Reply to PEG Framework Report

Submitted On Behalf Of

Toronto Hydro-Electric System Limited

d/b/a Toronto Hydro

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Toronto Hydro
Reply to PEG Framework Report

Introduction

On May 2, 2024, OEB Staff filed a copy of the Pacific Economics Group Research LLC ("PEG") report titled 'CIR 2.0 for Toronto Hydro-Electric System Limited' ("Framework Report"). The Framework Report raises various issues or concerns related to the jurisdictional review conducted by ScottMadden Management Consultants ("ScottMadden"). ScottMadden has reviewed the PEG Framework Report and provides the following reply comments in response to PEG's new issues and concerns.

Reply Comments

ScottMadden's jurisdictional review and findings were independent and unbiased as ScottMadden did not have any prior knowledge of Toronto Hydro's proposed Custom IR framework.

1. PEG has raised an issue as to whether ScottMadden's report has biased scope and emphasis. Specifically, PEG states: "Precedents that support the Company's proposal are highlighted while precedents that don't are either not mentioned in the direct evidence or not emphasized".

2. PEG has misunderstood the scope of ScottMadden's jurisdictional review. As stated in its response to JT5.25, ScottMadden selected examples of ratemaking frameworks based on 1) jurisdictions that have passed mandates regarding climate/ clean energy goals; 2) jurisdictions that have implemented elements of performance-based regulation; and 3) utilities that have proposed or implemented performance-based regulation in the context of meeting mandates regarding climate/ clean energy goals.

3. After completing this review, ScottMadden evaluated the proposed Toronto Hydro custom IR plan for relative consistency with ratemaking frameworks it identified. ScottMadden did not have any prior knowledge of Toronto Hydro's proposed Custom IR framework when conducting the jurisdictional review.

4. As an example of "biased scope", PEG states that ScottMadden reviewed Alberta's PBR1 plan, but not the PBR2 and PBR3 plans. However, ScottMadden presented Alberta's PBR 1 plan as an example where a separate funding mechanism was approved for certain capital investments (ScottMadden Jurisdictional Review, page 21). A similar mechanism was approved in all three iterations of Alberta's PBR plan, recognizing that the criteria for qualifying investments changed. It is important to note that Alberta's PBR3 plan was approved in October 2023, whereas ScottMadden's review was conducted in August 2023.

ScottMadden did not conduct a jurisdiction-by-jurisdiction scan of rate plans nor a trend analysis. The presence of varying mechanisms in other jurisdictions does not disprove ScottMadden's findings that there are certain modernized rate mechanisms currently approved for utilities that are facing challenges associated with energy transition.

5. PEG has misunderstood the nature of ScottMadden's review. In its criticism, PEG has cited and raised other jurisdictions where there are other types of rate mechanisms currently implemented. ScottMadden agrees there are other types of rate mechanisms approved in jurisdictions across North America.

6. However, PEG misses the point. Presence of other types of rate mechanisms in other jurisdictions does not disprove ScottMadden's findings of the rate mechanisms currently approved for utilities that are facing challenges associated with the energy transition, such as in UK, New York, and Hawaii.

7. As an example, PEG cites Alberta's k-bar mechanism which sets capital revenues based on historical forecasts. ScottMadden agrees that historical costs can be the basis for capital revenues. However, such an approach does not necessarily address the needs of the unprecedented change and transformation related to the energy transition.

8. In fact, the AUC recognized the k-bar was unsuitable for expenditures related to achieving net-zero objectives. Specifically, AUC noted: "The Commission agrees that there is the potential for net-zero objectives to drive the need for additional expenditures during the PBR3 term, and that the level of uncertainty and risk associated with the need for and timing of net-zero objectives makes capital investments required to respond to any such objectives unsuitable for funding through the Type 2 K-bar mechanism."[1]

PEG raises an issue that various ScottMadden findings are "misleading statements". However, PEG mischaracterizes ScottMadden's review, and in some cases, does not provide support on how the findings are misleading.

9. **First**, PEG has mischaracterized ScottMadden's findings on Indexed ARMs. PEG implies that ScottMadden has presented a "misleading statement" that there is a trend in ARM design to move away from indexing.

10. ScottMadden did not present any such finding. As mentioned earlier, ScottMadden did not conduct an industry trend analysis.

11. Rather, PEG presents a trends analysis stating that there is strong continuing interest on indexing in North America but provides only limited examples where these are recently approved. Jurisdictions cited by PEG have shown either 'keen interest' (e.g., Connecticut), or in proposal stage (e.g., British Columbia, Massachusetts). PEG also cited Indiana where the legislation requires the Commission to conduct a comprehensive study of PBR mechanisms, including index-driven revenue formulas.[2] Based on the examples provided, ScottMadden

[1] AUC Decision 27388-D01-2023 (October 4, 2023), page 62

[2] IN Code § 8-1-2.5-6.5 (2023)

does not see indication of continuing interest of utilities or regulator on indexing, as PEG claims.

12. **Second**, PEG has mischaracterized ScottMadden's findings on New York and UK rate mechanisms, particularly related to forecasted revenues.

13. For example, PEG states that: "In Great Britain, Ofgem's "building block" approach to ARM design places heavy weight on its own independent view of required future costs." ScottMadden did not state any finding contrary to what PEG has stated, and thus did not "mislead" in its report. Rather, PEG is putting emphasis on Ofgem's role, ignoring the fact that the foundation of forecasted revenue requirements that Ofgem reviews is utilities' capital and O&M forecasts.

14. Similarly, PEG states that: "Most multiyear rate plans in New York are the outcome of settlements and feature only three-year plan terms." Again, ScottMadden did not state any finding contrary to what PEG has stated, and thus did not "mislead" in its report. Rather, PEG is putting emphasis on New York's rate plans being settlements, ignoring the fact that the foundation of forecasted revenue requirements in these settlements is utilities' capital and O&M forecasts.

15. **Third**, PEG has misunderstood ScottMadden's findings on cost trackers. PEG states that "Most American utilities don't have multiyear rate plans" and that "under these circumstances, cost trackers can materially reduce the frequency of general rate cases without requiring sweeping changes in ratemaking systems".

16. PEG does not recognize that even without future test years, cost trackers are important since they address uncertainty in costs. By addressing this uncertainty, cost trackers can result in fewer rate cases.

17. **Fourth**, PEG mischaracterizes ScottMadden's findings on modernized PBRs balancing financial integrity and public policy goals. ScottMadden provided an example that in Hawaii, the PBR framework ensures the financial integrity of utility aligns with consumer interests. Utility financial integrity was one of the three guiding principles approved by the Commission during the PBR proceeding. The Commission noted, "The PBR Framework approved in this D&O has been carefully designed to include multiple safeguards and review opportunities to protect the Companies' financial health from extreme hardship".[3]

18. In its criticism, PEG states that: *"PEG was a witness for the Hawaiian Electric Company in this proceeding. Based on our experience, we can say that the HECO plans are not that favorable to the companies."*

19. PEG's statement seems inconsistent with the Commission's guiding principle of financial integrity as established in its PBR framework.[4] In addition, PEG's statement seems

[3] Docket No. 2018-0088, Decision and Order No. 37507 Instituting a Proceeding to Investigate a Performance-Based Regulation, Hawaii Public Utilities Commission, p. 210

[4] Docket No. 2018-0088, Decision and Order No.36326, Hawaii Public Utilities Commission, May 23, 2019, p. 6

inconsistent with HECO's May 2023 investor presentation in which is stated that its new regulatory framework "enhances opportunity for steady earnings growth" and "aligns utility long term goals with stakeholder interests".[5]

[5] HEI, Investor Presentation, May 2023 (page 5)