab 2)
[2] Risk cost is largely a product of the excess cost to replace an asset on an emergency basis and the interruption cost experienced by customers if it fails, which in turn is based on each individual asset's particular configuration within the distribution system.